



ELIZADE UNIVERSITY, ILARA-MOKIN, ONDO STATE

FACULTY: HUMANITIES, SOCIAL & MANAGEMENT SCIENCES

DEPARTMENT: ACCOUNTING & FINANCE

FIRST SEMESTER EXAMINATIONS 2019/2020 ACADEMIC SESSION

COURSE CODE: ACF 407

COURSE TITLE: ADVANCED FINANCIAL MANAGEMENT

DURATION: 2 Hours 30 minutes

INSTRUCTION: ATTEMPT QUESTION ONE (1) AND ANY THREE (3) OTHERS.

QUESTION ONE

- A. Cost of capital is a crucial factor in the financing decision and investing decision of a company. Succinctly elucidate. (4 marks)
- B. Chief Otedola is the Chairman of Board of Director of Forte Oil Nigeria Ltd, a dominant firm in the Oil & Gas sector of Nigeria since the past one decade. The earnings and dividend of the company over the past five years are hypothetically stated in algorithm manner as: 2015 (₦xxx); 2016 (₦xxx); 2017 (₦xxx); 2018 (₦xxx) and 2019 (₦xxx). The company is financed entirely by equity and there are xxxxxxunits of shares in issue, each with a market value of ₦xxxxx yet to be paid. You are required to determine the cost of equity of Forte Oil Nigeria Ltd. **Hint: If your answers are the same with other person(s), you both earn zero marks.** (10 marks)
- C. If the ordinary share capital of Forte oil Nigeria Ltd is ₦xxxx, net asset value is ₦xxxx, market value per share is xxxkobo, current dividend payable is ₦xxxx, earnings for the year is ₦xxxx while dividend as at three years ago is ₦xxxx. The board of director of Forte Oil Nigeria Ltd just recently appointed you as the financial manager and accountant of the company and mandated you to determine the dividend growth and cost of the firm equity using dividend valuation and Gordon growth methods. You are required to report on the dividend growth and cost of equity to the board of director during next week strategic meeting. **Hint: If your answers are the same with other person(s), you both earn zero marks.** (10 marks)
- D. While you were attempting to proffer solution to question C above, you quickly realized that the return on equity of Forte Oil Nigeria Ltd in the stock market is a function of the risk associated with the market and the market return itself, considering the firm's investment in Treasury Bills. With hypothetical figures, what do you think would be the return on equity if capital asset pricing model is employed? **Hint: If your answers are the same with other person(s), you both earn zero marks.** (3 marks).
- E. Investors often demonstrate three risk preference behavior when embarking on investment decision. Robustly elucidate on these three-risk preference behaviors with examples (3 marks)

(Total: 30 marks)

QUESTION TWO

(4marks)

- A. List FOUR (4) determinants of working capital
- B. The following information relates to Otiki Plc:

	₦
Sales	120,000
Cost of Goods Sold	80,000
Purchases	66,000
Raw Materials Stock	24,000
Work-in-progress	7,000
Finished goods stock	18,000
Debtors	15,500
Creditors	10,000

Note: Assume all purchases and sales are on credit.

Required:

- (i) Calculate the length of the working capital operating cycle
- (ii) Comment on the firm's liquidity margin

(3 marks)

(3 marks)

(Total: 10 marks)

QUESTION THREE

- (i) In a portfolio of investments, briefly explain the term coefficient of variation
- (ii) You are considering investing in one or both of securities X and Y and you are given the following information.

Security	Possible Rates Of return (%)	Probability of occurrence
X	25	0.1
	30	0.8
	20	0.1
Y	50	0.3
	25	0.4
	15	0.3

Required:

If the portfolio consists of 70% of security X and 30% of security Y,

- (i) Calculate the expected return, variance and standard deviation of each security. (5 marks)
- (ii) Calculate the expected returns, variance and standard deviation of the portfolio from these figures. (5 marks)

(Total: 10 marks)

QUESTION FOUR

- A. **Akeredolu Plc** maintains 3 working capital policies, ranging from conservative policy, average policy and aggressive policy. Sales under each policy is one million, six hundred thousand naira. Fixed asset value is taken to be 50% of sales in each policy. Current assets is 60% of sales under conservative policy, $\frac{1}{2}$ of sales under average policy and 40% of sales under the aggressive policy. Earnings before interest and tax under each policy takes 20% of sales revenue.

Required

- (i) Determine the return on assets under each policy and comment on the liquidity position of each policy. **(5 marks)**
- B. In a related development, the firm has decided to finance its total asset with 50% equity and 50% debt. The firm uses all long-term debt under conservative policy; half long-term debt and half short-term debt under average policy and all short-term debt under aggressive policy. Interest rate on both long-term debt and short-term debt attracts 8% respectively. The company pays income tax rate of 30%.

Required

- (i) Determine the return on equity (ROE) and liquidity level of the firm under each of the working capital policy and comment on your result. **(5 marks)**

(Total: 10 marks)

QUESTION FIVE

- A. In discussing dividend theory, Miller and Modigliani as well as Walter and Gordon came up with two schools of thought to explain dividend irrelevance and dividend relevance in firms and the stock market. Robustly expatiate on these two schools of thought, carefully highlighting at least two peculiar assumptions of each school of thought. **(5 marks)**
- B. Firm dividend policy has over time been empirically researched to affect value of shares and growth as well. The data below relate to three firms operating under three conditions, ranging from growth firm, normal firm and declining firm.

Growth firm	Normal firm	Declining firm
$r = 0.15$	$r = 0.10$	$r = 0.08$
$k = 0.10$	$k = 0.10$	$k = 0.10$
EPS = ₦10	EPS = ₦10	EPS = ₦10
Payout ratio 0%	applicable	applicable
Payout ratio 20%	applicable	applicable
Payout ratio 40%	applicable	applicable
Payout ratio 60%	applicable	applicable
Payout ratio 80%	applicable	applicable
Payout ratio 100%	applicable	applicable

If the firms maintain 40% each and 50% payout ratios, determine the dividend growth rate and the dividend paid out under each condition of the firm **(5 marks)**

(Total: 10 marks)