
CERTIFIED PUBLIC ACCOUNTANT INTERMEDIATE LEVEL EXAMINATIONS

11.1: MANAGERIAL FINANCE

MONDAY: 8 JUNE 2015

INSTRUCTIONS:

- 1. Time Allowed: 3 hours 15 minutes (15 minutes reading and 3 hours writing).**
- 2. This examination has two sections A & B.**
- 3. Section A has three Compulsory Questions while B has three Questions two to be attempted.**
- 4. In summary attempt five questions.**
- 5. Marks allocated to each question are shown at the end of the question.**
- 6. Show all your workings**

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SECTION A

This section has three compulsory questions

QUESTION ONE

The Amafaranga Company limited is using a machine whose original cost was Frw.7,200,000. The machine is two years old, and it has current market value of Frw 1,600,000. The assets is fully being depreciated over a twelve year period. At the end of twelve years the assets will have zero salvage value. Depreciation is on straight line basis.

The management is contemplating the purchase of new machine to replace the old one. The new machine costs Frw.7,500,000 and has an estimated salvage value of Frw.1,000,000. The new machine will have a greater technology capacity, and therefore annual sales are expected to increase from Frw. 100,000,000 to Frw 101,000,000. Operating efficiencies with the new machine will produce an expected saving of Frw.1,000,000 a year. Depreciation is on a straight line basis over a ten year life. The cost of capital is 12% and tax rate applicable is 40%.

When the new machine is bought, inventories will increase by Frw1,500,000 while payables will increase by Frw 500,000 for the entire life of the project.

REQUIRED:

- a) Should the old machine be replaced **(18 Marks)**
 - b) What other factors are likely to be considered in addition to quantitative ones highlighted above. **(7 Marks)**
- (Total 25 Marks)**

QUESTION TWO

The management of UKURI Ltd. are in the process of determining the optimal capital budget of the company for the year ending 30 June 2014. The following information is available:

1. The profit after tax for the year ending 30 June 2014 is estimated to be Frw. 22,500,000.
2. The dividend payout ratio is 40%.
3. The ordinary shares of the company are currently trading on the stock exchange at Frw.800 per share.
4. The ordinary shareholders expect a dividend of Frw.60 per share for the year ending 30 June 2014
5. The annual growth rate in dividend is 6% per annum
6. Flotation costs amount of Frw.80 per ordinary share issued. The company could issue an unlimited number of 11% preference shares at Frw.960 per share. The par value per share is Frw. 1,000.
7. The company could obtain bank loans of up to Frw. 24,000,000 at a pre-tax interest rate of 10% per annum. Thereafter, an unlimited amount of bonds could be issued under the following terms:

i	Coupon interest rate 12 % per annum
ii	Par value Frw 1,000 per bond
iii	Discount Frw 30 per bond
iv	Flotation cost Frw 20 per bond
v	Maturity period ten years

The optimal capital structure of the company comprises 15% debt, 40% preference share capital and 45% equity.

1. Corporation tax rate is 30%.

REQUIRED:

The cost of capital for each source of finance available to UKURI Ltd **(20 Marks)**

QUESTION THREE

- (i) Distinguish between internal financing and external financing when applied to a corporation. **(2 Marks)**
- (ii) Specify two differences between debt and equity. **(2 Marks)**
- b) The following has been obtained from the accounts of Kibazo Limited.

Year ended 31 st December	2014	2013
	Frw"000"	Frw"000"
Stock at 31 st December	282,000	201,000
Purchases	764,000	580,000
Cost of sales	990,000	760,000
Sales	1,095,000	870,000
Trade debtors	260,000	173,000
Trade creditors	107,000	91,000
Total assets excluding socks and debtors	90,000	92,000

REQUIRED:

- If a year has 365 days, calculate the length of working capital cycle for each year. **(8 Marks)**
 - Why is a working capital cycle of importance. **(3 Marks)**
- (Total 15 Marks)**

SECTION B

This section has three questions and two are to be attempted

QUESTION FOUR

The following information has been extracted from the published accounts of RUHAGO Corporation Limited, accompany quoted on Rwanda Stock Exchange:

Description	Amount in Frw
Net profit after tax and interest	9,900,000
Less: dividends for the period	7400,000
Retained earnings for year	2,500,000
Retained earnings balance brought down	8,100,000
Retained earnings balance carried forward	10,600,000
Share capital (Frw.100 par value)	80,000,000
Market price per share	120

REQUIRED:

- What is meant by “a company quoted on the Rwanda Stock Exchange “? (2 Marks)
 - Calculate for RUHAGO Corporation Limited the following ratios and indicate the importance of each to Miss Umurerwa, a shareholder :
 - Earnings per share ; (4 Marks)
 - Price earnings ratio; (5 Marks)
 - Dividend yield ; (5 Marks)
 - Dividend cover ; (4 Marks)
- (Total 20 Marks)**

QUESTION FIVE

- Using appropriate illustration, differentiate between Capital Structure and Financial Structure (5 Marks)
 - Discuss at least five (5) factors that affect the Capital Structure of a firm (5 Marks)
 - Discuss the following key concepts as used in finance:
 - Pecking Order Theory (2 Marks)
 - Equity Finance (2 Marks)
 - Rights Issue (2 Marks)
 - Bonus Issue (2 Marks)
 - Financial Risk (2 Marks)
- (Total 20 Marks)**

QUESTION SIX

Paul plans to invest in ordinary shares for a period of fifteen years, after which he will sell them out. He feels that X Ltd is currently, but temporarily, undervalued by the market. Paul expects X Ltd's current earnings and dividend to double in the next fifteen years. X Ltd's last dividend per share was Frw 30, and its share currently sells for Frw 350 a share.

- (i) If Paul requires a 12% return on his investment, will X Ltd be a good buy for him? **(6 Marks)**
- (ii) What is the maximum that Paul could pay for X Ltd's share and still earn his required 12%? **(4 Marks)**
- (iii) What might be the cause of such a market undervaluation? **(6 Marks)**
- (iv) Given Paul's assumptions, what market capitalization rate for X Ltd does the current price imply? **(4 Marks)**

(Total 20 Marks)

End of question paper

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