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(University of Choice)

MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY (MMUST)

MAIN CAMPUS/BUNGOMA CAMPUS/WEBUYE CAMPUS

UNIVERSITY EXAMINATIONS
2021/2022 ACADEMIC YEAR

FOURTH YEAR SPECIAL/SUPPLIMENTARY EXAMINATIONS

FOR THE DEGREE
OF
BACHELOR OF COMMERCE

COURSE CODE: BCF 440E

COURSE TITLE: STRATEGIC FINANCIAL MANAGEMENT

DATE: MONDAY, 1ST AUGUST 2022 **TIME:** 2=4PM

INSTRUCTIONS TO CANDIDATES

Attempt QUESTION ONE and any other two questions

TIME: 2 Hours

MMUST observes ZERO tolerance to examination cheating

QUESTION ONE(30 MARKS)

a) Discuss the various steps involved in financial strategy and policy formulation for an organization **(12 marks)**

b) Pendo Ltd has 800,000 shares outstanding at current market price of Sh 140 per share. The company needs Sh 23,000,000 to finance its proceeds expansion. The board of directors has decided to issue rights for raising the required funds. The subscription price has been fixed at Sh 85 per share.

i) How many rights are required to purchase one new share **(4 marks)**

ii) What is the price of one share after the rights issue (Ex-right price)? **(3 marks)**

iii) Compute the theoretical value of each right **(3 marks)**

c) Explain four advantages to an investor who invests his funds in a mutual fund **(8 marks)**

QUESTION TWO (20 Marks)

a)Distinguish between open mutual funds and closed mutual funds **(4 marks)**

b) Mkubwa company is considering whether it would be financially advisable to retire its existing long term debt with cheaper loan. The current loan of Sh 10million has an annual interest charge of 15% and has 10 years to maturity. The company has Sh 125,000 of unamortized loan expenses still in books. If the company decides to redeem the loan,there is an early payment amounting to 10% of the loan. A new Sh 10 million loan can be raised at 13% per annum for a 10 year period. It is expected that underwriting costs will amount to sh 600,000.In addition to these costs, the company will be further required to pay interest for two months which would allow the normal interest payment due to be reached for the old loan.Mkubwa company is in the 40% income tax bracket.

Required;

i)Calculate the net amount of cash investment required for the refunding of the loan.(**4 marks)**

ii)Compute the annual cash savings which result from refunding**(4 marks)**

iii)Determine whether refunding is advantageous to the company (PVIFA 8% = 6.71)**(4 marks)**

c)Uwezo Ltd wishes to elect seven directors at an annual general meeting .There are 200,000 shares outstanding and entitled to vote. If a group held 50,000 shares in Uwezo ltd ,how many directors would be possible for the group to elect? **(4 marks)**

QUESTION THREE(20 MARKS)

a)What is financial modeling? Discuss various tools and techniques of financial modeling. **(10 marks)**

b)A company is considering two mutually exclusive projects. The company uses a certainty equivalent approach. The estimated cash flow and certainty equivalents for each project are as follows:

	Project 1		Project 2	
Year	**Cash Flow (Sh)**	**Certainty Equivalents**	**Cash Flow (Sh)**	**Certainty Equivalents**
0	-30,000	1.00	-40,000	1.00
1	15,000	0.95	25,000	0.90
2	15,000	0.85	20,000	0.80
3	10,000	0.70	15,000	0.70
4	10,000	0.65	10,000	0.60

Which project should be accepted, if the risk-free discount rate is 15% **(10 marks)**

QUESTION FOUR(20 MARKS)

a) Highlight five unique features of share warrants which differentiate them from a right or a convertible security. **(10 marks)**

b)Rome Ltd is considering buying a new machine in order to produce a new product. The machine will cost Sh1,800,000 and is expected to last for 5 years at which time it will have an estimatedscrap value of Sh1,000,000.They expect to produce 100,000 units per year of the new product, which will be sold for Sh 20 per unit in the first year. Production costs per unit at current prices are as follows:

Materials Sh 8
Labour Sh 7

Materials are expected to inflate at 8% p.a. and labour is expected to inflate at 5% p.a..
Fixed overheads of the company currently amount to Sh1,000,000. The management accountant has decided that 20% of these should be absorbed into the new product. The company expects to be able to increase the selling price of the product by 7% p.a..An additional Sh 200,000 of working capital will be required at the start of the project. Capital allowances: 25% reducing balance ,Tax: 25%, payable immediately Cost of capital: 10%
Calculate the NPV of the project and advise whether or not it should be accepted.**(10 marks)**

QUESTION FIVE(20 MARKS)

a) Outline four reasons why financial planning is considered to be the most important aspect of the a finance manager's job. **(8 marks)**

b) A company has decided it needs a minimum balance of Sh 1,000,000. The transaction cost of making transfers to/from deposit is Sh5 per transaction. The standard deviation of cash flows is Sh 200,000 per day, and the interest rate is 5.11% per year. (or 5.11/365 = 0.014% per day). What should be the upper and lower limits, and the return point? **(6 marks)**

c)A company has sales of Sh20,000,000 per year .Customers currently take credit as follows:

Days	%'age
30	20%
60	50%
90	30%

They are considering offering a discount of 1% for payment within 30 days. It is estimated that 60%of customers will take advantage of the discount and that the remainder will take a full 90 days. The company's bank overdraft rate is 15% per annum.Calculate the net cost or benefit of the change of policy. Should they offer the discount?(Assume 365 days in a year)**(6 marks)**