National University of Science and Technology

Think in Other Terms

FACULTY OF COMMERCE

DEPARTMENT OF FINANCE

MASTER OF SCIENCE IN FINANCE AND INVESTMENT

FINAL EXAMINATION – OCTOBER 2015

FINANCIAL STATEMENT ANALYSIS AND PLANNING (CFI 5101)

TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDITATES

1. Answer **QUESTION ONE** and any other **THREE** questions. .
2. Start the solution to each full question on a fresh page of the answer book.
3. All questions carry equal **25 MARKS**.
4. Questions may be written in any order, but must be legibly numbered.
5. Write legibly.

QUESTION 1 (Compulsory)

Pauline ltd, a public limited company, has prepared its financial statements for the year ended 31 October 2013 and 2014. The following information relates to those financial statements.

	2014 $000 000	2013 $000 000
Group revenue	500	402
Gross profit	90	70
Profit from operations	20	18
Profit before taxation	24	16
Net profit for the period	10	8
Non-current assets	84	72
Current assets	110	86
Current liabilities	50	48
B&B-term loans	26	18
Capital and reserves	118	92

The company expects to achieve growth in retained earnings of about 20% in the year to 31 October 2013. Thereafter retained earnings are expected to accelerate to produce growth of between 20% and 25%. The growth will be generated by the introduction of new products and business efficiencies in manufacturing and in the company's infrastructure.

Pauline Ltd manufactures products from aluminium and other metals and is one of the largest producers in the world. Production for 2013 increased by 18% through the acquisition of a competitor company, increased production at three of its plants and through the regeneration of old plants. There has been a recent growth in the consumption of its products because of the substitution of aluminium for heavier metals in motor vehicle manufacture. Cost reductions continued as a business focus in 2013 and Pauline Ltd has implemented a cost reduction programme to be achieved by 2014.

In the period 2013 to 2014 Pauline Ltd expects to spend around $40 million on research and development and investment in non-current assets. The focus of the investments will be on enlarging the production capabilities. An important research and development project will be the joint project with a global car manufacturer to develop a new aluminium alloy car body.

The directors of Pauline Ltd have attempted to minimise the financial risk to which the group is exposed. The company operates in the global market place with the inherent financial risk that this entails. The management have performed a sensitivity analysis assuming a 10% adverse movement in foreign exchange rates and interest rates applied to hedging contracts and other exposures. The analysis indicated that such market movement would not have a material effect on the company's financial position.

Pauline Ltd has a reputation for responsible corporate behaviour and sees the work force as the key factor in the profitable growth of the business. During the year the company made progress towards the aim of linking environmental performance with financial performance by reporting the relationship between the eco-productivity index for basic production, and water and energy costs used in basic production. A feature of this index is that it can be segregated at site and divisional level and can be used in the internal management decision-making process.

The directors of Pauline Ltd are increasingly seeing their shareholder base widen with the result that investors are more demanding and sophisticated. As a result, the directors are uncertain as to the nature of the information which would provide clear and credible explanations of corporate activity. They wish their annual report to meet market expectations and not just the basic requirements of company law. They have heard that many companies deal with three key elements of corporate activity, namely reporting business performance, the analysis of the financial position, and the nature of corporate citizenship, and have asked your firm's advice in drawing up the annual report.

Required:

Prepare the annual report to the share holders of Pauline Ltd for the year ended 31 October 2014 setting out the following

(a) Business performance **(8 Marks)**
(b) Financial position analysis of the company **(9 Marks)**
(c) Risk analysis of the company **(8 Marks)**

QUESTION 2

(a) Anotida Ltd's year end is 31 December. The following transactions in shares took place during the year ended 31December 2012:

1 January ordinary shares in issue	1,000,000
1 April 100,000 shares issued	100,000
1 May 200,000 shares issued	200,000
1 Dec 10,000 shares repurchased	(10,000)
As at 31 December	1,290,000

Required:

Calculate the Weighted Average number of Ordinary shares outstanding.

(15 Marks)

(b) Windy ltd had at 31 December 2012 the following

An issued capital of 1 000 000 ordinary shares of 50c each nominal value.

Post tax earnings $1 150 000

Convertible 8% preference shares of $ 1 totaling 1000 000 convertible at one ordinary share for every 5 convertible preference share

Required:

Calculate basic earnings per share and diluted earnings per share.

(10 Marks)

QUESTION 3

River ltd is a listed manufacturing company, is considering a takeover bid for Rimuka ltd ,a smaller unlisted company in the same industry. Rimuka ltd has been making losses for the past 2 years, so it is considered that an asset based valuation should be used to value the business.

Extracts from Rimuka ltd financial statistics	**$ (000)**
Plant, property equipment (Ppe note 1)	1,207
Current assets	564
Total	**1,771**
Equity and liabilities	
Share capital $1	100
Retained earnings	553
Bonds	600
Current liabilities	518
Total	**1,771**

The non- current assets comprise specialised manufacturing equipment. To replace the equipment would cost $1,500 000 but if ribbon were to be closed down, the assets would sell for no more $1,000 000.

Receivables contain an amount of $120 000 from a large customer which has gone into liquidation. A contractor for the same customer, included in work in progress (inventory) at a value of $30 000 will now have to be scrapped.

Required:

Calculate the expected valuation of Rimuka ltd, from the perspective of River ltd. Explain and justify your figures. **(25 Marks)**

QUESTION 4

Chemuka ltd. financial position on 31st December 2014

	$
	(000 000)
Assets	
Non-current assets	
Property, plant and equipment (book values)	4,900
Current assets	
Inventories	160
Receivables	3,750
Cash	288
Total	**9,098**
Equity and liabilities	
Equity	
Share capital and reserves	3,418
Non-current liabilities	
Loan stock	2,700
Current liabilities	2,980
Total	**9,098**

- Chemuka ltd. has 400 million shares currently trading at $ 25.00 per share

• Replacement cost as per the current market value for the tangible assets is

$ 5,800 million

• The pre-tax return on the book value for Chemuka ltd's tangible assets 13% while the industry average is 16%

• The cost of capital for Chemuka ltd. is 15%

• The current tax rate is 30%

• A similar company's tangible non-current assets have a value of $7,400 million while its intangible assets have a value of $ 1,540 million.

Required:

Calculate the value of intangible assets using all the 3 methods. **(25 Marks)**

QUESTION 5 (25 Marks)

Elaborate on the various sources of synergies available in business and clearly state the pros and cons of each type of synergy selected. **(25 Marks)**

END OF EXAMINATION QUESTION PAPER