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CITY CAMPUS

MAIN EXAMINATION

AUGUST - DECEMBER 2016 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

EVENING PROGRAMME

CFI 425: STRATEGIC FINANCIAL MANAGEMENT

Date: DECEMBER 2016	Duration: 2 Hours
INSTRUCTIONS: Answer Question ONE and ANY OTHER TWO Questions	

Q1. a) CHICKHOUSE Restaurant operates for 360 days a year. Chicken stock is bought on a daily basis at sh. 500.00 per kg. The supplier offers 2.5/10, Net 50 credit terms. Next year the restaurant expects to sell a total of 18 720 kgs.

REQUIRED:

i) The value of free credit the restaurant may enjoy next year. **(3 marks)**

ii) Supposing Chickhouse can access short term bank finance at 25% p.a interest, should they take the supplier's discount offer? **(5 marks)**

b) SPEED LTD is in a growing market and has 4 million shares outstanding currently trading at sh. 75.00 each. STUCK LTD. with 2.4 million shares outstanding is in a matured market and is currently trading at sh. 20.00 per share. The cost of capital for both firms is 10%. Speed Ltd is contemplating to acquire 100% of Stuck Ltd. Expected results are:

- Speed Ltd dividend per share will be sh. 4.50 one year from acquisition date and grow at 3% annually thereafter.
- Due to stabilized earnings, the cost of capital for the combined entity will drop to 8%.

ISO 9001:2008 Certified by the Kenya Bureau of Standards

Required:

i) The value of synergy resulting from the combination. **(4 marks)**

ii) The effective cost of acquisition if Speed Ltd issues its 667 000 new shares to Stuck Ltd shareholders as consideration and incur sh. 1.55 million transaction cost **(4 marks)**

c) The following data is extracted from the books of a given firm:

	SH. 000
Sales for the just ended year	1 600
Projected Sales next year	2 400
Total Fixed Asset (Net)	2500

Required:

Assuming that the fixed assets were working at 80% capacity last year;

i) By what percentage can the firm's sales grow before additional fixed assets are necessary? **(4 marks)**

ii) How much additional investment in fixed assets is required to achieve the projected sales? **(4 marks)**

d) Briefly discuss the direct cost incurred by a firm that is experiencing financial distress. **(6 marks)**

Q2. a) A firm had sh. 135.000 million and sh. 165.000 million as capital invested at the end of year one and year two respectively, both of which were ¼ debt capital. For year two the adjusted Earnings Before Interest and Tax was sh. 36.00 million. The firm can borrow long term at 18% and the shareholders require 24% return. The tax rate is 20%.

Required:

Economic Value Added during year two **(9 marks)**

b) ZM Ltd maintains 1:4 Debt Equity ratio. The firm is contemplating to invest sh. 250.00 million in a project which is estimated to generate sh. 64.00 million annual adjusted EBIT to perpetuity. No further investment in this project will be required. ZM Ltd cost of capital is 12% and the shareholders require 15% late of return. Profit tax is 40%.

Required:

The present value of the project's Economic Value Added. **(11 marks)**

Q3. KUEA Merchants sell solar-powered lanterns on cash basis, 13000 units annually on average. Their financial year ends on 31st December. The product's profitability per unit is as follows:

	SH.
Selling price	2000.00
Variable cost	(1400.00)
Fixed cost	(200.00)
Profit before tax	400.00

The firm is considering to start selling on credit terms 1.5/10 Net 30 as from next year with the following expected results;

- Annual sales to expand by 20%
- Bad debts of 0.2% of sales
- 70% of all customers will take the discount
- Average debt collection period of 4 weeks
- A debt management software to be rented at sh. 200,000.00 annually payable in two equal installments in arrears, 30th June and 31st December.

Required:
Advice the management taking 20% as the firm's cost of capital. **(20 marks)**

Q4. a) Discuss the four basic elements that must be in a financial planning model. **(7 marks)**

b) KUPANGA LTD is compiling their year 2 financial plan. The following information is available:

BALANCE SHEET AS AT THEEND OF YEAR 1 PROJECTION FOR YEAR 2

Assets (Sh.000)		Liabilities (Sh.000)			(Sh.000)
Current	4050	L/T Bond	2100	Net income	420
Fixed	1800	0/Equity	3750	Current Assets	4,455
	5850		5850	Profit retention ratio	50%

Required:

i) Projected growth rate for year 2. Give reasons. **(2 marks)**

ii) Projected balance sheet assuming that fixed assets are operating item and available in lots of sh. 100 000.00 **(6 marks)**

iii) Using the Debt/Equity ratio, determine whether the projected growth rate is sustainable. Explain your answer. **(5 marks)**

END