

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR MASTER OF BUSINESS ADMINISTRATION

MBAD 832: ADVANCED FINANCIAL MANAGEMENT (Y2 S1)

STREAMS: MBAD

TIME: 3 HOURS

DAY/DATE: TUESDAY 13 /07/ 2021

2.30 PM – 4.30 PM

INSTRUCTIONS:

- Answer ALL questions

QUESTION ONE

- a) Bimbo limited is considering investing in 7 projects whose information is provided below.

Projects	Initial cost (000)	Annual Revenue (000)	Fixed cost (000)	Useful life
A	20	25	8	6
B	22	30	10	3
C	17	20	7	5
D	19	18	6	12
E	10	10	3	8
F	14	15	5	10
G	13	12	4	7

Additional information

- Variable costs are 40% of annual revenues
- Project D and F are mutually exclusive
- Cost of capital is 10% and the company has a limit of sh.60,000. Determine the optimal allocation of sh.60,000 among the projects if the projects are divisible. [10 Marks]

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- b) ABC limited is considering whether it should purchase a new machine to increase its production and sales. The machine costs sh. 1,200,000 and has an expected life of 10 years. The machine will be sold at the end of 10 years with a scrap value expected to be 15% of the initial cost. For each of the 10 years of usage sales production is expected to be 10,000 units Each unit can be sold for sh.200 per unit and will incur variable cost of sh.150 per unit. Fixed costs incurred will be sh.200,000. Depreciation is on straight line method, tax rate is 30% and the cost of capital is 15%. Determine the NPV of the project and by what percentage change is required in the cost of machine, scrap values and sales revenue for the project to be undesirable. [10 Marks]
- c) Agency problem arises when the agents pursues their own interest rather than the interest of the principal. Discuss the causes of conflicts between shareholders and auditors and the solutions to the conflict. [6 Marks]
- d) A company has a net operating income of sh.70,000, it has 12% sh.300,000 debenture, the overall capitalization rate is 10%. Calculate the value of the firm and the overall capitalization rate using the net operating income approach. [4 Marks]
- e) The following information has been extracted from the books of Hamisi Limited;
- | | |
|---------------------------|-----------|
| Earnings after tax | 5,000,000 |
| No. of outstanding shares | 100,000 |
| Internal rate of return | 8% |
| Dividend payout ratio | 70% |
| Cost of capital | 12% |

Required

- i) Calculate the value of the firm using Gordon's model [3 Marks]
- ii) Calculate the value of the firm using Walter's model [3 Marks]
- iii) Explain the various forms of dividends [4 Marks]

QUESTION TWO

- a) Dona limited is taking over Heron Limited. The shareholders of Heron would receive 0.8 shares of Dona for each share held by them. The data for the companies is as follows;

	Dona	Heron
Net Sales	800,000	500,000
Profit after Tax	400,000	200,000
No. of shares	100,000	60,000
Earnings per share	4	2.5
Market Price per share	100	60
Price Earnings ratio	25	20

Required;

- i. Compute the combined EPS, MPS, PER and the total market capitalization rate. [8 Marks]
 - ii. Explain the reasons why Dona decided to take over Heron Limited.[6 Marks]
- b) Shirandula limited has set the minimum cash balance of sh.18,000. The variance of the daily cash flow is sh.4,000,000 and the interest rate on marketable securities is 25% per annum. The transaction cost is sh.50. Required target cash balance, average cash balance and the spread. [6 Marks]

QUESTION THREE

- a) A company requires 12,500 units of a component in its manufacturing process which costs sh.200 each. The items are available locally and the lead time is 3 weeks. Each order costs sh.250 and the holding cost is sh.100 to prepare. The company considers giving a quantity discount of 18% if a minimum of 500 units are ordered advice whether the quantity discount should be given. [7 Marks]
- b) Haltons Limited has 1,200,000 shares outstanding at a current market price of sh 150 per share. The company needs 20,000,000 to finance its proposed project. The board of directors has decided to issue rights for raising required funds. The subscription price has been fixed at sh.50 per share. [6 Marks]

Required;

- i) How many rights are required to purchase one new share
 - ii) What is the price one share after rights issue
 - iii) Compute the theoretical value of the share
- c) Discuss the determinants of working capital needs of a firm. [7 Marks]

QUESTION FOUR

- a) A company wants to acquire an asset that costs sh.500,000 for 5 years. The company is to depreciate the asset using straight line method. There are two financing alternatives either leading or borrowing to buy the asset. The loan has an interest rate of 16% paid in equal year end installments or A lease that will be set to amortize the cost of the equipment over the lease period, the return on capital of the lessor is 15%. The corporate tax rate is 30% and no salvage value. Advise the company on whether to lease or buy the asset. [12 Marks]
- b) Describe the classification of lease financing [4 Marks]
- c) Differentiate between capital and money markets [4 Marks]
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