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GABA CAMPUS – ELDORET

MAIN EXAMINATION

JANUARY – APRIL 2023 TRIMESTER

SCHOOL OF BUSINESS

BACHELOR OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

CFI 425: STRATEGIC FINANCIAL MANAGEMENT

Date: April 2023	**Duration: 2 Hours**
Instructions: Answer Question ONE and any other TWO Questions	

Q1.

a) What are the main elements through which the ethical responsibility of a company is discharged? **(4 Marks)**

b) Define financial engineering and highlight factors that are responsible for financial innovation. **(4 Marks)**

c) You have completed the following forecast of free cash flows for an eight year period, capturing the normal business cycle of Marathon Inc.

Year	**FCF**
2015	1860.0
2016	1887.6
2017	1917.6
2018	1951.2
2019	1987.2
2020	2016.0
2021	2043.6
2022	2070.0

Free cash flows are expected to grow at 3% beyond 2022. The cost of capital is assumed to be 12%. What is Marathon's value? **(10 Marks)**

d) Ezra (2005) argues, "Profit maximization is a phrase which can easily lead o semantic muddles and it is probably hazardous to use it in the special and restricted sense of an operational objective.

Discuss this statement and suggest from where you sit an operational feasible objective which the financial manager should pursue and which also reflects the most efficient use of society's economic resources. **(12 Marks)**

Q2.

a) The following information is available for X Company's shares and Call option:

Current share price	Shs.185
Option exercise price	Shs.170
Risk free interest rate	7%
Time of the expiry of option	3 years
Standard deviation	0.18

Calculate the value of option using Black-Scholes formula. **(10 Marks)**

b) Discuss the factors that affect the value of a call option **(10 Marks)**

Q3.

Gascony, a public limited company with a market value of around $7 billion, is a major supplier of gas to both business and domestic customers. The company also provides maintenance contracts for both gas and central heating customers using the well-known brand name Gas for All. Customers can call emergency lines for assistance for any gas-related incident, such as a suspected leak. Gascony employs its own highly-trained workforce to deal with all such situations quickly and effectively. The company also operates a major new credit card, which has been extensively marketed and which gives users concessions, such as reductions in their gas bills.

Gascony has recently bid $1.1bn for Car-Care, a long established mutual organization (i.e. it is owned by its members) that is the country's leading motoring organization also obtains. Car-Care is financed primarily by an annual subscription to its 4.4 million members. In addition the organization also obtains income from a range of other activities such as a high profile car insurance brokerage, a travel agency and assistance with all types of travel arrangements. Its main service to members is the provision of a roadside break-down service, which is now an extremely competitive market with many other companies involved. Although many of its competitors use local garages to deal with breakdowns, Car-Care uses its own road patrols.

Car-Care members have to approve the takeover, which once completed provided them each with a windfall of around $300 each.

Gascony intends to preserve the Car-Care's name which is extremely well-known by customers.

Required:

a) Discuss the possible reasons why Gascony is seeking to by Car-Care. **(8 Marks)**

b) Discuss how the various stakeholders of Car-Care might react to the takeover. **(6 Marks)**

c) Discuss the potential problems that may take face Gascony in running Car-Care now that the takeover has been achieved. **(6 Marks)**

Q4.

a) A large sized chemical company has been expected to grow at 14 percent for the next 4 years and then to grow indefinitely at the same rate as the national economy i.e. 5 percent. The required rate of return is 12 percent. Assume that the company paid a dividend of shs. 2 per share last year. Determine the market price per share using Gordon dividend growth valuation model. **(8 Marks)**

b) XYZ Ltd has the following capital structure as at 31st July 2019.

	Shs (000)
Ordinary shares (400,000 @sh40)	16,000
10% Preference share capital	2,000
14% Bond capital	14,000

Additional information;

i) The market price of each ordinary share as at 31st July 2019 was sh. 40
ii) The firm paid a dividend of shs 4 for each ordinary share for year ended 31st July 2019.
iii) Annual growth in dividends is 7%.
iv) The corporate tax rate is 30%.

Required;

Compute the weighted average cost of capital for XYZ limited for the year to 31st July 2019.

(12 Marks)

END