



ZIMBABWE EZEKIEL GUTI UNIVERSITY

FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTING

DEPARTMENT OF ACCOUNTING AND FINANCE

EXAMINATION PAPER

COURSE CODE : CAC 209
COURSE TITLE : FINANCIAL MANAGEMENT
SPECIAL REQUIREMENTS : NONE
DURATION : 3 Hours
LEVEL : 2.2
DATE : 03 OCT 2022

INSTRUCTIONS TO CANDIDATES:

1. No cell phones are allowed in the examination venue
2. Use of silent, non-programmable calculators is allowed
3. Answer ALL questions in both Section A and Section B.
4. Begin each question on a new page.
5. The number of marks for each question or part question is shown in brackets []

SECTION A

Answer all questions in this section. Each question carries 2 marks.

Select the most appropriate answer

1. The 3 main areas of the business that Finance Managers plan are:

- A. Investments, Financing & Profitability.
- B. Dividend Policy, Financing & Investments.
- C. Return on Capital, Investments, and Profitability.
- D. Earnings per share, Profitability, Maximising shareholder wealth

2. The Agency problem exists because...

- A. Managers may be interested in maximising their own earnings.
- B. Shareholders have to rely on management to safeguard the assets of the business.
- C. Managers may be interested in short term gains over long term stability.
- D. All of the above.

3. The following financial information relates to an investment project:

	\$'000
Present value of sales revenue	50,025
Present value of variable costs	<u>25,475</u>
Present value of contribution	24,550
Present value of fixed costs	<u>18,250</u>
Present value of operating income	6,300
Initial investment	<u>5,000</u>
Net present value	<u>1,300</u>

What is the sensitivity of the net present value of the investment project to a change in sales volume?

- A 7.1%
- B 2.6%
- C 5.1%
- D 5.3%

4. Which of the following statements concerning capital structure theory is correct?

- A. In the traditional view, there is a linear relationship between the cost of equity and financial risk
- B. Modigliani and Miller said that, in the absence of tax, the cost of equity would remain constant.
- C. Pecking order theory indicates that preference shares are preferred to convertible debt as a source of finance
- D. Business risk is assumed to be constant as the capital structure changes

5. Which of the following actions is LEAST likely to increase shareholder wealth?

- A. The weighted average cost of capital is decreased by a recent financing decision
- B. The financial rewards of directors are linked to increasing earnings per share
- C. The board of directors decides to invest in a project with a positive NPV
- D. The annual report declares full compliance with the corporate governance code

6. The following are extracts from the statement of profit or loss of OK Co:

	\$'000
Sales income	60,000
Cost of sales	<u>50,000</u>
Profit before interest and tax	10,000
Interest	<u>4,000</u>
Profit before tax	6,000
Tax	<u>4,500</u>
Profit after tax	<u>1,500</u>

60% of the cost of sales is variables costs.

What is the operational gearing of OK Co?

- A 5.0 times
 - B 2.0 times
 - C 0.5 times
 - D 3.0 times
7. You will receive an amount of \$1 700 eight (8) years from now. However, if you could receive the amount right now and invest it, you would be able to earn 8% interest per annum on the amount.

What would the amount be worth if you could receive it now instead of waiting for eight year?

- A. \$ 819
 - B. \$918
 - C. \$1564
 - D. \$1700
8. Combining negatively correlated assets having the same expected return results in a portfolio with _____ level of expected return and _____ level of risk
- A. The same, lower
 - B. The same, higher
 - C. A higher, a lower
 - D. A lower, a higher

9. Kudu Chemical's ordinary share is currently trading for R25 per share. The stock is expected to pay a \$2, 50 dividend at the end of the year and Kudu Chemical's cost of equity is 14%. If the dividend pay-out rate is expected to remain constant:

What is the expected growth rate in Kudu Chemical's earnings?

- A. 2,00%
 - B. 4,00%
 - C. 6,00%
 - D. 8,00%
10. The _____ the coefficient of variation, the _____ the risk
- A. More stable, higher
 - B. Higher, lower
 - C. Lower, higher
 - D. Lower, lower

[Total 20marks]

SECTION B

Answer all questions in this section

Question One

Zimchoice, an unquoted manufacturing company, has been experiencing a growth in demand, and this trend is expected to continue. In order to cope with the growth in demand, the company needs to buy further machinery and this is expected to cost 30% of the current company value.

In the past, a high proportion of earnings have been distributed by way of dividends so few cash reserves are available. 51% of the shares in Zimchoice are still owned by the founding family. A decision must now be taken about how to raise the funds.

The firm has already raised some loan finance and this is secured against the company land and buildings.

Required

- a) Suggest the issues that should be considered by the board in determining whether debt would be an appropriate source of finance. [20marks]
- b) Explain Diversifiable and Non-Diversifiable risk [10marks]

[Total 30marks]

Question Two

- a) There is only one optimum capital structure for every firm, which when maintained enhances the value of the firm' Discuss. [15marks]
- b) Explain the roles of the financial manager [10marks]

[Total 25marks]

Question Three

Zimgold, a large stock-exchange-listed company, is evaluating an investment proposal to manufacture Product ZW, which has performed well in test marketing trials conducted recently by the company's research and development division. Product ZW will be manufactured using a fully-automated process which would significantly increase noise levels from Zimgold Company's factory. The following information relating to this investment proposal has now been prepared:

Initial investment	\$2 million
Selling price (current price terms)	\$20 per unit
Expected selling price inflation	3% per year
Variable operating costs (current price terms)	\$8 per unit
Fixed operating costs (current price terms)	\$170,000 per year
Expected operating cost inflation	4% per year

The research and development division has prepared the following demand forecast as a result of its test marketing trials. The forecast reflects expected technological change and its effect on the anticipated life-cycle of Product ZW.

Year	1	2	3	4
Demand (units)	60,000	70,000	120,000	45,000

It is expected that all units of Product ZW produced will be sold, in line with the company's policy of keeping no inventory of finished goods. No terminal value or machinery scrap value is expected at the end of four years, when production of Product ZW is planned to end. For investment appraisal purposes, Zimgold Company uses a nominal (money) discount rate of 10% per year and a target return on capital employed of 30% per year. Ignore taxation.

Required:

(a) Calculate the following values for the investment proposal:

- (i) Net present value; [5 marks]
- (ii) Internal rate of return; and [3 marks]
- (iii) Return on capital employed (accounting rate of return) based on average investment. [3marks]

(b) Briefly discuss your findings in each section of (a) above and advise whether the investment proposal is financially acceptable. [4 marks]

(c) Discuss how the objectives of Zimgold company's stakeholders may be in conflict if the project is undertaken. [5 marks]

(d) Explain any other capital budgeting technique you would recommend to the management of Zimgold [5 marks]

[Total 25marks]

END OF EXAMINATION QUESTION PAPER