"Investing in Africa's Future"

COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE

MFN 501 – FINANCIAL MANAGEMENT

END OF SECOND SEMESTER EXAMINATIONS

MAY 2018

Ms. N E CHIRIMA

DURATION: 3 (Three) HRS

INSTRUCTIONS

Answer ALL Questions. Marks are indicated at the end of each question.

Answers are to be presented clearly and neatly.

Answer each question on a new page.

Question 1 (20 possible marks)

You are the Director of Finance at Lomax Ltd. a company listed on the main board of the local stock exchange. It commenced business in 1992 in Kuala Lumpur, Malaysia as a small family owned concern. In 2008, due to its rapid growth it applied and successfully obtained a listing on the main board of the local stock exchange. Today the company is a major manufacturer of consumer products.

Since the company's inception it has firmly believes in the notion of financing all their investment projects with 100% equity which means that the company has essentially zero debt in its capital structure. There is currently an intense debate going on in the company about the current capital structure, some managers' are of the opinion that the company should begin including debt in the capital structure.

There is an important board meeting coming up in one months' time. The main purpose of this meeting is to make a decision on the viability of introducing debt into the capital structure of the company, and you will be required to present your views on the matter.

Required:

a) In anticipation of your presentation at the board meeting you are required to critically evaluate the potential impact on shareholder wealth on the decision to introduce debt into the capital structure of the company and consider whether the alternative decision to finance investment using equity finance would be more beneficial to the shareholders'. ***20 marks***

Question 2 (10 possible marks)

Mutare Ltd is considering expanding its operations to Mutare. The company wishes to make a rights issue to raise the required funding of $24 million. The company is listed on the ZSE and has currently 9 million shares in issue. The current share price on the ZSE is $10 and the subscription price will be set at $8 per share.

You are required to:

a. Compute the number of shares to be issued through the rights issue. ***3 marks***
b. What is the expected ex – rights price? ***5 marks***
c. What is the value of each right? ***2 marks***

Question 3 (20 possible marks)

a) From your understanding of financial accounting, what are your thoughts about the accuracy and value of financial reports for use by financial managers? ***8 marks***
b) In the context of risk, transferability and tax, discuss the advantages of being a sole trader, in a partnership or a company. ***8 marks***
c) Why are the concepts of risk and return important in making financing and investment decisions? ***4 marks***

Question 4 (15 possible marks)

The following information is available for Munya Ltd:

Current price per share	$2. 00
Current year's dividend per share	$0. 10
Expected Average growth rate of dividends	7%
Beta Coefficient for Munya Ltd	0.80
In addition the following information has been established:	
Expected rate of return on risk free securities	8%
Expected return on the market portfolio	12%

Required:

a) Explain what is meant by "cost of capital" for a particular company. ***3 marks***
b) Calculate the cost of equity for Munya Ltd from the data given, based on both the Dividend Growth Model and the Capital Asset Pricing Model. ***4 marks***
c) State, for each model separately, the main simplifying assumptions made and express your opinion about whether, in view of these assumptions, the models yield results that can be used in practice. ***8 marks***

Question 5 (15 possible marks)

a) "The level of gearing has no effect on the cost of capital." Discuss this statement. ***5 marks***
b) What factors should be considered in deciding on the appropriate capital structure? ***5 marks***

Question 6 (10 possible marks)

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 indicate that the market price of shares of a company does not react in the short term to the publication of the company's annual financial report.

Required:

a) Explain these findings in view of the efficient market hypothesis ***5 marks***

b) Briefly outline four conditions necessary for an efficient capital market ***5 marks***

Question 7 (10 possible marks)

a) Compare and contrast the Net Present Value with the Internal Rate of Return. ***5 marks***

b) Specify which of the two methods mentioned in (a) will, in your opinion; take precedence should the two methods have conflicting results. Explain. ***5 marks***

End of Paper

FORMULA SHEET

Lump Sum	FVA= I $[(1 + r)^{N} - 1]/ r$	***Lump Sum***
FV = PV $(1 + r)^{NM}$	***Annuity Due***	PV = FV / $(1 + r)^{N}$
Ordinary Annuity	FVA= $\{I [(1 + r)^{N+1} - 1]/ r\} – 1$	***Ordinary Annuity***

$PVA = I\,[(1 - (1 + r)^{-N})]/ r$

Annuity Due

$FVA = \{I\,[1 - (1 + r)^{N+1} - 1]/ r\} + 1$

Perpetuities

PV = Cash flow/ r

Operating Leverage

Contribution/ EBIT

Financial Leverage

EBIT/ (EBIT – I)

Combined Leverage

Contribution/ (EBIT – I)

Spread of cash limits

$\frac{3}{4}(cy^2/i)$

Value of a Right

Current Market Price – Expected Market Price

Earnings Per Share

EAIT/ Number of Ord Shares

Interest Cover

EBIT/ Interest

Gearing Ratio

Debt/ Equity

Cost of Debt

$R\,(1 - T)/ P_0$

Cost of Debt

$[R(1 - T) + 1/M\,(FCV - P_0)]/ [\frac{1}{2}\,(FCV + P_0)]$

Cost of Preference Shares

D / P_0

Cost of Equity

$(D_1 / P_0) + g$

Cost of Equity

$R^f + (R^M - R^f)\beta$

Current Ratio

Current Assets / Current Liabilities

Quick Ratio

(Current Assets – Stock)/ Current Liabilities

Stock Holding Period

(Average Stock /Cost of Sales) x 365 days

Debtors Collection Period

(Average Debtors/ Credit Sales) x 365 days

Operating Cycle

Stock Holding Period + Debtors Collection Period

Creditors Payment Period

(Average Creditors / Credit Purchases) x 365 days

Cash Conversion Cycle

Operating Cycle – Creditors Payment Period

Economic Order Quantity

$\sqrt{(2RC/ h)}$

Co – Variance

SD/ER

Coefficient of Variation

$SD_{ur}/ SD_u \times SD_r$