



OFFICE OF THE DEPUTY PRINCIPAL

ACADEMICS, RESEARCH AND STUDENTS' AFFAIRS

UNIVERSITY EXAMINATIONS

2020 /2021 ACADEMIC YEAR

FOURTH YEAR SECOND SEMESTER REGULAR EXAMINATION

FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBM 414

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: 15TH JULY, 2021

TIME: 1:00 PM TO 4:00PM

INSTRUCTION TO CANDIDATES

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THIS PAPER CONSISTS OF 5 PRINTED PAGES

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REGULAR – MAIN EXAM**BBM 414: FINANCIAL MANAGEMENT****STREAM: Accounting & Finance Students****DURATION: 3 Hours****INSTRUCTIONS TO CANDIDATES**

- i. Answer Question **ONE** and any other **TWO** questions.
- ii. Show all your calculations.
- iii. Do not write on the question paper.

SECTION A**Question One**

- (a) Discuss the drawbacks of using the following approaches in estimating a security's value:

- | | | |
|-------|---------------------|-----------|
| (i) | Book value; | (5 marks) |
| (ii) | Replacement value; | (4 marks) |
| (iii) | Substitution value; | (4 marks) |
| (iv) | Intrinsic value. | (5 marks) |

- (b) Ngomongo Holdings Limited has investment interests in three companies. Kirinyaga Video Limited (KVL), Kilgoris Hauliers Limited (KHL) and Turkana Fisheries Limited (TFL). The following financial data relate to these companies.

1. As at 31 December 2001, the financial statements of two of the companies revealed the following information:

Company	Price share Sh.	of Earnings per share Sh.	Dividend share Sh.	per share
Kirinyaga Video Ltd. (KVL)	160 270	8 18	8 9	
Kilgoris Hauliers Ltd. (KHL)				

2. Earnings and dividend information for Turkana Fisheries Ltd. (TFL) for the past five years is given below:

Year ended 31 December	1997 Sh.	1998 Sh.	1999 Sh.	2000 Sh.	2001 Sh.
Earnings per share	5.0	6.0	7.0	10.0	12.0
Dividend per share	3.0	3.0	3.5	5.0	5.5

The estimated return on equity before tax required by investors in Turkana Fisheries Ltd.'s shares is 20%.

Required:

- (i) For Kirinyaga Video Ltd. (KVL) and Kilgoris Hauliers Ltd. (KHL), determine and compare:
- Dividend yields (2 marks)
 - Price/Earnings ratios (2 marks)
 - Dividend covers. (2 marks)
- (ii) Company XYZ pays a dividend of 10% on its Sh.60 par value ordinary shares. This company uses a discount rate of 15%. Assuming no growth, compute the value of its ordinary share if there's growth of 5%, what would be the value of this company's ordinary shares. (10 marks)

(Total: 23 marks)**Question Two**

Clean Wash Ltd. manufactures and markets automatic washing machines. Among the hundreds of components which it purchases each year from external suppliers for assembling into the finished articles are drive belts, of which it uses 400,000 units per annum. It is considering converting its purchasing, delivery and stock control of this item to a Just-In-Time (JIT) system. This will raise the number of orders placed but lower the administrative and other costs of placing and receiving orders. If successful, this will provide the model for switching most of its inwards supplies into this system.

Details of current and proposed ordering and carrying costs are given below:

	Current	Proposed
Ordering cost per order	Sh.10,000	Sh.2,500
Purchase cost per item	Sh.25	Sh.25
Inventory holding cost (as a percentage of the purchase cost)	20%	20%

To implement new arrangements will require a one-off reorganization costs estimated at Sh.140,000 which will be treated as revenue item for tax purposes. The rate of corporation tax is 32.5% and Clean Wash Ltd. can obtain finance at an effective cost of 18%. The life span of the new system is 8 years.

Required

- (a) (i) The economic order quantity with current and proposed arrangements. (5 marks)
- (ii) New Present Value (NPV) of the new arrangement. Is the new arrangement worthwhile? (10 marks)
- (b) Briefly explain the nature and objectives of JIT purchasing arrangements concluded between components users and suppliers. (5 marks)

(Total: 20 marks)

Question Three

XYZ's management has set the minimum cash balance to be equal to Sh.10,000. The standard deviation of daily cash flow is Sh.2,500 and the interest rate on marketable securities is 9% p.a. The transaction cost for each sale or purchase of securities is Sh.20.

Required

- a) Calculate the target cash balance
- b) Calculate the upper limit
- c) Calculate the average cash balance
- d) Calculate the spread

Question Four

P. Muli was recently appointed to the post of investment manager of Masada Ltd. a quoted company. The company has raised Sh.8,000,000 through a rights issue.

P. Muli has the task of evaluating two mutually exclusive projects with unequal economic lives. Project X has 7 years and Project Y has 4 years of economic life. Both projects are expected to have zero salvage value. Their expected cash flows are as follows:

Project Year	X Cash flows (Sh.)	Y Cash flows (Sh.)
1	2,000,000	4,000,000
2	2,200,000	3,000,000
3	2,080,000	4,800,000
4	2,240,000	800,000
5	2,760,000	-
6	3,200,000	-
7	3,600,000	-

The amount raised would be used to finance either of the projects. The company expects to pay a dividend per share of Sh.6.50 in one year's time. The current market price per share is Sh.50. Masada Ltd. expects the future earnings to grow by 7% per annum due to the undertaking of either of the projects. Masada Ltd. has no debt capital in its capital structure.

Required:

- (a) The cost of equity of the firm. (3 marks)
- (b) The net present value of each project. (6 marks)
- (c) The Internal Rate of return (IRR) of the projects. (Rediscount cash flows at 24% for project X and 25% for Project Y). (6 marks)
- (d) Briefly comment on your results in (b) and (c) above. (2 marks)
- (e) Identify and explain the circumstances under which the Net Present Value (NPV) and the Internal Rate of Return (IRR) methods could rank mutually exclusive projects in a conflicting way. (5 marks)

(Total: 22 marks)

Question Five

- (a) What is meant by the term “capital flight?” (5 marks)
- (b) Why have African economies been characterized by much capital flight in the past? (8 marks)
- (c) What is the impact of massive capital flight on the value of the domestic currency? (5 marks)

(Total: 18 marks)
