



QQI

BA (HONS) ACCOUNTING & FINANCE

BA (HONS) FINANCIAL SERVICES

AUTUMN 2024 EXAMINATIONS

Module Code: **B7AF100**
Module Description: **Financial Management**
Examiner: **Derek Reynolds**
Internal Moderator: **Aida Salina Jailani/Paul Walsh**
External Examiner: **Shane Moran**

INSTRUCTIONS TO CANDIDATES.

Time allowed is 3 hours
Answer any 5 questions
All questions carry equal Marks
Calculators are allowed

By submitting your answers as part of this exam you certify that all work provided is wholly your own, done without the intervention, help or guidance of any third party

Question 1

Slainte is a large Irish company and are currently looking to raise finance in order to fund expansion. The directors have decided to make a one-for-five rights issue at a discount of 30% to the current market value. Extracts from the company's most recent financial statements are as follows:

Statement of Comprehensive Income for the year-ended 31st December 2023

Sales	<u>€ 1,400,000,000</u>
Operating profit	€ 52,000,000
Interest	<u>€ 24,000,000</u>
Profit before tax	€ 28,000,000
Corporation tax	<u>€ 7,000,000</u>
Profit after tax	€ 21,000,000

Statement of changes in Equity for the year-ended 31st December 2023

	Share capital	Retained Earnings	Revaluation Reserve	Total
Balance 1st January 2023	€ 60,000,000	€ 313,000,000	€ 140,000,000	€ 513,000,000
Profit for the year		€ 21,000,000		€ 21,000,000
Dividends for the year		<u>(€ 14,000,000)</u>		<u>(€ 14,000,000)</u>
Balance 31st December 2023	€ 60,000,000	€ 348,000,000	€ 140,000,000	€ 520,000,000

Additional information

- The shares of Slainte have a par value of €0.25 and are currently traded on the Euronext Dublin Stock Exchange at €1.50 per share.

An investor who owns 12,000 ordinary shares in the business has received information concerning the forthcoming rights issue but cannot decide whether to

- a) Take up the rights issue in full,
- b) Sell all his rights, or
- c) Allow the rights offer to lapse.

Requirement:

- a) Calculate the *theoretical ex-rights price* of an ordinary share in Slainte plc and the total number of shares in issue after the rights issue.

(6 Marks)

- b) Calculate the total value of funds raised assuming the rights issue is fully subscribed too.

(2 Marks)

- c) Evaluate each of the three options listed above for the investor who owns 12,000 ordinary shares in the company prior to the rights issue, assuming rights can be sold at the maximum price calculated in (b) above.

(8 Marks)

- d) Explain a *rights issue* and a *bonus issue* and explain **TWO** differences between them.

(4 Marks)

(Total 20 Marks)

Question 2

Candour plc plan on buying a new machine at a cost of €1,280,000 payable immediately. This new machine has an expected life of five years.

Production and sales from the new machine are expected to be 120,000 units per year. Each unit can be sold for €16.50 per unit and will incur variable costs of €11 per unit. Incremental fixed costs arising from the operation of the machine will be €160,000 per year. There is no inflation expected on selling price, variable costs or incremental fixed costs.

Additional information:

- Investment in working capital of €110,000 will be required at the start of the first year of operations.
- At the end of five years, the machine will be sold for scrap, with the scrap value expected to be 5% of the initial purchase cost of the machine.
- Candour plc currently has an after-tax cost of capital of 11% which they use as a discount rate for investment appraisal purposes.
- The company pays corporation tax in the year of the cashflow at a rate of 25% per year.
- This investment does not qualify for capital allowances and they should therefore be ignored.

Requirement:

- a) Calculate the net present value of investing in the new machine and advise whether the investment is financially acceptable.

(7 Marks)

- b) Calculate the internal rate of return of investing in the new machine and comment on whether the investment is financially acceptable.

(5 Marks)

- c) Briefly discuss ***TWO*** advantages and disadvantages of net present value as an investment appraisal technique.

(8 Marks)

(Total 20 Marks)

Question 3

- 1) Initial Public Offering (IPO)

(4 Marks)

- 2) Working Capital Management (WCM)

(4 Marks)

- 3) Liquidity

(4 Marks)

- 4) Weighted Average Cost of Capital (WACC)

(4 Marks)

- 5) Sensitivity Analysis

(4 Marks)

Requirement:

Explain the **FIVE** items above and the importance of each to Financial Management, providing examples where appropriate for each.

(Total 20 Marks)

Question 4

Boom plc is a large explosive supplies company, who currently supply demolition companies all over the globe. One ordinary share of Boom plc is currently trading at €3.25. Below is an extract from the Statement of Financial Position for Boom plc:

Statement of Financial Position (extract) 31st December 2023.**Equity & Liabilities**

Ordinary share capital (€0.67)	€ 1,206,000
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Non-current liabilities

4% Bond	€ 630,000
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8% Preference Shares (€1.30)	€ 260,000
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Current liabilities

Payables	€ 42,000
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Bank overdraft	€ 68,000
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You have also been supplied with the below information;

- a) Corporation tax rate is 25%.
- b) Current market price of preference shares is €2.75.
- c) The bond is trading in the secondary market at a discount to par of 12%.
- d) Equity shareholders expect at 10% return from their investment.

Requirement:

- a) Calculate the market value post-tax Weighted Average Cost of Capital (WACC) for Boom plc.

(14 Marks)

- b) Explain TWO advantages of using WACC as a discount rate for investment appraisal purposes.

(4 Marks)

- c) Explain TWO reasons when it is not appropriate to use WACC as a discount rate for investment appraisal.

(2 Marks)**(Total 20 Marks)**

Question 5**Part A**

You work as a general financial advisor for a large financial consultancy firm. You have numerous clients one of whom have come to you with a specific issue – listed below.

Client 1 – Issue

A professional American football player has been approached by three well known US football teams who have proposed the following packages payable over the term of the contract.

1. New York Giants have proposed a signing bonus €3,000,000, payable immediately and an annual salary of €600,000 from the first year increasing at a rate of 6% thereafter until the end of the **five-year contract**.
2. San Francisco 49ers have proposed at €3,200,000 signing bonus payable immediately and an annual salary of €700,000 from the first year increasing at a rate of 7% per annum until then end of the **four-year contract**.
3. New York Jet have proposed a signing bonus €2,500,000, payable immediately and an annual salary of €650,000 from the first year increasing at a rate of 8% thereafter until the end of the **six-year contract**.

Additional information

Assume that your client has other investments that return them 10% per annum.

Requirement:

- a) Calculate the present value of each option for your client.

(12 Marks)

- b) Make a recommendation about which team that your client should sign up to for the coming season, explaining the reason for your decision

(2 Marks)

Part B

A stock exchange listing comes with many advantages however there are also some disadvantages.

Requirement:

- a) Explain any **FOUR** disadvantages to any company of becoming listed on a recognised stock exchange.

(4 Marks)

- b) List **TWO** alternative sources of long-term finance that a company might consider rather than a stock exchange listing

(2 Marks)

(Total 20 Marks)

Question 6

Omega Ltd. has annual sales of €2,500,000, and has historically offered customers 30 days to pay. More recently customers are now taking 70 days to pay. As a result of poor cashflow over the last number of months, the CEO has come up with the following proposal.

They are considering offering customers a 2.5% discount for payments made within 15 days of the invoice being sent.

Additional information

- It is estimated that 60% of customers will take the discount.
- A bank overdraft is available at a cost of 11% per annum.
- Assume that the level of sales will be unaffected by the discount.
- The sales director has confirmed that 20% of sales are cash sales.

Requirement:

- a) Calculate if Omega Ltd should proceed with offering the early settlement discount.

(12 Marks)

- b) Explain the terms **factoring** with recourse and without recourse.

(4 Marks)

- c) Explain **TWO** negative associations that might arise from the use of a factoring agency.

(2 Marks)

- d) Briefly explain the concept in working capital management that *"a company can be liquid or profitable but not both"*

(2 Marks)

(Total 20 Marks)

Question 7

Gamma plc have approached you as a trainee financial advisor and has asked for help on the following items:

Item 1

Gamma plc purchased 40,000 in Junta plc on 31st July 2022 for a total of €730,000. These shares are now trading at €20.25 per share. You have just received a dividend of €1.87 per share.

Requirement:

Calculate Gamma plc's;

- a) Total euro return

(3 marks)

- b) Total percentage return

(1 marks)

Item 2

Gamma plc are considering two different machines for use in a project that they wish to undertake. Details have been provided below for each machine:

Machine 1 will cost €150,000 and it will last three years. It costs €50,000 per year to run.

Machine 2 is the cheaper model and only costs €100,000 but is only capable of lasting two years. Running costs associated with this machine are €60,000 each year.

Gamma plc has confirmed that their pre-tax cost of debt is 10%, and that the tax rate is 20%. Gamma plc uses post tax cost of debt for all investment decisions.

Requirement:

Advise Gamma plc on the optimum replacement cycle for the two machines.

(12 marks)

Item 3

The finance director of Gamma plc has been presented with a project that has a positive NPV of €120,000. The proposal is that each year 100,000 will be sold for the four years of the project. Selling price is estimated to be €22.50

The finance director has asked for your helping in showing the sales director that there is a risk associated with this project, using sensitivity.

Assume the same post tax cost of debt as used for the optimum replacement cycle in Issue 2, above.

Requirement:

Calculate the selling price per unit sensitivity and advise if the finance director is right to be concerned.

(4 marks)

(Total 20 marks)

END OF EXAMINATION