THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

A. M. E. C. E. A

P.O. Box 62157
00200 Nairobi - KENYA
Telephone: 891601-6
Fax: 254-20-891084
E-mail:academics@cuea.edu

MAIN EXAMINATION

MAY – JULY 2018 TRIMESTER

FACULTY OF COMMERCE

MBA PROGRAMME

WRITTEN COMPREHENSIVE EXAMINATION

FINANCIAL MANAGEMENT

Date: JULY 2018	**Duration: 3 Hours**
INSTRUCTIONS: Answer ALL Questions	

Q1. You have recently graduated with an MBA from CUEA and have been appointed the Financial Manager of Kenya Airways Limited, the largest airline in Kenya.

a) Discuss specifically your role in the company. **(18 marks)**

b) What repercussions do variations in the price of oil have on the value of the company? **(4 marks)**

c) Recommend financial methods that you will apply to mitigate losses from international oil price fluctuations. **(4 marks)**

d) Recommend financial methods that you will apply to mitigate losses from international foreign exchange price fluctuations. **(4 marks)**

Q2. Springs Co is concerned about the risk associated with a proposed investment and is looking for ways to incorporate risk into its investment appraisal process. The company has heard that probability analysis may be useful in this respect and so the following information relating to the proposed investment has been prepared:

Year 1		**Year 2**	
Cash flow ($)	Probability	Cash flow ($)	Probability
1,000,000	0·1	2,000,000	0·3
2,000,000	0·5	3,000,000	0·6
3,000,000	0·4	5,000,000	0·1

However, the company is not sure how to interpret the results of an investment appraisal based on probability analysis. The proposed investment will cost \$3·5m, payable in full at the start of the first year of operation. Springs Co uses a discount rate of 12% in investment appraisal.

Required:

a) Using a joint probability table:

   i) Calculate the mean (expected) NPV of the proposed investment **(8 marks)**

   ii) Calculate the NPV of the most likely outcome **(3 marks)**

   iii) Comment on the financial acceptability of the proposed investment. **(2 marks)**

b) Discuss the following methods of adjusting for risk and uncertainty in investment appraisal:

   i) Simulation **(4 marks)**

   ii) Adjusted payback **(4 marks)**

   iii) Risk-adjusted discount rates. **(4 marks)**

Q3. Malezi Foods Ltd is considering a piece of equipment requiring the investment of \$2.2 million. The equipment has a ten-year useful life and an expected salvage value of \$200,000. The company uses the straight-line method of depreciation for analyzing investment decisions and faces a tax rate of 40%. For simplicity assume that the depreciation method is acceptable for tax purposes.

A pessimistic forecast projects cash earnings before depreciation and taxes at \$400,000 per year compared with an optimistic estimate of \$500,000 per year. The probability associated with the pessimistic estimate is 0.4 and 0.6 for the optimistic forecast. The company has a policy of using a hurdle rate of 10% for replacement investments, 12% (its cost of capital) for revenue expansion investments into existing product lines and 15% projects involving new areas or new product lines.

Required:

a) Compute the expected annual cash flows associated with the proposed equipment investments. **(5 marks)**

b) Would you recommend acceptance of this project if it involved expansion of sales for an existing product? **(5 marks)**

c) Would it be acceptable if it was for the replacement of equipment with a book value of \$200,000 at the end of the tenth year but which could be sold at that time for only \$40,000? **(5 marks)**

d) Discounted cashflow methods were developed for idealized settings of complete and perfect capital, factor and commodity markets. Explain what complications arise when an attempt is made to apply these methods in real life markets that are neither complete nor perfect. **(5 marks)**

Q4. a) Discuss the major weakness in using Capital Asset Pricing Model (CAPM) as a method of valuing a firm? **(5 marks)**

b) Why would you consider the Arbitrage Pricing Theory (APT) to be much more robust than the Capital Asset Pricing Model? **(5 marks)**

c) Shareholder wealth maximization is generally considered a superior goal for the firm as compared to profit maximization. Discuss giving relevant examples. **(15 marks)**

END