NAMIBIA UNIVERSITY
OF SCIENCE AND TECHNOLOGY

**FACULTY OF MANAGEMENT SCIENCES**

**DEPARTMENT OF ACCOUNTING, ECONOMICS & FINANCE**

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|---|---|
| **QUALIFICATION: BACHELOR OF HOSPITALITY AND TOURISM MANAGEMENT HONOURS** | |
| **QUALIFICATION CODE: 08BHTH** | **LEVEL: 8** |
| **COURSE CODE: FMH810S** | **COURSE NAME: FINANCIAL MANAGEMENT: HOSPITALITY AND TOURISM** |
| **SESSION: JULY 2019** | **PAPER: PRACTICAL AND THEORY** |
| **DURATION: 3 HOURS** | **MARKS: 100** |

| **SECOND OPPORTUNITY EXAMINATION QUESTION PAPER** | |
|---|---|
| **EXAMINER** | MS. S KASITA |
| **MODERATOR:** | MR. V. MAENGAHAMA |

**INSTRUCTIONS**

1. This question paper is made up of three (3) questions.
2. Answer All the questions and in blue or black ink.
3. Start each question on a new page in your answer booklet and show all your workings.
4. Questions relating to this paper may be raised in the initial 30 minutes after the start of the paper. Thereafter, candidates must use their initiative to deal with any perceived error or ambiguities and any assumption made by the candidate should be clearly stated.

**PERMISSIBLE MATERIALS**

Non-programmable calculator

**THIS QUESTION PAPER CONSISTS OF 6 PAGES** (Excluding this front page)

**<u>Question 1 (70 Marks) (126 minutes)</u>**

**<u>Part A</u>**

## <u>Avengers endgame</u>

**Extracted Statement of profit or loss and other comprehensive income for the year ended 31 December 2018**

| | **N$'000** |
|---|---|
| Gross Profit | 862 150 |
| Profit before interest and tax | 129 094 |
| Finance cost | 13 628 |
| Profit after interest and tax | 115 466 |
| Income tax expense | 33 916 |
| | |
| Profit for the year | 81 550 |

**Extracted statement of financial position as at 31 December 2018**

| | **N$'000** |
|---|---|
| **Total Asset** | **737 177** |
| | |
| **Equity and Liabilities** | |
| **Total Equity** | **349 138** |
| | |
| Ordinary Share Capital (1 000 000 ordinary shares) | 75 000 |
| Non Distributable reserves | 53 095 |
| Retained Income | 221 043 |
| | |
| **Total liabilities** | **388 039** |
| | |
| **Non-current liabilities** | **144 938** |
| Long term loans | 89 156 |
| Debentures | 15 000 |
| Preference shares (500 000 preference shares) | 25 000 |
| Deferred tax | 15 782 |
| | |
| **Current liabilities** | **243 101** |
| Trade payables | 187 071 |
| Other payables | 29 610 |
| SARS | 26 420 |
| | |
| **Total equity and liabilities** | **737 177** |

**Additional information**

- In the previous financial year the company decided to issue an additional 200 000 ordinary shares to improve the debt to equity ratio.
- The company is also monitoring the debt to equity ratio closely as the interest rates on debt is the lowest in the past five years.
- The "Economist" published on article where they predict that the bank lending rate will increase in early 2019.

- The following are industry averages

| | |
|---|---|
| **Current ratio** | **2:1** |
| **ACID ratio** | **1:1** |
| **Debt ratio** | **45%** |
| **Debt to equity ratio** | **67%** |
| **Interest cover (TIE)** | **7.5** |
| **Gearing ratio** | **40%** |
| **Return on assets** | **17,25%** |
| **Return on operating assets** | **18,75** |
| **Net profit percentage** | **15%** |
| **Gross profit percentage** | **70%** |

**REQUIRED.**

| |
|---|
| (a) Calculate the following ratios for Avengers Endgame for the year 2018 |
| **(Round your answer to the nearest two decimal places)** |
| (i) Debt management ratios |
| (ii) Gearing ratio **(14 marks)** |
| (b) Comment on the significance of the ratios calculated in (a) in comparison to the averages for the industry **(6 marks)** |

**Use the same set of financial information as set out in PART A and consider the following additional information.**

**Current Capital structure**

- Ordinary shares currently trade at a market value of 400 each, cost of equity is 20%
- The preference shares have no conversion rights and carry a dividend pay-out of 11% similar preference shares are currently trading at 10%
- The debentures mature in 5 years' time at a premium of 10%. The debentures carry an interest rate of 12.5%. Similar debentures are trading at 11.11% before tax
- The long term loan matures in 8 years' time and carries an interest of 15%. The current long-term interest rate for a similar loan is 16.67%
- Trade creditors are normally paid in full with the normal credit period without any interest being paid or discount received. Short-term credit is not part of the long-term financing structure of the company.
- The bank overdraft rate is 18%

- The current tax rate is 28%

| REQUIRED | |
|---|---|
| Calculate the weighted average cost of capital (WACC) based on the current capital structure for 2018 based on market values | **(20 Marks)** |
| **(Round your calculations and answers to the nearest N$ and full percentage)** | |

**PART C**

The management team has decided to expand their current service offerings into the public transport sector. With the new toll fees that will be charged, less people will be able to afford the trip in their private vehicle between different destinations and the hotel. Many people can also not afford the private transport fees and there are few alternatives.

Operational manager is currently investigating two mutually exclusive investment possibilities

Project A Purchase 100 new 65 seater buses at cost of N$ 85 000 000

Project B Purchase 100 second hand 65 seater buses at a cost of N$ 49 750 000

The table below includes information relating to the two projects

| | **Project A** | **Project B** |
|---|---|---|
| | N$ | N$ |
| Current tax value | 85 000 000 | 48 000 000 |
| Cost price | 85 000 000 | 49 750 000 |
| Realizable value after 5 years | 15 000 000 | |
| Realizable value after 3 years | | 9 500 000 |
| Working capital in year 1 | 100 000 | 80 000 |
| Income from buses | 64 500 000 | 64 500 000 |
| Fixed cost per annum | 20 000 000 | 20 000 000 |
| Variable cost per annum | 15 000 000 | 21 000 000 |
| Net present value | ? | ? |

**Additional information**

- Depreciation is not included in the fixed cost ROR allows for wear and tear over five years on new vehicles and three years on the used vehicles
- You can assume that the WACC for this project is equal to 18%
- The current tax rate is 32%

**General information**

The new buses were manufactured based on newer technology and only uses diesel of 50ppm or lower to minimise the $CO_2$ emissions.

The company is currently looking at effective ways to manage its carbon footprint that directly impacts their reputational risk. Sustainable investments are a big strategic focus point for the directors in the next four years.

| REQUIRED |
| --- |
| (a) Write a report/memo to the managers advising on whether they should invest in any of these two projects by making use of the net present value (NPV) calculation (show you workings) **(10 marks)** |
| (b) Which project they should invest in if applicable ( show your workings) **(4 marks)** |
| (c) Discuss some qualitative and environment impact factors that management should consider when they make their investment decision **(7 marks)** |
| (d) Discuss some of the shortcomings when using the NPV method for capital budgeting **(4 marks)** |

**Part D (5 marks; 6 minutes)**

Consider the following two financing options for the capital expansion as discussed in PART C of the question

1) 19% Convertible preference shares
2) Bonds with a coupon rate of 16%

| REQUIRED |
| --- |
| Discuss which financing option you would recommends to management and why you choose the specific option. **(5 marks)** |

**Question 2 (20 Marks, 36 Minutes)**

Historically, the majority of companies' bankruptcy is attributable to many factors. One of such factors is their failure to undertake a thorough feasibility study which encompasses cost volume profit analysis (CVP). The what if analysis, as commonly known, does not only help the company to determine its break-even point, but it also serves as a cautionary measure as far as the company's revenue is concerned.

Mr Thomas would like to start selling chicken pies to NUST Students effective July 2018. Given his hectic schedule, he would contract someone to sell them on his behalf. However, he is still uncertain about this idea as he is not sure if it would be a profitable business or not. He has provided you with the following budgeted information so you help him answer some of his critical questions thereof for the month of July 2018:

- Selling price per pie — N$ 20,00
- Cost of ingredients — N$8,50
- Cost of sales person — 10% for every pie sold
- Fixed rental fee for a NUST stall/stand — N$ 1 900,00
- Budgeted monthly sales (chicken pies) — 300

| **REQUIRED: Each question should be answered in its own context:** | | **MARKS** |
|---|---|---|
| 5.1. | How many pies should Mr Thomas sell in order to break-even? | 4 |
| 5.2. | Determine Mr Thomas' break-even (N$) value. | 2 |
| 5.3.<br>Compute Mr Thomas' Margin of Safety:<br>i. In units,<br>ii. As a value (N$), and<br>iii. As a percentage (%). | | <br><br>2<br>2<br>2 |
| 5.4. | With the help of your answer in (5.3. i), what does such an answer mean to Mr Thomas? | 2 |
| 5.5. | Suppose Mr Thomas decides to reduce the price per pie to N$18,00. Other information remains constant. What effect would this change have to your answer in (5.1.) above? What would be his motive of reducing his selling price per pie? *((Your reasoning should be based on the given context/scenario, but not a mere generalization).* | 6 |
| **TOTAL MARKS FOR QUESTION 2** | | **20** |

**Question 3 (10 MARKS) (18 MINUTES)**

Cardale Industrial Metal Co (CIM Co) is a large supplier of industrial metals. The company is split into two divisions: Division F and Division N. Each division operates separately as an investment centre, with each one having full control over its non-current assets. In addition, both divisions are responsible for their own current assets, controlling their own levels of inventory and cash and having full responsibility for the credit terms granted to customers and the collection of receivables balances. Similarly, each division has full responsibility for its current liabilities and deals directly with its own suppliers.

Each divisional manager is paid a salary of N$120,000 per annum plus an annual performance-related bonus, based on the return on investment (ROI) achieved by their division for the year. Each divisional manager is expected to achieve a minimum ROI for their division of 10% per annum. If a manager only meets the 10% target, they are not awarded a bonus. However, for each whole percentage point above 10% which the division achieves for the year, a bonus equivalent to 2% of annual salary is paid, subject to a maximum bonus equivalent to 30% of annual salary.

The following figures relate to the year ended 31 August 2015:

| | Division F | Division N |
|---|---|---|
| | N$'000 | N$'000 |
| Sales | 14,500 | 8,700 |
| Controllable profit | 2,645 | 1,970 |
| Less apportionment of Head Office costs | (1,265) | (684) |
| Net profit | 1,380 | 1,286 |
| | | |
| Non-current assets | 9,760 | 14,960 |
| Inventory, cash and trade receivables | 2,480 | 3,260 |
| Trade payables | 2,960 | 1,400 |
| | | |

During the year ending 31 August 2015, Division N invested N$6·8m in new equipment including a technologically advanced cutting machine, which is expected to increase productivity by 8% per annum. Division F has made no investment during the year, although its computer system is badly in need of updating. Division F's manager has said that he has already had to delay payments to suppliers (i.e. accounts payables) because of limited cash and the computer system 'will just have to wait', although the cash balance at Division F is still better than that of Division N.

| |
|---|
| **Required:** |
| (a) For each division, for the year ended 31 August 2015, calculate the appropriate closing return on investment (ROI) on which the payment of management bonuses will be based. Briefly justify the figures used in your calculations. |
| ***Note: There are 3 marks available for calculations and 2 marks available for discussion. (5 marks)*** |
| (b) Discuss whether ROI is providing a fair basis for calculating the managers' bonuses and the problems arising from its use at CIM Co for the year ended 31 August 2015. **(5 marks)** |
| **TOTAL MARKS FOR QUESTION 3 — 10 MARKS** |