



MURANG'A UNIVERSITY OF TECHNOLOGY
SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF COMMERCE

UNIVERSITY ORDINARY EXAMINATION

2017/2018 ACADEMIC YEAR

THREE YEAR SECOND SEMESTER EXAMINATION FOR
BACHELOR OF COMMERCE

BCF 303 – ADVANCED FINANCIAL MANAGEMENT

DURATION: 2 HOURS

DATE: 20TH APRIL, 2018

TIME: 8.00 - 11.00 A.M.

Instructions to Candidates:

1. Answer **Question 1** and **Any Other Two** questions.
2. Mobile phones are not allowed in the examination room.
3. You are not allowed to write on this examination question paper.

QUESTION ONE.

- a) Differentiate between sensitivity and scenario analysis. (4 marks)
- b) Risk is inherent in almost every business decision, including capital budgeting decisions. Discuss any four sources of risk. (8 marks)
- c) Consider a project which has the following cash flow stream.

| Year | Cash flow |
|------|-------------|
| 0 | (1,100,000) |
| 1 | 200,000 |
| 2 | 200,000 |
| 3 | 350,000 |
| 4 | 380,000 |
| 5 | 400,000 |

- The cost of capital (r) for the firm is 10% .Determine the Net Present Value of the proposal. (6marks)
- d) Explain four factors that influence capital structure of a firm. (8 marks)
- e) Distinguish between stock split and stock repurchase. (4 marks)

QUESTION TWO

- a) Discuss the four types of dividend policies that can be adopted by an organization. (8 marks)
- b) A Company has the following capital structure as at 30th June 2017 .

| Source | Amount (shs) |
|----------------------|--------------|
| Ordinary share | 4,000,000 |
| 10% preference share | 1,000,000 |
| 14% Debentures | 3,000,000 |

The share of the company sells for Sh. 20 and it's expected that it will pay next year a dividend of Sh. 2 per share which will grow at 7% forever.

- i. Assume a 50 % tax rate, compute a weighted Average Cost of capital (WACC) based on the existing capital structure. (6 marks)
- ii. Compute the new marginal WACC if the company raised new additional finance of Sh. 2 million debt by issuing 15% debentures. This would result in increasing dividends to sh. 3 per share leaving growth rate constant but the price per share will decrease to sh. 15 per share. (6 marks)

QUESTION THREE

- a) Explain four assumptions of Baumol's model of cash management. (8 marks)
- b) i) Using a well labelled diagram explain the traditional theory of capital structure. (6 marks)
- ii) Firm A and B are similar in all aspects except their capital structure. The following information has been availed.

| | A | B |
|----------------|------|------|
| Earning | 24 m | 24 m |
| 10% loan | - | 180m |
| Cost of equity | 10% | 10 % |

Using Net operating income approach compute the value and cost of capital for each firm. (6 marks)

QUESTION FOUR

- a) Explain any four factors that influence dividend policy. (8 marks)
- b) Annual cash requirement for ABC Ltd. is 45 million with transaction cost of sh. 250 per transaction. Interest rate is 8% p.a.

Determine

- i. Optimal cash balance. (3 marks)
- ii. Transaction cost and holding cost. (3 marks)
- c) The following data relates to firm XYZ Ltd. and ABC Ltd.

| | Fixed Cost | Selling price per unit | Unit variable cost | volume/Unit. |
|-----|-------------|------------------------|--------------------|--------------|
| XYZ | 2 million | 500 | 150 | 20,000 |
| ABC | 2.5 million | 650 | 200 | 27,000 |

Interest expense from firm XYZ and ABC Ltd. is 1 million and 105 million respectively.

Determine

- i. The degree of operating Leverage for each firm. (3 marks)
- ii. Degree of financial leverage for each firm. (3 marks)