

**NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE
DEPARTMENT OF BUSINESS MANAGEMENT**

Diploma in Management

FINANCIAL MANAGEMENT

FINAL EXAMINATION

MDP 1003

JANUARY 2008

TIME 3 HOURS

INSTRUCTIONS TO CANDIDATES

Answer any **four** questions

Start the answer to each full question on a fresh page

INFORMATION FOR CANDIDATES

The number of marks is given in brackets [] at the end of each question or part question.

Workings should be shown.

You may use a calculator.

The businesses in this question paper are intended to be fictitious.

This paper consists of 4 printed pages

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QUESTION 1

- (a) Briefly explain what the function of financial management involves in a large organization. [4]
- (b) How does wealth maximization differ from profit maximization? [8]
- (c) Identify and explain solutions to agency problems that organizations can adopt. [13]

QUESTION 2

- (a) Below is an extract from Titfombe plc's annual report.

December	2006	2007
	\$'000	\$'000
Profit after tax	300 000	298 000
Taxation	120 000	119 200
Attributable earnings	180 000	178 800
Retained earnings	80 000	78 100
Number of shares in issue	300 million	300 million
Share price (cents)	200	250

From the above information calculate:

- (i) The total annual dividend for the two years. [4]
- (ii) The dividend per share. [2]
- (iii) The dividend yield for 2007. [4]
- (iv) The payout ratio for the two years. [3]
- (v) The dividend cover for 2006. [2]

- (b) Discuss major factors affecting the dividend decision in large corporate bodies. [10]

QUESTION 3

- (a) From the following information of Kwantu plc, calculate the current ratio and acid test ratio for both years.

(\$ thousands)	2006	2007
Cash and equivalents	21 904	32 203
Short-term investments	15 292	22 976
Current receivables	38 682	46 319
Inventories	20 000	25 000
Total current assets	95 878	84 667
Current Liabilities	52 533	59 687

[8]

(b) Explain the limitations of ratios in analyzing and interpreting financial statements. [9]

(c) Describe standards for comparisons used in analysis of financial statements. [8]

QUESTION 4

Having prepared the budget for 2008, the Directors of Webb plc are concerned with the company's profitability. They are considering the acquisition of a new machine for improving efficiency of production. The new machine must earn a return of at least 12%.

The Directors have to choose between two machines: the Provost and the Dean. The following data is available for the Provost and the Dean:

	Provost	Dean
Purchase price	\$36 000	\$50 000
Annual cost savings	\$10 000	\$13 000
Estimated useful life	5 years	5 years
Estimated disposal proceeds	\$3 000	\$5 000

Discounting Factors:

	12%	16%
Year 1	0.893	0.862
2	0.797	0.743
3	0.712	0.641
4	0.636	0.552
5	0.567	0.476

(a) To help the Directors make their choice of a new machine, calculate **separately** for the Provost and the Dean models:

- (i) The payback period
- (ii) The net present value [10]

(b) Which model would you advise the Directors to purchase, and why? [5]

(c) Evaluate the merits and limitations of the payback period. [10]

QUESTION 5

(a) Explain why Cash Flow Statements are important in an organization. [6]

(b) From the following information relating to year 2007, calculate the net cash flow from operating activities:

	\$'000
Operating profit	1 300
Depreciation of tangible non-current assets	200
Amortization of intangible assets	50
Profit on sale of non-current assets	7
Increase in inventories	400
Increase in receivables	200
Increase in payables	100
Increase in Debentures (2010/2015)	1 000
Proceeds from sale of non-current assets	23

[7]

(c) How much would a company issuing 1 350 000 000 ordinary shares of \$0.25 each receive if all shares are sold at a premium of \$0.05 each?

[2]

(d) What advantages would the company in part (c) above enjoy if it issues these share as bonus shares?

[4]

(e) Calculate the value of a share whose dividend is expected to grow constantly at 5%, if the current dividend is \$13 per share, and the expected market return on similar shares is 11%. Would you buy this share if on the Stock Exchange it is selling at \$225?

[6]

QUESTION 6

(a) Using the Capital Asset Pricing Model, calculate the expected return on a stock whose beta is 0.8, if government bonds pay 7% while similar stocks yield 13%.

[4]

(b) Calculate the expected return and standard deviation of a portfolio comprising the following assets:

	Asset A	Asset B
Investment in individual asset	\$4 million	\$6 million
Expected return	28%	23%
Standard deviation	7.89%	6.58%

The covariance of returns on Asset A and Asset B is 76. [8]

(c) With the aid of clear graph, explain the difference between diversifiable risk and non-diversifiable risk. [8]

(d) Why would rational investors select investment portfolios of assets whose returns are strongly negatively correlated instead of strongly positively correlated? [5]