UNIVERSITY OF JOHANNESBURG

Department of Commercial Accounting

Cost and Financial Management 1B

CFM11B1

Last Assessment Opportunity
November 2014

Time: 3 hours **Marks: 100**

Assessors: Mrs L Boyce
Mrs L Pelcher
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Internal moderator: Mr R Boersma

INSTRUCTIONS:

- This paper consists of 12 pages (including the cover page) and 6 pages of formulas and tables.
- Answer all questions. Show all calculations and workings clearly.
- **Start each question on a new page**.
- Silent, non-programmable calculators may be used.
- Round all calculations to two decimal places, unless stipulated otherwise.
- **INDICATE YOUR INDEX NUMBER (FROM THE CLASS LIST) IN THE TOP MIDDLE OF YOUR SCRIPT.**

Question	Topic	Marks	Time
1	Multiple choice and the Financial management function	15	18 minutes
2	Basic financial instruments and financial markets	15	18 minutes
3	Risk and uncertainty	15	18 minutes
4	Time value of money	20	36 minutes
5	Cost of capital	20	36 minutes
6	Principle of foreign trade and exchange rates	15	18 minutes
		100	**180 minutes**

QUESTION 1	**(15 marks)**

1.1 Stakeholders of a company includes:

(i) Suppliers

(ii) Shareholders

(iii) Competitors

(iv) Employees

a. i, ii, iii.

b. ii, iii, iv.

c. i, ii, iv.

d. All of the above. **(1)**

1.2 Which ONE of the following is a "safeguard" provided by the Bond Exchange of South Africa to investors?

a. Regulation of the market in an orderly fashion.

b. Assists in ethics and dispute resolution.

c. Provides fidelity cover.

d. All of the options are correct. **(1)**

1.3 Financial risk consists of two elements. Which of the following is not one of the two elements?

a. Uncontrollable increases in the prices of oil, gold and petrol.

b. Insufficient cash to pay interest charges on debt.

c. Insufficient cash to pay principle amount of debt on due date.

d. None of the options are examples of financial risk. **(1)**

1.4 The required rate of return for the providers of capital is also known as the:

a. Cost of equity.
b. Cost of debt.
c. Cost of preference shares.
d. Cost of capital. **(1)**

1.5 An exchange rate is the cost of money charged by a lender to a borrower in exchange for the provision of money for a specified period of time.

a. True
b. False **(1)**

1.6 Identify what type of stakeholder each of the following is:

a) Supplier **(1)**
b) Management **(1)**
c) Local government **(1)**

1.7 Explain the agency theory. **(2)**

1.8 List two differences between financial management and financial accounting. Present your answer in the form of a table. **(4)**

1.9 Explain the financial manager's role in creating value in the company. **(1)**

QUESTION 2	**(15 marks)**

Formulae:

PE = MPS ÷ EPS

DY = DPS ÷ MPS

QUESTION 2.1

2.1 Name the main difference between the Over-the-Counter market and the formal financial market. **(1)**

QUESTION 2.2

2.2 When a company hasexcess cash, the financial manager may choose to invest the money. The financial manager faces many questions in enabling him to make a choice on how to invest the money.

There are three investment vehicles that a financial manager can consider when investing for a long period of time namely: Bonds, ordinary shares and preference share.

REQUIRED:

2.2.1 List 4 questions that the financial manager will ask when making an investment decision. **(4)**

2.2.2 List the three investment vehicles referred above in order **from high risk to low risk.** **(3)**

QUESTION 2.3

Use the information below to answer question 2.3.1 – 2.3.4 (extracted from the Business Report on 29 August 2014):

Name	Close (cents)	High	Low	Day move (cents)	Volume trade (000)	12m %	DY	PE
MASSMART	**13188**	**13694**	**13077**	**-251**	**343.086**	**-12.7**	**2.7**	**21.4**
MR PRICE	**20399**	**20789**	**20343**	**-263**	**386.058**	**70**	**2.0**	**26.7**
WOOLIES	**7906**	**7951**	**7850**	**153**	**4450.989**	**32.1**	**2.7**	**21.6**
ABIL*	31	-	-	-	-	-	-97.4	-0.1

REQUIRED:

2.3.1 State how many WOOLIES shares changed hands on 29 August 2014? **(1)**

2.3.2 Why is there an asterisk next to ABIL? **(1)**

2.3.3 Calculate the opening price of MASSMART. **(1)**

2.3.4 Name 4 factors that could influence share prices. **(4)**

QUESTION 3 **(15 marks)**

Question 3.1

Weather Ltd has surplus cash worth R10 000. They are considering investing in a portfolio. Two investment opportunities exist, Project Sunshine and Project Thunderstorm. Weather Ltd will invest R4 000 (40%) in project Sunshine and R6 000 (60%) in project Thunderstorm.

Projected future returns on these projects are as follows:

Year	Expected return project Sunshine	Expected return Project Thunderstorm
2014	17%	18%
2015	27%	10%
2016	33%	24%

REQUIRED:

Calculate the expected return of the portfolio for each period and the average for the three years. Round your answer off to two decimal places. **(11)**

Question 3.2

Sepp Blatter, an investor, wants to invest his prize money from winning the 2013 FIFA Champions League Season.

Knowing that the shares of Germany Ltd have been performing outstandingly for the past year, he decided to invest his entire prize money in this company. His investment advisor has, however, indicated that it is better to invest in a portfolio of shares instead of only one share. The advisor has provided him with the following options:

Possible portfolio	**Correlation Coefficient**
Germany Ltd plus Uruguay Ltd	+0.92
Germany Ltd plus Netherlands Ltd	-0.36
Germany Ltd plus Brazil Ltd	-0.15
Germany Ltd plus Argentina Ltd	-0.86

REQUIRED:

3.2.1 Explain to Sepp Blatter why his investment advisor has recommended a portfolio instead of investing in only one share. You should identify the term that describes this concept in your answer. **(2)**

3.2.2 Refer to the table above and advise Sepp Blatter on the best portfolio option. Give a motivation for your answer. **(2)**

QUESTION 4 **(20 marks)**

4.1 Mr Cook wants to invest R3 000 at the beginning of every year for the next 15 years at an interest rate of 8% p.a. compounded yearly. Calculate how much he will have after 15 years. Use the applicable **interest rate factor tables** and round your answer off to two decimal places. **(3)**

4.2 Calculate the nominal interest rate if the effective rate is 12,95% p.a. compounded monthly. Show all calculations and round your answer off to two decimal places. **(2)**

4.3 Bongile wants to invest her annual bonus for the next three years to help her save for an overseas holiday. Her employer has indicated that she will receive the following cash bonuses at the end of each year:

Year 1: R30 000
Year 2: R35 000
Year 3: R39 000

Calculate what her investment will be worth after three years if she receives an interest rate of 7% compounded annually. Use the applicable **interest rate factor tables,** show all calculations and round your answer off to two decimal places. **(4)**

4.4 Thabo wants to invest a lump sum amount at an interest rate of 22% compounded annually. Calculate the lump sum amount if he wants to receive R1 000 000 after 12 years. Use the **calculator**, show all calculations and round off to two decimal places. **(4)**

4.5 Kayla would like to take her daughter to Victoria Falls. She has estimated that she will need R40 000 and she will receive an interest rate of 15% p.a. compounded annually. Kayla is unsure if she should make the payment in the beginning or at the end of each year.

REQUIRED:

4.5.1 Calculate how much Kayla should start saving if she invests an amount at the end of each year for the next six years. Use the applicable **interest rate factor table** and round your answer off to two decimal places. **(2)**

4.5.2 Calculate how much Kayla should start saving if she invests an amount at the beginning of each year for the next six years. Use your **calculator,** show all calculations and round your answer off to two decimal places. **(5)**

QUESTION 5 **(20 marks)**

5.1 Explain the meaning of “Cost of Capital”. Give 3 possible definitions. **(3)**

5.2 Define the term “Return on Investment”. **(1)**

5.3 The following is an extract from the most recent financial statements of MAGNITO Ltd:

MAGNITO LTD

Statement of Financial Position at 31 December 2013	**R**
ASSETS	
Property, plant and equipment	600 000
Inventories	400 000
Trade and other receivables	10 000
Cash and cash equivalents	50 000
	1 060 000
EQUITY AND LIABILITIES	
Ordinary share capital	508 800
Preference share capital	212 000
Long-term liabilities	339 200
	1 060 000

Management expects the current capital structure to be maintained in the indefinite future.

The cost of ordinary shares has been calculated at 20.69%; preference shares at 12.06% and debentures at 7.70% (before tax). Assume a current tax rate of 28%. Assume market value equals book value.

REQUIRED:

5.3.1 Calculate MAGNITO Ltd’s after-tax weighted average cost of capital. **(12)**

5.4 Xavier Ltd is busy with the calculation of its cost of capital and they have requested your assistance. On investigation the following information has been provided. 10 000 ordinary shares were issued 10 years ago at a par value of R5. The risk-free rate is estimated at 6.2% and because of the high inflation rates and labour unrest, Xavier Ltd estimates their risk premium to be 14.3%. Last year Xavier paid out a dividend of 11.3%.

Xavier Ltd also has a long-term loan from ABC Bank reflected at a market value of R150 000 in its statement of financial position. The interest rate on similar loans is 10.5% per annum.

The tax rate is 28%.

REQUIRED:

5.4.1 Calculate Xavier Ltd's required rate of return on **Equity**. **(2)**

5.4.2 Calculate Xavier Ltd's cost of **Debt.** **(2)**

QUESTION 6 **(15 Marks)**

You are given the following Rand exchange information for the 8th of September 2014:

Table 6.1:
US$1 = R10.86
EUR€1 = R15.21

REQUIRED:

6.1 Explain what a 'direct quoted price' means? Provide the value of the direct quoted price for US$ from table 6.1. **(3)**

6.2 Explain what an 'indirect quoted price' means? Provide the value of the indirect quoted price for the EUR€ from table 6.1. **(3)**

6.3 Explain what a 'Rand hedge' company is. **(1)**

6.4 You would like to buy shares in Sasol. You have done some investment research and see that this specific share is currently trading at R640 per share on the JSE-market and also trading at $65 per share on the NYSE-market.

6.4.1 Explain the concept 'arbitrage'. **(2)**

6.4.2 Calculate the arbitrage opportunity that occurs in the above scenario. Show all calculations and round your answer off to two decimal places. **(4)**

6.5 Explain what the difference between 'bid rate' and 'offer rate' is. **(2)**

[TOTAL MARKS = 100]