

**INTI**INTERNATIONAL COLLEGE PENANG (507232-U)
LAUREATE INTERNATIONAL UNIVERSITIESFinal
Examination Paper

(COVER PAGE)

Session : August 2017

Programme : DIPLOMA IN FINANCE

Course : FIN2150: FINANCIAL MANAGEMENT

Date of Examination : 8th December 2017 (Friday)

Time : 11.00am-1.00pm Reading Time : Nil

Duration : 2 Hours

Special Instructions :

This paper consists of SIX (6) questions. Answer any **FOUR (4)** questions in the answer booklet provided. All questions carry equal marks.

Materials permitted :

Non-Programmable Calculator

Materials provided :

Answer booklet

Examiner(s) : Ms. Eunice Mok Pei Sei

Moderator : Ms. Lim Tan Chin

This paper consists of 5 printed pages, including the cover page.

INTI INTERNATIONAL COLLEGE PENANG
DIPLOMA IN FINANCE (DIF)
FIN2150: FINANCIAL MANAGEMENT
FINAL EXAMINATION: AUGUST 2017 SESSION

Instructions: This paper consists of **SIX (6)** questions. Answer any **FOUR (4)** questions in the answer booklet provided. All questions carry equal marks.

Question 1

- a) What is the most important difference between a corporation and all other organization forms? What does the phrase limited liability mean in a corporate context? (5 marks)
- b) Financial managers ensure the financial health of an organization through investment activities and long-term financing strategies. Discuss the **THREE (3)** primary duties as a financial manager. (15 marks)
- c) Why is shareholders wealth maximization a more appropriate goal than profit maximization? (5 marks)

Question 2

- a) You purchase a 30-year, \$1000 face-value, zero-coupon bond at market value. The current interest rate is 5%. One year later the interest rate has changed to 6% and you decide to sell the bond at market price. What is your one-year holding period return? (5 marks)
- b) Which of the following bonds would have highest returns: a corporate Aaa bond, a Treasury Bill, a corporate Baa bond? What determines the differences in returns among these bonds? (Assuming that the maturities of all these bonds are the same) (7 marks)
- c) Region Ltd needs to raise \$25 million to fund a new office complex. The company plans on issuing ten-year bonds with a face value of \$1,000 and a coupon rate of 5.6% (annual payments). The following table summarizes the YTM for similar ten-year corporate bonds of various credit ratings:

Rating	AAA	AA	A	BBB	BB
YTM	6.86%	7.06%	7.16%	7.56%	8.06%

Assuming that Luther's bonds receive an AA rating, the number of bonds that Luther must issue to raise the needed \$25 million is closest to _____. (8 marks)

- d) How are the cash flows of a zero-coupon bond different from those of a coupon bond? (5 marks)

Question 3

- a) Applied plc plans to invest \$1.271 million in a new plant and machinery. At the end of the five year contract, the plant and machinery will have no more value.

With the new plant and machinery, the net cash flow change have been estimated as:

Year	1	2	3	4	5
Cash flow (\$'000)	92	450	589	561	508

Extract of the current financial statement

The following is an extract from the balance sheet of Applied plc at 31st December 2016:

	\$'m
Ordinary Shares of \$1 nominal value	48
10% coupon bond	<u>12</u>
Long term funds	<u>60</u>

Other information

The current share price is \$1.20 ex div and a dividend of \$0.15 per share has been paid for many years. Applied plc has no intention of changing the existing dividend policy. The bond is giving 10% coupon interest and the corporation tax is 25%.

Applied plc uses the Weighted Average Cost of Capital (WACC) to evaluate investment projects.

Required:

- i. Calculate the Weighted Average Cost of Capital of Applied plc, using the relevant financial information provided. (5 marks)
- ii. Calculate the net present value of the five year contract based on the cost at (a) and advise on its acceptability. (7 marks)

- iii. Find the IRR of the project. If the company required rate of return is 15%, should the company undertake the project? (8 marks)
- b) What are the concepts of capital budgeting decision? (5 marks)

Question 4

- a) Suppose that you have \$100 to invest and there are two projects that you can invest your money into. The returns on each of these projects are unrelated to each other. The returns on Project A depend on oil prices in the following manner:

Project A

Oil Prices	Probability	Return
High	0.2	20%
Average	0.6	10%
Low	0.2	0

The return on Project B depend on amount of snow fall in New York's Central park in the following manner:

Project B

Amount of snow	Probability	Return
High	0.2	18%
Average	0.6	10%
Low	0.2	2%

You consider two investment strategies: either invest all your \$100 in Project A or invest all your \$100 in Project B. For each of these strategies compute the expected return and variance of the returns. If you are risk averse, which one you would choose? (10 marks)

- b) Company is holding a cash though it is a non interest earning financial asset. Discuss the THREE (3) reason why companies choose to hold cash. (15 marks)

Question 5

- a) Rose plc has 850,000 shares outstanding with a current share price of \$5. What will be the share price if the company repurchases one-tenth of its shares? (6 marks)
- b) Discuss Modigliani and Miller's (1961) theory on the level of dividend payout. (13 marks)
- c) Explain under which condition an increase in the dividend payment can be interpreted as a signal of goods or bad news. (6 marks)

Question 6

- a) For each pair below, which type of asset is more likely to be liquidated for close to its full market value in the event of financial distress: (9 marks)
- i. An office building or a brand name?
 - ii. Product inventory or raw materials
 - iii. Patent rights or engineering "know-how"?
- b) A company makes bicycles. It produces 450 bicycles a month. It buys the tires for bicycles from a supplier at a cost of \$20 per tire. The company's inventory carrying cost is estimated to be 15% of cost and the ordering is \$50 per order.
- i. Calculate the Economic Order Quantity for a company (6 marks)
 - ii. What is the number of orders per year? (2 marks)
 - iii. Compute the average annual ordering cost. (2 marks)
 - iv. What is the average annual carrying cost? (2 marks)
 - v. Compute the total cost. (2 marks)
 - vi. Compute the average inventory. (2 marks)

- The End -

