University of Swaziland
Department of Accounting
Supplementary Exam Paper - Semester - II

Programme of Study	:	Bachelor of Commerce
Year of Study	:	Year Three / Level Five
Title of Paper	:	Corporate Finance I
Course Code	:	AC 325/416
Time Allowed	:	**3 Hours.**

Instructions:
1. Total number of questions on this paper is four (4).

2. Answer all the questions.

3. The marks awarded for a question / part is indicated at the end of each question / part of question.

4. Where applicable, submit all workings and calculations on the answer sheet alongside the case.

5. Calculations are to be made to two decimal places of accuracy unless otherwise instructed.

Note: You are reminded that in assessing your work, account will be taken of accuracy of the language and the general quality of expression, together with the layout and presentation of your final answer.

Special requirement : Financial Calculator

This paper is not to be opened until permission has been granted by the invigilator.

QUESTION 1:

a. Strong Boats Inc. currently has sales of E 1,000,000 and its days sales outstanding is 30 days. The Finance Manger estimates that offering longer credit terms would 1) increase the days sales outstanding (DSO) to 50 days and 2) increase sales to E 1,200,000. However, bad debt losses, which were 2 percent on the old sales, would amount to 5 percent on the incremental sales only (bad debts on the old sales would stay at 2 percent). Variable costs are 80% of sales, and Strong Boats has a 15 percent receivable financing cost.

Required:

i) What would the annual incremental pre-tax profits be if Strong Boats extended its credit period?

ii) Recommend which policy should be adopted according to **contribution income approach**, stating the reason.
Note: Use 360 day year. **(15 marks)**

b. You go to three different banks to borrow E 10,000 for one year. Each says it will lend you the money at 10 percent, but their terms differ as follows:

Bank A: Simple interest
Bank B: Add-on interest
Bank C: Discounted interest

Banks A and C require a single payment at the end of the year. Bank B requires 12 equal monthly payments beginning at the end of the first month. What is the difference between the highest and lowest effective annual rate in this case.

(10 marks)
Total (25 marks)

QUESTION 2:

Patricia Dlamini, the owner of Purity Garments., is planning to request a line of credit from her bank. She is a novice in budgeting and she asks you, a finance expert to help her with the preparation of cash budget. Her marketing manager has provided you with the following sales forecasts and purchases forecasts by the production manager for the firm.

Month and Year	Sales	Purchases
November, 2014	E 50,000	E 60,000
December	80,000	40,000
January, 2015	25,000	30,000
February	35,000	20,000
March	40,000	40,000
April	50,000	35,000

- Collection estimates obtained from the credit department are as follows:
  Collections within the month of sale, 25 percent
  Collections the month following the sale, 60 percent.
  Collections the second month following the sale, 15 percent
- Other cash inflows are expected to be E 5,000 in February and E 10,000 in March.
- Payments for purchases are typically made during the month following the one in which these costs have been incurred.
- Wages and salaries amount to 20 percent of preceding month's sales
- Lease payments are E 2,500 a month
- Depreciation charges will be E 8,000 a month
- Tax of E 10,000 is due in March
- The firm intends to buy noncurrent assets of E 2,000 in the month of January
- A principal payment of E 3,000 is due in February.
- Cash on hand on 1st January 2015 will amount to E 500

Required:

i) Prepare a cash budget for the first four months of the year 2015

ii) Assuming that the firm wishes to maintain E 2,000 of minimum cash balance through-out the budget period, determine the required total financing or excess cash balance for each month, January through April

iii) Required line of credit to cover the needed financing for the period January through April. How large would this line have to be? Explain your answer

Total(25 marks)

QUESTION 3:

a. Your company is considering two mutually exclusive projects, X and Y, whose costs and cash inflows after tax are shown below:

Year	X	Y
0	E – 2,000	E -2,000
1	200	2,000
2	600	200
3	800	100
4	1,400	75

The projects are equally risky, and the firms required rate of return on the projects is 12 percent.

Required:

i) Calculate NPV of each of the projects.
ii) Calculate IRR of each of the projects
iii) Also calculate MIRR of each of the projects
iv) Recommend which project is better based on each of the above three criterion.

(12 marks)

b. Swazi Candles is a big manufacturer of stylized candles in different shapes and colours, located in Ezulweni Valley. Through-out the year the firm uses 500,000 tons of wax for making the candles and the purchase price of the wax for the firm is E 1,000 per ton. The cost of placing each order is E 2,500 and the carrying cost is 10% per ton. It takes the company 7 days from the date of order to the day of receiving. The firm has a habit of keeping at least 5 days of inventory in stock.

Required:

i) What is the EOQ? (Round it off to nearest integer)
ii) How many orders should Swazi Candles place each year?
iii) What is the value of the average inventory in store?
iv) At what inventory level should an order be placed?
v) What are the total costs if the order quantity is a) EOQ b) 4,000 c) 6,000 units? Coment.
vi) Now, suppose the supplier of wax offers a discount of **1 percent** for orders at least 7,000 tons, should the firm increase its ordering quantity to utilize the discount?

(15 marks)
Total (27 marks)

QUESTION 4:

Write **Short Note** on the following:

a. Financial leverage	**(5 marks)**
b. Accounts receivable financing	**(5 marks)**
c. Distinguish Line of credit and revolving credit	**(5 marks)**
d. Capital budgeting process	**(5 marks)**
e. Disbursements control in cash management	**(3 marks)**

Total (23 marks)

End of exam question paper