WOMEN'S UNIVERSITY IN AFRICA

Addressing gender disparity and fostering equity in University Education

FACULTY OF MANAGEMENT AND ENTREPRENEURIAL SCIENCES

MASTERS DEGREE IN BUSINESS ADMINISTRATION

MAIN PAPER

MBA 214: FINANCIAL MANAGEMENT

INTAKE 21: SECOND YEAR FIRST SEMESTER

TIME: 2 HOURS

INSTRUCTIONS TO CANDIDATES

Answer **Question 1** and any other **two q**uestions.

Question 1

Don-Ash Mining Corporation has just paid a dividend of 175 cents per share. Dividends and earnings have been growing at 38% per year for the past two years. A corporate financier from Imara Asset management has predicted the following growth rates in dividends and earnings:

32% per year for the next five years

25% per year for the three years after that

10% per year in perpetuity

The required rate of return on the company's equity is 21% for the next eight years and it will change to 14% in perpetuity thereafter.

On another note, Don-Ash Mining Corporation owes LKAT Corporation $20 000 due in six months and $6 000 due in 11 months. Don-Ash Mining Corporation offers to pay $10 000 immediately if it can pay the balance in two year. LKAT Corporation agrees, on condition that they use a simple interest rate of 18% per annum. They also agree that for settlement purposes the $10 000 paid now will also be subject to the same rate.

Required

a) Determine the intrinsic value of Don-Ash Mining Corporation's shares? [20]

b) How much will Don-Ash Mining Corporation have to pay at the end of the two years? [20]

Question 2

ABC Ltd has a 5-year acceptable maximum payback period. The firm is considering the purchase of a machine and must choose between two alternative ones. The first machinery requires an initial investment of $150 000 and generates annual after tax cash inflows of $40 000 for each of the next 7 years. The second machinery requires an initial investment of $240 000 and provides an annual after tax cash inflows of $50 000 for 10 years. The cost of capital for both investments is 10%. Determine the following for each machine and comment on the acceptability of the machines, assuming they are independent projects

a) Payback period; [4]

b) Discounted payback period; [4]

c) Net Present Value; [4]

d) Internal Rate of Return; and [6]

e) Profitability Index [2]

Question 3

a) Suppose you deposit $10000 today in an account that pays simple interest of 20% per annum. How much will you have at the end of 3 years? [4]

b) LK owes AT $20 000 due in six months and $6 000 due in a year. LK offers to pay $10 000 immediately if he can pay the balance in two year. AT agrees, on condition that they use a simple interest rate of 18% per annum. They also agree that for settlement purposes the $10 000 paid now will also be subject to the same rate. How much will LK have to pay at the end of the two years? [8]

c) A bank's simple discount rate is 18%. If one signs a promissory note to pay $5 000 in six months' time, how much would one receive from the bank now? What is the equivalent simple interest rate? [4]

d) Find the compounded amount on $3 000 invested for ten years at 8.5% per annum compounded annually? [4]

Question 4

WaWal Pharmacies, has the following capital structures:

400 000 ordinary shares at 5 dollars each
200 000 10% preference share at 4 dollars each
Capital Reserves $350 000
Revenue Reserves $200 000
Retained Earnings $290 000
350 000 8% debentures at $12 each

Additional Information

a) Ordinary share dividend is expected to grow by 15% p.a constantly and the current price of $110 and a dividend of $30 have just been issued.
b) Preference shares have a cost of 10%.
c) Debenture attracts a cost of 12%.
d) Taxation is at 35%.

Required:

Calculate the weighted average cost of capital of Walgreen Pharmacies. [20]

Question 5

a) Tariro Enterprises owned by an indigenous entrepreneur borrowed $80 000 from a local bank. The interest rate was 25 % p.a. compounded semi-annually and the company will have to pay back at the end of every six months for three years.

Required:

(i) Determine the size of each instalment. [5]
(ii) Draw up an amortization table splitting interest payment from principal payments. [5]

b) Dr. Tough decides to save for her daughter's higher education and, every year, from the child's first birthday onwards, puts away $1 200. If she receives 11% interest annually, what will the amount be after her daughter's 18th birthday? [4]

c) Explore the differences between the dividend irrelevance theory, bird in the hand theory and the tax preference theory [6]

Question 6

a) Discuss the three main goals of corporate finance and relate them to their importance. [5]

b) Draw up an amortization table for a loan of $4 000 for three years at 12% per annum compounded half-yearly and repayable in six half-yearly payments. How much interest will you pay over the life of the loan? [15]

END

LIST OF FORMULAS

1. $S = P(1 + rt)$
2. $S\ (FV) = P\ (1+i)^n$
3. $DV = S\ (1-dt)\ or\ (S-D)$
4. $FVIFA_{n,i\%} = \frac{(1+i)^n - 1}{i}$
5. $FV_{OD} = [\frac{(1+i)^n - 1}{i}] \times R$
6. $PVIFA_{OD} = \frac{(1+i)^n - 1}{i(1+i)^n}$
7. $PV_{OD} = \left[\frac{(I+i)^n - 1}{i(1+i)^n}\right] \times R$
8. $IRR = A + [(a / a + b)][(B - A)]$
9. $K_e = \frac{D_1}{P_0} + g$
10. $\boldsymbol{K_d = \frac{INT(1-T)}{P_0}}$
11. $WACC = W_d\ K_d\ (1\text{-}T) + W_{ps}\ K_{ps} + W_e\ K_e$
12. $Vb = INT\ (PVIFA_{kd,n}) + M\ (PVIF_{kd,n})$
13. $P_0 = \frac{D1}{(1+ke)} + \frac{D2}{(1+ke)^2} + \frac{D3}{(1+Ke)\text{^}3} + \ldots\ldots + \frac{Dn}{(1+Ke)\text{^}n} + \frac{TVn}{(1+Ke)\text{^}n}$