

UNIVERSITY OF FORT HARE

**INTRODUCTION TO FINANCIAL MANAGEMENT
BEC225 AND BEC225E**

DEGREE EXAMINATIONS

NOVEMBER MAIN EXAMINATION 2018

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Time: 2 Hours
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Marks: 75

This paper consists of 10 pages including the cover page

Internal Examiners

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INSTRUCTIONS

1. Answer THREE questions: Question 1 in Section A (compulsory).
Answer 2 questions from Section B.
2. Number the questions correctly.
3. Write your student number and name on your answer books.
4. Write legibly.
5. Enter your student number on the multiple choice answer sheet provided with this paper and place the answer sheet inside the front cover of your answer book.

SECTION A
QUESTION 1 IS COMPULSORY
QUESTION 1: MULTIPLE CHOICE QUESTIONS

1. The short-term financial goal should be to ensure the profitability, liquidity and solvency of the firm. The main objective of financial management is to _____.
 - a) maximise the remuneration paid to executive management
 - b) maximise shareholders' value
 - c) ensure maximised profits
 - d) ensure maximised sales

2. The decision-makers in financial management should understand the **THREE** main fundamental principles of financial management. Which of the following is the fundamental principle of financial management?
 - a) Time value of money
 - b) Financing-investment decision
 - c) The governance of risk
 - d) Business rescue

3. When the JSE is classified as a secondary market it means that:
 - a) it facilitates the trading of new shares between the issuing company and investors.
 - b) it facilitates the raising of new capital
 - c) it allows for the trading of previously issued securities to investors.
 - d) none of the above apply.

4. The required rate of return on debenture is influenced by _____.
 - a) Liquidity risk
 - b) Default risk
 - c) Maturity risk
 - d) All of the above

5. Which of the following statements regarding users of financial information is correct?
 - a) Managers of an entity are considered to be internal decision makers, they use financial information to plan and control the activities of the firm
 - b) External decision makers can obtain whatever financial data they need and whenever they need it
 - c) Accounting information is prepared for and useful to only outside decision makers
 - d) SARS uses financial statements in order to determine the growth rate of the GDP.

6. A firm has R30 million in equity, a mortgage loan of R20 million and current liabilities of R4 million. The account receivables are R5 million, the inventory is R5 million and cash of R3 million. The firm's non-current assets is closest to _____.
 - a) R13 million
 - b) R41 million
 - c) R35 million

- d) R18 million
7. Which of the following measurements is **NOT** a typical measurement of profitability of a firm?
- Inventory Turnover
 - Return of Investment
 - Return of Equity (ROE) or Return on Net Assets (RONA)
 - Gross Profit Margin
8. Fort Hare Dairy Distributors Ltd has achieved a Net profit of R322 028 for the past financial year. The Company's total assets amount to R3 950 000 and the shareholder equity amounts to R3 220 000. The company's return on equity (ROE) is _____.
- 6%
 - 8%
 - 10%
 - 12%
9. The cash budget is used in order to help ensure the liquidity of the firm, which of the following statements is more correct? Cash budgets indicates:
- The extent, time and sources of expected cash inflows
 - The extent, time and purposes of expected cash outflows
 - The expected availability of cash in comparison with the expected need for it
 - All of the above.
10. Which of the following statements about generic corporate strategy is **NOT** correct?
- a focus strategy could either be a cost focus or a differentiation focus but it will have to be aimed at a very specific market
 - Cost leadership means a firm manufactures or buys and sells standard products to the broad market at the lowest possible cost
 - Differentiation means the firm provides a product different from the standard product by adding some unique features and qualities, but usually charges a price higher than other suppliers
 - None of the above.
11. Which of the following statements are correct?
- Total risk is a combination of an asset's non-diversifiable and diversifiable risk
 - Diversifiable risk is also known as systematic risk
 - Non-Diversifiable risk cannot be eliminated through diversification
 - The beta coefficient (β) is a measure of diversifiable risk
- (i); (iii)
 - (i); (iv)
 - (i); (ii); (iii)
 - (i); (ii); (iv)

12. The _____ financial manager requires an increase in return for a given increase in risk. While The _____ manager requires no change in return for an increase in risk. Nevertheless, most financial managers are _____.
- a) risk-taking; risk-indifferent; risk averse
 - b) risk-averse; risk-indifferent; risk takers
 - c) risk-averse; risk-indifferent; risk averse
 - d) risk-control; risk-indifferent; risk takers
13. A refrigerated truck was purchased a year ago for R240 000 and currently has a market value of R290 000. During the year, it has generated R9 600 in after-tax cash receipts. What is the refrigerated truck's rate of return?
- a) 24.8%
 - b) 17.8%
 - c) 14.9%
 - d) 7.0%
14. What is the difference between the future value of R2 000 invested at 12% per year compounded interest for one year if: (i) Interest is calculated semi-annually, or (ii) Interest is calculated monthly?
- a) R0.00
 - b) R3.35
 - c) R6.45
 - d) R13.65
15. Calculate the growth rate of the following dividend payments over the period from 2013 to 2017:
- i. 2013: R2.50;
 - ii. 2014: R2.60;
 - iii. 2015: R2.66;
 - iv. 2016: R2.80;
 - v. 2017: R3.00
- a) 3.71%
 - b) 5.50%
 - c) 7.02%
 - d) 8.10%.
16. When the market price of a bond increases, it is an indication that the yield-to-maturity:
- a) has increased
 - b) has decreased
 - c) has remained the same
 - d) is higher than the coupon rate.

17. The debenture is said to be trading at a premium when_____.
- a) the required return is equal to the coupon rate, the market value is equal to the par value
 - b) the required return is less than the coupon rate, the market value is greater than the par value
 - c) the required return is greater than the coupon rate, the market value is less than the par value
 - d) the required return is greater than the coupon rate, the market value is greater than the par value.
18. Assume Eskom debentures will be issued at par value of R1 000 each. Interest is paid annually and the required rate of return is equal to the debenture`s coupon interest rate of 12% (R120). The initial maturity is 10 years. The value of the debenture is:
- a) R322.00
 - b) R678.00
 - c) R708.40
 - d) R1 000.00
19. An aggressive financing strategy implies that the firm finances _____.
- a) Its seasonal needs with long-term funds
 - b) All its needs with short-term funds
 - c) Its seasonal needs and some of its permanent needs with short-term funds
 - d) Only its long-term needs with short-term funds
20. A firm can manage its cash conversion circle by:
- a) Acceleration the collection of accounts receivable
 - b) Stretching accounts payable
 - c) Efficient inventory and production management
 - d) All of the above
21. Which of the following statements are **INCORRECT**? In order to decrease total risk, management can:
- i. Decrease the amount of cash on hand
 - ii. Decrease inventory levels if sales decreases
 - iii. Collect debtors accounts faster
 - iv. Decrease the amount of networking capital.
- a) (i); (ii)
 - b) (ii); (iii)
 - c) (i); (iv)
 - d) (iii); (iv)

22. Which one of the following statements is incorrect?
- a) The payback period measures the amount of time required to recover the initial investment
 - b) The NPV and IRR techniques consider the time value of money
 - c) The NPV and IRR techniques always rank projects in the same order
 - d) The PI is a measure of a project's profitability relative to each rand invested in the project.
23. Conflicting ranking using the net present value (NPV) and internal rate of return (IRR) results from difference in
- a) Discount rate
 - b) Magnitude of the cash flow
 - c) Timing of the cash flow
 - d) b) and c) are correct
24. Complete the following sentence by choosing one or more of the options set out below:
The break-even point can be defined as the level of activity where _____
- a) Profits equal fixed costs
 - b) Variable costs are covered by sales revenue
 - c) Contribution equals fixed costs
 - d) The cash flow is zero.
25. Complete the following sentence by choosing one of the options set out below: Break-even analysis as a measure of dealing with risk is most useful when _____
- a) Sensitivity analysis is also used as a method of assessing the risk of the project
 - b) Capital investment projects are being considered
 - c) Short-term decisions have to be made
 - d) A best case for investment is presented using scenario analysis.

SECTION B ANSWER ANY TWO QUESTIONS

QUESTION 2 [25 Marks]

- a) Excise Moving Company Ltd is looking to expand their service offering by introducing a new courier line specifically targeted at medium-sized removals. The owners of the firm need to invest in a new fleet of smaller removal vehicles. A dealer draws up a quote for the firm for two different types of small lorry; a more expensive, reputable model manufactured domestically, and a cheaper, imported model. The owners decide to buy a fleet of the more expensive model despite the higher capital cost. Explain why this is or is not a good financial decision in terms of cost-benefit as well as solvency.

[10 Marks]

- b) Your brother wants to invest R6000 in your farm with you paying 6% interest compounded annually. How much will you owe in 6 years if your return his R6000 plus interest. **[5 marks]**
- c) Suppose you want to have R500 000 saved by the time you reach age 30 and suppose that you are 20 years old today. If you can earn 5 % on your funds how much would have to invest today to reach your goal. **[5marks]**

QUESTION 3 [25 Marks]

Mulch Ltd is a large gardening supplies wholesaler. The CEO would like to know whether it would be prudent to expand business given the predicted economic slow-down of growth forecast for his country, and so he asks the CFO to test the firm's financial ratios against the industry averages. The condensed statement of financial performance and the statement of financial position are as follows:

CONDENSED STATEMENT OF FINANCIAL PERFORMANCE FOR THE YEAR ENDED 28 FEBRUARY 2016		
Sales		45 633 284
Less cost of goods sold:		15 654 500
Beginning inventory	1 455 647	
Plus purchases	19 550 257	
	21 005 904	
Minus ending inventory	1 348 675	
Gross profit		29 978 784
Less operating expenses		8 661 457
Earnings before interest and taxes		21 317 327
Less interest expense		100 323
Earnings before tax		21 217 004
Less tax (28%)		5 940 761
Earnings after tax		15 276 243
Net profit distributed as follows:		
Dividends to ordinary shareholders		4 526 852
Retained earnings		10 749 391
		15 276 243

STATEMENT OF FINANCIAL POSITION AT 28 FEBRUARY 2016			
Non-current assets	56 050 000	Shareholders' interest	
		Ordinary shares	49 000 000
Current assets		Retained earnings	6 867 414
Cash	450 000	Long-term debt	1 034 520
Accounts receivable	1 000 000	Current liabilities	
Inventory	1 348 675	Accounts payable	1 046 741
Total assets	57 948 675	Equity and liability	57 948 675

*Number of ordinary shares issued = 49 000 000 at 1 000 cents each

*Current market price per share = 2 540 cents

RATIO	INDUSTRY AVERAGE
Gross profit margin	45%
Net profit margin	25%
ROI	10%
ROE	8%
EPS	160 cents
DPS	25 cents
P/E	6
Net working capital	1 951 934
Current ratio	2,2
Quick ratio	1,0
Inventory turnover	13,5 times
Average collection period	30 days
Debt ratio	11%
Debt–equity ratio	16%
Times interest earned ratio	23

- a) Calculate the basic profitability, liquidity, debt and securities market ratios of the firm based on the figures above. **[15 Marks]**
- b) Use the figures you've calculated to discern whether or not Mulch Ltd are well-positioned for the coming economic changes. (Hint: tabulating the results against the industry averages will assist you in comparing the figures.) **[10 Marks]**

QUESTION 4 [25 marks]

Green Fingers are a chain of nurseries selling a variety of plants, trees and flowers to the public. Although they do provide basic services such as gardening advice and free local delivery, they are looking to expand their services, and to increase the range of products they have on offer. They consider opening a coffee shop with a play park for children at each of their branches, to encourage people to extend their visits at the nursery. Currently, Green Fingers are investigating several investment alternatives that were deemed viable during a first round of screening. However, their available capital funds are quite limited, and they will only be able to choose one of the project alternatives. Therefore, they must determine which project will add the most value – both at present, and in the future. Information about two of these alternatives are shown in the table below. Use this information to answer the questions that follow.

Net cash flow		
Initial investment	-R73 500	-R77 000
Year	Project D	Project E
1	R30 000	R45 000
2	R30 000	R30 000
3	R30 000	R25 000
4	R30 000	R15 000
	R120 000	R115 000

The initial investment (I₀) includes all the initial costs, that is, the purchasing and installation costs of the assets required. The depreciation on the two projects can be calculated using straight-line depreciation. The firm has a 16% cost of capital.

a) For each of the two projects determine:

- The payback period **[6 Marks]**
- The NPV **[12 Marks]**
- The PI **[3 Marks]**

b) Which of these options should Green Fingers decide on and why? **[4 Marks]**