LAIKIPIA UNIVERSITY

UNIVERSITY EXAMINATIONS

2ND SEMESTER 2023/2024 ACADEMIC YEAR

THIRD YEAR EXAMINATION FOR THE DEGREE OF
BACHELOR OF COMMERCE

BFIN 322: FINANCIAL MANAGEMENT I

STREAM: ***TIME: 2 HRS***

DAY: TUESDAY [2.30-4.30 P.M] ***DATE: 16/04/2024***

THIS QUESTION PAPER CONSISTS OF FOUR (4) PAGES

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Answer question ONE and any other TWO

QUESTION ONE (Compulsory 30 Marks)   Time: 2 HRS

a) XYZ, Inc. with a 14 percent cost of capital after taxes is considering a project with an expected life of 4 years. The project requires an initial certain cash outlay of Shs.50, 000. The expected cash inflows and certainty equivalent coefficients are as follows:

Year	After-Tax Cash Flow (Shs)	Certainty Equivalent coefficient
1	10,000	0.95
2	15,000	0.80
3	20,000	0.70
4	25,000	0.60

If the risk-free rate of return is 5 percent;
Required:
Compute;
i) The NPV and **(6 Marks)**
ii) The IRR. **(6 Marks)**

b) Explain the importance of dividend policy to listed companies. **(8 Marks)**

c) The following information has been taken from the income statement and statement of financial position of A Co:

Revenue	Shs.350m
Production expenses	Shs.210m
Administrative expenses	Shs.24m
Tax allowable depreciation	Shs.31m
Capital investment in year	Shs.48m
Corporate debt	Shs.14m trading at 130%

Corporate tax is 30%
The WACC is 16.6%. Inflation is 6%.
These cash flows are expected to continue every year for the foreseeable future.
Required:
Calculate the value of equity. **(10 Marks)**

QUESTION TWO

a) The Summerall Corporation wishes to introduce one of two products to the market this year. The probabilities and present values of projected cash inflows are given below.

Products	Initial Investment ($)	PV of Cash Mows ($	Probabilities
A	225,000		1.0
		450,000	0.4
		200,000	0.5
		-100,000	0.1
B	80,000		1.0
		320,000	0.2
		100,000	0.6
		-150,000	0.2

Required:

i. Construct a decision tree to analyze the two products. **(10 Marks)**

ii. With reasons, indicate the product you would introduce. **(2 Marks)**

b) The Wayne Company manufactures and sells doors to home builders. The doors are sold for Shs.25 each. Variable costs are Shs.15 per door, and fixed operating costs total Shs.50, 000 the Wayne Company has total financial charges of Shs.2, 000, half in interest expense and half in preferred stock dividend. The corporate tax rate is 40 percent.

Required:

i) Determine their financial leverage, and **(4 Marks)**

ii) Total leverage of Wayne Company manufactures **(4 Marks)**

QUESTION THREE

a) Explain the importance of ratios to the management **(4 Marks)**

b) Explain the weaknesses of the dividend growth model. **(4 Marks)**

Write short notes on the following theories of dividend policy

c) Irrelevancy theory **(4 Marks)**

d) Traditional view **(4 Marks)**

e) Residual theory **(4 Marks)**

QUESTION FOUR

a) There are simple approaches to preparing budgets, such as looking at relationships between account balances and sales. However, a financial planner and forecaster should have a clear understanding of past financial performance to help in predicting future financial performance. Further, extending past trends and adjusting for what is expected is a common approach to preparing a forecast.

Required:

Explain the other techniques that can be used to improve financial forecasting. **(10 Marks)**

b) Discuss the extent to which the concept of maximization of wealth is relevant to the formulation of company financial objectives. In doing this, you should make reference to a valuation formula based on dividend growth and to the importance of statistics of earnings per share. **(10 Marks)**