NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE

DEPARTMENT OF BUSINESS MANAGEMENT

MANAGEMENT DEVELOPMENT PROGRAMME

FEBRUARY 2010 EXAMINATIONS

FINANCIAL MANAGEMENT - MDP 1003

TIME ALLOWED: 3 HOURS

INSTRUCTIONS TO CANDIDATES

Answer **all** questions in Section A and any **one** question in Section B

INFORMATION TO CANDIDATES

i) Questions can be answered in any order.

ii) All questions in **SECTION B** carry **24** marks each.

iii) This paper contains **Six** questions.

SECTION A

QUESTION 1

A debenture has a face value of $1 000, a coupon rate of 25% per annum, 15 years to maturity and a yield 20% per annum. What is the value of the debenture? Is the debenture selling at a premium, discount or at par?

a) A firm is about to issue preference shares with a par value of $1 000 and a coupon dividend rate of 20% per annum. If the required rate of return for such preference shares on the market is 25% per annum, how much is the value of the preference shares?

[2 Marks]

b) A company has just paid a dividend of 295 cents. The dividend growth rate has been maintained at 8% per annum. The required rate of return on the stock is 15%. What is the value of the stock? **[4 Marks]**

d) Valuation is being done for C (Pvt) (Ltd) an unlisted firm. An extract of information from the firm's profit and loss account and balance sheet shows the following:

Net income	$12 500 000
Dividends paid	$ 3 000 000
Number of shares issued	20 000 000
Price/Earnings (P/E) ratio	2.5

Calculate the following for C (Pvt) Ltd:

i) Earnings per share, **[2 Marks]**
ii) Price per share, **[2 Marks]**
iii) Dividend per share. **[2 Marks]**
iv) Value of the firm, **[2 Marks]**
v) Value of the firm if the P/E ratio was 4 instead of 2.5 **[2 Marks]**

QUESTION 2

a) What is the yield on the preference shares if they are trading at $280, and the dividend payable yearly is 80 cents? **[2 Marks]**

b) If a firm has a beta of 1.5 the market rate of return is 25%, and the risk free rate is 15%. What is the cost of equity? **[3 Marks]**

c) A firm considers its long-term objective to be financed by 30% debt, 10% preference shares, and 60% equity. The firm has an after tax cost of debt of 10%, a cost of preference shares of 22% and a cost of equity of 25%.
Calculate the Weighted Average Cost of Capital (WACC). **[5 Marks]**

QUESTION 3

A Ltd and B Ltd are similar companies in the same industry and enjoying the same market. The following information relates to these two companies:

	A Ltd		B Ltd
	$		$
Ordinary share capital ($1 shares)	10 000		20 000
10% Debentures		10 000	-
Capital Employed (CE)		20 000	20 000

For both companies, Earnings before interest and tax (EBIT) is 30% of Capital employed and tax rate is 30%. Further, both companies distribute as dividends all their net earnings

Required:

a) For each company, calculate the following:

i) Earnings before interest and tax (EBIT) [2 Marks]
ii) Earnings after tax (EAT) [4 Marks]
iii) Earnings per share (EPS) [2 Marks]
iv) Dividend per share (DPS) [2 Marks]

b) Assuming you hold 1 000 shares in each of the companies, how much dividend would you receive from each company? What action would you take if the current earnings by the two companies are likely to be maintained in the foreseeable future.
Give reasons for your proposed action. [6 Marks]

QUESTION 4

An investor is considering the following two investments A and B:

Probability	Return on A	Return on B
0.25	15%	18%
0.15	24	20
0.30	21	12
0.20	5	22
0.10	12	8

Required:

a) For each investment, calculate the following:
   i) Expected return [2 Marks]
   ii) Variance [8 Marks]
   iii) Standard deviation [2 Marks]
   iv) Coefficient of variation [2 Marks]
   v) Covariance [6 Marks]
   vi) Correlation coefficient [2 Marks]

b) Which investment is preferable? Give reasons for your answer. [3 Marks]

c) Assuming you create portfolio AB made up of 40% of A and 60% 0f B, what would be the expected return and standard deviation of this portfolio? [5 Marks]

SECTION B

Answer one question in this section.

QUESTION 5

(a) What is the role of a financial manager in an organization? [6 Marks]

(b) Explain the agency problem in financial management. [9 Marks]

(c) How best can shareholders deal with problems of agency relationships? [9 Marks]

QUESTION 6

Discuss each of the following dividend policy theories and explain their applicability in Zimbabwe:

(a) The Dividend Relevance Theory, [8 Marks]

(b) The Dividend Irrelevance Theory, [8 Marks]

(c) The Residual Theory of Dividends. [8 Marks]

END OF EXAMINATION