UNIVERSITY OF JOHANNESBURG

**SUPPLEMENTARY EXAMINATION**

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| **PROGRAMME** | : | **SPORT MANAGEMENT HONS.** |
| **SUBJECT NAME** | : | **SPORT FINANCE** |
| **SUBJECT CODE** | : | **HMS 8X15 / SPB 11X7** |
| **DATE** | : | **10 JANUARY 2018** |
| **DURATION** | : | **180 MINUTES** |
| **TOTAL MARKS** | : | **150 MARKS** |

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| **EXAMINER** | : | **R. VAN GAALEN** |
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| **MODERATOR** | : | **MR K THOMAS** |
| **NUMBER OF PAGES** | : | **THIRTEEN (13) PAGES** |

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**INSTRUCTIONS TO CANDIDATES:**

**MAKE SURE THAT YOU HAVE THE COMPLETE QUESTION PAPER.**

**ANSWER ALL THE QUESTIONS**

## <u>QUESTION 1</u> [50 MARKS]

**REQUIRED:**

Answer the following questions by choosing the correct answer. Write the letter you have chosen as your answer next to the question number on your answer sheet.

A. The primary goal of a public company should be to: minimize the chance of losses
B. maximize the share price
C. minimize the debt used by the firm
D. maximize the expected earnings per share (2)

1.2 Identify which ONE of the following actions by a financial manager creates an agency problem?

A Granting a contract to a friend without considering other tenders.
B Investing in assets that will add value to the company.
C Agreeing to pay bonuses based on the market value of the company shares
D Increasing selling prices in order to increase the market value of the shareholders’ equity (2)

1.3 Identify which ONE of the following actions is not typically performed by a financial manager?

A managing financial accounting
B making financial decisions
C financial analysis and planning
D making investment decisions (2)

1.4 Identify <u>how many</u> of the following statements are correct?

- There are no legal requirements in the preparation of management accounts.
- The management accounts of various companies can easily be compared.
- Within Financial Management risk is fundamental.
- Within Financial Accounting information is generally expressed in quantitative terms.

A. One
B. Two
C. Three
D. All of the above statements are correct (2)

1.5 An extract from Charlie's Cash Budget is provided below:

| | Sept | Oct | Nov |
|---|---|---|---|
| | R'million | R'million | R'million |
| Total receipts | 220 | 245 | 245 |
| Total payments | 232 | 257 | 230 |
| Net receipts/ (payments) | (12) | (12) | 15 |
| | | | |
| Balance brought forward | 4 | (8) | (20) |
| Balance carried forward | (8) | (20) | (5) |

Which of the following overdraft facilities would you advise Charlie to request for the three months ended 30 November?

A No overdraft facility is required
B An overdraft a little over R5000 000 is required
C An overdraft a little over R8000 000 is required
D An overdraft a little over R20 000 000 is required (2)

1.6 Which of the following is not a stage in the budget process?

I Communication of budget policy details and guidelines to those people responsible for preparation of budgets
II Determination of the factors that will increase input
III Coordination and review of budgets
IV Final acceptance of budgets
V All of the above

A. I, II, III
B. II, IV,
C. V
D. III, (2)

1.7 The definition: Goods finished but ready for sale refers to which term:

A. Work-in-progress
B. Finished goods
C. Inventory
D. Cost of goods sold (2)

1.8 Cost of goods sold is calculated by taking:

A. Total manufacturing cost, adding beginning work-in-progress inventory and deducting the ending work-in-progress inventory
B. Cost of goods manufactured, adding the beginning finished goods inventory and deducting the ending finished goods inventory
C. Raw materials used in production adding direct labour and manufacturing overheads
D. Raw materials adding purchases of raw materials and deducting the ending inventory of raw materials (2)

1.9 Ratio analysis can consist of two components:

A. Calculating profit and then calculating ratios
B. Valuing assets on a relative basis and finding similar assets
C. Measuring debt and equity and then interpreting this
D. Comparing the company to other companies past performance and other companies in general (2)

1.10 The Blue Dog Company has 10 000 ordinary shares in issue that has a current price of $20 per share. The expected risk-free rate of interest is 2.5%, and the beta is 0.8whereas the expected market premium is 5%. Calculate the cost of equity.

A. 7.5%
B. 5%
C. 2.5%
D. None of the above (2)

1.11 The cost of capital.

A. will decrease as the risk level of a firm increases
B. is primarily dependent upon the equity financing of the company
C. remains constant for all projects undertaken by the same firm
D. depends on how the funds are going to be utilized (2)

1.12 What do liquidity ratios tell us about the company?

A. Does the business have enough money to honour its short term liabilities?
B. Does the company have a lot of debt and is it financed mainly by equity?
C. How effectively has the company used its fixed and current assets?
D. How does the market see this company? (2)

1.13 Identify which of the following statements is CORRECT concerning the cash cycle:

A. The longer the cash cycle, the more likely a firm will need external financing
B. Increasing the accounts payable period, increases the cash cycle
C. The cash cycle can exceed the operating cycle if the payables period is equal to zero
D. The cash cycle plus the accounts receivable period is equal to the operating cycle. (2)

1.14 Quick Manufactures has an average inventory period of 45 days, pays suppliers after 60 days and collects outstanding debtors accounts after 80 days.

Determine the operating cycle of Quick Manufacturers.

A. 65 days
B. 95 days
C. 125 days
D. 185 days (2)

1.15 When comparing an ordinary annuity and an annuity due, which of the following is true?

A. The FV of annuity due is always greater than the FV of an identical ordinary annuity
B. The FV of an ordinary annuity is always greater than the FV of an identical annuity due
C. The FV of annuity due is always less than the FV of an identical ordinary annuity, since one less payment is received with an annuity due
D. All things being equal, one would prefer to receive an ordinary annuity than an annuity due (2)

1.16 Which of the following will NOT appear in a cash budget?

A. Depreciation of machinery
B. Sales revenue
C. Wages
D. Machinery bought on hire purchase (2)

1.17 What is the difference between a static budget and a flexible budget?

A. Static: the budget is fixed for the period, Flexible: the budget is flexible and changes continuously
B. Static: developed for a specific period, Flexible: is continually updated by periodically adding a new time period
C. Static: sets all initial figures of each activity to zero, Flexible: uses the initial figures and builds upon them.
D. Static: prepared for one level of activity, Flexible: a series of fixed budgets set to different levels of sales activity (2)

1.18 What is the basic principle of cost behavior?

A. Costs will not change based on a decision between alternatives
B. As the level of activity rises, costs will usually rise too.
C. Costs depend on the time period involved
D. All of the above (2)

1.19 Which of the following are FALSE with regards to the effect taxation has on the company?

I. Interest paid by a company on a debt instrument can be added to taxable income
II. Results in a tax saving for the company
III. Preference and ordinary dividend are deductible for tax purposes
IV. Results in a tax liability for a company
V. Interest paid by a company on a debt instrument can be is exempt from taxable income

A. I, III, IV, V
B. II
C. II, III, V
D. All of the above are false (2)

1.20 Ratio analysis can consist of two components:

A. Calculating profit and then calculating ratios
B. Valuing assets on a relative basis and finding similar assets
C. Measuring debt and equity and then interpreting this
D. Comparing the company to other companies past performance and other companies in general (2)

1.21 Which of the following statements are INCORRECT regarding the difference between financial accounting and financial management?

A. Financial accounting is considered to be uncertain as it is set on the accrual basis whereas financial management is seen to be more certain as it focuses on cash flows
B. Financial management focuses on recording and planning for the future whereas financial accounting only reports on the performance and financial position
C. Financial accounting is can focus on a specific area within the business whereas financial management looks at the business as a whole
D. Financial management focuses on future planning whereas financial accounting looks at the past

1.22 Which of the following is NOT an <u>external stakeholder</u> of the Bronco's football club

A. The Bronco's management team
B. The football regulatory body

C. The Bronco's football club's bank
D. The suppliers to the football team

1.23 Maximus Football Association is hosting a new football championships among all their clubs. They plan to open the championship with a big opening ceremony. Which ONE of the following costs can be classified as an indirect cost of the event.

A. Printing of tickets
B. Stadium lights
C. Costs of food and beverages
D. Wages for the opening ceremony performers

1.24 The current Minister of Finance of South Africa is:

A. Trevor Manuel
B. Malusi Gigaba
C. Pravin Gordhan
D. Gill Marcus (2)

1.25 Who is the governor of the Reserve Bank?

A. Lesetja Kganyago
B. Gill Marcus
C. Pravin Gordhan
D. None of the above, there is no finance minister (2)

## QUESTION 2 [23 Marks]

Health-Cook is a company that produces ready-made health meals. They produce all kinds of meals ranging from various health snacks to main meals like breakfast and dinner. The company has been running for a couple of years and is gaining popularity.

At the beginning of the year the company had a balance of R55 000 in cash and sales debtors of R275 000. Selling and administrative costs amount to R500 000 per month.

All sales are on account, but one third of all sales are collected in the month in which they occur and the remaining two thirds in the next month. All purchases of ingredients and materials are on a cash basis, and are estimated at being R370 000 in January and R480 000 in February.

The company has entered into an agreement with Truce Bank to obtain financing so that in all circumstances there would be a minimum cash balance of R25 000.

The budgeted sales set out accordingly for the next couple of months is as follows:
January: R890 500
February: R820 670

**REQUIRED:**

2.1 You are required to prepare a cash budget for the two months together with a schedule indicating the cash collections. **(11)**

2.2 Name and explain two reasons why we produce budgets. **(6)**

2.3 Costs can be classified according to three criteria. Name and explain these criteria. **(6)**

## QUESTION 3 [20 marks]

You and your friend own a dance studio, called Step-It, where you both teach various dance classes. Your dance studio has been running for three years. Your friend has asked whether the dance studio is doing alright financially. Since you completed the sports finance module at university you decide to analyse the financial statements.
A small bookkeeping company does the financial statements for you, and sends you the following information:

| **Step-It** | |
|---|---|
| | **Statement of Financial Position as at 31 March 2016** |
| | (R ) |
| Current assets | 750 000 |
| Non-current assets | 160 000 |
| Total Assets | 910 000 |
| | |
| Current Liabilities | 120 000 |
| Long term liabilities | 190 000 |
| Owner’s equity | 600 000 |
| Total equity and liabilities | 910 000 |

| | Statement of Comprehensive Income for the year ended 31 March 2016 |
|---|---|
| | (R ) |
| Revenue | 900 000 |
| Cost of services | 450 000 |
| Gross profit | 450 000 |
| Operating expenses | 309 000 |
| Earnings before tax | 141 000 |
| Tax | 42 300 |
| Net profit | 98 700 |

**REQUIRED:**

3.1 Calculate the profitability ratios for 2016. **(8)**

3.2 Explain and discuss the profitability ratios. **(8)**

3.3 What are the steps involved in conducting ratio analysis. **(2)**

## QUESTION 4 [16 marks]

Spartan Gym Supplies are evaluating their cost of capital under two alternative financing arrangements and want to determine the optimal weighting of debt and equity for their company.

In consultation with investment bankers, Spartan has in issue:

- R12 000 000 in bonds with a rate of 12%, currently trading at a par rate of 97%;
- 9 000 000 ordinary shares outstanding of Spartan is currently selling for $20.00 a share.

Market analysts feel a risk premium of 7.5% is appropriate for companies such as Spartan. The return on a government bond is 3.75%. The beta of the company is 1. The marginal tax rate is 35%.

**REQUIRED:**

4.1 Calculate the market value of the various sources of financing the company has. **(2)**

4.2 Calculate the cost of equity and cost of debt. **(2)**

4.3 If Spartan raises capital using 50% debt and 50% ordinary shares, what is the cost of capital? **(3)**

4.4 If Spartan raises capital using 35% debt and 65% ordinary shares, what is the cost of capital? **(3)**

4.5 Comment on which weighting of the various sources of financing would be best for the company to use? **(2)**

4.6 When calculating the weighted average cost of capital, the weighting can be done in two ways. Name those two ways. **(2)**

4.7 What is the cost of capital? **(2)**

## **<u>QUESTION 5</u>** **[20 marks]**

Contender Inc. specialises in making products and accessories for running and bicycle races. Their main product, which they have named the It-Kit, is a race pack that contains various items that race participants can use during the race. Their race pack has gained momentum since it was launched a few years back and is now the race pack of choice amongst race organisers and participants.

The It-Kits, which include items such as the It-Kit bag, sports drinks, protein bars, water bottle, sweat bands and sunblock, are put together by their employees at their warehouse.

The financial statements of Contender Inc., for the year, have shown that the company incurred a cost of R315 400 for the It-Kit items and paid a total of R380 000 in wages to its employees. The company also incurred a depreciation cost of R112 000 and insurance costs of R115 300.

The balance at the beginning of the year for inventory was as follows:

- It-Kit items R464 000
- Work-in-progress R425 400
- Finished good (completed It-Kits) R535 000

By the end of the year the inventory amounts were:

- It-Kit items R271 500
- Work-in-progress R382 000
- Finished good (completed It-Kits) R575 000

**REQUIRED:**

5.1 Calculate the raw materials (It-kit items) used in producing the It-Kits **(3)**

5.2 Calculate the manufacturing cost **(3)**

5.3 Calculate the cost of goods sold **(4)**

## <u>QUESTION 6</u> [10 marks]

Vitamins and Minerals (V & M) manufacture a range of tonics and energy boosters. V & M has inventory in the storeroom for 36 days, debtors settle their accounts on average after 40 days and suppliers are paid after a period of 60 days.

**REQUIRED:**

6.1 Calculate the cash conversion cycle **(3)**

6.2 Explain to management the impact of having too high or too low levels of inventory. **(2)**

6.3 Explain three motives for holding cash in a company. **(3)**

6.4 Explain the advantages and disadvantage of an aggressive working capital financing policy. **(2)**

## <u>QUESTION 7</u> [16 Marks]

State whether the following statements are TRUE or FALSE. **<u>Motivate</u>** your answer in **<u>each</u>** case.

7.1 Sunk cost is the cost that will not change based on a decision between alternatives **(2)**

7.2 Purchasing raw material on credit from a supplier at a discounted price will decrease the short term financing needs of a company. **(2)**

7.3 The statement of financial position is a snapshot of a company's financial condition at a point in time. **(2)**

7.4 An investment that earns simple interest will have a higher future value than an investment that earns compound interest. **(2)**

7.5 If you invest R20 000 today at CAPTA Bank at an interest rate of 12%, you will have R30 000 after 3 years. **(2)**

7.6 The definition of 'inventory' is: Goods that are not finished or ready for sale at the end of a month/year **(2)**

7.7 Companies only use cost information to assist long term decision making **(2)**

7.8 Manufacturing overheads is all the costs that are used in the process of production which are not directly associated with a cost object (product) **(2)**

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## **QUESTION 8** **[5 marks]**

8.1 Explain why profit maximization ≠ wealth maximization (5)