

ZIMBABWE EZEKIEL GUTI UNIVERSITY



**DEPARTMENT OF BUSINESS STUDIES
B. COM ENTREPRENEURSHIP**

COURSE: BUSINESS FINANCE

COURSE CODE: CBM 204

4 DECEMBER 2018

DURATION: 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. No cell phones are allowed in the examination venue.
2. Answer **ALL FOUR** questions
3. Begin each question on a new page.
4. The number of marks allocated to each question or part question is shown in brackets
5. Hand-held, self-powered, non-programmeable, silent calculators are allowed into the examination.

Question 1

Part A

1. Critically discuss the objectives of financial management, clearly bringing out the main objective. (5 marks)
2. Discuss the role of a finance manager. (3 marks)

Part B

Tan Ltd, a multi-product company, is considering four investment projects, details of which are given below. Development costs already incurred on the projects are as follows.

A	B	C	D
\$	\$	\$	\$
100,000	75,000	80,000	60,000

Each project will require an immediate outlay on plant and machinery, the cost of which is estimated as follows.

A	B	C	D
\$	\$	\$	\$
2,100,000	1,400,000	2,400,000	600,000

In all four cases the plant and machinery has a useful life of five years at the end of which it will be valueless. Unit sales per annum, for each project, are expected to be as follows.

A	B	C	D
150,000	75,000	80,000	120,000

Selling price and variable costs per unit for each project are estimated below.

	A	B	C	D
	\$	\$	\$	\$
Selling price	30.00	40.00	25.00	50.00
Materials	7.60	12.00	4.50	25.00
Labour	9.80	12.00	5.00	10.00
Variable overheads	6.00	7.00	2.50	10.50

The company charges depreciation on plant and machinery on a straight line basis over the useful life of the plant and machinery. Development costs of projects are written off in the year that they are incurred. The company apportions general administration costs to projects at a rate of 5% of selling price. None of the above projects will lead to any actual increase in the company's administration costs. Working capital requirements for each project will amount to 20% of the expected annual sales value. In each case this investment will be made immediately and will be recovered in full when the projects end in five years' time. Funds available for investment are limited to \$5,200,000. The company's cost of capital is estimated to be 18%.

Required:

- (i) Calculate the NPV of each project. (12 marks)
- (ii) Calculate the profitability index (P.I) for each project and advise the company which of the new projects, if any, to undertake. You may assume that each of the projects can be undertaken on a reduced scale for a proportionate reduction in cash flows. Your advice

should state clearly your order of preference for the four projects, what proportion you would take of any project that is scaled down, and the total NPV generated by your choice (5 marks)
[Total: 25 marks]

Question 2

Part A

Consider the information below relating to the annual rates of return for two companies X and Y over a period of 4 years:

Year	X	Y
	Rate of return %	Rate of Return %
1	-4.76	-4.75
2	5.34	7.65
3	12.09	6.98
4	-2.98	9.65

Required:

Calculate the mean return and covariance of returns per year between the two companies.
 (5 marks)

Part B

- 1) Define the following terms:
 - a) Financial statement (2 marks)
 - b) Financial statement analysis (2 marks)
 - c) Ratio analysis (2 marks)
 - d) Differentiate between fund flow and cash flow (4 marks)

2) Below are the XY Ltd Statement of Financial Position extracts:

	2016 (\$000)	2017 (\$000)
Share Capital + reserves		
Ord shares @\$1	250	250
8% Preference	50	50
G/reserve	30	80
Retained income	<u>26</u>	<u>50</u>
	356	430
12% debentures	<u>40</u>	<u>120</u>
	396	550

Statement of Profit or Loss and Other Comprehensive Income extract:

	2016	2017
	(\$000)	(\$000)
retained income BIT	133	200
Interest payable	-5	-15
Retained income before tax	128	185
Taxation	<u>-47</u>	<u>-57</u>
Retained income after tax	81	128
Pref dividend	-4	-4
Ordinary dividend	25	50
Transfer to general reserve	-30	-24
Retained income for the year	<u>22</u>	<u>24</u>

	2016	2017
Retained income b/fwd	4	26
Retained income c/fwd	26	50

Required:

Calculate the following ratios and comment on the performance of XY Ltd:

- i) Earnings Per Share (EPS) ratio (3 marks)
- ii) Dividend cover (2 marks)
- iii) Price Earnings Ratio (PER) (3 marks)

[Total: 25 marks]

Question 3

- i) "In managing working capital the finance manager faces the problem of compromising the conflicting goals of liquidity and profitability". Comment. (5 marks)
- ii) Critically discuss the "conservative approach" and the "aggressive approach" to working capital financing. (5 marks)
- iii) Discuss the variables that determine the amount of working capital needed in an organisation? (5 marks)
- iv) Explain the factors that will reduce the length of the working capital cycle? (5 marks)
- v) Explain factors that must be considered in determining the minimum stock level of raw materials? (5 marks)

[Total: 25 marks]

Question 4

Part A

A 6-year RBZ bond with a nominal value of \$10 000 and a coupon rate of 9% is issued today, when the Yield To Maturity (YTM) required by investors is 9%.

Required:

Calculate the value of the bond. (6 marks)

Part B

A company has issued 10 million ordinary shares of \$1 each. Details of the company's earnings and dividends per share during the past four years are as follows:

<i>Year ended 31 December</i>	<i>Earnings per share</i>	<i>Dividend per share</i>
2008	35c	26c
2009	33c	27c
2010	43c	29c
2011(<i>estimated</i>)	42c	30c

The current (31 December 2011) market value of each ordinary share of the company is \$2.35 cum dividend. The 2011 dividend of 30c per share is due to be paid in January 2012.

Required:

- (i) Estimate the cost of capital for the company's ordinary share capital. (5 marks)
- (ii) "It is commonly accepted that a crucial factor in the financial decisions of a company, including the evaluation of capital investment proposals, is the cost of capital". Explain what is meant by cost of equity capital. (4 marks)

Part C

TBMF Ltd is considering two mutually exclusive projects X and Y. Project X costs \$5 million and will generate a net cash flow of \$2 million per year for four years. Project Y cost \$7 million and will generate a net cash flow of \$3 million per year for four years. The residual value of either project at the end of four years is expected to be 30% of cost. The depreciation deduction is 20% per year on a straight -line basis. The cost of capital is 11% and corporate tax rate is 28%.

Required:

Advise TBMF Ltd on the best project to invest in. (10 marks)

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