"Investing in Africa's Future"

FACULTY OF MANAGEMENT AND ADMINISTRATION

MAC 410 FINANCIAL MANAGEMENT 11

END OF SECOND SEMESTER EXAMINATIONS

APRIL/MAY 2017 (1)

LECTURER: I. RARAMI

DURATION: (3 HRS)

CONVENTIONAL

INSTRUCTIONS

Answer **ALL** questions

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

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

Show all your workings

Credit will be given for presentations that are neat, logical and grammatically well constructed.

QUESTION ONE [25 MARKS]

Modigliani and Miller's analysis resulted in a lot of research into the areas of capital structure decisions. Some of the areas which researchers have looked at are listed below.

a). Agency **[8 marks]**

b). Financial Distress **[7 marks]**

c). Tax Exhaustion **[5 marks]**

d). Debt Capacity **[5 marks]**

Required

Discuss each of the above areas of capital structure decision making, clearly showing the effect on firm value and MM. Use graphs where applicable to illustrate the effect on the firm.

QUESTION TWO [25 MARKS]

Shandai Manufacturing (Pvt) Ltd is considering a proposal to replace an automated press in one of its plants with a newer model that is expected to reduce labour and raw material costs by $150 000 per year. Due to its greater capacity and increased output, net income before taxes will increase by $50 000 per year.

The new press will cost $550 000plus an additional $50 000 for installation. It will be depreciated on a straight-line basis over its 5 year depreciable life to a zero book value. However, at the end of five years it is still expected to have a market value of $100 000, for which it is expected to be sold. The increased output will require an immediate, one time increase of $50 000 in net working capital.

The old press can be sold today for $120 000. It was purchased 5 years ago for $300 000, and is being depreciated over its 10 year life to a book value of zero.

Required

Given a tax rate of 40%, and a required rate of return of 12%, should the Shandai Manufacturing (Pvt) Ltd replace the old machine now? No initial or investment allowance applies and inflation should be ignored. **[25 marks]**

QUESTION THREE [25 MARKS]

From the following information relate to Zimbabwe Products Ltd's investment.

State of investment	Probability	Return X	Return Y
Excellent	0.1	30%	18%
Good	0.5	20%	27%
Bad	0.4	-5%	8%

Required:

i). Calculate the covariance **[10 marks]**

ii). Calculate the expected return, if investment is 60% in X and 40% in Y and the variance. **[4 marks]**

iii. Explain the difference between systematic risk and non-systematic risk. **[4 marks]**

ii). State any seven assumptions need to be made in order to use the Capital Asset Pricing Model (CAPM) **[7 marks]**

QUESTION FOUR [25 MARKS]

a). Explain the difference between translation exposure and transaction exposure. **[4 marks]**

b). State and explain the three major determinants of exchanges rates **[9 marks]**

c). When a firm is a target of a hostile acquisition, what are the defensive strategies to be implemented to discourage shareholders from signing or accepting the tender offer? **[7 marks]**

d). State and explain the three basic causes of business failure. **[3 marks]**

e). State and explain the two methods that are useful in trying to predict business failure. **[2 marks]**

END OF PAPER