UGANDA MARTYRS UNIVERSITY

FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT

UNIVERSITY EXAMINATIONS

SEMESTER II 2016/ 2017

CORPORATE FINANCE I (COR2201) EXAMINATION

DATE:19th JUNE 2017

TIME: 6:00PM – 9:00PM

DURATION 3 HOURS

INSTRUCTIONS:

- **The paper has two Sections; Section A is compulsory**
- **Section B has Four equally weighed questions, attempt any Three questions from this Section**
- **Don't write any anything on the question paper**
- **Begin each answer on a fresh sheet of paper**
- **Refer to the answer booklet for more examination instructions.**

SECTION A (25 marks)

Question One

The following information relates to an investment project which is being evaluated by the directors of Fence Co, a listedcompany. The initial investment, payable at the start of the first year of operation, is $3·9 million.

Year	1	2	3	4
Net operating cash flow ($000)	1,200	1,500	1,600	1,580
Scrap value ($000)				100

The directors believe that this investment project will increase shareholder wealth if it achieves a return on capitalemployed greater than 15%. As a matter of policy, the directors require all investment projects to be evaluated using boththe payback and return on capital employed methods. Shareholders have recently criticised the directors for using theseinvestment appraisal methods, claiming that Fence Co ought to be using the academically-preferred net present valuemethod.

The directors have a remuneration package which includes a financial reward for achieving an annual return on capitalemployed greater than 15%. The remuneration package does not include a share option scheme.

1. What is the payback period of the investment project? (5 marks)
2. Explain the strength and weakness of payback period. (6 marks)
3. Based on the average investment method, what is the return on capital employed of the investment project? (5 marks)
4. What do you understand by the term share option scheme (2 marks)
5. What are the benefits and challenges Fence Co is likely to face due to linking rewards with performance. (7 marks)

SECTION B

Choose any **THREE** questions from this section. All questions carry equal marks

Question Two

From the following information which relates to Zola Co you are required to prepare a month by month cash flow forecast for the second half of 2018. (25 marks)

(a) The company's only product, a vest, sells at $40 and has a variable cost of $26 made up of material $20, labour $4 and overhead $2

(b) Fixed costs of $6,000 per month are paid on the 28th of each month.

(c) Quantities sold/to be sold on credit

May	*June*	*July*	*Aug*	*Sept*	*Oct*	*Nov*	*Dec*
1,000	1,200	1,400	1,600	1,800	2,000	2,200	2,600

(d) Production quantities

May	*June*	*July*	*Aug*	*Sept*	*Oct*	*Nov*	*Dec*
1,200	1,400	1,600	2,000	2,400	2,600	2,400	2,200

(e) Cash sales at a discount of 5% are expected to average 100 units a month.

(f) Customers settle their accounts by the end of the second month following sale.

(g) Suppliers of material are paid two months after the material is used in production.

(h) Wages are paid in the same month as they are incurred.

(i) 70% of the variable overhead is paid in the month of production, the remainder in the following month.

(j) Corporation tax of $18,000 is to be paid in October.

(k) A new delivery vehicle was bought in June. It cost $8,000 and is to be paid for in August. The old vehicle was sold for $600, the buyer undertaking to pay in July.

(l) The company is expected to be $3,000 overdrawn at the bank at 30 June 20X5.

(m) No increases or decreases in raw materials, work in progress or finished goods are planned over the period.

(n) No price increases or cost increases are expected in the period.

Question Three

(a) Explain what is meant by the concept of "time value of money" and why it is important in finance decisions. (5 marks)

(b) Jan is considering selling his car to Feb on 1 November 2017, Feb is willing to give an immediate payment of shs 10 million and a further deferred payment on 31 October 2020 of shs 6 million. If Jan's cost of capital is 12%. What is the total consideration of Jan's car? (10 marks)

(c) Explain any five sources of short term finance for Small and Medium Enterprises (SMEs) applicable in Ugandan economy. (10 marks)

Question Four

Road works an international construction company requires cement worth 45,000 million annually, which is purchased from one supplier at a cost of shs 30,000 per bag. Its costs shs 3,000 to hold a bag of cement in the period and each order made costs shs 224,500fixed costs andshs 500 per bag variable cost

(i) Compute the economic order quantity for cement (7 marks)

(ii) Discuss how JIT system will solve problems of inventory management of cement (6 marks)

(iii) Discuss any othertechniques that can be used to achieve effective stock control (6 marks)

(iv) Explain the cost of low and of excessive inventory levels. (6 marks)

QuestionFive

BAM Masaka a limited liability company is trying to decide whether to buy a machine to improve its processes. The new machine costs for $80,000 which will save costs of $20,000 per annum for 5 years and it's expected to have a resale value of $10,000 at the end of year 5. If it is the company's policy to undertake projects only if they exceed the company's cost of capital of 10%,

(i) Ascertain whether this machine should be bought using the internal rate of return (IRR) (16 marks)

(ii) What do you understand by the term cost of capital (3 marks)

(iii) Explain the strength and weakness of IRR (6 marks)

Question Six

Jane and Joan operate a financial service firm. They manage other people's money
of their financial analysis using ratios.

(a) Explain the benefits and limitations of using ration analysis (15 marks)

(b) Explain the rations from the category of solvency/ liquidity providing th
and the information they give to their stakeholders. (10 marks)