



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
DURATION : 3 Hours
DATE : 19 NOV 2019

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.
4. Each question carries 25 marks.
5. Begin each question on a new page.
6. The number of marks for each question or part question is shown in brackets.

Question One

Part A

1. "The wealth maximization objective provides an operationally appropriate decision criterion" – Analyse the statement. (4 marks)
2. Discuss the arguments levelled against profit maximization objective. (3 marks)

Part B

The management of Flocks is trying to decide which of two machines to purchase, to help with production. Only one of the two machines will be purchased.

Machine X costs \$63,000 and machine Y costs \$110,000. Both machines would require a working capital investment of \$12,500 throughout their operational life, which is four years for machine X and six years for machine Y. The expected scrap value of either machine would be zero.

The estimated pre-tax operating net cash inflows with each machine are as follows:

<i>Year</i>	<i>Machine X</i>	<i>Machine Y</i>
	\$	\$
1	25,900	40,300
2	28,800	32,900
3	30,500	32,000
4	29,500	32,700
5	–	48,500
6	–	44,200

With machine Y, there is some doubt about its design features, and consequently there is some risk that it might prove unsuitable. Because of the higher business risk with machine Y, the machine Y project cash flows should be discounted at 15%, whereas machine X cash flows should be discounted at only 13%.

Flocks intends to finance the machine it eventually selects, X or Y, by borrowing at 10%.

Tax is payable at 30% on operating cash flows one year in arrears. Capital allowances are available at 25% a year on a reducing balance basis.

Required:

For both machine X and machine Y, calculate:

- (i) The (undiscounted) payback period (4 marks)
- (ii) The net present value and (12 marks)
- (iii) Recommend which of the two machines Flocks should purchase. (2 marks)

[Total: 25 marks]

Question Two

Part A

- i. Discuss the factors that influence investment decisions. (2 marks)
- ii. Under what circumstances do the net present value (NPV) and internal rate of return (IRR) methods differ? Which method would you prefer and why?(4 marks)
- iii. Do the NPV and Profitability Index (PI) always lead to the same investment decision? Discuss (2 marks)

Part B

- 1) If you wish to accumulate \$140,000 in 13 years, how much must you deposit today in an account that pays an annual interest rate of 14%? (2 marks)
- 2) What will \$247,000 grow to be in 9 years if it is invested today in an account with an annual interest rate of 11%? (2 marks)
- 3) How many years will it take for \$136,000 to grow to be \$468,000 if it is invested in an account with an annual interest rate of 8%? (4 marks)
- 4) At what annual interest rate must \$137,000 be invested so that it will grow to be \$475,000 in 14 years? (4 marks)
- 5) If you wish to accumulate \$197,000 in 5 years, how much must you deposit today in an account that pays a quoted annual interest rate of 13% with semi-annual compounding of interest? (5 marks)

[Total: 25 marks]

Question Three

Case scenario – Fast-Jet takes off to 342c share price

Fast-Jet, Africa's largest low-cost airline, saw its share price rise strongly on its first day of trading as a public limited company, rising 10% to \$3.42. The offering was priced at \$3.10 a share with the issue of 63 million shares raising \$195 million. The issue, solely to institutional investors, represented about 25% of the enlarged share capital. The stake held by Georgiana, founder and chairwoman of the company, was valued at about \$328 million. Mrs. Georgiana and her brother and sister still control about 75% of Fast-Jet.

Investment bankers said the issue attracted strong interest. The performance of the shares had been helped by the strong rise of Ethopair, the leading African low-cost airline, which has been used by investors as a yardstick for the Fast-Jet offering. Fast-Jet shares have also proved attractive because the company has seen its passenger numbers rise markedly over previous years. Capital raised from the share issue is earmarked to support the purchase of new aircraft as part of the group's plans for a rapid expansion during the next few years, which includes the addition of 32 new Boeing 737-700s, more than doubling the size of the fleet.

Required:

- 1) Define the terms:
 - a. Public limited company (2 marks)
 - b. Share price (2 marks)
- 2) Outline two possible sources of long-term finance available to Fast-Jet. (6 marks)
- 3) Explain why an expansion in Fast-Jet's passenger numbers has increased the need for short-term and long-term finance. (6 marks)
- 4) Evaluate the view that Fast-Jet's decision to raise long-term finance by selling shares is preferable to raising it through borrowing. (9 marks)

[Total: 25 marks]

Question Four

Part A

Your client is planning to invest in a portfolio of investments. Details are as follows:

Investment 1

Investment of \$300,000 in Cape Verde property, from which expected annual returns are as follows:

Annual Investment Return	Probability of Occurrence
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-20%	0.5
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40%	0.5
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Investment 2

Investment of \$700 000, in a London Alternative Investment Market (AIM); an equity index fund for a minimum five year period. The fund provides a guarantee against capital erosion and its expected annual returns are as follows:

Annual Investment Return	Probability of Occurrence
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8%	0.9
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12%	0.1
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The co-efficient of correlation between the two investments is calculated at - 0.2.

Required:

- Explain the terms systematic risk and unsystematic risk. **(3 marks)**
- Compare the expected return and the risk of the two proposed investments. **(5 marks)**
- Calculate the expected return and risk from your client's proposed portfolio. **(5 marks)**

Part B

“Preference shares are a hybrid of debt and equity and contain the best features of each as far as the issuing company is concerned. It follows that companies should make extensive use of preference shares for their long-term financing requirements” Discuss **(12 marks)**

[Total: 25 marks]

END OF EXAMINATION