AFRICA UNIVERSITY
(A United Methodist-Related Institution)

FACULTY OF MANAGEMENT AND ADMINISTRATION

COURSE TITLE: MFN 501, FINANCIAL MANAGEMENT

SEMESTER 1: FINAL EXAMINATION-NOVEMBER 2013

LECTURER: MS CHIRIMA

TIME: 3 HOURS

INSTRUCTIONS

Answer **ALL questions.** Total possible mark is **100.**

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

Credit will be awarded for logical, systematic and neat presentations.

SECTION A

Answer all questions [20 marks]

1. Identify the fundamental objective of a Financial Manager. [1 mark]

2. Distinguish between profit maximization and wealth maximization. Are these two concepts mutually inclusive or mutually exclusive? [5 marks]
3. Indicate why agency problems exist between management and shareholders. What factors will ensure an alignment between the objectives of shareholders and managers? [5 marks]
4. The following limited information is available for returns on two shares listed on the stock exchange.

Year	G	P
2008	0.2	0.16
2009	0.28	0.12
2010	0.36	0.1
2011	0.12	0.18

Despite the limited number of readings, a normal distribution of returns may be assumed. In addition, past performance is considered to reflect expected future performance.

a. Calculate the average return, standard deviation and co – efficient of variation for each of the two shares. [6 marks]
b. Taking the role of an investment advisor, recommend one of the two shares to a client who wishes to make a choice between an investment in G or an investment in P. Advise the client of the issues which should be considered. [3 marks]

SECTION B

Select and answer any TWO (2) questions [50 marks]

Question 1

Property Investments Group Ltd is considering an investment in a small industrial property which is currently offering a gross rental of $120 000 per year. The asking price for the property is $1, 32 million. Operating costs such as maintenance, administration and rates are expected to amount to $36 000 per year. Rentals and costs are expected to increase at a rate of 4% per year for the next three years. The group intends to hold onto its property for three years when the group expects to sell the property for $1, 68 million. Tax is charged at a rate of 28% and the company will also pay Capital Gains Tax on any profit on disposal. The required rate of return is 9%.

You are required to:

a. Compute the Net Present Value from investing in this property. **[10 marks]**
b. Compute the Internal Rate of Return. **[10 marks]**
c. Explain why the NPV and the IRR capital budgeting techniques are preferred to other methods of project valuation. **[5 marks]**

Question 2

Given below are details in respect of two machines to be acquired by Tonto Ltd.

The expected cash flows for the machines are as follows:

Year	1	2	3	4	5
Machine A	20 500	22 860	24 210	23 410	35 100
Machine B	32 000	26 100	25 400	26 000	38 600

Other relevant details are as follows:

	Machine A	Machine B
Cost	$50 000	$88 000
Terminal Value	$5 000	$8 000
Relevant Discount Rate reflecting risk	12%	14%*

*Machine B will use new untested technology that management deems to be more risky.

Required:

a. Determine the discounted payback period for each machine. [5 marks]
b. Determine the NPV for each machine. [10 marks]
c. Advise the company on which machine to buy. [5 marks]
d. Briefly, explain the factors you would take into account before deciding on the 'cost of capital' to apply in appraising an investment project. [5 marks]

Question 3

Jojo Ltd has an outstanding ordinary share capital of 50 000 ordinary shares of $100 each. They were trading at $270 each at the start of the just ended year. It also has 12% bonds, par value $2, 5million. The company, which operates in a fast growing industry made an operating income of $960 000 in the year just ended. Tax is at a rate of 30%. At the beginning of the year, the company's management was contemplating redeeming the bonds at a premium of 20%. The funds for the redemption would be raised through a rights issue at a price of $240 per share. It is the wish of management to maximize the annual EPS.

Required:

a. Determine the degree of financial leverage, the interest cover and the Earnings per Share of the company. [6 marks]
b. Compute the EPS and the theoretical ex – right price per share should management redeem the bond. [6 marks]
c. Determine the minimum level of operating income at which the EPS would not have changed irrespective of the decision taken by management. [9 marks]
d. In your opinion, is it advisable for Jojo to redeem the bond? Explain. [4 marks]

Question 4

Investigations into the issue of the annual published financial reports of companies by shareholders have shown the report as an important source of information for making decisions on equity investments. Other studies show that the market price of the shares in a company does not react in the short term to the publication of the company's annual report.

- ***a.*** Explain these findings in view of the Efficient Market Hypothesis (EMH). ***10 Marks***
- ***b.*** Briefly explain any five methods through which a company may obtain a listing of its shares on the stock exchange. **15 marks**

<u>**SECTION C**</u>
Select and answer any ONE (1) question [30 marks]

Question 5

a) How is it possible that dividends are so important, but, at the same time, dividend policy is irrelevant? [10 marks]

b) Explain factors that you, as a Manager, would consider when making a dividend decision. [10 marks]

c) Outline how the three financial management decisions are inter – related. [10 marks]

Question 6

a) If increases in dividends tend to be followed by increases in share prices, how can it be said that dividend policy is irrelevant? [10 marks]

b) A 70 year old lady has just retired from the Ministry of Education (in your home country) where she worked as a primary school teacher for the past 45 years. She is yet to receive her investment package and is wondering how best to utilize it. As a business administrator, conversant with the current economic conditions in your home country, advise the lady on how best to utilize her pension funds. [10 marks]

c) The value of a company is the present value of future dividends. How is this inconsistent with the proposition that dividends are irrelevant? [10 marks]

END OF PAPER