ADDENDUM B: COMPULSORY WRITTEN ASSIGNMENT 02/2016 FOR THE FIRST SEMESTER

DUE DATE: 6 APRIL 2016 (No extension of time will be given for submission of this assignment)

Before attempting this assignment, you should be fully conversant with the all the contents of MAC2602.

Marks awarded for this assignment contributes 75% towards your year mark of 20% and 15% towards your final mark.

This assignment contains longer type questions.

Please remember to indicate the unique number on your assignment cover, the unique number for this assignment is:

MAC2602 - Unique number – 780546

Important: See guidelines on how to submit written assignments electronically via my unisa under Frequently asked questions page 12 to 14 of this Tutorial letter.

COMPULSORY ASSIGNMENT 02/2016 FOR THE FIRST SEMESTER

THIS ASSIGNMENT MUST BE COMPLETED IN FULL AND SUBMITTED TO REACH THE UNIVERSITY BEFORE OR ON THE DUE DATE OF 6 APRIL 2016.

LONGER TYPE QUESTIONS (100 marks) (120 minutes) Unique number – 780546

Set your calculator on four decimal places for this assignment.

QUESTION 1 (28 marks)
[This question consists of two parts, Part A and Part B.]

PART A

The EEF-J company is in process of applying to be listed on the Johannesburg Stock Exchange (JSE). They have 30 million equity shares in issue. Their current financial statements for the year ended April 2016 has just been approved by the directors. An extract of information from the financial statements is provided to you:

	R'000
Current assets	25 850
Current liabilities	4 556
Total assets	29 800
Total liabilities	9 540
Retained earnings	2 100
Net profit for the year	8 588
Taxation for the year	1 222
Revenue	40 520

In the year ended April 2012, they had a qualified audit report. Thereafter they have improved the internal control procedures and received satisfactory audit reports for the following years.

Mr JJM, the financial manager, approached you as trainee financial manager to assist him in the process of listing the EEF-J company on the JSE.

REQUIRED:

a) Name and briefly explain the process that takes place when a company applies to be listed for the first time. (2)

b) List four of the JSE listing requirements. Apply the financial information of the EEF-J company and determine whether the company will comply with each requirement or not. (10)

c) Provide a conclusion as to whether the EFF-J company complies with the JSE listing requirements as well as a recommendation of what could be done in the instance of not complying. (3)

[15]

PART B

The EEF-J company raised capital by the issuing of shares. To ensure that they attain their target capital structure, they decided to make use of debt financing for their new expansion project. The bond that they are interested in has the following details:

Par value	R16 500 000
Current market value	R12 600 000
Annual interest	14%
Company tax rate	28%
Redeemable after 6 years	Par value

Mr JJM, the financial manager, asked you as trainee financial manager, the following questions regarding the debt financing.

REQUIRED:

a) Which process should EEF-J follow before they can issue corporate bonds? (2)

b) Explain what the ”effective cost of finance” entails. (3)

c) Mr JJM wants to know how the new bond will affect their cash flows over the period of the debt. (Ignore the effective interest and taxation. Only indicate the specific in- and outflows regarding the bond for each of the years 0 to 6). (4)

d) Calculate the after-tax cost of the new bond by using your financial calculator. Show detailed inputs. (4)

[13]

<u>QUESTION 2</u> (25 marks)

A cattle farming business, Bhrama Ltd, already owns a number of farms in the Zeesim area. They are in the business of buying and breeding cattle and then selling cattle to various butcheries. They are currently listed on the stock exchange. They are considering expanding the business by acquiring more farms in the Rodsee area. Bhrama Ltd is a leader it the cattle farming business.

The following information for the financial year ended 29 February 2016 is provided to you:

Gross profit	R606 424 000
Net profit	R360 796 000
Gross profit margin	61,35%
Current assets	R1 379 568 000
Non-current assets (including value of farms purchased)	R1 620 984 000
Total liabilities	R1 444 541 000
Long-term debt (including current portion)	R659 900 000
Retained earnings	R56 011

- The company has an issued share capital of 150 million ordinary shares.
- The current (2016) market price per share is 1 400 cents.
- The dividend per share is 10 cents.

REQUIRED:

a) Explain the importance of strategic information of a business. (3)

b) List seven kinds of information that can be included in strategic information and link each kind to the specific information regarding Bhrama Ltd provided in the question. (7)

c) Calculate the following ratios for the year 2016:

i. Net profit margin. Explain what the ratio indicate and whether you reckon the calculated ratio is good or bad with a motivation. (4)

ii. Asset turnover (industry average 0,50). Explain what the ratio indicate

and whether you reckon the calculated ratio is good or bad with a motivation. (4)

iii. Debt to equity ratio (based on market value) (3)

iv. Earnings per share (2)

v. Dividend yield (2)

[Round your final answers to two decimals in the case of a percentage or to the nearest rand in the case of values.] [25]

QUESTION 3 (17 marks)

Lovin'-it Ltd imports handcrafted gifts. They purchase an average of R1 000 000 stock from a supplier in India on an annual basis. The credit terms of the supplier is 3/10 net 50. The cost of other short-term financing options has an effective annual rate of 19%. The current tax rate is 28%.

You may ignore the effect of foreign exchange variances.

REQUIRED:

a) Name and briefly explain two advantages and two disadvantages of trade accounts payable. (4)

b) Calculate the value of discount received from the supplier in India if all purchases are paid within the discount period. How should it be accounted for (disclosed) in Lovin'-it Ltd's statement of profit or loss and other comprehensive income? (4)

c) Calculate the effective annual rate of utilising the full credit period. (6)

d) Advise Lovin'-it Ltd of the best financing option (should they make use of the discount offered or not)? Motivate your advice by referring to relevant calculations. (3)

[Work to four decimals and round only your final answer to two decimals.]

[17]

QUESTION 4 (20 marks)

The Rain-from-Spain company is an innovative manufacturing and rental studio that offers a fresh approach to events infrastructure. They manufacture and rent modern furniture and accessories for events. They also illuminate items thereby creating a unique atmosphere in any venue. One of the directors, Mr AB, made a suggestion (option 1) to buy a new manufacturing machine at a cost of R650 000. Depreciation is calculated on a straight-line basis on the cost of the machine over its useful life of 3 years. Mr AB has compiled the following cash flow table.

Cash flows:	Year 1	Year 2	Year 3
Net cash in/(outflow)[Excluding depreciation and after tax]	R247 867	R273 067	R363 067
Factor at 15%	0,870	0,756	0,658
Present value (rounded to the nearest rand)	R 215 644	R206 439	R238 898

The second director, Mr JP, made a suggestion (option 2) that they can rather invest the R650 000 at a specific interest rate at the bank. He said that they then would have R870 000 at the end of 3 years.

These two investment options are mutually exclusive. Management's target rate for investment projects is set at 16%.

REQUIRED:

a) Determine the internal rate of return (IRR) should the company buy the new manufacturing machine as suggested by Mr AB (option 1). Interpolate between 15% and 18%. (9)

b) Use the mathematical formulae method and information given with regard to Mr JP's investment suggestion (option 2) to determine the effective interest rate of his suggestion. Which of the two investment option's should be chosen? Motivate your conclusion regarding the best option by referring to your calculations in (a) and (b) and relevant evaluation criteria. (5)
[Work to four decimals and round only your final answer to two decimals.]

c) Calculate the accounting rate of return (ARR) for the investment in the manufacturing machine (option 1). Use the ARR of buying the machine as calculated as well as evaluation criteria to explain to management why the new manufacturing machine option should be the best choice. (6)

[20]

<u>QUESTION 5</u> (10 marks)

This question consists of five multiple-choice questions. Each question must be considered independently, except where specific reference is made to information in another question. Each question has only one correct answer, and the marks per question (5.1 – 5.5) are indicated in brackets after each question.

Please answer the five questions by listing the question numbers below one another, from 5.1 – 5.5, with your corresponding answer next to it, for example:

5.1 (a)
5.2 (b)

The questions are as follows:

5.1 The directors of a consulting company realised that stakeholders have varying degrees of influence over the strategic choices that their company makes. Which ONE of the following alternatives does NOT relate to reasons why key stakeholders have an influence on the choice over future strategies?

a) dependency
b) degrees of power
c) level of interest
d) maturity of the organisation (2)

5.2 The Poetry Company arranged a break-away weekend for management to brainstorm on their strategic planning and way forward. They approached you to explain the SWOT analysis approach to strategic planning to them. Which ONE of the following statements is FALSE and should therefore not be included in your explanation?

a) In SWOT analysis, the situational analysis should cover the organisation and its environment currently, as well as how the environment may develop in the future.
b) Strategy formulation is the process when decisions are evaluated to achieve the organisation's strategic objectives.
c) Strategy achievement programmes (implementation) entails putting the strategy into action or making the strategy work as intended by developing detailed plans.
d) Strategy evaluation is the final step at the end of the year when performance is measured to determine the success of the implementation of the detailed plans (2)

5.3 The Pearl Company has done an intensive exercise to identify and evaluate the risks in the company. They have appointed a risk management team to monitor the effectiveness of the risk management process. Which ONE of the following combinations of methods is available to the risk management team to monitor the effectiveness of the risk management process?

a) Scenario management, loss management, key risk indicators, risk and control self-assessments completed by management
b) Risk assessment, risk responses, results of audit reviews
c) Risk reporting, residual risk assessment, documentation of risk
d) Risk description, inherent risk rating, risk categorisation (2)

5.4 The CARE-full Company has a low risk appetite. Management are in the process of formulating risk responses to their inherent risk ratings. Which combination of the risk responses below can be linked to financial, credit risk?

1) Board approved limits, monitoring of results, lending procedures
2) Uninterruptable power supply, system testing
3) Member surveys, increased marketing
4) Human resource development and training plans
5) Underwriting of loans, semi-annual loan reviews

a) Statements (2) and (5)
b) Statements (1) and (4)
c) Statements (2) and (3)
d) Statements (1) and (5) (2)

5.5 The MMdoc Company is compiling a risk register. Which combination of data should NOT BE included in a risk register?

a) Description and date when risk was identified
b) Risk factors, internal and external perspectives
c) Root cause analysis and risk responses as well as the target/implementation date
d) Inherent- and residual risk rating, interdependencies with other risks

(2)
[10]

Total [100]