



University of Fort Hare
Together in Excellence

NKUHLU DEPARTMENT OF ACCOUNTING

Financial Management 2A

AFM 211E

JUNE FINAL EXAMINATION, 2023

ASSESSOR: Mr SM Msakatya
MODERATOR : Mrs E Mason
TIME: 3 hours
MARKS: 150
PAGES: 14 pages (including front page)

INSTRUCTIONS:

1. Answer all the questions.
2. Start each question on a new page.
3. Show all workings clearly – marks are allocated to workings.
4. Only answers in ink will be marked (including workings). Pages where pencil or tippex were used will not qualify for remarking.
5. Only silent, non-programmable calculators are allowed.
6. Students that contravene the rules in the General Prospectus of the University of Fort Hare will be disciplined in accordance with said rules.

Question	Topics covered	Marks
1	Time Value of Money	15
2	Risk and Return	10
3	Portfolio Analysis	31
4	Financial Statement Analysis	42
5	Valuations	32
6	Cost of Capital	20
	TOTAL	150

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QUESTION 1**15 MARKS**

Jackie secured a R500 000 loan from Development Bank to start a small business. The term of the loan is that the loan be repaid over a period five years, in equal monthly instalments. The first payment, however, will be ten months after the granting of the loan. The interest rate is 15% p.a. compounded monthly.

QUESTION 3: REQUIRED		Marks	
		Sub-total	Total
(a)	Calculate the monthly instalments that must be paid by Jackie.	6	
(b)	How much interest (to the nearest Rand) will Jackie pay in total.	3	
(c)	Jackie estimates that her business will do very well in three years after getting the loan and plans to settle the loan in full. Calculate the capital balance three years after the granting of the loan, which Jackie will need to pay should she wish to settle it.	6	
Total			15

QUESTION 2**10 MARKS**

You are recently appointed as the financial manager of Wise Group Limited. You have been provided with the following information:

A summary of Wise Group Limited sales and costs for the year ended 28 February 2021 are set out below:

	R
Sales	200 000 000
Variable costs	<u>(75 000 000)</u>
Contribution	125 000 000
Fixed costs	<u>40 000 000</u>
Earnings before interest and tax	85 000 000
Fixed interest	<u>(12 000 000)</u>
Earnings before tax	<u>73 000 000</u>

After proper due diligence, you discovered that the previous financial manager was stealing large amounts funds from the company for almost 10 years without being detected. You decided to report this to the CEO (Mr Brown) who informed you that this cannot be reported as it will negatively affect the earnings of the business as customers and other stakeholders will not trust the company. Mr Brown anticipated the following cash flows for the business due to this issue:

Cash flows (Earnings)	Probability	Event
75 500 000	20%	Not reported to the Media
40 000 000	50%	Reported to the Media
60 000 000	30%	Reported privately to Police only

QUESTION 2: REQUIRED		Marks	
		Sub-total	Total
(a)	As the financial Manager what step are you going to follow from what the CEO informed you.	3	
(b)	Is it ethically correct not to report the information to the public and explain your answer.	3	
(c)	Calculate the expected return and standard deviation of Wise Group Limited's expected cash flows for the next financial year. Show all workings.	4	
Total			10

QUESTION 3**31 MARKS****PART A****17 MARKS**

Your brother wishes invest in a share portfolio so he has obtained the following information from his stock broker in order to make his decision.

Fund	Nandi Holdings	Best Holdings	Magu Holdings
Expected Return	15%	12.5%	14.5%
Standard Deviation	10.5%	11.5%	12%
Beta	1.2	0.85	1.0

QUESTION 3A: REQUIRED		Marks	
		Sub-total	Total
(a)	Explain what is a share portfolio, purpose and benefits of a portfolio vs holding a single share.	5	
(b)	If your brother invested R500 000 in shares of Nandi Holdings and R 350 000 in shares of Best Holdings, calculate the following: <ul style="list-style-type: none"> • Expected return of the portfolio • Beta of the portfolio. 	5 3	
(c)	If your brother was only going to invest in one company's shares (i.e. not a portfolio) which company would he not chose first and why.	4	
	Presentation	1	
Total			18

PART B**13 MARKS**

While you were doing the JSE challenge you discovered two companies that you became very interested in and researched them. You believe these companies will assist you with your diversification strategy. The following annual returns was made available to you about the two companies.

Year	Long Bank	Wide Insurers
2021	17%	19%
2022	15%	12%
2019	18%	21%
2020	9%	15%
2021	14%	10%
2022	19%	22%

QUESTION 3B: REQUIRED		Marks	
		Sub-total	Total
(a)	Calculate the average return of each share.	2	
(b)	Calculate the standard deviation of each share and explain which company is less risky.	6	
(c)	Calculate the correlation coefficient of the two companies and explain what it means.	4	
	Presentation	1	
Total			13

QUESTION 4

42 MARKS

You have been provided with the financial statements of Wanger Limited.

Statement of Financial Position of Empire Limited as at 30 June 2022

	2022	2021
	R	R
Assets		
Non-current assets		
Property, plant and equipment	3 850 000	2 510 000
Investments	1 750 000	1 550 000
Current assets	2 471 000	2 772 600
Inventory	195 000	186 000
Trade receivables	900 000	810 000
Taxation receivable	120 000	
Cash and cash equivalents	1 256 000	1 776 600
Total assets	8 071 000	6 832 600
Equity		
Ordinary share capital	2 450 000	1 500 000
Accumulated profit	3 702 000	3 025 600
Liabilities		
Non-current liabilities		
Long-term loan (13%)	1 375 000	1 850 000
Current liabilities		
Trade payables	544 000	457 000

Statement of Financial Performance of Empire Limited for the year ended 30 June 2022

	2022	2021
	R	R
Revenue	6 500 000	5 600 000
Cost of sales	(3 750 500)	(3 400 000)
Gross profit	2 749 500	2 200 000
Dividend income	175 000	155 000
Operating costs	(594 900)	(497 600)
Profit before interest and tax		
Finance costs	(165 000)	(222 000)
Profit before tax	2 164 600	1 635 400
Taxation	(606 088)	(457 912)
Profit for the year	1 558 512	1 177 488

Other relevant information:

- 75% of all sales are on credit while 25% is cash sales.
- All purchases are on credit.
- Inventory as at 1 July 2020 amounted to R165 000.

The following are the industry ratio's applicable of Empire Limited for the 2022 financial year:

Current Ratio	2.20
Times Interest Earned	5 times
Creditors Payment Period	34.07 days
Debtors Collection Period	48.91 days
Fixed Asset Turnover	10.82
Debt Ratio	20%
Gross Profit Margin	30%
Net Profit Margin	15%

QUESTION 4 REQUIRED		Marks	
		Sub-total	Total
(1)	1.1 Calculate the following profitability ratios of Empire Limited for the 2022 financial year. <ul style="list-style-type: none"> Gross Profit Percentage Net Profit Margin Return on Equity 	6	12
	1.2 Has the gross profit changed from 2021 to 2022? Provide 2 reasons that could cause the gross profit percentage to change.	4	
	1.3 Briefly explain what the gross profit percentage in 2022 of Empire Limited compared to the industry.	2	
(2)	Calculate the following for 2022 financial year		16
	2.1 Inventory holding period.	2	
	2.2 Debtors collection period.	3	
	2.3 Creditors payment period	4	
	2.4 What is the length of the business' working capital cycle	2	
2.5 What is your comment when you compare the Debtors collection period and Creditors Collection Period of Empire Limited compared to the industry.	5		
(3)	3.1 Calculate the current ratio and acid test ratio for 2022	5	9
	3.2 Briefly explain the difference between the current ratio and acid test ratio.	2	
	3.3 What are these ratios attempting to measure?	1	

	3.4 What type of companies would use acid test ratio?	1	
(4)	4.1 Calculate the debt ratio of 2022.	2	4
	4.2 Why would a bank be interested in a debt ratio and Times Interest earned ratio?	2	
	Presentation		1
Total			42

QUESTION 5**32 MARKS**

Your friend's mother (Mrs Jester) heard that you are doing Financial Management 2 at University of Fort hare and asks for your assistance in her investment portfolio.

Mrs Jester investment portfolio is made up as follows:

Investment	Note	Amount R
Bonds at Investec Bank	1	1 200 000
Sweets Ltd	2	1 100 000
2 200 shares in Wayne Limited	3	500 000
Electrical Ltd	4	700 000
Super Ltd	5	120 000

Notes:

1. 8% coupon Bonds in Investec Bank with a par value of R20 000. The bonds were issued at a par value five years ago and are repayable in six years' time at their par value. Interest is payable semi-annually. Similar bonds are trading at an effective rate of 10.5%.
2. Mrs Jester owns 4.5% shareholding in Sweets Ltd. A recent valuation revealed that the company was worth R28 500 000.
3. An investigation into the shares of Wayne Limited revealed a current dividend of R13.80 had just been paid. Dividends are expected to grow by 6% during year 1 and 13% in year 2. Thereafter they are expected to increase at a constant rate of 3% per year. The required rate of return of Wayne Limited Ltd is 9%.
4. Mrs Jester has 7000 ordinary shares in Electrical Ltd. These shares are currently trading at R115 each.
5. Mrs Jester owns 2 100 non-cumulative redeemable preference shares in Super Ltd. The preference shares will start paying an annual preference dividend of R12 per share in 4 years' time. The market requires a 13% return on the investment.

QUESTION 6**20 MARKS**

Electrical Manufacturers Limited wants to expand its manufacturing business to other countries within African continent. The board of directors are discussing whether to finance the expansion through debt financing or equity

A summary of Electrical Manufacturers Limited's current Statement of Financial Position as at 31 March 2022 shows:

<u>ASSETS</u>	
Non-current assets	45 800 000
Land and buildings	30 000 000
Plant and equipment	13 800 000
Net-current assets	<u>12 700 000</u>
	<u>58 500 000</u>
<u>EQUITY AND LIABILITIES</u>	
Ordinary shares (1 million in issue)	8 600 000
Retained earnings	<u>10 700 000</u>
	19 300 000
12% Debentures	18 500 000
Long term loan (15%)	<u>20 700 000</u>
	<u>58 500 000</u>

Statements of Comprehensive Income for the year's ending 31 March:

	2020	2021	2022
	<u>R'000</u>	<u>R'000</u>	<u>R'000</u>
Operating income	9 565 000	10 879 000	12 544 000
Interest on Debentures	(2 220 000)	(2 220 000)	(2 220 000)
Interest on long term loan	<u>(3 105 000)</u>	<u>(3 105 000)</u>	<u>(3 105 000)</u>
Net income before taxation	4 240 000	5 554 000	7 219 000
Dividend per share	R2.55	R2.77	R2.89
Dividend yield	11.11%	11.11%	11.11%
Current market value of the shares	R21.54	R22.83	R24.60
Expected growth rate			7%

Long term debentures similar to those issued by Electrical Manufacturers Limited are currently yielding a return of 15.5% per annum. The debentures are non-redeemable.

The long term loan matures on 31 March 2026 and interest is payable annually in arrears. Long term loans are currently being offered at a yield to maturity of 14.25% per annum.

The finance required for expansion will be raised through a long-term loan at the current ruling interest rate. The company tax rate is 28%.

QUESTION 6: REQUIRED		Marks	
		Sub-total	Total
(a)	Calculate the weighted average cost of capital of Electrical Manufacturers Limited assuming market values approximate the target capital structure.	20	
Total			20

***end of paper ***