

UGANDA MARTYRS UNIVERSITY, NKOZI CAMPUS

FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT

DEPARTMENT OF ACCOUNTING AND FINANCE

NKOZI / RUBAGA BAM II FULL TIME

CODE: 2205.COURSE: CORPORATE FINANCE I

Date:9th May 2019

Time allowed: 3 hours

Instructions to candidates:

Read the following before answering the examination questions

- 1) Do not write anything on the question paper
 - 2) Write neatly and show all workings.
 - 3) Every question attempted should be started on a new page
 - 4) Attempt any four questions.**
 - 5) All questions carry equal marks.
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Question One

- a) In order to be successful, the organization may be seen as showing high **profit maximization** and **wealth maximization**. Explain the meaning of the two terms and state why wealth maximization is viewed as superior to profit maximization objective. **(6 Marks)**
- b) With reference to the Agency Theory, discuss the possible areas of conflict between Managers and shareholders and suggest ways these conflicts can be minimized **(6 Marks)**
- c) Enterprise PKW Ltd anticipates an increase in demand of their products in this year's festive season. The Marketing Manager has requested for additional funds to meet the increasing demand however; the financial manager insists that there is no money for that.

Required

Advise management on any 5 possible sources of short-term finance available in Uganda clearly stating the advantages for each. **(13 Marks)**

Question Two

- (a) Company PKL Ltd is considering a capital investment in new equipment with a six-year life span and requiring shs. (200,000) as initial cost. The management maximum desired payback period is three years. The Cash flows for the six years are given below.

Year	1	2	3	4	5	6
Cash flow	70,000	60,000	55,000	40,000	30,000	25,000

- (i) Compute the payback period for this project. **(4 Marks)**
- (ii) What would be the discounted payback period if the discount rate is 10%? **(5 Marks)**
- (iii) Advise PKL Ltd on the way forward on investment decision. **(2 Marks)**
- (iv) Explain briefly three advantages and two disadvantages of payback period method of project appraisal of the firm. **(5 Marks)**
- (b) KLL Ltd requires an initial investment of shs.3,600,000 to yield an estimated cash flows with interest rate of 14%.the cash flows are for seven years as given below

Year	1	2	3	4	5	6	7
Cash flow	100,000	500,000	1,000,000	1,500,000	200,000	500,000	1,000,000

Required:

- (i) Calculate the present value of the cash flows and profitability index(PI) of the project. **(7 Marks)**
- (ii) Advise the Company on the viability of the project. **(2 Marks)**

Question Three

- (a) The financial manager faces an increasing risk that cash flow from the assets may not be realized in the future. The further one goes into the future, the more necessary it becomes that the decision to invest the firm's resources in assets be evaluated very carefully.

Required:

Why is Capital budgeting necessary?

(10 Marks)

- (b) Picfare Industry Ltd is considering setting up a new Paper Mill at a cost of shs 100 million. It is expected to stay economical for 5 years after which the company expects to upgrade to a more efficient technology and sell it for shs 30 million.

The following is an extract from a report prepared by the marketing department and engineering department. All amounts are in million.

Years	1	2	3	4	5
Revenue inflows	90	85	80	70	60
Cash out flows	50	46	40	36	40
Net cash flows before tax	40	39	40	34	20

A tax rate of 30% is applicable to both income, gains, and is not expected to change in 5 years. Tax Policy requires the company to depreciate the plant over 5 years with shs 10 million-salvage value. A discount rate of 8% is appropriate.

Required:

Using the appropriate appraisal method, evaluate the performance of firm after considering the tax implications and advise the company whether it should go ahead to set Paper Mill.

(15 Marks)

Question Four

- (a) Imagine a debate between two Corporate Finance I students and their area of contention is 5 advantages and 5 disadvantages of any four(4) business organizations in the business world. The best candidate in this debate wins a free trip to the USA.

Required:

Show case that you are the best candidate:

(20 marks)

- (b) Discuss any three(3) major decision areas of financial management. **(10 Marks)**

Question five

The following information relates to BBA Ltd

	Shs."000"	Shs."000"	Shs. "000"	Shs. "000"
Years	2018		2017	
Revenue		80,000		120,000
Cost of sales				
Opening inventory	25,000		22,500	
Add: Purchases	50,000		91,000	
	75,000		113,500	
Less: closing Inventory	<u>15,000</u>	<u>60,000</u>	<u>17,500</u>	<u>96,000</u>
Gross profit		20,000		24,000
Less: operating expenses				
Selling and administration	1,000		3,000	
Interest charge	<u>4,000</u>		<u>3,000</u>	
		<u>5,000</u>		<u>6,000</u>
Profit before tax		15,000		18,000
Tax		<u>5,000</u>		<u>3,000</u>
Net profit		10,000		15,000

BBA statement of Financial Position as at 31.12. 2018

	Shs. "000"	Shs. "000"	Shs. "000"	Shs. "000"
<u>Fixed Assets</u>				
Non-current Assets		2,000		14,000
<u>Current Assets</u>				
Inventory	15,000		15,500	
Accounts receivables	25,000		20,000	
Bank	<u>5,000</u>	<u>45,000</u>	2,500	<u>38,000</u>
Total Assets		47,000		52,000
Shareholders Equity & liabilities				
<u>Liabilities</u>				
Trade payables		5,000		10,000
Non -current Liabilities				
Long term loan		<u>4,500</u>		<u>3,400</u>
Total liabilities		9,500		13,400
<u>Equity</u>				
Share capital		27,000		23,600
Retained earnings		10,500		15,000
Total liabilities and equity		47,000		52,000

Required:

(a) Compute following liquidity ratios and gearing ratios for the above firm for the given years and comment on the performance of the firm. **(14 Marks)**

- (i) Current ratio
- (ii) Quick ratio
- (iii) Accounts receivable days
- (iv) Accounts payable days
- (v) Gearing ratio
- (vi) Interest cover ratio

(b) Explain the significance of ratio analysis to management, employees and lenders. **(6 Marks)**

(c) Explain any four(4) limitations of ratio analysis in evaluating financial health of a company. **(5 Marks)**

Question six

(a) State 5 factors that may determine the level of working capital in an organization. **(5 Marks)**

(b) YBK Ltd had opening cash balance on 1st January of Shs. 40,000, the sales budgeted were given as follows:

	November	December	January	February	March
Shs “000”	80,000	90,000	75,000	75,000	80,000

According the management accountants’ records shows that the trade receivables settle according to the following pattern: 60% within the month of sale; 25% the month following and 15% the month that follows.

The extract from the Purchases budget were as follows

December	Shs. 60,000
January	Shs. 55,000
February	Shs. 45,000
March	Shs. 55,000

Additional Information:

- All the purchases are on credit and 90% are settled in the month of purchase and the balance settled the month after
- Wages are Shs. 10,000 per month and overheads of Shs. 15,000 per month (includes shs. 5,000 depreciation) are settled monthly
- Taxation of shs. 5,000 has to be settled in February and the company will receive settlement of an insurance claim of shs. 20,000 in March. The company disposed of some equipment's at shs. 11,000 in the month of February.
- Received proceeds from share issue of Shs. 19,000 in month of January

Required:

- (i) Prepare a cash budget for January, February and March. **(15 Marks)**
- (iii) The difference between a company that succeeds and one that fails is often cash management. As an expert in cash budgeting explain the management of YBK Ltd why cash budgets are important to the company's financial health.
(5 Marks)

- **GOOD LUCK** -