(Knowledge for Development)

KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

SECOND YEAR FIRST SEMESTER

SPECIAL/SUPPLEMENTARY EXAMINATION

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: BCF 211/BCF200

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: 15TH JULY,2022 **TIME:** 8.00AM - 10.00AM

INSTRUCTIONS TO CANDIDATES

1. Answer Question One in Section A and Any other TWO (2) Questions in Section B

2.Question **one** carries **30**marks and each of the other two questions carry **20** marks each.

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

SECTON A (COMPULSORY)

QUESTION ONE

a) Explain "agency theory " as applied in financial management and indicate causes of conflict of interest between shareholders and debt holders

(6 marks)

b) Discuss factors that a company should consider when choosing between equity and debt as sources of finance (8 marks)

c) Indicate what you would consider to be the shortcomings of financial deepening (8 marks)

d) The existing capital structure of Manukato Ltd is given as follows:

	Sh.(000)
Ordinary share capital (sh. 100 par value)	40,000
Reserves	15,000
12% debentures (sh. 100 par value)	25,000
10% preference share capital (sh. 20 par value)	20,000
	100,000

Additional information:

i) The company's ordinary shares are currently selling at sh. 80 each.

ii) The 12% debentures and 10% preference shares are currently selling at sh. 90 and sh. 30 respectively.

iii) The most recent ordinary dividend paid by the company is sh.2.00. This is expected to grow at the rate of 10% each year to perpetuity.

iv) The corporation tax rate is 30%.

Required:

The weighted average cost of capital (10 marks)

SECTION B

ANSWER ANY TWO QUESTIONS

QUESTION TWO

a) Explain the rationale behind the valuation of financial assets (5 marks)

b) XYZ Ltd had issued 72,000 ordinary shares as at 31 March 2018. The company had maintained an annual dividend of sh.180,000 including for the year ended 31 March 2018.

On 1 April 2018, the management of the company identified an investment opportunity which will cost sh. 720,000. The cost was expected to be financed through an issue of ordinary shares at par. The return on investment is expected to be 25% per annum on cost over the next four years ending 31 March 2022.

All earnings would continue to be paid out as dividends to the shareholders. The cost of capital is 20 %.

Required:

a) Calculate the value of an ordinary share as at 31 March 2018 (4 marks)
b) Determine the value of the company as at 1 April 2018 assuming the management undertook the investment (6 marks)

QUESTION THREE

a) Explain why capital budgeting decisions are important (5 marks)
b) The management of kibabii stores Ltd intends to purchase a machine worth sh.1,500,000 which will have a residual value sh.200,000 after a five year useful life. The savings in cost resulting from its use are as shown below:

Year	savings in cost (sh.)
1	800,000
2	350,000
3	0
4	680,000
5	775,000

Required:

i) Evaluate the project using the using the net present value and internal rate of returns (7 marks)
ii) Advise the management if the machine should be acquired (3 marks)

QUESTION FOUR

a) Distinguish between a credit policy and working capital policy (4 marks)
b) Explain the approaches that can be used by the company to finance its working capital management (6 marks)
c) The following information was obtained from the financial statements of Gammah Ltd for the period ended 31 December 2019.

	Sh.
Annual sales	10,000,000
Average stock	2,000,000
Average debtors	666,667
Average creditors	800,000

Additional information:

i) The company's gross profit margin is 40%

ii) All sales are on credit terms

iii) A year has 360 days

Required:

The company's cash conversion cycle (10 marks)

QUESTION FIVE

a) Discuss five factors that would determine the capital structure of a corporate organization (5 marks)

b) Enumerate five ways in which the dividend decision affects the wealth maximization goal of a company quoted on the securities exchange (5 marks)

c) The following data relates to mamba Ltd for the year ended 31 January 2018.

Current ratio	1.7
Debt /Equity	1.5
Interest cover	3.2
Current liabilities	sh. 600,000
Total asset turnover	1.4 times
Fixed asset turnover	5.6 times
Gross profit margin	30%
Earnings before interest and tax/sales	5%

Required:

i) Income statement for the year ended 31 January 2018 (6marks)

ii) A condensed statement of financial position as at 31 January 2018 (4 marks)