



***"Investing in Africa's Future"***

**FACULTY OF MANAGEMENT AND ADMINISTRATION**

**COURSE TITLE: MAC 403 Financial Management (Parallel)**

**SEMESTER 1: Final Examination October 2014**

**LECTURER: Mr P Paradza**

**TIME: 3 HOURS**

***INSTRUCTIONS***

Answer **all five (5)** questions.

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Start **each** question on a new page in your answer booklet.

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The marks allocated to **each** question are shown at the end of the question.

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Show all your workings.

**QUESTION 1 (32 marks)**

- (a) Identify 6 assumptions of basic capital investment appraisal. ( 6 marks)  
 (b) Explain the concept of relevant costs in capital investment appraisal (10 marks)  
 (c) The following information relates to a proposed project:

	\$
Capital outlay	180 000
Sales in Year 1	76 000

Sales are expected to increase every year for the next 4 years at the rate of 13%, 20%, 23% and 28% of the previous year's figures respectively. Variable costs are 75% of sales. Fixed costs will be \$27 000 p.a. for the 5 years, and 20% of these costs are directly related to the project. The capital allowance is equal to accounting straight-line depreciation for 5 years without taking salvage value into account. Net working capital, which is currently \$4 500, is expected to be 10% of sales throughout the project period.

At the end of the 5 years, the salvage value of the project is expected to be \$27 670. The rate of company tax is 30%, and the salvage value will attract a balancing charge of 25%.

**REQUIRED**

Calculate the relevant cash flows for the above project and present them in tabular format. All calculations may be rounded off to the nearest \$. (16 marks)

**QUESTION 2 (19 marks)**

- (a) Identify and explain 6 methods which can be used to specifically consider risk and reduce the level of overall risk in capital investment appraisal. ( 9 marks)  
 (b) The following information relates to a project:

	Year			
	0	1	2	3
	\$	\$	\$	
Capital outlay	1 200 000			
Cash inflows		680 000	480 000	400 000
Abandonment value	1 200 000	800 000	360 000	-

The company's cost of capital is 20%.

**REQUIRED**

Using the NPV method, determine if the project should be completed or abandoned before the original completion date. (10 marks)

**QUESTION 3 (23 marks)**

- (a) Explain the effect of capital structure on a company's value and cost of capital. ( 8 marks)  
 (b) With the aid of a diagram, explain the traditional approach to capital structure. (15 marks)

**QUESTION 4 (12 marks)**

- (a) State and give examples of 3 major classifications of capital investment projects. ( 6 marks)
- (b) Explain the following terms in capital investment appraisal:
  - (i) Divisible project ( 2 marks)
  - (ii) Indivisible project ( 2 marks)
  - (iii) Incremental cash flows ( 2 marks)

**QUESTION 5 (14 marks)**

- (a) List 10 questions, the answers to which may be provided by a knowledge and application of cost-volume-profit (CVP) analysis (I.M. Pandey 2005). ( 5 marks)
- (b) Explain the following concepts in CVP analysis:
  - (i) Operating leverage and degree of operating leverage ( 3 marks)
  - (ii) Financial leverage and degree of financial leverage ( 3 marks)
  - (iii) Total leverage and degree of total leverage ( 3 marks)

**END OF PAPER**