JARAMOGI OGINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY

SCHOOL OF BUSINESS AND ECONOMICS

UNIVERSITY EXAMINATION

FOR DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH IT

3RD YEAR 1ST SEMESTER 2018/2019 ACADEMIC YEAR

COURSE CODE: ABA 303

COURSE TITLE: FINANCIAL MANAGEMENT

DATE:

TIME: 2.00 HOURS

INSTRUCTIONS:

1. **Answer Question ONE (Compulsory) and ANY other 2 Questions**
2. **Candidates are advised not to write on the Question paper**
3. **Candidates must hand in their answer booklets to the invigilator while in the examination room**

QUESTION ONE

a) Briefly explain the yardsticks used in ratios analysis. (5 marks)

b) List and explain at least SEVEN differences between Debt Capital and Equity Capital. (7 marks)

c) Enumerate the assumptions underlying the economic order quantity model (4 marks)

d) XYZ Company Limited is a distributor of air filters to retail shops. It buys its filters from several manufacturers. Filters are ordered in lot sizes of 100 and each order costs Sh.400 to place. Demand from retail shops is 200,000 filters per month and the carrying cost is Sh.10 per filter per month.

Required

i. Compute the optimal order quantity with respect to number of lot sizes”
(3 marks)

ii. If a safety stock of 2,000 filters is desired calculate the total relevant costs
(3 marks)

iii. A certain manufacturer offers a discount of 2% for purchases of 50 lot sizes or more. Determine whether the discount should be taken. (Assume that each filter costs Sh.100). (8 marks)

QUESTION TWO

a) Identify the objectives of working capital management and discuss the central role of working capital management in financial management (8 marks)

b) Suggest and discuss any three policies that a Limited Company may be using in the management of the working capital (6 marks)

c) A firm may adopt a conservative policy or an aggressive policy in financing its working capital needs. Clearly distinguish between:

i) A conservative policy and (3 marks)

ii) An aggressive policy. (3 marks)

QUESTION THREE

a) Company ABC Limited is considering the purchase of a new machine. Two alternative machines, Pesi and Upesi, which will cost Sh.8, 000,000each are available in the market. The company’s cost of capital is 12%. The cash flow after taxation of each machine are as follows:

	Cash flow	
Year	**Pesi**	**Upesi**
	Sh.	**Sh.**
1	600,000	1,800,000

2	1,800,000	2,400,000
3	2,000,000	3,000,000
4	3,000,000	1,800,000
5	2,400,000	1,600,000

Assume that the company's cost of capital is 12%.

Required:

i) Determine the Payback period for each machine (4 marks)

ii) Compute the net present value of each machine. (8 marks)

iii) Calculate the profitability index of each machine (3marks)

iv) Advise the management which machine to invest in and why (2 mark)

b) Explain the limitations of the goal of profit maximization. (3 marks)

QUESTION FOUR

a) Write short notes on the following:

i) The Modigliani and Miller (MM) Approach to capital theory (4 marks)

ii) Residual Dividend Policy (3 marks)

iii) Dividend Stability Policy (2 marks)

iv) Hybrid Dividend Policy (2 marks)

b) ABC Ltd belongs to a risk class for which the appropriate capitalization rate is 10%. It currently has outstanding 5000 shares selling at Kshs: 100 each. The firm is contemplating the declaration of dividend of Kshs: 6 per share at the end of the current financial year. The company expects to have net income of Kshs: 50,000 and has a proposal for making new investments of Kshs: 100,000.

Required:

Show that under the MM hypothesis, the payment of dividend does not affect the value of the firm. (9 marks)

QUESTION FIVE

a) The following financial statements related to the A B C company

Assets	Kshs**.**	**Liabilities & net worth**	
Cash	28,500	Trade credit	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 2016.

Sales	sh.1, 972,500
Less cost of sales	1, 368, 00
Gross profit	604, 500
Selling and distribution expenses	498, 750
Earnings before interest and tax	105,750
Interest expense	34,500
	71,250
Estimated taxation (40%)	28,500
Earnings after interest and tax	42, 750

Required:

a) Calculate

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

(Note: Round off your ratio to one decimal place)

b) The ABC company operates in an industry whose norms are as follows:

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

Required:

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