LAIKIPIA UNIVERSITY

UNIVERSITY EXAMINATIONS

2ND SEMESTER 2023/2024 ACADEMIC YEAR

EXAMINATION FOR MASTERS OF BUSINESS ADMINISTRATION

MBAD 731: ADVANCED FINANCIAL MANAGEMENT

STREAM: ***MBA*** ***TIME: 3 HRS***

DAY: WEDNESDAY [12.30-3.30 P.M] ***DATE: 27/03/2024***

THIS QUESTION PAPER CONSISTS OF FOUR (4) PAGES

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INSTRUCTIONS:

This paper contains four questions

Answer question one and any other two questions in the answer booklets provided

QUESTION ONE

a). Midos Leisure Industries is already highly geared by industry standards, but wishes to raise external capital to finance the development of a new beach resort. Outline the arguments for and against a rights issue by Midos Leisure Industries **(4marks)**

b). Describe the three forms of capital market efficiency **(6marks)**

c). Company A is considering investing in a project which has a three-year life. The project would involve an initial investment of Sh.20 million. The finance manager has come up with expected probabilities for various possible economic conditions as follows:

Year	Economic Conditions	Sh.'000' Net cash flows	Probability
0		(20,000)	1.0
1	High growth	10,000	0.2
	Average growth	6,000	0.7
	No growth	2,000	0.1
2	High growth	12,000	0.3
	Average growth	8,000	0.5
	No growth	4,000	0.2
3	High growth	16,000	0.4
	Average growth	12,000	0.3
	No growth	6,000	0.3

Required:

Assuming a discount rate of 15% should company A invest in the project? **(9 marks)**

d). Explain three methods of handling risks in capital budgeting. **(6 marks)**

e). Discuss the limitations of Modigliani and Miller Approach (MM Model) in dividend decisions by firms **(9marks)**

QUESTION TWO

a). How does a company's working capital policy impact on its liquidity – profitability position? Explain with reference to the strategies available to the firm for financing its working capital. **(7 marks)**

b). Discuss four managerial functions of the finance manager in an organization **(8marks)**

QUESTION THREE

Aqua Limited is considering the purchase of a new machine. Two alternative machines X and Y which will cost Sh.6, 000,000 each are available in the market. The cash flow of each machine are as follows:

	Cash flow	
Year	**X**	**Y**
	Sh.	**Sh.**
1	600,000	1,800,000
2	1,800,000	2,400,000
3	2,000,000	3,000,000
4	3,000,000	1,800,000
5	2,400,000	1,600,000

The company's required rate of return is 10%.

Required: Compute the following for each machine

i) Payback period (PBP) **(2marks)**
ii) Net present value (NPV) **(6marks)**
iii) Profitability Index (PI) **(4marks)**
iv) Advice the company on which machine is viable based on the results in i-iii above **(3marks)**

QUESTION FOUR

Millennium Investments Ltd. wishes to raise funds amounting to Sh.10 million to finance a project in the following manner:
Sh.6 million from debt; and
Sh.4 million from floating new ordinary shares.
The present capital structure of the company is made up as follows:
600,000 fully paid ordinary shares of Sh.10 each
Retained earnings of Sh.4 million

200,000, 10% preference shares of Sh.20 each.
40,000 6% long term debentures of Sh.150 each.

The current market value of the company's ordinary shares is Sh.60 per share. The expected ordinary share dividends in a year's time are Sh.2.40 per share. The average growth rate in both dividends and earnings has been 10% over the past ten years and this growth rate is expected to be maintained in the foreseeable future. The company's long term debentures currently change hands for Sh.100 each. The debentures will mature in 100 years. The preference shares were issued four years ago and still change hands at face value.

Required:

Compute the component cost of:

i) Ordinary share capital; **(2 marks)**
Debt capital **(2 marks)**
Preference share capital. **(2 marks)**

(ii) Compute the company's current weighted average cost of capital (WACC). **(4 marks)**

(iii) Compute the company's marginal cost of capital if it raised the additional Sh.10 million as envisaged. (Assume a tax rate of 30%). **(5 marks)**