



CRAWFORD UNIVERSITY

FAITH CITY, IGBESA

TITLE OF EXAMINATION : B.Sc EXAMINATION.
COLLEGE: COLLEGE OF BUSINESS AND SOCIAL SCIENCES
DEPARTMENT: ACCOUNTING AND FINANCE
SESSION : 2018/19 **SEMESTER: HARMATTAN**
COURSE: FINANCIAL MANAGEMENT
COURSE CODE: FIN 403/ACC 405 **CREDIT: 3 UNITS**
TIME ALLOWED:
INSTRUCTIONS: (i) Answer two questions from each section.

(ii) Time allowed: 2 hours 30 minutes

SECTION A

QUESTION ONE

The relevant data for two companies is as follows:

	Ojo Plc	Aina Plc
Current earnings	₦1,600,000	₦700,000
Number of shares in issue	2,000,000	2,000,000
Proportion o earnings retained.	None	40%
Return on investment	N/A	25%
Required return on ordinary shares	15%	18%

Both dividends have just been paid.

Aina Plc wishes to take over Ojo Plc, it will retain the same dividend policy but the return earned on new investments will fall to 20% and the required rate of return of the ordinary share will be 16%.

Required:

- Calculate the existing price of Ojo Plc and Aina Plc. 7mks
- Evaluate the maximum price which Aina Plc should pay for Ojo Plc. 4mks
- Calculate the number of shares issued to the shareholders of Ojo Plc if the takeover price is agreed at ₦11million. 4mks

(15MARKS)

QUESTION TWO.

Kings Ltd manufactures chocolate products and sells through a number of wholesalers:

- (i) The budgeted sales for the company for the eight months up to 31st December, 2017 are as follows:

Month	Sales. ₦
May	1,200,000
June	1,400,000
July	600,000
August	800,000
September	900,000
October	1,600,000
November	2,000,000
December	1,800,000

- (ii) Cash sales are generally about 10% of total sales; a further 60% of total sales are paid for within about 30 days and another 25% within 60 days; Bad debts tend to average at about 5% of sales.
- (iii) The company purchases its raw materials at 65% of their final sales value. Purchases are made two months prior to sale and suppliers are paid one month after delivery.
- (iv) Other expenses paid as incurred are expected to amount to ₦200,000 per month.
- (v) The budgeted sales for January and February 2017 are ₦1,500,000 and ₦1,000,000 respectively.
- (vi) At the end of June 2017, the cash balance is expected to be ₦100,000.

(15MARKS)

QUESTION THREE

Discuss the dividend policy of a firm under the residual theory and the arguments in favour of high dividend payouts.

(15MARKS)

SECTION B

QUESTION FOUR

4a

KRISKEY VENTURES LTD expects ₦1,000,000 income before interest and taxes and has ₦2000,000 debentures whose coupon rate is 10%. Granted that equity capitalization rate (which is equity cost of capital) is 16%. Calculate using net income approach, the

1. Net income

1mk

- II. Value of equity 1mk
- III. Total value of firm 1mk
- IV. Overall cost of capital 2mks

4b. Suppose the firm decides to issue 1,000,000 10% debenture in addition to the existing one, in place of the same amount of equity in its capital structure, what will happen to the overall cost of capital and the value of the firm. 2mks.

4c. List what make of debt capital 1 mark

8marks

4d

EzyChigo Plc and Precious Charles Plc are in the same risk class and identically levered company, has #9,000,000 debenture, carrying 10% rate of interest. Both companies earn 20% before interest and taxes on their total assets of #15,000,000. Assume perfect market, tax rate of 50% and capitalization rate of 15% for an all equity company

- i. Compute the value of both companies using net operating income approach.
- ii. Using net operating income approach; calculate the overall cost of capital for both companies

7 marks

(15MARKS)

QUESTION FIVE

- A. What is the major problem in IRR(Internal Rate of return) calculation and how do you go about that 2 marks
- B. An oil exploring company is considering a capital project costing #7,500,000. The project is expected to generate future cash flow of the following stream

Year 1	#1,500,000
Year2	#2,000,000
Year3	#2,800,000
Year4	#2,300,000
Year5	#2,500,000
Year6	#2,100,000
Year7	#1,900,000
Year8	#1,500,000
Year9	#2,000,000
Year10	#1,800,000

The company cost of capital is placed at 25% meanwhile; the policy of the company is to maintain 20% of the initial outflow as scrap value of the invested

asset. You are required to calculate the internal rate of returns for the project using a straight line method of depreciation 10marks

- C. Assuming the company decided to do away with this project and the investment was disposed off in the 9th year, you are required to determine the next return on investment 3marks

(15MARKS)

QUESTION SIX

- a. Company must have certain character to be considered viable or valuable towards its ability to be in continuous business. What in your opinion makes company valuable 2marks
- b. Why should Joy as business consultant when carrying out business valuation, focus on cash flow 3marks
- c. Darlington and Sons Plc and Promise Plc are two companies operating in the same line of business. Darlington Plc is considering taking over promise Plc and the deal is concluded on the 31st Dec 2017. The statement of financial position of the two companies are as follows,

	Darlington Plc	Promise Plc
Capital employed		
1.00 ordinary share	#2,000,000	#1,000,000
10% preference share	#500,000	-----
Capital reserve	-----	#40,000
Retained profit	#500,000	#50,000
10% debenture	#300,000	#75,000
Employment of capital		
Noncurrent assets	#2,800,000	#900,000
Net current assets	<u>#500,000</u>	<u>#265,000</u>
Total	<u>#3,300,000</u>	<u>#1,165,000</u>

The company has a maintainable annual profit of :

#480,000

#150,000

In considering the takeover bid, evaluate the two businesses separately using the following basis

- I. Net assets value per share
- II. Earnings per share
- III. Debt equity ratio
- IV. Compute (i) to (iii) above by merging the two companies

10 marks

(15MARKS)