MAC 2602
EXAM PACK 2016

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Welcome

If you are reading these tutorials you are studying **(MAC2602)** with UNISA. These are being written in collaboration with all our Together We Pass (MAC2602) group members this term, and will be built upon year on year to create the best set of study material, with the most useful summaries, hints and tips we can possibly put together.

Good luck this term, and we look forward to working with you!

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QUESTION 1 (15 marks) (18 minutes)

(1) Mxolisi has deposited an amount of R1 500 in a bank account. This account earns simple interest of 8% per annum.

REQUIRED:
Calculate the amount of interest that he will earn after 2 years.
Show detailed workings.
[Use four decimal places for your calculations and round your final answer to the nearest rand.]
(2)

a) Every year after Mary has paid all her additional expenses and treated herself to some luxuries she still has R4 200 from her annual bonus available in her bank account. She wants to save this amount and decided to deposit this amount, on an annual basis, for the next 3 years. The special savings account she decided on earns interest at 12%, compounded annually.

REQUIRED:
Calculate the total value of Mary's special savings account at the end of year three by using the mathematical formula.
Show the mathematical formula and detailed workings.
[Use four decimal places for your calculations and round your final answer to the nearest rand.]
(4)

a) Helen will be investing an amount of R3 900 annually at the end of each of the following four years. She will earn compounded interest of 14% per annum.

REQUIRED:
Calculate the present value of Helen's investment by using your financial calculator and showing detailed inputs with regard to periods and interest rate.
[Use four decimal places for your calculations and round your final answer to the nearest rand.]
(2)

c) Simeon wants to invest an amount now that will have a total value of R10 000 after five years. The compounded interest rate of the investment is 12% per annum.

REQUIRED:
Calculate the amount that Simeon will have to invest today to receive R10 000 at the end of year five by using the mathematical formula.
Show the mathematical formula and detailed workings.
[Use four decimal places for your calculations and round your final answer to the nearest rand.]
(4)

a) Today is Michaela's birthday. She received a total of R2 000 cash as presents from her friends and family. She wants to invest this money and decided on a fixed term bank deposit for six years at an annual compounded interest rate of 16%.

REQUIRED:
Calculate the value of her investment at the end of year six by using the mathematical formula.
Show the mathematical formula and detailed workings.
[Use four decimal places for your calculations and round your final answer to the nearest rand.]
(3)

[15]

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QUESTION 2 (20 marks) (24 minutes)

a) Pete Limited has the following forms of capital funding:

Form of capital funding	R mil
Leases	80
Issued share capital	500
Non-distributable reserves	214
Bonds	230
Mortgage bonds	211
Retained income	(56)

REQUIRED:
Based on bookvalues, show in detail the amounts financed by equity and the amounts financed by debt as well as the total capital funding. Then calculate the capital structure and provide the debt:equity ratio. (8)

(1) The cost of equity can be determined by the Capital Asset Pricing Model (CAPM). Supply the formula of the CAPM and name the two elements that the expected rate of return required by ordinary shareholders essentially comprises of. (2)

(1) The following is an extract from DA-NC Limited's statement of financial position as at 31 August 2014:
The given rate (in the table below) for the debt funding is after-tax rates.

Ordinary shares issued.	1 000 000
Market value of debentures at 11%	R20 500 000

DA-NC Ltd. has a beta of 0,9, a risk-free rate of 7% and a market risk premium of 6,5%. Their shares are currently trading at R82,30 per share.

REQUIRED:
Calculate the weighted average cost of capital (WACC) for DA-NC Limited by using the WACC formula. The cost of equity should be calculated by using the CAPM (round to full percentage).

[Set your calculator on four decimal places for the calculations of this question and round your final answers to two decimal places. Show the formulas used and detailed calculations.] (10)

[20]

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QUESTION 3 (23 marks) (28 minutes)

PART A

The directors of Shine Ltd need more information regarding different types of financial analysis and have asked you to help them analyse some of their financial information. You are given the following additional information and extracts:

Additional information:

a) Shine Ltd has the following information with regards to its statement of profit or loss and other comprehensive income for the period ended 31 July 2014:

	R'000
Revenue	45 336
Gross profit	29 447
Operating costs	(15 200)

5.8 The earnings per share was 198,3 cents (2013: 213,7 cents) and they had 5 000 000 issued shares as at 31 July 2014. The current share price is R16,10 (2013: R14,00)

3. Shine Ltd has the following information with regards to its statement of financial position as at 31 July 2014:

	R'000
Non-current assets	9 270
Current assets	6 723
Capital and reserves	3 109
Non-current liabilities	8 921
Current liabilities	3 963

a) Shine Ltd is under new management since the beginning of 2014. The new management focused on cutting expenditure as well as paying off long-term liabilities.

REQUIRED:

a) In performing financial analysis, there are different types of techniques one can use to make the information useful and give meaning to it. Name the different techniques that can be used in the following two stages of performing financial analysis:

(i) Preparation of financial information for analysis (3)
(ii) Analysis of financial information (3)

a) Calculate the following ratios for Shine Ltd on 31 July 2014. (Clearly indicate the formula and specific figures used in each case.) Round your final answers to two decimal places.

(i) Operating profit margin (2013:29,15%) (3)
(ii) Current ratio (3)
(iii) Debt ratio (3)
(iv) Earnings yield (3)

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PART B

The soccer managing and agent company, Jooky Hiltons, requested you to assist them in the management of their accounts receivables. They do offer discount to their customers but are not sure if this credit terms have a positive effect on the profitability of the company. The credit terms offered to the customers of Jooky Hiltons are: 1,5/10 net 30.

They supplied you with their debtors' aging schedule as at the end of May 2014.

Jooky Hiltons		
Number of days outstanding	**Balance of the account R**	**Percentage of total balance %**
0-10	256 200	25%
11-30	510 350	50%
31-60	132 302	13%
60 +	125 770	12%
	1 024 622	100%

REQUIRED:

a) List the four areas that a company's credit policy focusses on. (2)

b) Analyse the debtors' ageing schedule of Jooky Hiltons and indicate the percentage of customers that are not complying with the company's credit terms. (2)

c) List one possible issue that Jooky Hiltons should look into by referring to their credit policy. (1)
[23]

QUESTION 4 (22 marks) (26 minutes)

Ezi-Melt Limited is considering whether to continue with their production with its existing melting-furnace or to replace it with a new melting-furnace with a fusing agent section which is expected to speed up the melting process.

Information regarding the **existing** melting furnace:

Cost price: R660 000	Current book value: R396 000
Current market value: R200 000	Useful life: 5
Current tax value: R220 000	Remaining years: 3
Realisable value end of useful life: Nil	Maximum annual production capacity: 5 600 units

Information regarding the **new** melting furnace with fusing agent section:

Cost to purchase new melting-furnace with a fusing agent section	R840 000
Useful life of new melting-furnace with a fusing agent section	3 years
Realisable value end of useful life:	Nil
Maximum annual production capacity	6 700 units

The following expected economic conditions and additional information will have to be considered:

	Year		
	1	2	3
Estimated demand for products	4 500	5 600	6 660
Selling price - per unit	170	196	225
Variable manufacturing cost - per unit	89	105	156
Fixed cost per annum - to be incurred excluding depreciation	22 000	13 000	20 000

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1. The depreciation policy of the company is to depreciate assets straight line over the useful life, while the wear and tear policy of the South African Revenue Service makes provision for assets to be written-off over a period of three years, with no realisable value at the end of the period.
2. The company's cost of capital is 14% per annum and the current rate of normal taxation is 28%.
3. All the estimated cash flows will arise at the end of the year to which they are applicable except the initial outlays which occur at the beginning of the year.
4. The net present value (NPV) of the new melting-furnace with the fusing agent section was correctly calculated by the company to be R46 809.

REQUIRED:

a) Name two factors that affect the capital budgeting decision. (2)

a) Determine the net present value of the existing melting-furnace by using the net present value method. Advise whether the company should keep the existing melting-furnace or purchase the new melting-furnace with a fusing agent section and motivate your recommendation.
[Work to the nearest Rand, round off all your factors to three decimal places and show all your calculations. **(20)**

[22]

<u>QUESTION 5</u> (20 marks) (24 minutes)

This question consists of ten multiple-choice questions. Each question must be considered independently, except where specific reference is made to information in another question. Each question has only one correct answer, and the marks per question (5.1 – 5.10) are indicated in brackets after each question.

Please answer the ten questions in your examination answer book and list the question numbers below one another, from 5.1 – 5.10, with your corresponding answer next to it, for example:
= (a)
= (b)

The questions are as follows:
= "It should inspire change, be easy to understand and easily communicated and be long-term in nature as it will not change."
This is characteristics of _____?

core values
mission statement
strategy

d) vision statement (2)

f. Connected stakeholders are those groups that are connected through the contractual relationship they have with the organisation and they are interested in the objectives of the organisation in as far as these objectives affect their own respective goals.
Which one of the following is **NOT** a connected stakeholder to Massmart (Pty) Ltd?

Pressure groups
Suppliers
Customers
Banks

(2)

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= Threats are related to external factors in the SWOT analysis. The following examples are given to you:

Increasing competition that results in excess capacity.
Strikes by workers in the industry.
Extensive wastage of raw materials
Price wars among competitors.
Insufficient research and development facilities.

Which of the above are examples of "threats"?

a) Statements (1), (2) and (3)
b) Statements (1), (2), (4) and (5)
c) Statements (1), (2) and (4)
d) Statements (2), (3), (4) and (5) (2)

h. Which one of the following alternatives best describes the definition of "strategic financial management"?

It is making decisions about the allocation of an organisation's resources. The allocation of the organisation's resources includes the organisation's capital and people.
Organisational arrangements, systems for gathering together human, physical financial and information resources at all levels of the system.
The management and control of money and money-related operations within the business. It includes planning, organising and controlling the financial activities of a business. The financial activities include the acquiring of funds as well as the use of these funds by applying general management principles.
The identification of possible strategies capable of maximising an organisation's net present value, the allocation of scarce capital resources among the competing opportunities and the implementation and monitoring of the chosen strategy so as to achieve stated objectives.(2)

i. Which one of the following alternatives is **NOT** descriptive of a non-profit company?

All the income and assets must be utilised for the determined objective although relevant parties may be paid a reasonable remuneration.
The company is incorporated for the purpose of financial gain for its shareholders.
No income or assets may be transferred to its directors, members, officers or incorporators with the exception of reasonable remuneration for services.
The benefit must be to further some "public benefit" relating to one or more cultural or social activities, or communal or group activities. (2)

i. Which of the following statements do **NOT** correctly describe factoring?

Factoring allows the organisation to withdraw money up to the original credit limit once a certain percentage has been repaid and/or extra cash can be paid into the account and withdrawn again later.
It is created when the organisation sells a bill of exchange to the bank.
It is a form of debtor's financing which results in improving the collection period.
Factoring is not regarded as finance secured by the debtors' book.
The factoring agreement drawn up is described as a continuous agreement whereby the factor is compelled to take over all approved claims of the organisation depending on the terms of the agreement.

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- Statements (1), (2) and (3)
- Statements (2), (3) and (5)
- Statements (1), (2), (3) and (5)

d) Statements (1), (2) and (4) (2)

- Which of the following statements are **TRUE** with regard to capital markets?

A capital market is a financial market in which equity and longer-term debt securities are traded.
It is also called security markets and they trade in ordinary shares, preference shares, bonds and loans that have terms of more than one year.
The Johannesburg Stock Exchange (JSE) is an equity market and one of the divisions of the capital market.
The capital market is a provider of a secondary market for trading in previously issued instruments that investors sell to one another.
Large investors, governments and organisations can invest their surplus funds on the capital market.

Statements (1), (2) and (4)
Statements (2), (3), (4) and (5)
Statements (1), (2), (3) and (5)

d) Statements (1), (2), (3), (4) and (5) (2)

4.1 Which one of the following alternatives is **FALSE**?

Equity holders control the organisation.
Interest is deductible for tax purposes where dividends normally are not deductible.
In the case of liquidation, equity is repaid before debt.

d) Equity tends to be part of the organisation for life. (2)

4.3 Which one of the following statements does **not** relate to strategic risk?

Actions of the competitors.
Day-to-day operations of the organisation
The organisation's position and relation with the external environment in the long-term.

d) Risk from the external environment that is not under the control of the organisation. (2)

4.5 Which one of the following alternatives is **NOT** a method to identify risk?

Brainstorming
Organisation charts and flow charts
WACC

d) SWOT-analysis (2)

[20]

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EXAM SUGGESTED SOLUTION

QUESTION 1 (15 marks) (18 minutes)

4. (a) Simple interest

Study guide 1, p. 83 (Revised guide 1, p. 79)

Simple interest for 2 years @ 8% per annum = (R1 500 x 8%) x 2
(R1 500 x 0,08) x 2
R120 x 2= R240 (2)

b. Future value – ordinary annuity

$$FV\ annuity = I \times \left[\frac{(1+i)^{n} - 1}{i}\right]$$

$$= R4\ 200 \times \left[\frac{(1+0,12)^{3} - 1}{0,12}\right]$$

$$= R4\ 200 \times \left[\frac{(1,12)^{3} - 1}{0,12}\right]$$

$$= R4\ 200 \times \left[\frac{(0,4049) - 1}{0,12}\right]$$

\+ R4 200 x 3,3744

= R14 172,00 (rounded to the nearest rand) (4)

c. Present value – ordinary annuity (Financial calculator)

3 900 +/- PMT
4 n
14 i
PV = 11 363

Or PV = annuity x present value of R1 per period
And Table B at 14% for 4 years = 2,914
then = R3 900 x 2,914
= R11 364,60
= R11 365 (rounded to the nearest rand) (2)

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d. Present value – single payment

$$PV = \frac{FV}{(1+i)^n}$$

$$PV = \frac{10\ 000}{(1+0,12)^5}$$

$$PV = \frac{10000}{(1,12)^5}$$

$$PV = \frac{10\ 000}{1,7623}$$

PV = R5 674,40

PV = R5 674 (rounded to the nearest rand)

(4)

e. Future value – single payment

Study guide 1, p. 86, 121 (Revised guide 1, p. 82, 117)

$FV = PV(1+i)^n$

a. R2 000 x $(1+0,16)^6$

b. R2 000 x $(1,16)^6$

c. R2 000 x (2,4364)

d. R4 872,79

= R4 873 (rounded to the nearest rand) (3)

[15]

QUESTION 2 (20 marks) (24 minutes)

- Debt: Equity ratio for Pete Limited

Calculate the amount financed by equity:

Equity funding	**R mil**
Issued share capital	500
Non-distributable reserves	214
Retained income	(56)
Total	**658**

Calculate the amount financed by debt:

Debt funding	**R mil**
Leases	80
Bonds	230
Mortgage bonds	211
Total	**521**

Total capital funding = R658 + R521 = R1 179 million

Capital structure:

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Equity (658/1 179 x 100/1) = 55,81%
Debt (521/1 179 x 100/1) = 44,19%
D:E ratio = 44,19:55,81 (8)

b) Formula of CAPM:

$K_e = R_f + \beta(R_m - R_f)$

The two elements in the CAPM that the expected rate of return required by ordinary shareholders essentially comprises of:

i. **Risk-free rate**

ii. **Market risk premium** ($R_m - R_f$)

**Market risk is the risk associated with the economical environment in which ALL organisations do business and which is influenced by interest rates, exchange rates, oil prices and various other factors that are difficult to quantify.*

(2)

c) Calculation of WACC

Cost of equity **calculation by using CAPM (k_e)**

$k_e = R_f + \beta(R_m - R_f)$

$k_e = 0,07 + 0,9(0,065)$

$k_e = 0,07 + 0,0585$

$k_e = 0,1285$ (rounded to 13%)

Take note that the market risk premium was given as 6,5%
Therefore ($R_m - R_f$) = 0,065
While R_f is given as 0,07
It follows that ($R_m - R_f$) = (R_m - 0,07) = 0,065 AND R_m = 0,135 or 13,5%

Using the formula:

$$WACC = \frac{k_e v_e + k_d v_d}{v_e + v_d}$$

$$WACC = \frac{(13\% \times 82300\,000) + (11\% \times 20500000)}{82300\,000 + 20500000}$$

$$WACC = \frac{10\,699\,000 + 2\,255\,000}{102\,800\,000}$$

$$WACC = \frac{12\,954\,000}{102\,800\,000}$$

WACC = 0,1260
WACC = 12,60%**

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Calculations:

Market value of equity (v_e):
Current market price: given as R82,30 per share.
Number of shares: 1 000 000 shares as per statement of financial position.

v_e = Number of shares x current market value per share. v_e
= 1 000 000 x R82,30. Therefore v_e = **R82 300 000**

Market value of debt (v_d) and cost of debt (v_e)

Given as R20 500 000 and 11% (already after tax)

Or Using the table: (to give an understanding of how the formula links to the table format)

Type of capital	Total amount at market values	% of total capital (weight)	Cost of capital	Weighted cost of capital
	R	%	%	%
E: Equity - Ordinary shares V_e	82 300 000	E/V 80,06	13④	10,41①
+ D: Debt - Debentures V_d	20 500 000	D/V 19,94	11⑤	2,19②
= V: Value	102 800 000	100,00		12,60

(10)

① 82 300 000/102 800 000 = 80,06% and 80,06% x 13% = 10,41% ②20 500 000/102 800 000 = 19,94 and 19,94 x 11% = 2,19% ④Calculated by using CAPM in (c)
⑤After-tax cost - given

[20]

QUESTION 3 (23 marks) (28 minutes)

PART A

a) Different techniques in performing financial analysis (**Name** the different techniques that can be used in the following two stages of performing financial analysis)

STAGE

i. **PREPARATION OF FINANCIAL INFORMATION FOR ANALYSIS, Scenario i** (SG 2, p. 11)

- **Comparative financial statements**
- **Indexed financial statements**
- **Common size statements** (3)

STAGE

ii. **ANALYSIS OF FINANCIAL INFORMATION, Scenario ii**

- **Failure prediction**
- **Trend analysis**
- **Ratio analysis** (3)

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b) Ratio analysis

i) **Operating profit margin** (SG 2, p. 23)

	2014
Operating profit x100 / Revenue	= 14 247[1] / 45 336 x 100
	= 31,43 %

[1] 29 447 – 15 200 = 14 247

Gross profit – operating cost = operating profit (3)

ii) **Current ratio:** (SG 2, p. 30)

	2014
Current assets: Current liabilities	= 6 723: 3 963
	= 1,70 :1

[Indicates how many **times** current assets cover current liabilities]

(3)

iii) **Debt ratio** (SG 2, p. 37)

	2014
Total debt x100 / Total assets	= 12 884[1] / 15 993[2] x 100
	= 80,56 %

[1] 8 921 + 3 963 = 12 884
[2] 9 270 + 6 723 = 15 993

[**Percentage** of all debt forms covering the assets] (3)

iv) **Earnings yield** (SG 2, p. 43)

	2014
Earnings per share (EPS) / Share price x 100	= 198,3 cents **or R1,983** / 1 610,0 cents **or R16,10**
	= 12,32 %

[EPS was given and need not to be calculated first]
EPS being Earnings or net profit/ Number of shares issued (3) Part A total **18**

(a) **LIST** 4 areas on which a company's **CREDIT POLICY** focus:

1. **Creditworthiness** (financial strength of customers and their ability to repay debt)
2. **Credit period**(length of time to pay outstanding balance)
3. **Discounts** (for early payment – before credit period expires)
4. **Collection policy** (how to collect overdue accounts payable) (2)

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(b) **ANALYSIS OF THE DEBTORS AGEING SCHEDULE** (SG 2, p. 58 - 59)

Analyse the ageing schedule **AND** indicate the percentage of customers that are not complying with the company's credit terms.
The ageing schedule of Jooky Hiltons indicates that **several of its customers are not complying with its credit terms**. A large proportion of the accounts receivable balance, equalling **25% (13%+12%), is more than 30 days old**. This is the case in spite of Jooky Hiltons's credit terms that require full payment within 30 days. (2)

(c) With reference to their credit policy list ONE possible issue that Jooky Hilton should look into.

Creditworthiness of customers
(Based on an analysis of the ageing schedule, it seems that Jooky Hiltons are too lenient in granting credit to customers. This may have increased their revenue, but could also result in higher bad debts.)
OR

Credit period
(The credit period granted to trade debtors of Jooky Hiltons is 30 days but 25% of customers exceed the period.)
OR

Discounts
(It seems that the small discount of 1,5% offered by Jooky Hiltons to their customers was not sufficient to motivate them to pay earlier.)
OR

Collection policy
(Based on an analysis of the ageing schedule, it seems that they might have to use stricter debt collecting procedures and work on a more aggressive collection policy. Jooky Hiltons have to be careful not to damage relationships with their customers.)

OR

Credit terms
(This include the credit period as well as discounts) (1) Part B total 5

[23]

QUESTION 4 (22 marks) (27 minutes)

(a) Factors listed below influence the capital allocation/budgeting decision:

Name ANY TWO of the 8 listed factors

- the returns of the individual projects under consideration
- availability of funds
- current and target capital structure of the organisation
- legal factors
- lending policies of financial institutions
- immediate need for the project
- future earnings

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- risks and uncertainties (2)

(b) Calculation of Net present value of **EXISTING** melting furnace

	Year			
	0	1	2	3
	R	R	R	R
Current realisable value forfeited (Opportunity cost)	(200 000)	-	-	-
Sales ①	-	765 000	1 097 600	1 260 000
Variable cost②	-	(400 500)	(588 000)	(873 600)
Fixed cost	-	(22 000)	(13 000)	(20 000)
Annual net cash flow before tax	-	342 500	496 600	366 400
Taxation ③		(39 900)	(139 048)	(102 592)
Net cash flow	(200 000)	302 600	357 552	263 808
Factor at 14% [Table A: $1/(1+i)^n$]	1,000	0,877	0,769	0,675
Net present value	(200 000)	265 380	274 957	178 070
(200 000) – 718 407 = **518 407**				

Calculations:

① Sales

Yr 1 4 500 x R170 = R765 000

Yr 2 5 600 x R196 = R1 097 600

Yr 3 5 600 x R225 = R1 260 000 (**Maximum capacity for existing melting-furnace is 5 600 units**)

② Variable cost

Yr 1 4 500 x R89 = R400 500

Yr 2 5 600 x R105 = R588 000

Yr 3 5 600 x R156 = R873 600 (**Maximum capacity for existing melting-furnace is 5 600 units**)

③ Taxation

	Year		
	1	2	3
	R	R	R
Realisation/scrapping allowance forfeited ④	20 000	-	-
Sales	765 000	1 097 600	1 260 000
Variable cost	(400 500)	(588 000)	(873 600)
Fixed cost	(22 000)	(13 000)	(20 000)
Wear and tear (R660 000 / 3)	(220 000)	-	-
Taxable amount	142 500	496 600	366 400
Tax payable at 28%	39 900	139 048	102 592

④ Realisation/Scrapping allowance forfeited

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	R
Tax value	220 000
Less: Realisable value	200 000
Realisation allowance forfeited by modifying and not selling	20 000

Net present value Existing melting furnace calculated to be R518 407.
Net present value NEW melting furnace given to be R46 809.

Advice/recommendation and motivation thereof:
The existing melting-furnace should not be replaced as it delivers a higher net present value than the new melting furnace based on the expected economic conditions.
The project with the highest net present value should be chosen. [22]

How the NPV of the **new melting furnace** was calculated. **NOT PART OF THE SOLUTION – NPV GIVEN IN THE QUESTION as R46 809**

	Year			
	0	1	2	3
	R	R	R	R
Cost price	(840 000)	-	-	-
Sales ①	-	765 000	1 097 600	1 498 500
Variable cost ②	-	(400 500)	(588 000)	(1 038 960)
Fixed cost excl. depreciation	-	(22 000)	(13 000)	(20 000)
Annual net cash flow before tax		342 500	496 600	439 540
Taxation ③		(17 500)	(60 648)	(44 671)
Net cash flow	(840 000)	325 000	435 952	394 869
Factor at 14% [Table A]	1,000	0,877	0,769	0,675
Net present value	(840 000)	285 025	335 247	266 537
R46 809				

Calculations:

① Sales
4 500 x R170 = R765 000
5 600 x R196 = R1 097 600
6 660 x R225 = R1 498 500

② Variable cost
4 500 x R89 = R400 500
5 600 x R105 = R588 000
6 660 x R156 = R1 038 960

③ Taxation

	Year		
	1	2	3
	R	R	R
Sales	765 000	1 097 600	1 498 500
Variable cost	(400 500)	(588 000)	(1 038 960)
Fixed cost	(22 000)	(13 000)	(20 000)
Net cash inflow before tax	342 500	496 600	493 540
Wear and tear 28%	(280 000)	-	-
Taxable amount	62 500	216 600	159 540
Tax payable at 28%	17 500	60 648	44 671

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QUESTION 5 (20 marks) (24 minutes)

5.1 Alternative **(b)** is the correct answer (2)

5.2 Alternative **(a)** is the correct answer (2)

Pressure groups are secondary stakeholders (external stakeholders).

5.3 Alternative **(c)** is the correct answer (2)

Statements (3) and (5) are examples of internal factors which are weaknesses.

5.4 Alternative **(d)** is the correct answer (2)

Alternative (a) is the definition for strategic planning
Alternative (b) is the definition for organisational structure
Alternative (c) is the definition for traditional financial management

5.5 Alternative **(b)** is the correct answer because it is
descriptive of **profit companies** and not of non-profit companies. (2)

5.6 Alternative **(d)** is the correct answer (2)

Statement (1) relates to revolving credit
Statement (2) relates to a banker's acceptance
Statement (4) factoring IS regarded as financing secured by the debtor's book

5.7 Alternative **(d)** is the correct answer (2)

All the statements are true with regard to capital markets.

5.8 Alternative **(c)** is the correct answer In the case of
Liquidation debt is repaid before equity. (2)

5.9 Alternative **(b)** is the correct answer

Strategic risk focuses on the long-term and has more to do with the organisation's position in relation with the external environment on the long-term
Operational risks are more concerned with the **day-to-day operations** of the organisation.
(2)

5.10 Alternative (c) is the correct answer (2)
[20]

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EXAM PRACTICE PAPER 11

Question 1 (21 Marks)

a.) Melissa would like to pay a deposit of R50 000 on a house in four years' time. How much will she need to invest today at a rate of 6% compound interest per annum in order to have the R50 000 as deposit after four years?
Make use of the factor table method to calculate your answer.
[Show the equation you used as well as the detailed workings. Use four decimal places and Round your final answer to the nearest rand.] (3)

b.) Tasneem will invest an amount of R7 000 at the end of each year for the next six years in a money market account that earns 6% compound interest per annum. Determine the current value of her intended investment? (3)

Make use of the factor table method to calculate your answer and show detailed workings.
[Show the equation you used as well as your workings. Round your workings to four decimal places and your final answer to the nearest rand.] (3)

c. Petronella has an investment which earns effective interest of 11% per annum. Interest is compounded quarterly. What is the nominal rate of her investment?
[Show the formula you used to determine the nominal rate as well as your workings. Use four decimal places for your calculations and round your final percentage to two decimal places.](3)

d. An amount of R25 000 is invested for a period of eight years at 8% interest, calculated annually. What will the total value of the investment be at the end of the investment period if Simple interest is calculated? **[Round your calculations to two decimal places and your final Answer to the nearest rand.] (3)**

e. One of the local banks in your region is offering a fixed term deposit option that calculates interest at the end of each quarter at an annual compound interest rate of 9%. What is the periodic rate of this fixed term deposit option? (3)
[Round your workings to four decimal places and your final answer to two decimal places]

f. Boity has invested an amount of R2 000 today in a deposit account that earns compounded interest of 5% annually. He is not planning on using the money until six years has passed. What will the value of his investment be by then? (3)

[**Make use of the mathematical formula to calculate your answer. Round your calculations to four decimal places and your final answer to the nearest rand.]**

g. What is the present value of R6 000 payable in 6 year‟s time, if the interest rate is 9.3% per annum, compounded annually?

[Round your workings to four decimal places and your final answer to the nearest rand.]

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h. An annuity pays R15 000 per year at the end of every year for 15 years. Interest is compounded at 8% per annum. What is the present value of the annuity?

i. You have calculated the present value of a future amount to be R207,54 by using a discount rate of 5% and the present value of the same future amount to be R183,30 by using 6% as the discount rate
By using extrapolation, calculate the discount rate that will achieve a present value of R165,25.

[Round your final answer to two decimal places]

Question 2 (20 marks)

Pete Limited has the following forms of capital funding:

Form of capital funding	**R mil**
Leases	80
Issued share capital	500
Non-distributable reserves	214
Bonds	230
Mortgage bonds	211
Retained income	(56)

REQUIRED:
a) Based on book values, show in detail the amounts financed by equity and the amounts financed by debt as well as the total capital funding. Then calculate the capital structure and provide the debt:equity ratio. (8)

b) The cost of equity can be determined by the Capital Asset Pricing Model (CAPM). Supply the formula of the CAPM and name the two elements that the expected rate of return required by ordinary shareholders essentially comprises of. (2)

c) The following is an extract from DA-NC Limited's statement of financial position as at 31 August 2014:
The given rate (in the information below) for the debt funding is after-tax rates.

Ordinary shares issued.	1 000 000
Market value of debentures at 11%	R20 500 000

DA-NC Ltd. has a beta of 0,9, a risk-free rate of 7% and a market risk premium of 6,5%. Their shares are currently trading at R82,30 per share.

REQUIRED:
Calculate the weighted average cost of capital (WACC) for DA-NC Limited by using the WACC formula. The cost of equity should be calculated by using the CAPM (round to full percentage).
[Set your calculator on four decimal places for the calculations of this question and round your final answers to two decimal places. Show the formulas used and detailed calculations.]

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Question 3 (23 Marks)

The directors of Shine Ltd need more information regarding different types of financial analysis and have asked you to help them analyse some of their financial information. You are given the following additional information and extracts:

Additional information:

1. Shine Ltd has the following information with regards to its statement of profit or loss and other comprehensive income for the period ended 31 July 2014:

	R000
Revenue	45 336
Gross profit	29 447
Operating costs	(15 200)

2. The earnings per share was 198,3 cents (2013: 213,7 cents) and they had 5 000 000 issued shares as at 31 July 2014. The current share price is R16,10 (2013: R14,00)

3. Shine Ltd has the following information with regards to its statement of financial position as at 31 July 2014:

	R000
Non-current assets	9 270
Current assets	6 723
Capital and reserves	3 109
Non-current liabilities	8 921
Current liabilities	3 963

4. Shine Ltd is under new management since the beginning of 2014. The new management focused on cutting expenditure as well as paying off long-term liabilities.

REQUIRED:

a) In performing financial analysis, there are different types of techniques one can use to make the information useful and give meaning to it. Name the different techniques that can be used in the following two stages of performing financial analysis:

(i) Preparation of financial information for analysis (3)
(ii) Analysis of financial information (3)

b) Calculate the following ratios for Shine Ltd on 31 July 2014. (Clearly indicate the formula and specific figures used in each case.) Round your final answers to two decimal places.

(i) Operating profit margin (2013:29,15%) (3)
(ii) Current ratio (3)
(iii) Debt ratio (3)
(iv) (iv) Earnings yield (3)

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QUESTION 4 (20 marks)

This question consists of ten multiple-choice questions. Each question must be considered independently, except where specific reference is made to information in another question. Each question has only one correct answer, and the marks per question (5.1-5.10) are indicated in brackets after each question.The questions are as follows:

5.1 "It should inspire change, be easy to understand and easily communicated and be long-term in nature as it will not change."
This is characteristics of _____?
a) core values
b) mission statement
c) strategy
d) vision statement (2)

5.2 Connected stakeholders are those groups that are connected through the contractual relationship they have with the organization and they are interested in the objectives of the organization in as far as these objectives affect their own respective goals.

Which one of the following is **NOT** a connected stakeholder to Massmart (Pty) Ltd?
a) Pressure groups
b) Suppliers
c) Customers
d) Banks

5.3 Threats are related to external factors in the SWOT analysis. The following examples are given to you:

(2) Increasing competition that results in excess capacity.
(3) Strikes by workers in the industry.
(4) Extensive wastage of raw materials
(5) Price wars among competitors.
(6) Insufficient research and development facilities.

Which of the above are examples of "threats"?
b) Statements (1), (2) and (3)
c) Statements (1), (2), (4) and (5)
d) Statements (1), (2) and (4)
e) Statements (2), (3), (4) and (5) (2)

5.4 Which one of the following alternatives best describes the definition of "strategic financial management"?
b) It is making decisions about the allocation of an organisation's resources. The allocation of the organisation's resources includes the organisation's capital and people.
c) Organisational arrangements, systems for gathering together human, physical financial and information resources at all levels of the system.

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d) The management and control of money and money-related operations within the business. It includes planning, organising and controlling the financial activities of a business. The financial activities include the acquiring of funds as well as the use of these funds by applying general management principles.
e) The identification of possible strategies capable of maximising an organisation's net present value, the allocation of scarce capital resources among the competing opportunities and the implementation and monitoring of the chosen strategy so as to achieve stated objectives.(2)

5.5 Which one of the following alternatives is **NOT** descriptive of a non-profit company?

b) All the income and assets must be utilised for the determined objective although relevant parties may be paid a reasonable remuneration.
c) The company is incorporated for the purpose of financial gain for its shareholders.
d) No income or assets may be transferred to its directors, members, officers or incorporators with the exception of reasonable remuneration for services.
e) The benefit must be to further some "public benefit" relating to one or more cultural or social activities, or communal or group activities. (2)

5.6 Which of the following statements do **NOT** correctly describe factoring?
(2) Factoring allows the organisation to withdraw money up to the original credit limit once a certain percentage has been repaid and/or extra cash can be paid into the account and withdrawn again later.
(3) It is created when the organisation sells a bill of exchange to the bank.
(4) It is a form of debtor's financing which results in improving the collection period.
(5) Factoring is not regarded as finance secured by the debtors' book.
(6) The factoring agreement drawn up is described as a continuous agreement whereby the factor is compelled to take over all approved claims of the organisation depending on the terms of the agreement
a) Statements (1), (2) and (3)
b) Statements (2), (3) and (5)
c) Statements (1), (2), (3) and (5)
d) Statements (1), (2) and (4) (2)

5.7 Which of the following statements are **TRUE** with regard to capital markets?
(2) A capital market is a financial market in which equity and longer-term debt securities are traded.
(3) It is also called security markets and they trade in ordinary shares, preference shares, bonds and loans that have terms of more than one year.
(4) The Johannesburg Stock Exchange (JSE) is an equity market and one of the divisions of the capital market.
(5) The capital market is a provider of a secondary market for trading in previously issued instruments that investors sell to one another.
(6) Large investors, governments and organisations can invest their surplus funds on the capital market.

b) Statements (1), (2) and (4)
c) Statements (2), (3), (4) and (5)
d) Statements (1), (2), (3) and (5)
e) Statements (1), (2), (3), (4) and (5) (2)

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5.9 Which one of the following alternatives is **FALSE**?
a) Equity holders control the organisation.
b) Interest is deductible for tax purposes where dividends normally are not deductible.
c) In the case of liquidation, equity is repaid before debt.
d) Equity tends to be part of the organisation for life. (2)

5.10 Which one of the following statements does **not** relate to strategic risk?
b) Actions of the competitors.
c) Day-to-day operations of the organisation
d) The organisation's position and relation with the external environment in the long-term.
e) Risk from the external environment that is not under the control of the organisation. (2)

5.10 Which one of the following alternatives is **NOT** a method to identify risk?
b) Brainstorming
c) Organization charts and flow charts
d) WACC
e) SWOT-analysis (2)

Question 5 (10 marks)

Tilny Limited has a beta of 1,2. The market rate of return is 22,8% and the risk free rate is 13%. Tilny"s last dividend was R2 per share and the dividend is expected to grow by 14% per year indefinitely. A share currently sells for R20,57.

REQUIRED:
b) Calculate the cost of equity by means of the two methods, namely: capital asset pricing model (CAPM) and dividend growth model. (6)

c) Briefly discuss the criticisms against the dividend growth model. (2)

d) Briefly explain the assumption on which the CAPM is based. (2)

Question 6

Tasneem Limited has the following funding structure:
5 000 Bonds issued with a nominal value of R1 000 each and time to maturity of 15 years. It pays an annual coupon rate of 8% per annum and the current market return on similar bonds with a life of 15 years is 6% per annum.
300 000 Ordinary shares are in issue with a nominal value of R30 per share. The next dividend payable will be R3 per share. It is expected that dividends will have a long-term sustainable growth rate of 3%. The shares have a current market value of R40 per share.
The corporate tax rate is 28%

REQUIRED:
Calculate the weighted average cost of capital (WACC) for Tasneem Limited. (12)

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Question 7 (10 marks)

Once it has been decided to fund a new project by increasing the organisation‟s borrowings, there are further decisions to be made. Should the funds be raised by means of short term debt that is repayable within one year, medium term debt, or loans that are repaid over periods of 10 to 25 years?

REQUIRED:
Discuss the factors that should be taken into consideration when deciding on the most appropriate form of funding.

Question 8 (5 marks)

A retail organisation has an annual turnover of R36 million. The organisation earns a constant mark-up of 20% on sales. All sales and purchases are on credit and are spread evenly over the year. The following amounts are maintained at a constant level throughout the year.
Stock R6 million
Debtors R8 million
Creditors R3 million

REQUIRED:
Calculate the organisation‟s cash cycle to the nearest day

Question 9

Link Med is an organisation that manufactures and sells a range of medical products. The organisation has expanded rapidly. The board of directors has asked you to prepare a report to assist the managing director with the appointment of a financial manager to strengthen the management team.

REQUIRED:
List the responsibilities of a financial manager.

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Question 10

Lee Limited is considering a major investment. The company‟s financial manager needs an appropriate rate at which to discount the estimated after tax cash flows of the investment. It is the company‟s policy to use the weighted average cost of capital (WACC) to value its investments.
The figures relating to long-term financing, extracted from the company‟s most recent statement of financial position are:

Equity total	7 200 000
6 million ordinary shares of R0,50 each	3 000 000
Share premium account	1 700 000
Revaluation reserve	1 600 000
Retained earnings	900 000
10% Redeemable debentures	2 500 000
Current liabilities	
Trade creditors	150 000
Total Equity + Liabilities	9850000

Additional information:
5. A dividend of R0,80 per share has just been paid. Dividends have shown a constant growth rate of 7% p.a. over recent years and it is assumed to continue in the foreseeable future. The current share price is R20,00 per share.

6. The current market return for similar debentures with a life of four years is 12%.

7. The current rate of taxation is 28%.

REQUIRED:
b) Calculate the weighted average cost of capital (WACC) for Lee Limited (8)

c) List reasons why the cost of debt is usually lower than the cost of equity (5)

Question 11(10 marks)

A family-owned business needs to raise funds to enable a new project to be undertaken. The main shareholders (family members) are not willing to increase their stake in the company and, they do not want to sell shares to new shareholders for fear of diluting their holdings.

REQUIRED:
Discuss the costs and benefits of the funding forms that could be used to obtain the funds as well as factors that should be taken into account when considering different forms of financing.

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Solutions

Question 1

a. Present value – single amount
Present value single amount:
PV = FV x (PV of R1 per period) (Table A at 6% for 4 years = 0,792)
R50 000 x 0,792 = R39 600 (rounded to the nearest Rand)
OR
Mathematical formula
PV = where (1 + i)n = future value of R1 per period factor in Table D = 1,2625
□□□□□□+n)i1(FV
= □□□□□□2625,100050
= 39 603,96
= R39 604 [Rounding difference may occur depending on which table was used]

b.
Present value - ordinary annuity

Factor table method:
PV = I x PV of R1 per period factor
Table B at 6% for 6 years = 4,917
R7 000 x 4,917 = R34 419

c.
Nominal rate

Where i = effective interest
rate = 11%
n = number of periods per annum used to compound
interest = 4 (quarterly)
Nominal rate = n [(1 + i)1/n - 1]
= 4 [(1 + 0,11) ¼ - 1]
= 4 [(1,11) ¼ - 1]
= 4 (1,0264 – 1)
= 4 (0,0264)
= 0,1057 x 100
= 10,57% (rounded to two decimal places)

d**. Simple interest**
R25 000 x 8% x 8 years = R16 000
Therefore: R25 000 + R16 000 = R41 000

e.
Where n = 4 (quarterly = every 3 months therefore 4 times per year) iNom = 9%
= i periodic x n
9% = 2,25% x 4
Periodic rate (iPER) = iNom

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= 2,25% (rounded to two decimal places)

g. FV = PV(1+) =
R2 000(1+0,05)6
= R3 500 (1,3401)
= R2 680,19
= R2 680 (rounded to the nearest rand)

h. Where FV = Future value
PV = Present value
i = Interest rate
n = Number of years or periods
= R3 519,0892
= R3 519 (rounded to the nearest rand)

f. R128 392 (rounded to the nearest rand)

g. = 6,7446%

Question 2

a.Debt: Equity ratio for Pete Limited

Calculate the amount financed by equity:

Equity funding	**R mil**
Issued share capital	500
Non-distributable reserves	214
Retained income	(56)
Total	**658**

Calculate the amount financed by debt: **Debt funding**	**R mil**
Leases	80
Bonds	230
Mortgage bonds	211
Total	**521**

Total capital funding = R658 + R521 = R1 179 million
Capital Structure
Equity (658/1 179 x 100/1) = 55,81%
Debt (521/1 179 x 100/1) = 44,19%
D:E ratio = 44,19:55,81

b.
Formula of CAPM:
Ke = Rf + β(Rm - Rf)

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The two elements in the CAPM that the expected rate of return required by ordinary shareholders essentially comprises of:

ii. Risk-free rate

iii. Market risk premium (Rm - Rf)

**Market risk is the risk associated with the economical environment in which ALL organisations do business and which is influenced by interest rates, exchange rates, oil prices and various other factors that are difficult to quantify.*

c) Calculation of WACC
Cost of equity **calculation by using CAPM**
(ke) ke = Rf + β(Rm- Rf)
ke = 0,07 + 0,9(0,065)
ke = 0,07 + 0,0585
ke = 0,1285 (rounded to 13%)
Take note that the market risk premium was given as
6,5% Therefore (Rm- Rf) = 0,065
While Rf is given as 0,07
It follows that (Rm- Rf) = (Rm- 0,07) = 0,065 AND Rm = 0,135 or 13,5%

Type of capital	Total amount at market values	% of total capital (weight)	Cost of capital	Weighted cost of capital
E: Equity -	R	%	%	%
Ordinary shares	82 300 000	E/V 80,06	□ 13	□10,41
Ve	20 500 000	D/V 19,94	□ 11	□2,19
+ D: Debt - Debentures Vd				
= V: Value	102 800 000	100,00		12,60

82 300 000/102 800□000 = 80,06% and 80,06% x 13% = 10,41%
20 500 000/102 800□000 = 19,94 and 19,94 x 11% = 2,19%
Calculated by using□ CAPM in (c)
After-tax□ cost – given

Question 3

a) Different techniques in performing financial analysis (**Name** the different techniques that can be used in the following two stages of performing financial analysis)

STAGE
i. **PREPARATION OF FINANCIAL INFORMATION FOR ANALYSIS**
• **Comparative financial statements**
• **Indexed financial statements**
• **Common size statements** (3)

STAGE

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ii. **ANALYSIS OF FINANCIAL INFORMATION,**

- **Failure prediction**
- **Trend analysis**
- **Ratio analysis (3)**

Bi) Operating profit margin
29 447 – 15 200 = 14 247
Gross profit – operating cost = operating profit

Current Ratio
bii)Current assets: = 6 723: 3 963
Current liabilities
biii) 8 921 + 3 963 = 12 884 9 270 + 6 723 = 15 993
[**Percentage** of all debt forms covering the assets]
= 80.56%

Biv) Earnings yield =
12.32%

QUESTION 4 (20 marks)

4.2 Alternative **(b)** is the correct answer
4.3 Alternative **(a)** is the correct answer
Pressure groups are secondary stakeholders (external stakeholders).
4.4 Alternative **(c)** is the correct answer Statements (3) and (5) are examples of internal factors which are weaknesses.
4.5 Alternative **(d)** is the correct answer
Alternative (a) is the definition for strategic planning
Alternative (b) is the definition for organisational structure
Alternative (c) is the definition for traditional financial management
4.6 Alternative **(b)** is the correct answer because it is descriptive of **profit companies** and not of non-profit companies. (2)
4.7 Alternative **(d)** is the correct answer
Statement (1) relates to revolving credit
Statement (2) relates to a banker's acceptance
Statement (4) factoring IS regarded as financing secured by the debtor's book
4.7 Alternative **(d)** is the correct answer
All the statements are true with regard to capital markets.
4.9 Alternative **(c)** is the correct answer.In the case of liquidation debt is repaid before equity. (2)
4.10 Alternative **(b)** is the correct answer
Strategic risk focuses on the long-term and has more to do with the organisation's position in

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Relation with the external environment on the long-term Operational risks are more concerned with the **day-to-day operations** of the organisation. (2)

4.10 Alternative (c) is the correct answer (2)

Question 5

a) Cost of equity
Expected returns:
Ke = Rf + β (Rm - Rf)
= 13% + 1,2 (22,8% - 13%)
= 0,13 + 1,2 (0,228 - 0,13)
= 0,13 + 0,1179
= 0,2476
= 24,76%

Dividend growth model
Required rate of return:
Ke =01
P
D + g [and D1 = D0 x (1 + g)]
Ke = 20,57
(2 x 1,14)
+ 0,14
= 20,57
2,2800
+ 0,14

h. 0,1108 + 0,14
i. 0,2508
j. 25,08%

b. Expected future dividends are uncertain.
Expected growth rate in dividends is uncertain and it is unrealistic to assume that it will stay Constant

c. The CAPM is based on the assumption that an investor can avoid specific risk by investing in a diversified share portfolio and therefore spreading his risk and limiting it to a minimum. Thus, market risk is the only risk an investor can expect compensation for, and the expected rate of return (compensation) is determined by means of the CAPM.

Question 6

Cost of debt
(bonds) = 4,32%

Market value (Mv) of debt
Interest paid: = PV of annuity of R80 at 6% for 15 years

k. R80 x PV factor at 6% for 15 years (use Table B)
l. R80 x 9,712
m. **R776,96**

Plus

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Redemption value: = PV of R1 000 at 6% after 15 years
= R1 000 x PV factor at 6% after 15 years (use Table A)
= R1 000 x 0,417
= **R417,00**
= **R1 193,96** per bond
= R1193,96X5000
Therefore vd = **R5 969 800**

Cost of equity= 10,50%

Market value (Mv) of equity= ve = 300 000 x
R40 = 12 000 000
Total capital ve + vd = R12 000 000 + R5 969 800 =
R17 969 800
WACC= {(10,5% x R12 000 000) + (4,32% x R5 969 800)}/ 17 969
800 WACC = 0,0845
WACC = 8,45%

Question 7

Organisations use debt to finance projects as it is usually less expensive than the other alternative funding sources.By borrowing, the company is committed to paying interest at regular intervals. The repayment of the original sum can be spread over the period of the loan or repaid in full at the end of the loan period.The organisation's decision whether to use short, medium or long term debt will depend on a number of factors such as:Maturity structure of the form of funding e.g. does the debt have to be repaid over the short term (less than one year), medium term (between one and three years), or long term (more than three years) Cost of the form of funding. (Use the cheapest form).Matching the term of the project with that of the form of funding, e.g. a long term asset should be funded by long term debt and short term expenses with short term debt.Flexibility of the form of funding e.g. can a longer term be negotiated if necessary or can the debt be paid off earlier in order to save on interest payments.

Question 8

Accounts Receivables = 81days
Inventory days = 38days
Accounts Receivables = 76 days
CCC = 119

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Question 9 (4 marks)

Financial manager responsibilities include:

Planning, organising and controlling the financial activities of a business. Managing business risk.Managing business performance.
Direct involvement in the development and implementation of an organisations' strategy.
Not just a scorekeeper but a business partner who contributes to the business performance.
Contribute towards the long-term creation of sustainable wealth for the owners/investors of the organisation.

Question 10

a.Ordinary shares (at current market value)
Ve = 6 000 000 x R20,00 = R 120 000 000
Required rate of return (= cost of ordinary shares)
Where P0= current market price of the share at point 0 in time D1=
the expected dividend per share for year 1 [D1 = D0 x (1 + g)]
Ke = the required rate of return (market discount rate or cost of ordinary shares)
g = expected constant growth rate in dividends
Ke = g
= 0,1128 (or 11,28%)
After tax cost of debentures=
7,20% WACC = 11,20%

B(i).The cost of debt is usually lower (as long as the debt level is acceptable to the debt providers) than the cost of equity because debt carries a lower risk. As discussed in Topic 4, debt can be secured by assets and debt providers is repaid before equity providers in the case of liquidation.This lower risk also has the effect that the lenders require lower expected returns.

ii) The cost of debt is lower because interest is deductible from taxable income. This is also referred to as the tax shield and means that the South African Revenue Services (SARS) funds the cost of debt to the extent of the ruling tax rate. For example, if the interest payment is R100 and the tax rate is 28%, the interest payment is deducted from other taxable income and the tax payment to SARS is R28 less (effectively a cash inflow netted off against the regular tax payment).

Question 11

Issue of ordinary shares:
The main shareholders do not wish to invest any more money in the business and also do not want to Dilute their holding by inviting outsiders to acquire shares in the company. It is therefore not possible to raise additional funds by issuing ordinary shares. Issue of preference shares:

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The company could offer non-participating preference shares. The dividend offered on the preference shares might however need to be higher than the rate of interest that would be payable on debt. This can therefore increase the cost of capital for the company. Increase debt: Since the main shareholders (family) want to retain control of the company they will usually prefer to obtain funds by means of increasing the company's debt. The nature of the project will determine if the company will use either long-term or short-term debt. For a major project, it is likely that long-term debt would be more appropriate as it is unlikely that repayment of both the debt and the interest will be possible in the short-term.

- The company could issue debentures:
Debentures could have a restrictive agreement that restricts the freedom of the management with regard to the running of the company. Usually this restrictive clause controls the risk to which management may expose the company.Debentures can be secured over a specific asset and if the company fails to pay interest or capital repayments, the debenture holders can force the sale of the assets that were offered as security.Debentures present a lower risk to the lenders, they therefore require a lower return. The latter reduces the company's cost of debt financing and therefore its cost of capital.

- Long-term loans:
A long term- loan could also be taken out. The terms will vary according to the lender's view of the company's credit risk.Medium term financing in the form of leasing could be another method to consider.

Factors that the company needs to take into account:

n. Availability of funds
o. The cost of the funds
p. The tax implications of the different methods of funding
q. The impact the new funding will have on the capital structure of the com

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