The Co-operative University of Kenya

END OF SEMESTER EXAMINATION DECEMBER -2018

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

UNIT CODE: HCOB 2305/HBC 2202

UNIT TITLE: FINANCIAL MANAGEMENT I/INTRODUCTION TO FINANCIAL MANAGMENT I

DATE: 17TH DECEMBER, 2018 **TIME: 9:00 AM – 11:00 AM**

INSTRUCTIONS:

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

QUESTION ONE

(a) Holding cash is a cost to the business, discuss THREE motives holding cash. (6 Marks)
(b) Discuss THREE factors that affect business investment decisions. (6 Marks)
(c) Briefly explain the operations of the central depository system (CDS) in facilitating securities trading. (6 Marks)
(d) An investor deposits kshs 10,000 in a bank for FOUR years in an account earning 10% rate. Determine the future values of the investment at the end of the 4th year if the amount is deposited;
 (i) At the end of the year (6 Marks)
 (ii) At the beginning of the year (6 Marks)

QUESTION TWO

(a) Explain why the weighted average cost of capital of a firm that uses relatively more debt capital is generally lower than that of a firm that uses relatively less debt capital. (5 Marks)
(b) The total of the net working capital and fixed assets of Frida Ltd as at 30th April 2016 was sh. 100,000,000. The company wishes to raise additional funds to finance a project within the nest one year in the following manner.
Sh. 30,000,000 from debt
Sh. 20,000,000 from selling new ordinary shares.

The following items make up the equity of the company;

	Shs.
3,000,000 fully paid up ordinary share	30,000,000
Accumulated retained earnings	20,000,000
1,000,000 10% preference shares	20,000,000
200,000 6% long term debentures	30,000,000

The current market value of the company's ordinary shares is sh. 30. The expected dividend on ordinary shares by 30th April 2016 is forecast at sh. 1.20 per share. The average growth rate in both earnings and dividends has been 10% over the last 10 years and this growth rate is expected to be maintained in the foreseeable future.

The debentures of the company have a face value of sh. 150. However, they currently sell for sh. 100. The debentures will mature in 100 years.
The preference shares were issued four years ago and still sell at their face value.
Assume a tax rate of 30%.

Required;

(i) The expected rate of return on ordinary shares. (3 Marks)

(ii) The effective cost to the company of;
- Debt capital (3 Marks)
- Preference share capital (3 Marks)

(iii) The company's existing weighted average cost of capital (3 Marks)

QUESTION THREE

The following information represents the financial position and financial results of XYZ Limited for the year ended 31st December 2015.

XYZ LIMITED
STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31ST DECMBER 2015;

		Shs. '000'		Shs. '000'
Sales - cash				300,000
- Credit				600,000
				900,000
Less; cost of sale				
Opening stock		210,000		
Purchases		660,000		
		870,000		
Less; closing stock	(150,000)			720,000
Gross profit				180,000
Less expenses;				
Depreciation		13,100		
Directors emoluments		15,000		
General expenses		20,900		
Interest on loan		4,000		
			(53,000)	
Net profit before tax				127,000
Corporation tax at 30%			(38,100)	
Net profit after tax				88,900
Preference dividend		4,800		
Ordinary dividend		10,000		14,800
Retained profit for the year				74,100

XYZ LIMITED
STATEMENT OF FINANCIAL POSITION AS AT 31ST DECEMBER 2015

	Sh. '000'	Sh. '000'	Sh.'000'
Fixed Assets			213,900
Current Assets;			
Stocks	150,000		
Debtors	35,900		
Cash	20,000	205,900	
Current Liabilities;	60,000		
Trade creditors	63,500		
Corporation tax payable	14,800	138,300	67,600
			281,500
Financed by;			
Ordinary share capital (sh. 10 par value)		100,000	
8% preference share capital		60,000	
Revenue reserves		81,500	
10% bank loan		40,000	
			281500

Additional information;

1. The company's ordinary shares are selling at sh. 20 in the stock market.
2. The company has a constant dividend payout of 105.

Required;

(a) Determine the following financial ratios;

(i) Acid test ratio (2 Marks)
(ii) Operating ratio (2 Marks)
(iii) Return on total capital employed (2 Marks)
(iv) Price earnings ratio (2 Marks)
(v) Interest coverage ratio (2 Marks)
(vi) Total Assets turnover

(b) Determine the working cycle for the company. (8 marks)

QUESTION FOUR

(a) Enumerate FOUR advantages of convertible bonds from the point of view of the borrower. (4 Marks)

(b) The finance manager of Bidii Industries ltd. Which manufactures Consumables, has identified the following THREE projects for potential investment;

PROJECT I

The project will require an initial investment of sh. 18 million and a further investment of sh. 25 million at the end of two years. Cash profits from the project will be as follows:

		Sh.
End of year	2	15,000,000
	3	0
	4	12,000,000
	5	0
	6	8,000,000
	7	8,000,000

	8	8,000,000 8,000,000 8,000,000

Project II

This project will involve an initial investment of sh.50 million on equipment and sh. 18 million on working capital. The investment on working capital would be increased to sh. 20 million at the end of the second year. Annual cash profit will be sh. 20 million for five years at the end of which the investment in working capital will be recovered.

Project III

The project will require an initial investment on capital equipment of sh. 84 million and sh. 24 million on working capital. The profits from the project will be as follows;

		Contribution sh.	Fixed costs sh.
End of Year	1	35 million	8 million
End of Year	2	30 million	6 million
End of year	3	14 million	8 million

Fixed costs include an annual depreciation charge of sh. 3 million. At the end of year 3, the working capital investment will be recovered and the capital equipment will be sold for sh. 8 million,

Bidii Industries Ltd's cost of capital is 12%. Ignore taxation.

Required;

(i) Evaluate each project using the net present value (NPV) method. (14 Marks)

(ii) Which of the THREE projects should Bidii Industries Ltd. Accept? (2 Marks)

QUESTION FIVE

Kikwetu Ltd. Has FOUR categories of debtors; A, B, C and D. The average collection period and the percentage of bad debts for each category of debtors is shown below:

Category	Average collection period (days)	Bad debts (%)
A	15	0.5
B	20	2.5
C	30	5.0
D	40	9.5

The profit per unit of the company's product is shown below;

	Shs.	Shs.
Selling price		25
Less: materials	10	
Wages	9.5	
Variable costs	3	
Fixed costs	0.5	23
Profit		2

The company has the opportunity to increase its sales by sh. 10,000,000 per annum, split between categories C and D of the debtors in the proportion 2:3 respectively. The company borrows at an interest rate of 11.5 per annum (assume a year has 365 days).

Required;

(i) Calculate the additional contribution to be realized from the increased sales. (10 Marks)

(ii) Calculate the bad debts expense arising from the increased sales for each category of debtors. (6 Marks)

(iii) Compute the net profit or loss realized from the increased sales. (4 Marks)