kasneb

ATD LEVEL II

FUNDAMENTALS OF FINANCE

TUESDAY: 28 November 2017. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Highlight four factors that could influence the amount of cash that a firm should hold. (4 marks)

(b) Describe three challenges faced by Islamic financial institutions (IFIs) in your country. (6 marks)

(c) The following data relates to Takymatt Ltd.:

Selling price per unit	Sh.80
Variable cost per unit	Sh.50
Fixed cost per unit	Sh.10
Annual credit sales	300,000 units
Collection period	2 months
Rate of return	16%

The company is considering a change in policy that would relax its credit policy.

Additional information:

1. Sales were expected to increase by 20%.
2. Collection period would change to 3 months.
3. Bad debt losses were expected to be 3% of the increased sales.
4. Collection costs were expected to increase by Sh.20,000.

Required:

Determine whether Takymatt Ltd. should relax its credit policy. (10 marks)

(Total: 20 marks)

QUESTION TWO

(a) Highlight three advantages and three disadvantages of private placement as a source of finance to the issuing company. (6 marks)

(b) Explain two assumptions that justify the use of weighted average cost of capital (WACC) as a discount rate when undertaking capital budgeting decisions. (4 marks)

(c) The following extract of the statement of financial position of Mapato Ltd. shows the capital structure of the company as at 31 December 2016:

	Sh."000"
Ordinary share capital (Sh.125 par value)	62,500
Reserves	121,500
Shareholder's funds	184,000
14% debentures (Sh.500 par value)	118,500
	302,500

The management of the company consider the above capital structure optimal.

Additional information:

1. The company's earnings before interest and tax (EBIT) average is Sh.75 million per annum. These earnings are expected to be maintained in the foreseeable future.
2. The ordinary shares are currently trading at Sh.400 per share.
3. The market price of the debentures is Sh.525 per debenture.
4. The corporate tax rate is 30%.
5. The firm adopts 100% dividend payout ratio as its dividend policy.

Required:

(i) The cost of equity. (3 marks)

(ii) The after-tax cost of debt. (2 marks)

(iii) Market-weighted average cost of capital (WACC). (5 marks)

(Total: 20 marks)

QUESTION THREE

(a) Discuss three limitations of profit maximisation as an objective of a firm. (6 marks)

(b) Juma Masese receives an annuity of Sh.20,000 payable once every two years. The annuity stretches out to over 20 years. The first payment occurs two years from today. The annual interest rate is 6%.

Required:

Calculate the present value (PV) of the annuity. (4 marks)

(c) Kipande Ltd., a manufacturing company intends to invest in a new product line. This requires an investment of Sh.10 million in plant and machinery. The production is expected to last for five years and will have a salvage value of Sh.2 million at the end of this period.

Additional information:

1. The annual contribution from the product will be Sh.4,600,000.
2. Fixed operating costs excluding depreciation would amount to Sh.950,000 per annum.
3. As a result of the expansion of the product line, working capital is expected to increase by Sh.1,500,000 at the start of production and will be released at the end of the economic life of the project.
4. The company employs a straight line depreciation policy.
5. The corporate tax rate is 30% per annum.
6. The company's cost of capital is 12% per annum.

Required:

Using the Net Present Value (NPV) approach, advise Kipande Ltd. on whether to invest in the new product line. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Describe five functions of a financial system in your country. (10 marks)

(b) Madar Ltd. has had stable earnings growth rate of 8% per annum for the past 10 years. In year 2016, the company paid dividends of Sh.2.6 million on net income of Sh.9.8 million. However, in 2017 earnings are expected to increase to Sh.12.6 million and Madar Ltd. plans to invest Sh.7.3 million in a plant expansion. This one-time unusual earnings growth will not be maintained though, and after 2017, the company will return to its previous 8% earnings growth rate.

The company's target debt ratio is 35%.

Required:

Calculate Madar Ltd.'s total dividends for the year 2017 under each of the following policies:

(i) The company's year 2017 dividend payment is set to force dividends to grow at the long run growth rate in earnings. (2 marks)

(ii) The company continues with the year 2016 dividend payout ratio. (2 marks)

(iii) The company uses a pure residual policy with all distributions in the form of dividends. (2 marks)

(c) Polycarp Omondi expects to make a deposit of Sh.500,000 in his savings account at the end of the year 2017. He intends to make a deposit of Sh.100,000 at the end of each subsequent year. The sum deposited will earn interest at the rate of 6% per annum compounded annually.

Required:

The cumulative amount that will be in his account at the end of the year 2020. (4 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Outline four roles of a finance manager. (4 marks)

(b) Citing three reasons, justify why there is need for a company to pay stable dividends. (6 marks)

(c) Distinguish between "systematic risk" and "unsystematic risk". (4 marks)

(d) The forecasted rate of return on the stock of firm X Ltd. in different states of nature and their probability of occurrence are given as follows:

State of nature	Probability	Forecasted return (%)
Boom	0.3	15
Most likely	0.5	10
Recession	0.2	–5

Required:

(i) Expected return for the stock. (2 marks)

(ii) The standard deviation of return. (4 marks)

(Total: 20 marks)

....