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University Examinations 2024/2025

….. YEAR …. SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ….

BFC 3332: ADVANCED FINANCIAL MANAGEMENT

DATE: JANUARY 2025 **TIME:2 HOURS**

INSTRUCTIONS: *Answer question **one** and any other **two** questions*

QUESTION ONE (30 MARKS)

a) Discuss the factors that influence dividend decision of a firm (8 marks)

b) Explain the importance of sensitivity analysis in financial decision-making. (6 marks)

c) A financial analyst is evaluating a new investment with three possible outcomes: high gain, moderate gain, and loss. The probabilities and payoffs are as follows:

- High Gain: 20% probability, Kshs 500,000 payoff
- Moderate Gain: 50% probability, Kshs 200,000 payoff
- Loss: 30% probability, - Kshs 100,000 payoff

Required:

i. Construct the decision tree (5mks)

ii. calculate the expected monetary value. (5mks)

A company currently extends credit terms of 30 days and has an annual bad debt expense of Kshs 15,000 on credit sales of Kshs 3,000,000. The company is considering extending credit terms to 45 days, which it estimates will increase sales to Kshs 3,500,000 but will also raise bad debts to Kshs 20,000.

Required:

Should the company extend the credit terms if its contribution margin is 25%? (6mks)

QUESTION TWO (20 MARKS)

a) Discuss the factors that influence the capital structure decisions of a firm (8mks)

b) A Company is evaluating its optimal capital structure based on the Trade-Off Theory. The company's unlevered cost of equity is 15%, the cost of debt is 7%, and the corporate tax rate is 35%. The bankruptcy cost increases by Kshs 100,000 for each additional Kshs 1,000,000 of debt.

i. Derive the formula to determine the optimal debt level for Company. (8mks)

ii. Calculate the optimal debt level. (4mks)

QUESTION THREE (20 MARKS)

a) Discuss the limitation of non-discounted cashflow techniques in capital budgeting

(6mks)

b) A company has two projects with the following cash flows. The required rate of return is 8%.

Project X:

Initial Investment: Kshs 150,000

Year 1: Kshs 40,000

Year 2: Kshs 60,000

Year 3: Kshs 90,000

Project Y:

Initial Investment: Kshs 120,000

Year 1: Kshs 50,000

Year 2: Kshs 60,000

Year 3: Kshs 40,000

Required:

Calculate for both projects and decide which project is better using:

i. NPV (5mks)

ii. IRR (6mks)

iii. PI (3mks)

QUESTION FOUR (20 MARKS)

Discuss the determinants of working capital requirement by firms (l0mks)

A company has an annual cash requirement of Kshs 500,000. The company incurs a transaction cost of Kshs 25 every time it converts securities to cash. The opportunity cost of holding cash is 5% per year.

Required:

Using the **Economic Order Quantity (EOQ) Model** for cash management, calculate the optimal amount of cash the company should hold (10mks)

QUESTION FIVE (20 MARKS)

a) Discuss the importance of cost of capital to a firm (8mks)

b) A firm has the following capital structure:

- Debt: Kshs 500,000 at a 6% interest rate.
- Equity: Kshs 1,500,000 with a beta of 1.2.
- The risk-free rate is 3%, and the market return is 10%.
- The company's tax rate is 35%.

Using the **Capital Asset Pricing Model (CAPM)** for the cost of equity, calculate the company's WACC. (12mks)