CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF MASTERS IN BUSINESS ADMINISTRATION

MBAD 832: ADVANCED FINANCIAL MANAGEMENT

STREAMS: MBA **TIME: 3 HOURS**

DAY/DATE: TUESDAY 03/12/2019 **2.30 PM – 5.30 PM**

INSTRUCTIONS:

ANSWER ALL QUESTIONS

QUESTION ONE

(a) The objectives of financial management is to maximize the value of the firm. Explain how the achievement of this objective might be compromised by the conflict which may arise between manager and shareholders in the organization. [5 marks]

(b) Discuss the functions performed by the financial system in Kenya. [7 marks]

(c) ABC limited is evaluating new equipment for its production. The equipment has two years and costs sh 240,000. In the first year the equipment has an equal chance of getting high returns and moderate returns with associated cashflows of sh 153,000 and 120,000 respectively if it generates high returns the second year cashflow will be 122,000, 140,000 and 180,000 with associated probabilities of 0.2, 0.3, and 0.5 respectively. If they generate moderate returns the second year cashflows will be 20,000, 220,000 and 250,000 with associated probabilities of 0.6, 0.2 and 0.2 respectively.

Required:

(i) A decision tree depicting this information and expected net present value. [7 marks]

(ii) State the advantages of decision tree technique. [2 marks]

(d) A company whose risk-free rate is 5% and the risk premium is 7% is considering investing in a project that has the following information

Years	Cashflow (000)	Abandonment value (000)
1	1800	1500
2	1750	1800
3	1600	1700
4	800	500

The cost of the project is sh 5,320,000. Required advise on the optimal time to abandon the project. [7 marks]

(e) Discuss the managerial finance functions. [6 marks]

(f) Assume a company has 3 assets ABC.

Asset A has a probability of 50% of generating a return of sh 20 and 50% of generating a return of sh 10.
Asset B has a probability of 40% of generating a return of sh16 and 60% of generating a return of sh 12.
Asset C has a probability of 70% of generating a return of sh 25 and 30% of generating a return of sh 8.
Required: Calculate the expected utility of wealth of each asset and advise on which asset to invest. [6 marks]

QUESTION TWO

(a) Describe the series of steps that most firms take in setting dividend policy in practice. [6 marks]

(b) The following information has been extracted from the books of XYZ limited.

Earnings after tax 7.5 million
Number of outstanding ordinary shares 1 million
Cost of capital 10%
Dividend payout ratio 60%
Internal rate of return on investment 12.5%

(i) Required: Calculate the market value of the companies share using Walters model. [4 marks]

(ii) Criticize Walters model [2 marks]

(c) Assume a firm has an annual net operating income of sh 100,000 and an overall cost of capital of 10% and an initial debt of sh 500,000 at 6% interest rate

Required: calculate the value of the firm and the equity capitalization rate under net operating income approach. [5 marks]

(d) Explain MM proposition II [3 marks]

QUESTION THREE

(a) An industrial unit desires to acquire a diesel generating set costing 2 million which has an economic life of 10 years with no scrap value. The unit is considering choices of taking machinery on lease or purchasing the asset by raising a loan of 16% lease rentals are made at the beginning and the lessor requires the asset to be completely amortized and the lease will yield a return of 10%. Tax rate is 50%. The firm uses straight line method of depreciation. As a financial consultant indicate what advise you will give to the industrial unit. [14 marks]

(b) Differentiate between financial lease and operating lease. [3 marks]

(c) Explain the bird in hand dividend irrelevance theory. [3 marks]

QUESTION FOUR

(a) A company is considering relaxing its credit standards. The firm's credit term is net 30 but the average collection period is 60 days. Current annual sales amount to sh 8,000,000. The firms wants to extend the period to net 90 days with that sales will increase by 40%, bad debts will increase from 2% to 2.8% of annual credit sales. Collection costs will increase by 100,000. Return on investment in debtors is 12%. Selling price per unit is 100 and variable cost per unit is sh 75. Assume a year has 360 days.
Required: Should the firm change the credit policy. [8 marks]

(b) Sunrise limited is considering taking over sunset limited. The shareholders would receive 0.8 shares of sunrise for each share held by them

	Acquiring company (Sunrise)	Acquired company (Sunset)
Net sales	335,000	118,000
Number of shares	12,000	3,000
Profits after tax	58,000	12,000
Earnings per share	4.8	4.0
Market price per share	30	20
Price earning ratio	6.5	5

Required: Calculate the combined

(i) Earnings per share
(ii) Market price per share
(iii) Price earnings ratio
(iv) Earning per share of sunset after merger [8 marks]

(c) Describe the reasons why companies merge. [4 marks]
