



ASSIGNMENT MEMORANDUM

SUBJECT : FINANCIAL MANAGEMENT 2 (FM202)

ASSIGNMENT : 2ND SEMESTER 2011

QUESTION 1 [35]

1.1 The role of marketing is to support the medium- to long-term financial goal which is to increase the value of the firm✓, thereby increasing the wealth of the owners✓. Marketing can contribute to wealth creation by ensuring proposals to invest in assets that will generate adequate returns in excess of the original investment costs✓. (Medium term is regarded as 12 months to 5 years and long term refers to a period of 5 years or longer.) The short-term (up to 12 months) financial goal of a business is to ensure profitability✓, liquidity✓ and solvency✓. **(6)**

Profitability relates to the ability of the business to generate revenues that will exceed total costs✓ by using its assets for productive purposes✓. The **role of marketing** in achieving the profitability goal is to market products or services✓ to include a sufficient profit margin✓, with the support of promotion✓ at competitive prices✓ to appropriate target markets✓ through appropriate distribution channels✓. **(8)**

Liquidity is the ability to satisfy short-term obligations as they become due and can be achieved by:

- Accelerating cash flows from accounts receivable (debtors) ✓
- Delaying cash flows by paying accounts payable (creditors)✓ as late as possible without damage to the credit record of the business✓ and maintaining good relations with suppliers✓.

Marketing's role in improving liquidity is to design campaigns and promotions that will stimulate sales✓ to ensure that any over-investment in inventory (stock) is reduced✓ and by stocking a range of products that are in demand and will turn over rapidly✓. **(Maximum 6)**

Allow 1 mark per ✓, maximum of 20

- 1.2 Marketing must understand both financial and management accounting and the role and importance of each discipline in the business environment. In many organisations, it is unlikely to find a specialist cost and management accountant. In such instances marketing will find that their roles as marketing specialists require a considerable amount of management accounting skills. It is under these circumstances that marketing staff need to understand what tools are available to aid decision making.

Ratio analysis✓ is one tool in the strategic decision-making process. Management accountants use ratios along with other internal business data and publicly available information✓ to assess aspects of a company's performance✓. **(3)**

Other tools available to a management accountant include:

- **Cash flow forecasts**✓ which look at likely future flows of costs and revenues✓. The business uses these to plan expenditure and to see where it might need to borrow✓. **(3)**
- **Budgets**✓, which are financial plans for the future. They help the business to see where it will incur costs and where revenues will come from✓. They are particularly important in helping to coordinate the different parts or activities of a business✓. **(3)**
- **Variance analysis**✓ which shows the difference between what was forecast to happen (in a budget) and what actually happened✓. The reason for this difference can then be analysed to show why the variance occurred. Management accountants can then see how the business can build on positive variances or avoid negative ones in future✓. **(3)**

- **Investment appraisal** ✓ helps to decide whether a particular investment is worthwhile or not ✓. It looks at the costs of investing, for example, in a new factory or processes and at the likely financial returns ✓. **(3)**

Allow 1 mark per ✓, maximum of 15

QUESTION 2

[20]

The firm is **making use of equity and debt financing** as a form of long-term financing ✓.

The firm has an **authorised** share capital of:

500,000,000 ordinary shares ✓,
 20,000,000 non-redeemable cumulative non-participative preference shares ✓,
 18,000,000 'A' convertible redeemable non-cumulative participative preference shares ✓,
 4,000,000 'B' convertible redeemable non-cumulative participative preference shares ✓.

The equity financing comprises issued share capital of the respective classes as set out in note 8 (increases in all classes over 2009) ✓,
 plus premiums (increase from 2009) ✓,
 plus general reserves (increase from 2009) ✓,
 plus retained profits (decline from 2009) ✓.

The firm has also issued preference shares ✓

Total debt ratio =	<u>Non-current liabilities + Current liabilities</u>	<u>x 100</u>	<u>895.3 + 9802.3</u>	<u>858.3 + 8571.9</u>	
	Total assets	1	14289.4	12526.9	
			74.86%	75.28%	✓✓
The Total debt ratio declined from the previous year	from 75.28% to 74.86%				✓
The financial risk was reduced in comparison to the previous year as a smaller percentage of assets were financed through borrowed funds					✓✓

Debt-equity ratio =	<u>Non-current liabilities</u>		<u>895.3</u>	<u>858.3</u>	
	Total equity		3591.8	3096.7	
			0.25	0.28	✓✓
The Debt-equity ratio declined from the previous year	from 0.28 times to 0.25 times				✓
Shareholders' funds covers debt at a ratio of R1 debt for R4 worth of equity indicating low financial risk exposure through long-term debt					✓✓

Each ✓ = 1 mark

QUESTION 3**[35]**

a) Gross profit margin =	<u>Gross profit</u>	<u>x 100</u>	<u>8571.7</u>	<u>7777.7</u>		
	Sales	1	47451	43128.7		
			18.06%	18.03%	✓✓	
The gross profit margin improved over the previous year	from 18.03% to 18.06%				✓	
This results from a moderate increase of 10.02% in sales and					✓	
a moderate increase of 9.98% in cost of sales.					✓	5
b) Net profit margin =	<u>Profit for the year</u>	<u>x 100</u>	<u>1211.8</u>	<u>1281.6</u>		
	Revenue	1	47550.6	43231.8		
			2.55%	2.96%	✓✓	
The net profit margin declined from the previous year	from 2.96% to 2.55%				✓	
This results from a moderate increase of 13.05% in Employment costs and					✓	
a moderate increase of 13.35% in Occupancy costs and					✓	
a significant increase of 109.57% in Foreign exchange loss and					✓	
a moderate increase of 14.83% in Other operating costs.					✓	(max. 5)
c) Return on Assets =	<u>Profit for the year</u>	<u>x 100</u>	<u>1211.8</u>	<u>1281.6</u>		
	Total assets	1	14289.4	12526.9		
			8.48%	10.23%	✓✓	
The ROA declined from the previous year	from 10.23% to 8.48%				✓	
This results from a small decrease of -4.31% in Profit before taxation and					✓	
a moderate increase of 14.07% in Total assets.					✓	5
d) Return on Equity =	<u>Profit for the year</u>	<u>x 100</u>	<u>1211.8</u>	<u>1281.6</u>		
	Total equity	1	3591.8	3096.7		
			33.74%	41.39%	✓✓	
The ROE declined from the previous year	from 41.39% to 33.74%				✓	
This results from a small decrease of -4.31% in Profit before taxation and					✓	
a significant increase of 15.99% in Total equity.					✓	5
e) Current ratio =	<u>Current assets</u>		<u>9314.5</u>	<u>8129.4</u>		
	Current liabilities		9802.3	8571.9		
			0.950	0.948	✓✓	
The current ratio improved over the previous year	from 0.948 times to 0.95 times				✓	
This results from a moderate increase of 14.58% in Current assets and					✓	
a moderate increase of 14.35% in Current liabilities.					✓	5
f) Quick ratio =	<u>Current assets - Inventories</u>		<u>9314.5 - 5601.5</u>	<u>8129.4 - 4893.2</u>		
	Current liabilities		9802.3	8571.9		
			0.379	0.378	✓✓	
The quick ratio improved over the previous year	from 0.378 times to 0.379 times				✓	
This results from a moderate increase of 14.48% in Inventories and					✓	
a moderate increase of 14.35% in Current liabilities.					✓	5
g) Inventory turnover =	<u>Cost of sales</u>		<u>38879.3</u>	<u>35351</u>		
	Inventories		5601.5	4893.2		
			6.94	7.22	✓✓	
The inventory turnover declined from the previous year	from 7.22 times to 6.94 times				✓	
This results from a moderate increase of 9.98% in cost of sales and					✓	
a moderate increase of 14.48% in Inventories.					✓	5

Each ✓ = 1 mark

QUESTION 4**[10]**

		% change	2010	2009	
Degree of operating leverage (DOL) =	<u>% change in Operating profit</u>	<u>-4.30%</u>	<u>1866.7</u>	<u>1950.6</u>	
	% change in Sales	10.02%	47451.0	43128.7	
		-0.43			✓✓
The DOL is negative					✓
This results from a small decrease of -4.31% in EBIT and a moderate increase of 10.02% in Sales.					✓
Thus from base sales of R43128.7m a given % increase in sales lead to a change in EBIT that is -0.43 as large.					
Possible reasons for this can be attributed to:		Rm			
11.57% change in Depreciation and amortisation		39.7			✓
131.25% change in Impairment of assets		2.1			✓
13.05% change in Employment costs		387.1			✓
13.35% change in Occupancy costs		156.3			✓
109.57% change in Foreign exchange loss		85.9			✓
14.83% change in Other operating costs		203.3			✓
The most significant of these are the R387.1m change in Employment costs					✓

Each ✓ = 1 mark. Allow maximum of 10 marks for this question.