TECHNICAL UNIVERSITY OF MOMBASA

School of Business

DEPARTMENT OF ACCOUNTING AND FINANCE

UNIVERSITY EXAMINATIONS FOR DEGREE IN BACHELOR OF COMMERCE

BFI 4301: FINANCIAL MAHEGEMENT

SUPPLIMENTARY EXAMINATIONS

SERIES: APRIL 2022

TIME: 2 HOURS

INSTRUCTIONS:

Answer Question **ONE (Compulsory)** and any other **TWO** questions

This paper consists of Four printed pages

Question One.

PV Co, a large stock-exchange-listed company, is evaluating an investment proposal to manufacture Product W33, which has performed well in test marketing trials conducted recently by the company's research and development division. Product W33 will be manufactured using a fully-automated process which would significantly increase noise levels from PV Co's factory. The following information relating to this investment proposal has now been prepared:

Initial investment sh.2 million

Selling price (current price terms) sh.20 per unit

Expected selling price inflation 3% per year

Variable operating costs (current price terms) sh.8 per unit

Fixed operating costs (current price terms) sh.170,000 per year

Expected operating cost inflation 4% per year

The research and development division has prepared the following demand forecast as a result of its test marketing trials. The forecast reflects expected technological change and its effect on the anticipated life-cycle of Product W33.

Year	1	2	3	4
Demand (units)	60,000	70,000	120,000	45,000

It is expected that all units of Product W33 produced will be sold, in line with the company's policy of keeping no inventory of finished goods. No terminal value or machinery scrap value is expected at the end of four years, when production of Product W33 is planned to end. For investment appraisal purposes, PV Co uses a nominal (money) discount rate of 10% per year and a target return on capital employed of 30% per year. Ignore taxation.

Required:

(a) Calculate the following values for the investment proposal:

(i) Net present value; (5 marks)

(ii) Internal rate of return; and (5 marks)

(iii) Return on capital employed (accounting rate of return) based on average investment. (5 marks)

(b) Discuss how the objectives of PV Co's stakeholders may be in conflict if the project is undertaken. (5 marks

(c) What is meant by 'Financial management' Explain its importance (10 marks)

Question Two.

Ulnad Co has annual sales revenue of sh.6 million and all sales are on 30 days' credit, although customers on average take ten days more than this to pay. Contribution represents 60% of sales and the company currently has no bad debts. Accounts receivable are financed by an overdraft at an annual interest rate of 7%.

Ulnad Co plans to offer an early settlement discount of 1.5% for payment within 15 days and to extend the maximum credit offered to 60 days. The company expects that these changes will increase annual credit sales by 5%, while also leading to additional incremental costs equal to 0.5% of turnover. The discount is expected to be taken by 30% of customers, with the remaining customers taking an average of 60 days to pay.

Required

(a) Evaluate whether the proposed changes in credit policy will increase the profitability of Ulnad Co. (6 marks)

(b Identify and explain the key areas of accounts receivable management. (6 marks)

(c) Discuss the key factors to be considered when formulating a working capital funding policy. (8 marks)

Question Three

Capit SA is a large firm listed on the Nairobi Securities Exchange. It has the following capital structure:

Long Term Capital	sh. 000
Debt Capital – 5 yrs; 8%	25,000
5% Preferred Shares – 5%	15,000
Ordinary shares @10/=	10,000
Retained Earnings	23,000

The current dividend for the company is sh. 50/share and is expected to grow at 3% per year in the foreseeable future. The equity shares trade at sh. 450/share. The preferred shares trade at sh. 104/share. The debt currently trades at sh. 950. The firm's income tax rate is 30%

Required:

(a) Calculate the firm's weighted average cost of capital (WACC): (10 marks)

(b) Discuss the firm's dividend payout policy and whether it has an impact on share price? (5 marks)

(c) Explain why the different sources of capital have different levels of risk and return. (5 marks)

Question Four

(a) Briefly explain any five importance of Capital budgeting (10 marks).

(b) Explain briefly five factors determining the amount of fixed capital. (10 marks)

Question Five

(a) Firm A and Firm B are both subsidiary companies of Groupe Trojan Electronics. The directors of Groupe Trojan Electronics are reviewing the capital structure of the two subsidiary companies. You have been engaged to advise the directors on the appropriate capital structure for the subsidiaries.

You have obtained extracts from the financial results of the two companies for the past financial year and projection of the annual results for the current year, which is in its first quarter.

	Projected Results - 2019		Historical Results -2018	
	Firm A	Firm B	Firm A	Firm B
Sales units (millions)	7.2	3.6	12	6
Price per unit (shs.)	40	62	40	62
	Sh. Millions	Sh. Millions	Sh. Millions	Sh. millions
Sales Revenue	288.00	223.20	480.00	372.00
Less Varaible cost	172.80	44.64	288.00	74.40
Fixed Costs	40.00	128.00	40.00	128.00
Total Operating Costs	212.80	172.64	328.00	202.40
Operating Profits	75.20	50.56	152.00	169.60
Interest Expenses	35.00	110.00	35.00	110.00
Profit before tax	40.20	(59.44)	117.00	59.60
Tax	10.05	(14.86)	29.25	14.90
Profit after Tax	30.15	(44.58)	87.75	44.70

Required:

i) Compute the degree of operating leverage for each of the two companies. Based on the degree of operating leverage you obtain, advise the directors on the relative level of business risk associated with the two subsidiaries and the implication of that for capital structure design.(7 marks)

ii) Compute the degree of financial leverage for each of the two companies. Based on the degree of financial leverage you obtain, advise the directors on the relative level of financial risk associated with the two subsidiaries and the implication of that for capital structure design. (7 marks)

iii) Compute the degree of combined leverage for each of the two companies. Based on the degree of combined leverage you obtain, advise the directors on the relative level of combined risk associated with the two subsidiaries and the implication of that for capital structure design. (6 marks)