"Investing in Africa's Future"

COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE

MFN 501 - FINANCIAL MANAGEMENT

END OF SEMESTER EXAMINATIONS

AUGUST 2019

Ms. N E CHIRIMA

DURATION: 3 (Three) HRS

INSTRUCTIONS

Follow the instructions indicated at the beginning of each section.

Answers are to be presented clearly and neatly. Select and answer any ***FOUR*** questions.

Answer each question on a new page.

Question 1 (25 possible marks)

a) Illustrate how each of the four financial management concepts relates to the financial manager's objective. ***10 marks***

b) The Agent – Principle Assumption brings about close knit relationships among key stakeholders of a company who aim at achieving the same objective of maximizing the value of the company. It also ensures smooth trading and operations in the financial markets. With reference to at least one 21st century scandal, illustrate how failure to uphold this assumption affected:

   a. The company itself ***5 marks***

   b. Financial markets ***10 marks***

Question 2 (25 possible marks)

Following extensive analysis and forecasting, you have established that an investment in Mills Limited offers the following probability distribution of returns, given different states of the economy:

State of the economy	Probability of state of economy	Conditional return	
		Asset 1	Asset 2
Super - boom	5%	30%	97%
Boom	20%	25%	43%
Normal	48%	20%	-6%(negative)
Recession	17%	10%	-20% (negative)
Severe Recession	10%	-5% (negative)	-42% (negative)

Required:

a) Compute the Expected Return for Asset1 and Asset 2 ***3 marks***

b) Compute the risk, using standard deviation, for asset 1 and asset 2 ***7 marks***

c) Compute the risk of a portfolio comprising of asset 1 and asset 2 ***2 mark***

d) As a manager, would you recommend your company to invest in ether asset 1, asset 2 or both? Explain. ***3 marks***

e) Illustrate the effect of investing in a portfolio on risk and return. ***10 marks***

Question 3 (25 possible marks)

Carol Ltd has an outstanding ordinary share capital of $5 million in shares of $100 each. They are currently trading at $204 each. It also has 9% bonds par value $2, 4 million. The company made an operating income of $972 000 in the year just ended.

Required:

a) Compute the company's current level of equity gearing and its interest cover. ***3 marks***

b) The company is to raise $2, 4 million to finance a new investment. This will be made through a rights issue of $153, 60 per share. Compute and interpret the theoretical ex – price. ***3 marks***

c) Assume the $2, 4 million was raised by way of a 15%loan repayable over 5 years in installments paid at the beginning of the year. Determine (to the nearest thousand) the annual installment to be paid and amortize the loan. ***8 marks***

d) Assume the $2, 4 million was raised by way of a 15%loan repayable at the end of 5 years including the accrued interest. Determine (to the nearest thousand) the amount to be paid at the end of the loan period. ***6 marks***

e) Illustrate the difference between a rights issue and a bonus issue. ***5 marks***

Question 4 (25 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 and its implication to the manager. ***10 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. ***6 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. ***9 marks***

Question 5 (25 possible marks)

Despite what is happening in Zimbabwe, the stock market is having a rally. There are people making a lot of money now while most Zimbabweans do not understand how the stock market works. There are 65 companies listed on the ZSE and there are 15 brokerage companies which facilitate the buying and selling of those shares. According to veteran stock-broker Wellington Mapedzamombe, the current rally is caused by foreigners who are taking positions ahead of the elections, little or no return on the money market, hedging, speculation on the return of Zimbabwean dollar, hopes for a repeat of the 2009 scenario and discount of bond notes, mirroring the parallel market. Discounting of the bond notes means that for a company that is dual-listed like Old Mutual, if the shares are US$3 in South Africa, they sell for US$6 in Zimbabwe since the bond notes are exchanging at a discount of about 55% to the US dollar on the black market. Dual listed shares like Old Mutual and PPC are fungible, which means they can be bought in Zimbabwe and sold outside the country. There are no laws to stop that but liquidity or availability of shares for sale is usually the limiting factor. The ZSE is a relatively small market:

MARKET ACTIVITY 29 JULY 2019

Market Cap:	***ZWL$ 24,556,727,656***
Turnover:	***ZWL$ 2,385,637.70***
Foreign Buys:	***ZWL$ 499,850.60***
Foreign Sales:	***ZWL$6,460.00***
Trades:	***74***
(Zimbabwe Stock Exchange, 2019)	

The best investment strategy is to buy and hold so in the long-term you will realize value. Zimbabwe has had some unique challenges though with currency devaluation and regulatory uncertainty.

I hear everyone in Zimbabwe talking about bringing investors to rescue our economy but we have a very viable stock market that we can use to do that. There have been plans to launch a small-to-medium enterprises stock market by the ZSE and, once it goes live, small enterprises will find it easier to raise capital.

Investors are so hungry for liquidity you can list anything on the ZSE right now and it would sell. The challenge is how to bring ordinary Zimbabweans to invest in the market so as to build wealth locally. It is possible to market an initial public offer to ordinary Zimbabweans, but it would need massive investor education and the brokers need to be committed to selling to small investors.

Source of Article: (Peters, 2018)

a) Based on the information in the above extract from an article by Debrah Peters, how would you best describe the ZSE – as bullish or bearish? Support your answer. ***10 marks***
b) Peters described ZSE as a "small market" based on 5 indicators. Briefly explain what is meant by market capitalization. ***4 marks***
c) Information flow determines the level of efficiency of a capital market. Based on the information above, argue your opinion on the efficiency level of the ZSE. ***11 marks***

Question 6 (25 possible marks)

Part 1

With reference to examples of mergers in Zimbabwe, outline the tactics companies employ to avoid takeovers. To what extent have these strategies been successful? ***10 marks***

Part 2

Mrs Ruey is a 65 year old who was employed by the Ministry of Education as a primary school teacher for the past 40 years (in Zimbabwe). She retired in June this year and will be receiving her pension before December 2017. Her niece, Kuda, who is a young Finance student has advised to buy shares on the Zimbabwe Stock Exchange and is in the process of convincing her that there are high returns and risk is moderate.

Required:

a) Comment on the advice given Mrs Ruey by her niece Kuda. ***1 mark***
b) In your opinion, what would be best investment for Mrs. Ruey and explain why? ***2 marks***
c) Company J and Company L are both listed on the Zimbabwe Stock exchange. Company J's dividend per share has been growing steadily over the past 10 years while its Earnings per Share has remained constant. On the other hand, Company L's Earnings per Share have been growing steadily while its Dividend per Share has been declining. Mr. B, a Danish investor who is one of the Facebook Business Page (on which you are a member) participants is asking for advice on which of the two companies to invest in. Advise Mr. B on what to consider when making his decision. 1***2 marks***

End of Paper

FORMULA SHEET

Lump Sum

$FV = PV\ (1 + r)^{NM}$

Ordinary Annuity

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

Annuity Due

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

Lump Sum

$PV = FV\ /\ (1 + r)^{-N}$

Ordinary Annuity

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

Annuity Due

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

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

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

Standard Deviation

$$\sigma = \sqrt{\frac{\sum (x - \overline{x})^2}{n}}$$

σ = lower case sigma
$\sum$ = capital sigma
$\overline{x}$ = x bar

Cost of Preference Shares

$D\ /\ P_0$

Cost of Equity

$(D_1\ /\ P_0) + g$

Cost of Equity

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

Expected Return

$\sum(R - \acute{R})$

Coefficient of Variation $SD_{ur} / SD_u \times SD_r$