

Tutorial letter 203/2/2014

Application of financial management techniques

SEMESTER 2

Department of Management Accounting

IMPORTANT INFORMATION:

This tutorial letter contains important information about your module.

Dear Student

Enclosed please find the solution in respect of assignment 03/2014. It is in your own interest to work through the suggested solution in conjunction with the assignment and your own answer.

Kind regards

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SOLUTION FOR ASSIGNMENT 03/2014 FOR THE SECOND SEMESTER**QUESTION 1**

Calculate the value of the investment

Description and (Calculation)		Year 1	Year 2
		Rand	Rand
Cash inflow:			
Year 1:		(2 500)	
Year 2:			4 000
Dividend tax	(4000 x 0.15)		(600)
Net cash in- / (outflow)		(2 500)	3 400
Fair rate of return @ 16%		0,862	0,743
Fair value per period		(2 155)	2 526
Net present value			371

The value of the company has increased by R371 as a result of accepting the investment.

Therefore, **Option (3)** is correct.

QUESTION 2

Statement 1 is correct

Statement 2 is correct

Statement 3 is incorrect

*The cost of capital for companies with a fluctuating dividend policy is **higher** than those with a stable dividend policy due to an increased risk taken by the shareholders.*

QUESTION 2 (continued)

Statement 4 is correct

Therefore, **Option (3)** is correct.

QUESTION 3

Calculate the value of 10% minority shares:

Description	Calculation	Rand
Dividends		
Year 1	R100 000 x 1,20	120 000
Annuity	①	1 971 429
Total		2 091 429
Fair rate of return @ 22%		0,820
NPV		1 714 972

Note ①

$$\begin{aligned} \text{Year 2 Dividends (P}_1\text{)} &= \text{R120 000} \times 1,15 \\ &= \text{R138 000} \end{aligned}$$

Calculate the share price at the beginning of year 2 by using Gordon's dividend growth model:

$$\begin{aligned} P_1 &= D_2 / (r - g) \\ &= \text{R138 000} / (0,22 - 0,15) \\ &= \text{R1 971 429} \end{aligned}$$

$$100\% \text{ shareholding} = \text{R1 714 972}$$

$$\begin{aligned} 10\% \text{ shareholding} &= \text{R1 714 972} \times 10\% \\ &= \text{R171 497} \end{aligned}$$

Therefore, **Option (3)** is correct.

QUESTION 4**Calculate Rand amount received**

The foreign receipt of USD 650 000 needs to be converted into Rand, therefore the bank will buy the foreign amount and we will use the bank's **buying** rate. The amount was received via a cheque we will use 0,0977.

$$\begin{aligned} \text{Amount received} &= \text{Foreign currency / exchange rate} \\ &= \text{US\$650 000 / 0,0977} \\ &= \text{R6 653 019} \end{aligned}$$

Therefore, **Option (3)** is correct.

QUESTION 5**Calculate the forward rate**

The number of days between the spot date (31 August 2013) and the forward date (30 November 2013) is 90 days. We need to adjust the annual premium:

$$\text{R12,85} + (\text{R12,85} \times 6,10\% \times \frac{90}{360}) = \text{R13,04}$$

or

$$\text{R12,85} \times (1,0001694)^{90} = \text{R13,04} *$$

Therefore, **Option (4)** is correct.

$$*1 + (0,061 / 360) = 1.0001694$$

QUESTION 6**Additional working capital requirements**

Working capital requirement for debtors:

- Determine the current ratio of debtors:sales

Current debtors = R550 000

Current sales = R10 000 000

Debtors : Sales ratio = R 550 000/R10 000 000

= 5,5%

- If there is an increase in sales by R 2000 000 then the debtors should increase in line with the same ratio as determined above.

Increase in debtors = R2 000 000 x 5,5%

= R110 000 increase in debtors

Working capital requirement for inventory:

- Determine the current ratio of inventory: sales

Current inventory = R600 000

Current sales = R10 000 000

Inventory: Sales ratio = 600 000/10 000 000

= 6%

If there is an increase in sales by R 2 000 000 then the inventory should increase in line with the same ratio as determined above.

Increase in inventory = R2 000 000 x 6%

= R120 000

Therefore, the **increase in working capital for debtors and inventory** :

R110 000 + R120 000 = R230 000

Therefore, **Option (2)** is correct.

QUESTION 7**Evaluation of statements**

Statement 1 is true

Statement 2 is true

Statement 3 is false

*Net working capital is the difference between **current** assets and **current** liabilities.*

Statement 4 is false

Conservative financing takes place where financing is of a permanent long-term nature.

Therefore, **Option (3)** is correct.

QUESTION 8**Calculate the profit to the company**

		Rand
Gross profit	$(R500 - R300) \times 1\,000$	200 000
Discount allowed	$(R500 \times 1\,000 \times 40\%) \times 2\%$	(4 000)
Collection cost	$R10 \times 1\,000$	(10 000)
Carrying cost		
- Debtors using the discount	$(R500 \times 1\,000 \times 40\%) \times 15/365 \times 17\%$	(1 397)
- Debtors not using the discount	$(R500 \times 1\,000 \times 60\%) \times 45/365 \times 17\%$	(6 288)
Net profit		178 315

Therefore, **Option (2)** is correct.

QUESTION 9

Operating profit margin for S&F (Pty) Ltd for 2x13:

$$= \frac{\text{EBIT}}{\text{Turnover from ordinary activities}}$$

$$= \frac{\text{R691 600}}{\text{R10 991 000}}$$

$$= 6,29\%$$

Therefore, **Option (2)** is correct.

QUESTION 10

Total return on other assets:

$$= \frac{\text{Finance income}}{\text{Financial assets}}$$

$$= \frac{\text{R20 500}}{\text{R85 000}}$$

$$= 24,12\%$$

Therefore, **Option (4)** is correct.