END OF SEMESTER EXAMINATION MAY 2017

EXAMINATION FOR THE DEGREE OF BACHELOR OF CO-OPERATIVE BUSINESS (YR III SEM I / SEM II)

UNIT CODE: HCOB 2305

UNIT TITLE: FINANCIAL MANAGEMENT I

DATE: 4TH MAY, 2017 **TIME: 2:00 PM – 4:00 PM**

INSTRUCTIONS:

- Answer question **ONE (compulsory)** and any other **TWO** questions

QUESTION ONE

(a) Why do lenders charge interest for the use of their money? Give any THREE reasons (3 marks)

(b) Name and briefly discuss any TWO borrowing needs of a business? (2 marks)

(c) Explain payback method of capital budgeting. Give its advantages and disadvantages (10 marks)

(d) XYZ company needs to buy either machine A or Machine B.

i. Macine A costs kshs 500,000 and would generate annual cash flows of kshs 200,000 for 4 years after which the machinery has a zero value

ii. Machine B costs kshs 600,000 and generate annual cash flows of Ksh 250,000 for 4 years after which it has a zero value. Calculate accounting rate of return for both machines (showing your working) if the company applied straight line depreciation on both machines. (8 marks)

$\frac{1}{(1+r)^n}$

Required:

Choose the better machine to buy & provide reasons

i. Distinguish between internal and external sources of finance for a limited liability company (5 marks)

ii. What is a venture capital (2 marks)

QUESTION TWO

(a) Give a comparison of NPV and IRR mentioning at least three distinguishing features of each of these (6 marks)

(b) Figures given below are the estimated cash flow from two mutually exclusive investments (projects)

(All figures in Kenya Shillings)

	Project A	Project B
Initial investment	12,500	30,000
Year 1 net cash flow	7,000	14,000
Year 2 net cash flow	6,000	14,000
Year 3 net cash flow	6,000	14,000

Required:

Calculate NPV at 14% cost of capital and IRR of both project and mention which project should be selected (14 marks)

QUESTION THREE

The following financial statements relate to the ABC company

Assets	Shs	Liabilities & net worth	Shs
Cash	28,500	Trade creditors	116,250

Debtors	270,000	Notes payable (9%)	54,000
Stock	649,500	Other current liabilities	100,500
Total current assets	948,800	Long term debt 10%	300,000
Net fixed assets	285,750	Net worth	663,000
	1,233,750		1,233,750

Income statement for the year ended 31 March 1995

	Kshs
Sales	1,972,500
Less cost of sales	1,368,000
Gross profit	604,500
Selling and administration	498,750
Expenses	105,750
Earnings before interest and	34,500
tax	71,250
Interest expense	28,500
	(42,750)
Estimate taxation (40%)	
Earnings after interest and tax	

Required:

(a) Calculate:

i. Inventory turnover ratio; (3 marks)
ii. Times interest earned ratio; (3 marks)
iii. Total assets turnover; (3 marks)
iv. Net profit margin (3 marks)

(Note: Round your ratios to one decimal place)

(b) The ABC company operates in industry whose norms are as follows;

Ratio	Industry Norm
Inventory turnover	6.2 times
Times interest turnover	5.3 times
Total assets turnover	2.2 times
Net profit margin	3%

Required:

Comment on the revelation made by the ratios you have computes in part (a) above when compared with the industry average (8) ~~(20~~ marks)

QUESTION FOUR

The following is the existing capital structure of company XYZ Ltd

	Shs
Ordinary shares at Kshs 10 par	1,000,000
Retained	800,000
12% preference shares shs 10 par	400,000
16% loan shs 100 per	300,000
Total capital employed	2,500,000

The company's ordinary shares have a divided cover of 3 times and pay a dividend of 10% on its ordinary share capital

Ordinary shares sell at shs 18
Preference shares sell at shs 15
Debentures are selling at par. The tax rate is 30%

Compute

(a) Growth Equity (10 marks)
(b) W.A.C.C (10 marks)

QUESTION FIVE

Nyakua Ltd is contemplating acquiring Uza Ltd.
Incremental cash follows arising from the acquisition are expected to be as follows;
Average of year (in shs '000')

	Average of years (in shs '000;)		
	1-5	6-10	11
Cash flow after taxes	100	150	200
Investment required	50	60	70
Net cash flow	50	90	130

Uza Ltd has an all equity capital structure. The required rate of return of Uza Ltd is always 5% above the risk free rate. The risk free rate is 9%

Required:

(a) Using the information provide, compute the maximum price that Nyakua Ltd might buy ~~pay for~~ Uza Ltd (14 marks)

(b) What other factors might influence the management of Nyakua Ltd in their decision to purchase Uza Ltd (6 marks)