(Knowledge *for Development*)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

FOURTH YEAR SECOND SEMESTER

SPECIAL/SUPPLIMENTARY EXAMS

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: BCF 440E

COURSE TITLE: STRATEGIC FINANCIAL MANAGEMENT

DATE: 20TH JANUARY,2022 **TIME:** 2.00PM - 4.00PM

INSTRUCTIONS TO CANDIDATES

1. Answer Question One in Section A and Any other TWO (2) Questions in Section B

2. Question **one** carries **30**marks and each of the other two questions carry **20** marks each.

TIME: 2 Hours

QUESTION ONE

a) Outline the characteristics of strategic financial management decisions [10 marks]

b) Extract financial statement of ABC ltd are as shown below, the management forecasts a 25% sales growth in 10 years. You are required (i) to construct pro-foma statements for the tenth year, and (ii) write a report on management on possible financing decisions.

Balance Sheet (shs in Millions)				Income Statement (shs in Millions)	
Assets		**Liabilities and Owners' Equity**			
Current Assets		**Current Liabilities**		Sales	1200
Cash	200	Accounts Payable	400	Cost of Goods Sold	900
Accounts Receivable	400	Notes Payable	400	Taxable Income	300
Inventory	600	Total Current Liabilities	800	Taxes	90
				Net Income	210
Total Current Assets	1200	Long-Term Liabilities		Dividends	70
		Long-Term Debt	500	Addition to Retained Earnings	140
Fixed Assets		Total Long-Term Liabilities	500		
Net Fixed Assests	800	**Owners' Equity**			
		Common Stock (shs 1 Par)	300		
		Retained Earnings	400		
		Total Owners' Equity	700		
Total Assets	**2000**	Total Liab. and Owners' Equity	**2000**		

Assumptions;

(i)The Notes Payable, Long-Term Debt, and Common Stock accounts do not vary automatically with Sales.

(ii) The firm does not intend to change its dividend policy (Payout ratio)

[20 marks]

Q2.

a)

XYZ Ltd has 900,000 shares outstanding at current market price of Sh 130 per share. The company needs Sh 22,500,000 to finance its proposed expansion. The board of directors has decided to issue rights for raising the required funds. The subscription price has been fixed at Sh 75 per share.

Required:

(i) How many rights are required to purchase one new share? [2 marks]

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

[4marks]

(iii) Compute the theoretical value of each right [2 marks]

(iv) Consider the effect of the rights issue on the shareholders' wealth under the three options available to the shareholders (Assume he owns 3 shares and has Sh 75 cash on hand). [2 marks]

b)

Discuss the synergistic benefits of a merger and acquisition strategy [10 marks]

Q3.

Tin Co is planning an expansion of its business operations which will increase profit before interest and tax by 20%. The company is considering whether to use equity or debt finance to raise the shs2m needed by the business expansion. If equity finance is used, a 1 for 5 rights issue will be offered to existing shareholders at a 20% discount to the current ex dividend share price of shs5·00 per share. The nominal value of the ordinary shares is shs1·00 per share. If debt finance is used, Tin Co will issue 20,000 8% loan notes with a nominal value of shs100 per loan note.

Financial statement information prior to raising new finance;

	SHS.000,000		SHS.000,000
EBIT	1597	EQUITY & LIABILITY	
INT	(315)	Ordinary Shares	2500
TAX	(282)	Retained Earnings	5488
EAT	1000	Long term liabilities	4500
		Total Equity & Liability	12488

The current price/earnings(P/E) ratio of Tin Co is 12·5 times. Corporation tax is payable at a rate of 22%.Companies undertaking the same business as Tin Co have an average debt/equity ratio (book value of debt divided by book value of equity) of 60·5% and an average interest cover of 9 times.

Required:

(a)

(i) Calculate the theoretical ex rights price per share. (3 marks)

(ii)Assuming equity finance is used, calculate the revised earnings per share after the business expansion (4 marks)

(iii)Assuming debt finance is used, calculate the revised earnings per share after the business expansion. (3 marks)

b)

Use calculations to evaluate whether equity finance or debt finance should be used for the planned business expansion. (10 marks)

Q4. The following are abstracts of Income statement and Balance sheet from the books of Unga limited

	2018	**2017**
Revenue:		
Project Advisory Fees	200,000	186,000
Total Revenue (A)	**200,000**	**186,000**
Expenses:		
Direct Expenses	100000	95000
Total Operating Expenses (B)	**100,000**	**95000**
Operating Income (C = A minus B)	100,000	91,000
Tax Rate	30%	30%
Tax on operating income (D = C * Tax Rate)	30,000	$27,300
Net Operating Income After Tax (C minus D)	**70,000**	**63,700**

Particulars	Balance Sheet	
	2018	**2017**
Equity	20,000	17,000
Debt	10,000	7,000
Sources of Funds (A)	**30,000**	**24,000**
Fixed Assets	20,000	18,000
Current Assets	20,000	16,000
Less: Current Liabilities	10,000	10,000
Uses of Funds (B)	**30,000**	**24,000**
Cost of Debt	8%	8%
Cost of Equity	10%	12%

Required;

a) Calculate the Weighted Average Cost of Capital (WACC) [5 marks]

b) Calculate the Economic Value Added (EVA) for the year 2017 [15 marks]

Q5.

a) Highlight and explain the reasons for BUSINESS FAILURE (10 marks)

b) Limuru Tea limited, a listed firm on NSE, had the following data;

- Sales: Shs1000000
- EBIT: Shs 500,000
- Total Assets: Shs 2000000
- Book Value of Total Liabilities: 1000000
- Retained Earnings: 1000000
- Market Value of Equity:shs 3000000
- Working Capital: shs 500,000

Required; Calculate the firms Altman Z- score, and comment on your answer. (10 marks)