

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

SECOND YEAR EXAMINATION FOR THE AWARD OF MASTER
OF BUSINESS ADMINISTRATION

MBAD 832: ADVANCED FINANCIAL MANAGEMENT

STREAMS: MBAD (Y2S1)

TIME: 3 HOURS

DAY/DATE: TUESDAY 06/04/2021

8.30 A.M. – 11.30 A.M.

INSTRUCTIONS: ANSWER ALL QUESTIONS

QUESTION ONE

(a) ABC Ltd intends to acquire a new asset to replace the existing one. The new asset will cost sh 120,000 and it will require an installation cost of sh 3500. The new asset has an economic life of 8 years and a salvage value of sh 20500. The old asset has a net book value of 20000 and the market value of the machine is sh 15000. The company uses straight line method of depreciation. As a result of this replacement, sales will increase from 190,000 to 218500. In addition it will reduce cost from sh 170,000 to sh 161,000. The company tax rate is 30%.

Required: Advice the company whether it should replace the asset if the cost of capital is 11% [9 marks]

(b) Agency problem arises when the agents pursue their own interest rather than the interest of the principal. Discuss the causes of conflicts between shareholders and managers and the solutions to the conflict. [8 marks]

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(c) Bimbo limited is evaluating a new technology for its production. The technology has 2 years and costs sh 50000 Its impact on the company is subject to uncertainties. In the first year the management estimates that the technology has an equal chance of generating good and normal returns of 30000 and 20000. If it provides good returns in the first year then the second year cash flows will be 25000, 40000 and 50000 with associated probabilities of 0.2, 0.6 and 0.2 respectively. If it provides normal returns in the first year then the second year cash flows will be 40000, 60000 and 80000 with associated probabilities of 0.3, 0.4 and 0.3 respectively. Require a decision tree depicting the above information and the expected net present value if the cost of capital is 13%

[10 marks]

(d) There are two firms A and B. A does not use any debt in its financing while B has sh 500,000 10% debentures in its financing. Both firm have an earnings before interest and tax of sh 120,000. The equity capitalization rate is 7%.

Required:

(i) Calculate the value of the firms [2 marks]

(ii) Assume a corporate tax rate of 30% exist what will be the value for the firms

[2 marks]

(iii) Highlight the assumptions of MM hypothesis [3 marks]

(e) Highlight the functions of the finance manager in the contemporary organization

[6 marks]

QUESTION TWO

(a) A company is considering relaxing its credit standards, the firm currently credit terms is net 30 but the average collection period is 45 days. Current annual sales amount to sh 6 million, the firm wants to extend the period to net 60, with that sales will increase by 25%, and bad debts will increase from 2% to 2.5% of annual credit sales. Collection cost will increase by 90000. The return on investment in debtors is 13%. Selling price per unit is sh 100 and the variable cost per unit is sh 70. Assume a year has 360 days. Required should the firm change the credit policy

[8 marks]

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(b) A company is in a risk class and the capitalization rate is 8%. It has sh 10,000 outstanding shares selling at sh 125 each. The dividend for the current financial year is sh. 10. The company expects to have a net income of sh 80,000 and a proposal of new investment worth sh 160,000

Required:

- (i) Show that under MM hypothesis dividend payments has no effect on the value of the firm [6 marks]
- (ii) Explain the factors that affect the dividend payment of a firm. [6 marks]

QUESTION THREE

(a) An industrial unit desires to acquire a diesel generating set costing 2 million which has an economic life of 8 years with no scrap value. The unit is considering choices of taking machinery on lease or purchasing the asset by raising a loan of 15%. Lease payments are made at the end and the lessor requires the asset to be completely amortized over its useful life and the lease will yield a return of 10%, tax rate is 30%, the firm uses straight line method of depreciation. As a financial consultant indicate what advice you will give to the industrial unit. [14 marks]

(b) Discuss the functions of the financial markets to the Kenyan economy. [6 marks]

QUESTION FOUR

(a) A limited intends to acquire B limited by offering three of its shares for every five shares held in B limited

	A	B
Earnings per share	Sh 2	Sh 4
Market price per share	Sh 100	Sh 40
Total Earnings	Sh 300000	Sh 500000
Total Market Value	Sh 10,000,000	Sh 10,000,000
Number of shares	100000	200000
Price Earnings Ratio	50	20

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Required:

- (i) Compute the combined EPS, MPS, PER and total market capitalization
[10 marks]
 - (ii) Describe the defensive tactics that a company can employ when threatened with a takeover
[6 marks]
 - (b) Highlight the strategies that the firm employs in managing its cash [4 marks]
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