



## ASSIGNMENT 1<sup>ST</sup> SEMESTER : FINANCIAL MANAGEMENT 3 (FM303)

**STUDY UNITS COVERED : 1 - 2**

**DUE DATE : 3:00 p.m. 20 MARCH 2012**

**TOTAL MARKS : 100**

### INSTRUCTIONS TO CANDIDATES FOR COMPLETING AND SUBMITTING ASSIGNMENTS

The complete 'Instructions to Students for Completing and Submitting Assignments' must be collected from any IMM GSM office, the relevant Student Support Centre or can be downloaded from the IMM GSM website. It is essential that the complete instructions be studied prior to commencing your assignment. The following points highlight only a few important notes.

1. You are required to submit ONE assignment per subject.
2. The assignment will contribute 20% towards the final examination mark, and the other 80% will be contributed by the examination, however the examination papers will count out of 100%.
3. Although your assignment will contribute towards your final examination mark, you do not have to earn credits for admission to the examinations; you are automatically accepted on registering for the exam.
4. Number all the pages of your assignment (e.g. page 1 of 4) and write your name and surname, student number and subject at the top of **each** page.
5. The IMM GSM requires assignments to be presented on plain A4 paper. You must show all working calculations, including and where appropriate multiple choice working calculations.
6. A separate assignment cover, which is provided by the IMM GSM, must be attached to the front cover of each assignment.
7. Retain a copy of each assignment before submitting, in case the original does not reach the IMM GSM.
8. The assignment due date refers to the day up to which assignments will be accepted for marking purposes. The deadline is 3:00 p.m. on 20 March 2012. Late assignments will be accepted, but **25 marks** will be deducted from the maximum mark, if received after 3:00 p.m. on 20 March 2012 and up to 5:00 p.m. the following day, after which no assignments will be accepted.
9. If you fail to follow these instructions carefully, the IMM Graduate School of Marketing cannot accept responsibility for the return of the assignment. It may even result in your assignment not being marked.

Results will be available on the IMM GSM website, [www.immgsm.ac.za](http://www.immgsm.ac.za), on Friday, 4 May 2012.

**SPECIFIC INSTRUCTIONS:**

**Answer ALL the questions.**

**Show ALL calculations.**

**Read all the questions carefully to determine exactly what is required before attempting to answer.**

**Number your answers clearly and set them out under appropriate headings and sub-headings.**

**QUESTION 1 [10]**

Discuss the **three (3)** fundamental principles of financial management.

**QUESTION 2 [20]**

2.1 Access the GDP release P0441 Stats SA website: <http://www.statssa.gov.za> for the third quarter 2011. This statistical release includes seven tables that relate to estimates of nominal and real GDP.

Tables 1 and 2 show values added by industry at constant 2005 basic prices, in rand million and as percentage changes from the same quarter in the previous year.

- a) Study Table 1 and rank the industries by size of contribution to the GDP. **(5)**
- b) Study Table 2 and rank the industries by growth % for the last available quarter. **(5)**

2.2 You are required to record the repo rate and prime overdraft rate as at 28 February 2012. **(2)**

2.3 Explain the concepts repo rate and prime overdraft rate and explain the relationship between the two rates. **(8)**

**QUESTION 3 [10]**

Apply your knowledge of purchasing power parity to answer the following question. Illustrate your figures by means of a table, accompanied by the explanation to the following:

The exchange rate of R8.15/USD and the product price in South Africa of R500. The product sells in USA for 68 USD.

How does the South African product compare to the US product?

The CPI in South Africa = 4%, CPI in USA = 1.2% and exchange rate strengthens to R6.90/USD.

How does the South African product now compare to the US product?

**QUESTION 4** [25]

4. You are required to answer the following questions about Mayflower Manufacturers.

Mayflower Manufacturers	
Sales	1 500 000
Less: Cost of sales (55% variable)	600 000
Gross Profit	900 000
Less: Fixed operating costs	320 000
EBIT	580 000
Less interest	105 000
Earnings after interest before tax	475 000
Less: Taxes (28%)	133 000
Earnings after taxes	342 000

- 4.1 a) Explain the term '*financial leverage*'. (4)  
 b) Give the alternative formula to calculate the degree of financial leverage of a firm. (1)  
 c) Calculate the degree of financial leverage for the firm. (4)
- 4.2 a) Explain the term '*operating leverage*'. (2)  
 b) Give the alternative formula to calculate the degree of operating leverage of a firm. (1)  
 c) Calculate the degree of operating leverage for the firm. (4)
- 4.3 Calculate the degree of combined leverage for the firm. (3)
- 4.4 If sales should increase by 25% for this firm:  
 a) By what percentage would the earnings after tax increase? (3)  
 b) What is the new rand value of earnings after tax? (3)

**QUESTION 5** [10]

You are required to calculate the WACC of the firm Action Ltd. which has the following capital structure. The firm has a 30% marginal tax rate.

Action Ltd		
Source of finance	Amount	Pre-tax cost
Debt	5 092 000	11.00%
Preference shares	2 680 000	14.00%
Ordinary shares	4 690 000	12.50%
Retained earnings	938 000	15.00%

**QUESTION 6****[25]**

AgriFarms is operated on business principles. The owners have to choose between borrowing R1,750,000 in order to buy a combine harvester and leasing it. If they take the loan, it must be repaid in 4 annual instalments at an interest rate of 10%. These loan payments amount to R552,074 per annum. The firm is subject to a 30% tax rate.

If the asset is leased, annual lease payments are R535,000.00.

The annual maintenance will cost the firm as follows:

Year 1	R18,000
Year 2	R20,000
Year 3	R15,000
Year 4	R26,000

Straight-line depreciation per annum is R437,500.

Required:

- Prepare an amortisation schedule for the loan if the item is acquired by a loan. **(8)**
- Determine the after-tax flows for borrowing the money and buying the item. **(8)**
- Perform a comparison of after-tax flows of borrowing and buying vs leasing the item. **(8)**
- Indicate if it is better to lease or to borrow and buy the item. **(1)**

Prepare your answer using a table/column format.

**ASSIGNMENT TOTAL: 100**