MNB102-E

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Financial management function (Page 408)

- Cash inflow
- ***Inflow of funds***
-
-
-

Cash outflow

Outflow of funds

Financial Manager's Tasks

- **Investment decision-making (chapter 18)**
- **Financing decision making (chapter 19)**

Investment Financing (Pg 410)

Assets	**Long-term funds**
-Land & buildings	- Shareholders interest
-Plant & equipment	Ordinary share capital
-Vehicles	Preference shares
	-Long-term debt
Current assts	**Current liabilities**
-Cash	-Trade creditors
-Debtors	-Bank overdraft
-Inventory	-Arrear expenses

Fundamental principle, basic concepts (chapter 17)

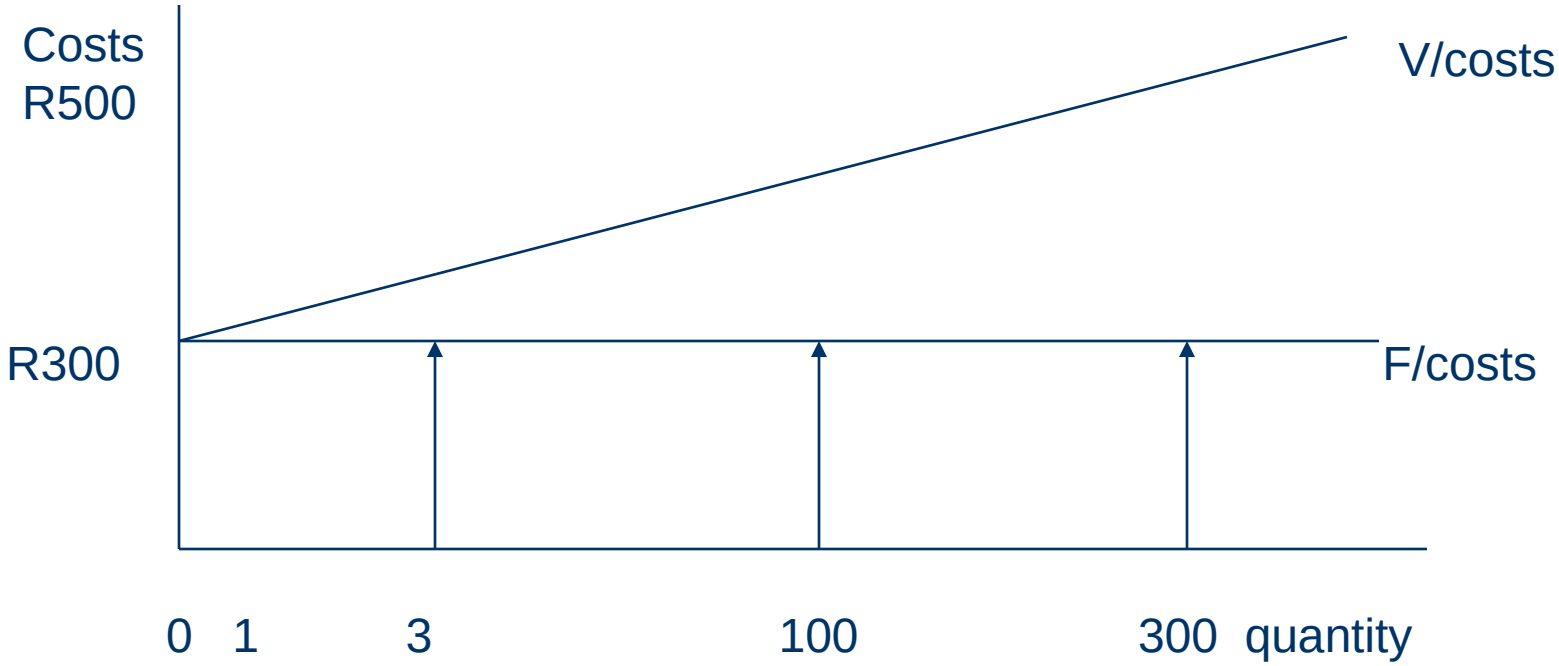
- **BASIC CONCEPTS**

- ***Balance sheet-*** fixed assets, current assets, shareholders interest, owners equity, long and short-term funds
- ***Income statement-*** income, costs, profit

- **FUNDAMENTAL PRINCIPLES**

-risk-return principle
-cost-benefit principle
-time value of money principle
-analysis of the financial statement

Fixed cost V/S variable cost (TL 101, pg 412-413)



Cost-volume-profit relationships (assignment 4, 5, 9 and 10)

- Break-even analysis

- N = Total fixed cost/marginal income per unit

Cost Volume Profit Analysis

Suppose you are given the following Information:

Selling price per unit = R10

Total variable costs = R600

Fixed cost per unit = R3

Total fixed costs = R300

- calculate the number of units sold
- calculate the profit generated
- calculate the number of units to break-even

Time value of money

- Tables will be provided (application of the table is important) Pg 420 and 421
- Cash flows and notice the differences (e.g. table 17.11)
- Financial calculator
- Derivation of the factor

Time value of money

Year	Cash flow
1	R45 000
2	R83 000
3	R75 000

Cost of capital 10%

Calculate the **present** value

Time value of money

Year	Cash flow
1	R45 000
2	R83 000
3	R75 000

Cost of capital 10%

Calculate the **future** value

Analysis of financial statement

- Income statement
- Balance sheet

We use ratios

- Why do we analyze the financial statements
- Define each group of ratios
- Know the equations
- Calculate the ratios
- Calculator allowed (not programmable)
- How one can improve the performance

Reasons for analyses

- Profitability
- Liquidity
- Solvency
- Performance
- Sustainability

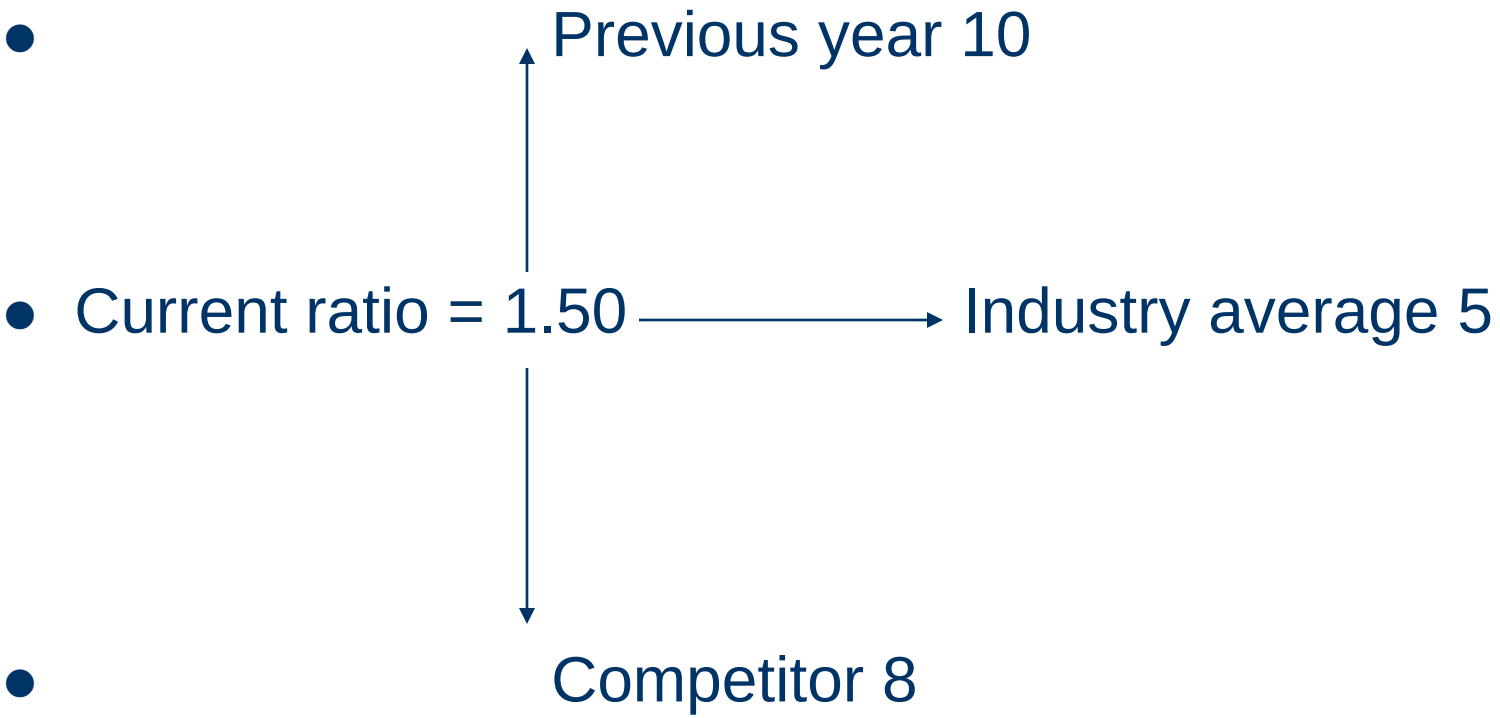
Define the ratio

- Liquidity ratio refers to the ability of the business to meet short-term obligation

Calculations (application)

	R
Cash	124 000
Debtors	852 000
Inventory	340 000
Current liabilities	857 000
Net fixed assets	2 500 000
Total liabilities	2 300 000

Interpretation of ratios



Improving the ratio (performance)

- Profitability ratio
- Can be improved by:

  -increasing prices

  -increasing production

  -reducing cost

Objective of the financial Manager

Create value

Investment ← → Financing

Profitability ↑

Liquidity ↑

Solvency ↑

Investment	Financing
Assets	**Long-term funds**
-Land & buildings	-Owner's equity
-Plant & equipment	-Preference shares
-Vehicles	-Shareholders interest
	-Long-term debt
Current assts	**Current liabilities**
-Cash	-Trade creditors
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CHAPTER 18
Investment management

- Management of current assets (define)
  - Cash management
  - Debtor management
  - Inventory management

Investment in current asset

- OVER-INVESTMENT
- -cost/risk

- UNDER-INVESTMENT
- -cost/risk

Cash management

- Motives for holding cash
- Cash cycle
- Cash Budget

Management of debtors

- Consumer credit
- Trade credit

= =

Facets of management of debtors

⟶ credit policy →credit standard

⟶ credit terms

⟶ collection policy

Management of inventory

- Profit objective
  - High stock turnover
  - Low stock
- Operating objective
  - Low stock turnover
  - No interruption in production

Management of fixed assets (capital investment) (capital budgeting)

- Importance of capital investment
- -the amount involved
- -strategic nature
- -long-term nature

Capital budgeting

- CASH FLOWS
- -initial investment
- -operating cash flow
- -terminal cash flow

- **How do we use the cash flows?**
- **-**use capital budgeting technique (NPV)

(Question)
NPV TECHNIQUE

- Initial investment of the project is R2000
- Cost of capital is 15%
- Operating cash flows

Year	***Inflows***	***Outflows***
1	R1 000	R 600
2	R1 200	R 800
3	R1 600	R1 000
4	R2 000	R1 300
5	R2 400	R1 600

NPV TECHNIQUE

Year	***Inflows***		***Outflows***		***N/flow***
1	R1 000	-	R 600	=	R400
2	R1 200	-	R 800	=	R400
3	R1 600	-	R1 000	=	R600
4	R2 000	-	R1 300	=	R700
5	R2 400	-	R1 600	=	R800
	R8 200		R5 300		R2 900

NPV TECHNIQUE

Year	Net flows		PVF		PV
1	R400	X	0,8696	=	R348
2	R800	X	0,7561	=	R302
3	R600	X	0,6575	=	R395
4	R700	X	0,5718	=	R400
5	R800	X	0,4972	=	R398
	R2 900				R1 843

- NPV = PV cash flow - initial investment
- NPV = R1 843 - R2 000 = -R153

Investment	Financing
Assets	**Long-term funds**
-Land & buildings	-Owner's equity
-Plant & equipment	-Preference shares
-Vehicles	-Shareholders interest
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Current assts	**Current liabilities**
-Cash	-Trade creditors
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Chapter 19
Financing decision

- FINANCIAL MARKETS
- FINANCIAL INSTITUTIONS
- FINANCIAL ASSETS

Financial Markets (define)

Short-term

Money Market

(Primary M **Secondary M)**

New **second**

Long-term to maturity

Capital Market

(Primary **Secondary M)**

New **second**

Short-financing decision-making

- Risk/cost

Short-financing decision-making

- Trade credit
- Accruals
- Bank overdraft
- Factoring

Financing strategies

- Matching approach
- Conservative approach
- Aggressive Approach

Matching Approach

- Fixed assets → Long-term funds
- Permanent current assets → Long-term funds
- Temporary current assets → Short-term funds

Aggressive Approach

- Fixed assets → Long-term funds
- Permanent current asses → Long-term funds
- Permanent current asses → Short-term funds
- Temporary current assets → Short-term funds

Conservative Approach

- Fixed assets → Long-term funds
- Permanent current assets → Long-term funds
- Temporary current assets → Long-term funds

SOURCE OF LONG TERM FUNDS

- Ordinary shares
- Preference share
- Debt
- -loan
- -credit
- *(Ensure that you understand the characteristics)*

Cost of long term funds

- Weighted average cost of capital (WACC)

Form	Amount	Weight	Cost
Ordinary	R1 400m		20%
Preference	R3 00 000		10%
Long-term debt	R 500 000		9%

- NB: 9% after-tax

Answer

Component	Amount	Cost	Weight	Weighted cost
Owners` equity	1 400	20%	X 63,6	= 12,72%
Preference Shares	300	10%	X 13,6	= 1,36%
Debt	500	9%	X 22,8	= 2.05%
	2 200			
			WACC	16.13

Cost Volume Profit Analysis

R300/R3 = 100 units

S – C = P

R10 x 100units – (R300 + R600) = R100

number of units to break-even

$$N = \frac{F}{(Sp - V)}$$

$$N = \frac{R300}{(R10 - R6)}$$

$$= 75 \text{ units}$$

Time Value of Money

- Assuming you are the bank manager of Easifin Bank. On 1 January 2001 your client deposited R15, 000 into a fixed deposit account that pays 10 percent interest per year. On 1 January 2002 he deposited a further R2, 000 into the account. On 31 December 2004, he closed the account and deposited the money into another account that pays a higher interest rate of 15 percent per year. How much will the client have in his account on 1 January 2009?

Solution

-15 000 PV
4 N
10 I
COMP FV: R21 961.50
- 2000 PV
3 N
10 I
COMP FV: R2 662.00
Add totals: R21 961.50 + R2 662.00 = R24 623.50
Compute FV of Total amount:
-24 623.50 PV
4 N
15 I
COMP FV
R43 066.66

Time Value of Money

Calculate the NPV of project that has the following projected cash flows. The discount rate is 10 percent

Year	Cash flows
0	(R65 000)
1	R45 000
2	R83 000
3	R75 000

Solution

NPV = -R65 000+PV

PV = R45 000 x 0.9091+ R83 000 x 0.826

+R75 000 x 0.751

= R40 909.50 +R68 558 +R56 325

= R165 792.50

NPV = -R65 000 + R165792.50

= R100 792.50

Weighted Average Cost of Capital

Alpha Pharmaceuticals has a marginal tax rate of 30%, and a required return of 19% for owners' equity. You have also been given the following book values for its capital structure:

Capital Components	
Owners equity	R500 000
10% preference shares	R200 000
Long term debt[13.5% debentures]	R300 000
Total	R1 000 000

Weighted Average Cost of Capital

1	2	3	4	5
Capital Components	Amount	Proportion	Component cost Of capital (after tax)	Weighted Cost
Owners equity	R500 000	0.5	0.19	0.095
10% preference shares	R200 000	0.2	0.1	0.02
Long term debt[13.5% debentures]	R300 000	0.3	0.0945	0.02835
Total	R1 000 000			0.14335

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