

UNIVERSITI SAINS MALAYSIA

SPECIAL EXAMINATION
1992/93 ACADEMIC SESSION.

MASTER OF BUSINESS ADMINISTRATION

AGW 518 - FINANCIAL MANAGEMENT

TIME : 3 HOURS
TOTAL MARKS : 100

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Answer any five questions including Question No. 1 which is compulsory. All questions carry equal marks.

1. M & N Sdn Bhd has requested a loan from your bank. The loan is to be used to finance current assets, and will be repaid within three years. The company has supplied the bank with its financial statements as follows.

M & N SDN BHD

Balance Sheet as at December 31, 1986

	\$
Cash	750
Trade debtors	24,000
Stocks	68,250
Total Current Assets	<u>93,000</u>
Land	39,000
Building and equipment, net (depreciation - \$57,000)	93,000
Total Fixed Assets	<u>132,000</u>
	<u>225,000</u> =====
Trade creditors	33,000
Short-term loans	70,500
Total Current Liabilities	<u>103,500</u>

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Long-term loans	34,425
Shares	47,250
Unappropriated profits	39,825
	<u>225,000</u>

Trading and Profit and Loss Account for year ended
December 31, 1986

		\$
Sales		240,000
Cost of goods sold		<u>144,000</u>
Gross profit		<u>96,000</u>
Less:	Fixed operating expenses	31,500
	Variable operating expenses	24,000
	Depreciation	15,000
	Interest	9,150
	Total Expenses	<u>79,650</u>
Profit before tax		16,350
Income Tax		<u>8,175</u>
Net profit		<u>8,175</u>

(a) Based on the financial statements, complete the following table:

	<u>1985</u>	<u>1986</u>	<u>Industry Average</u>
1. Current ratio	1.84	-	1.80 times
2. Quick ratio	0.78	-	0.70 times
3. Average collection period (use 360 days)	36 days	-	37 days
4. Stock turnover (use 360 days)	2.59 times	-	2.5 times
5. Total debt to total asset	50%	-	50%
6. Long-term debt to total capitalization	33.8%	-	33%
7. Interest coverage ratio	4.0 times	-	3.8 times
8. Gross profit margin	40%	-	38%
9. Profit margin before tax	9.6%	-	10%

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10.	Net profit margin	3.6%	-	3.5%
11.	Total asset turnover	1.11 times	-	1.14 times
12.	Fixed asset turnover	2.02 times	-	1.40 times
13.	Return on total assets	10.6%	-	4.0%
14.	Return on shareholders' funds	8.0%	-	9.5%

- (b) What are the factors you would consider in assessing M & N's loan request?
- (c) Based on the information available, should the bank grant the loan to M & N? Explain.
2. The directors of Maju Bhd. have asked you to analyse the following information in the context of working capital management.

Year ended December 31,	<u>19X4</u>	<u>19X5</u>
	\$	\$
Sales	300,000	360,000
Cost of sales	255,000	306,000
Total materials purchased	150,000	180,000
Stocks: Materials	36,000	54,000
Finished goods	22,500	27,000
Trade creditors	30,000	18,000
Trade debtors	37,500	60,000

Exercise:

- (a) Calculate the operating cycle of the company for each year and suggest possible reasons for any change in the length of the operating cycle.
- (b) Analyse the change in working capital due solely to:
 (i) the increase in sales and the cost of sales
 (ii) a change in the turnover periods.
 Comment briefly on the effect of the above on the cash position of Maju Berhad.

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3. Chemical Company Berhad

The management of Chemical Company Berhad is considering replacing one of its machines used in trimming moulded plastic. The old machine was purchased five years ago at a cost of \$75,000. The machine had an expected life of fifteen years at the time it was purchased, and it was estimated then that its salvage value would be zero at the end of the fifteen years. The machine is being depreciated on a straight-line basis and its present book value is \$50,000.

The production manager reports that a new machine can be purchased at the following costs:

Invoiced price of new machine	\$100,000
Installation cost	10,000
Shipping cost	6,000
Freight insurance	4,000
	<hr/>
	\$120,000
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The new machine has an expected useful life of ten years. It will reduce labour and raw material usage sufficiently to cut operating costs from \$70,000 to \$40,000 per annum. It is estimated that the new machine can be sold for \$20,000 at the end of ten years. The old machine's actual current market value is \$15,000 and the estimated cost of disposing this machine is \$5,000.

An investment tax credit of 25 per cent can be claimed on the total outlay if the new machine is acquired. Working capital would increase by \$10,000.

The company uses discounted cash flow techniques to evaluate capital replacement decisions. Assume that company's tax rate is at 45% depreciation is on a straight-line method, accounting and tax rates for depreciation of assets to be equal and tax expense is paid in the year it is incurred.

Exercise:

- (a) Establish the cash flows of the replacement decision.
- (b) If the company's cost of capital is 10%, calculate the following:
 1. the payback period;
 2. the net present value;
 3. the profitability index; and
 4. the internal rate of return
 Should the company proceed with its plan? Explain.

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4. 'Cash is no different from any other asset - if it is not being utilised properly it is going to result in lower profits.'

Discuss this statement, in particular referring to the motives for holding cash.

5. (a) The term 'financial intermediaries' can be applied to those financial institutions which assist in overcoming the difficulties of ensuring that savings are channelled into economically desirable projects.

You are required to describe:

- (i) the nature of these difficulties
- (ii) four main ways in which financial institutions help to overcome the difficulties
- (iii) why growth in size of such financial institutions can be advantageous.

- (b) In relation to financial markets, you are required to:

- (i) distinguish between the nature and functions of 'primary' and 'secondary' markets.
- (ii) comment briefly on the suggestion that inadequate investment in industry is caused by diversion of funds into speculation in secondary markets.

6. (a) For what purposes might a company consider making a rights issue of ordinary shares?

Why under particular circumstances might this be preferable to other means of raising long-term capital?

- (b) Do you consider that a dilution in net earnings per share as the result of a rights issue would ever be acceptable to the shareholders?

7. Comment on the desirability of using a bank overdraft instead of a long-term debt to finance investment projects.

...6/-

	11%..	12%..	13%..	14%..	15%..	16%..	17%..	18%..	19%..	20%..	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	2
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	3
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	4
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	5
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	6
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.311	0.296	0.279	7
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	8
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	9
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	10
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	11
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	12
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	13
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	14
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	15

...7/-

APPENDIX II

FINANCIAL MANAGEMENT

	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
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