



ZIMBABWE EZEKIEL GUTI UNIVERSITY

FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTING

DEPARTMENT OF ACCOUNTING AND FINANCE

EXAMINATION PAPER

COURSE CODE : CAC 406
COURSE TITLE : INVESTMENT AND PORTFOLIO MANAGEMENT
DURATION : 3 Hours
SPECIAL REQUIREMENTS : Non- programmable Calculator
DURATION : 3 Hours
LEVEL : ⁴19¹ NOV 2019
DATE :

INSTRUCTIONS TO CANDIDATES:

1. No cell phones are allowed in the examination venue.
2. Answer all the **FOUR (4)** questions
3. Begin each question on a new page.
4. The number of marks for each question or part question is shown in brackets []

Question 1

- a) What information is necessary before a financial planner can assist a person in constructing an investment policy statement? (9 marks)
- b) What are the advantages of investing in the common stock, rather than the corporate bonds of a company? (4 marks)
- c) 'Young people with little wealth should not invest money in risky assets such as the stock market because they cannot afford to lose the little money that they have.' Explain why you agree or disagree with this statement? (7 marks)
- d) Discuss the key considerations important in determining a dividend policy in a firm in the communication industry in Zimbabwe. (5 marks)

[Total: 25 marks]

Question 2

Zimbo Plc is an oil exploration company. The recently completed Statement of Financial Position of Zimbo Plc is shown below:

Statement of financial position as at 30 April, 2011

	\$'000	\$'000
Non-current assets		8,200
Current assets	15,580	
Amounts falling due within a year: Creditors		
	(10,906)	
Net current assets		4,674
Total net assets		12,874
Less: long-term liabilities		
Creditors (note 1)		(5,300)
Net assets		7,574
Equity and liabilities		
Called up share capital(note2)		2,200
Retained earnings		5,374
		7,574

The following information is also relevant:

- 1) The company has in issue two categories of long term debt:
 - a. 8% five-year Debentures with a par value of \$2,100,000, which were issued on April 30th 2003. These Debentures currently have a market value of \$105 per \$100 par value (ex-interest).
 - b. 5% irredeemable loan stock which has a par value of \$3,200,000 and is currently trading at \$76 per \$100 par value (ex-interest).
- 2) The company's share capital comprises of ordinary shares which have a par value of 50c and a market value of \$3.50 (ex-div.). There have been no changes in the amount of issued share capital in the last 10 years.
- 3) The company received annual earnings before interests and tax for the year ended 30th April 2004 of \$4 million.
- 4) Zimbo Plc has a dividend policy of distributing 40% of its earnings, which results in dividend growth of 6% per annum.
- 5) The company is subject to corporation tax at the rate of 30%.
- 6) The government is currently offering grants and subsidized loans to encourage companies to invest in alternative forms of energy production such as wind farms (windmills that are used to generate electricity). The directors of Zimbo Plc are therefore evaluating capital investments of this type.

Required:

- a) Estimate the weighted average cost of capital (WACC) of Zimbo Plc. For calculation of the redemption yield use 3% and 5% as your discount rates. **(18 marks)**
- b) Discuss the limitations of using the dividend valuation model by Zimbo Plc in determining the discount rate for a project to construct a wind farm. **(7 marks)**

[Total: 25 Marks]

Question 3

X Plc and Y Plc are two companies in the same markets with identical levels of business risk. The two companies have different capital structures in that the former has an all equity structure whilst the latter is geared. You are given the following information:

	X Plc	Y Plc
	\$	\$
Annual dividends	180,000	100,000
Annual interest	-	*80,000
Total annual cash earnings	180,000	180,000

Total market value of equity	1,800,000	500,000
Total market value of debt	-	1,000,000
Total market value	1,800,000	1,500,000

Assume that the capital market is perfect with no taxation and no transactions costs; the markets in the shares of X and in debt of Y are in equilibrium.

Required:

- a) Assume that Mr M owns shares with a market value of \$10,000 in both companies. Demonstrate how Mr M can improve his financial position whilst keeping his current level of financial risk the same. Explain the concepts underlying the operations.

(12 marks)

- b) Demonstrate that in equilibrium Y's cost of equity can be estimated by the formula:

$$K_e = K_o + (K_o - K_d)D/E.$$

(4 marks)

- c) Critically discuss the argument by Miller and Modigliani that there is no optimal capital structure.

(9 marks)

[Total: 25 marks]

Question 4

- a) Discuss the variables that determine the amount of working capital needed in an organisation? **(5 marks)**
- b) Explain the factors that will reduce the length of the working capital cycle? **(5 marks)**
- c) Explain factors that must be considered in determining the minimum stock level of raw materials? **(5 marks)**
- d) List the possible causes of an increase in stock levels? **(5 marks)**
- e) What possible steps can a company take to improve its cash flow? **(5 marks)**

[Total: 25 marks]

*****END OF PAPER*****