Financial Management II

Posted by Jean - 2009/06/06 13:37

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Chapter 2; Page 49
No Answers been provided in Module; Need tutor / peers to verify

Guys,

Pls see the exercise 2.2 question no.3

Refer the answers below ... is it correct?

Pb = C (PVIFA) + Pn (PVIF) ~ i=7%; n=23yrs

= 100 (11.272) + 1000 (0.2109)

= 1127.2 + 210.9

= RM 1,338.10

Pb = C (PVIFA) + CP (PVIF) ~ i=7%; n=8yrs

= 100 (5.9713) + 1090 (0.5820)

= 597.13 + 634.38

= RM 1,231.51

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Re:Financial Management II

Posted by Jean - 2009/06/12 10:06

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Unit 1 Tutorial 1

1. Differentiate between temporary and permanent current assets.

Temporary Current Assets:
- To meet seasonal fluctuations.
- To meet rising demand during specific period of business cyclical nature. (when enconomy is strong)

Permanent Current Assets:
- Maintained ALL the time even during enconomic slacks off.
- Maintain minimum level of inventory to meet continuous demand by customers all year round.

2. What are the three different approaches that firms may adopt to finance both temporary and permanent portions of current assets.

a. Conservative Approach
- Uses mall amount of short-term debt to finance temporary current assets.
- The balance finance through sale of some marketable securities that the firm has invested for this purpose.

b. Maturity Matching / Self-Liquidating Approach
- Match maturity of assets and liabilities.
- Ensure or minimize the risk of firm from unable to payoff it's maturing obligation in due time.

c. Aggressive Approach
- Part of permanent current assets & temporary current assets

are being financed by short-term sources.
- Degree of aggressiveness depends on proportion of permanent current assets & fixed assets that is financed by short-term financing instruments.
- Firm would subject to dangers of rising interest rates & loan renewal problems.
- Some firm prefers this type of approach because short-term debt is often cheaper than long-term debt.

3. Differentiate between spontaneous sources of financing and other sources of financing?

- Spontaneous Financeing:
-> Accruals
-> Accounts Payable

Characteristics:
-> No explicit costs attached.
-> Suitable for daily operations.
-> Unsecured & does NOT require collateral.

4. Define the following:
(a) Accrual expenses
- Services already received but not yet make payment for it. (Liabilities)
_ Example:
-> Accrued Wages
-> Accrued Income Taxes

(b) Compensating balance
- Banks required borrowers to maintain an average demand deposit balance equal to 10-20% of loan face amount.
- Particular money unavailable for use; hence, increases the Cost of Borrowing, because Interest is paid on Total Amount of Borrowing (include money that borrower cannot touch)

(c) Discount loan
- Bank deducts the interest in advance.
- Thus, borrower receives less than face value of the loan.

(d) Commitment fees
- Percentage interest on the non-borrowed balance of the Revolving Credit Agreement.
- Example:
-> Agreement which allows firm to borrow up to limit of $5 Million.
-> Firm already borrowed $3 Million; Still got $2 Million balance.
-> If fee is 0.5%, then:
Commitment Fees = $2 Million x 0.005
= $10,000

5. Calculate the annual financing cost of foregoing the cash discount under the following:
(a) 2/10, net 50

AFC = x
= x
= 0.0204 x 9
= 0.1836
= 18.36%

(b) 2/15, net 30

AFC = x

= x
= 0.0204 x 24
= 0.4896
= 48.96%

6. MRSB Bhd. currently is involved in manufacturing of furniture products, while Wood Malaysia Sdn. Bhd. is the sole supplier of raw wood for MRSB Bhd. MRSB Bhd. currently purchases an average of RM20,000 per day in raw materials on credit terms of net 20. The company expects sales to increase in the near future. Therefore, it anticipates that the raw material purchase will increase from RM20,000 a day to RM30,000 a day. MRSB Bhd. believes that part of purchase of raw material could be funded by stretching accounts payable.

(a) Let us say, the company currently pays its accounts payable at the end of the credit period (20 days). What is the level of trade credit?

RM20,000 x 20 = RM400,000

(b) If MRSB Bhd. is stretching its accounts receivable an extra 10 days beyond the original credit period of 20 days, how much additional short-term funds will be created?

RM20,000 x First 20 Days = RM400,000
RM30,000 x Extra 10 Days = RM300,000

Total Short-Term Funds Created = RM700,000

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Re:Financial Management II

Posted by Jean - 2009/06/12 10:09

UNIT 1 TUTORIAL 2

1. Differentiate between medium and long-term financing.

Medium-term Financing:
- Interim substitute for long-term financing needs.
- Provide flexibility in the timing of long-term financing.
- Mature within 1-10 Years
- Offer potential cost advantages over long-term financing.

2. Briefly describe the following:

(a) Term loan
- Intermediate-term Financing
- Debt Obligation having Initial Maturity between 1-10 years.
- Lack the permanency characteristics of long-term debt.
- Payable in periodic terms: Quaterly, Semi-Annually, Annually

(b) Balloon loan
- Make Equal Periodic Payments over loan life
- Loan partially amortized, leaving lump sum payment that falls due termination day of loan period.

(c) Bullet loan
- Make Periodic Interest Payment over loan life.
- Make single Principal payment @ maturity.

(d) Mortgage loan
- Finance structure purchase
- Example: home, office building, apartment, etc.
- Particular asset served as collateral
IF borrower fails to make payment, lender will take the ownership

of particular property.
- Lower interest rate as compared to equivalent risk loan wth
  no collateral
- Interest based on fixed or floating rate

(e) Medium term notes
- Sold to investors through investment banks.
- Mostly unsecured: issuers are usually large & reputable as
  evidenced by their credit worthiness
- Maturity from 9 months to 10 years.
- Registered with Security Exchange Commission (SEC)
- Offer flexibility to borrower
- similar to bonds

(f) Equipment financing
- Equipment (asset) used as collateral to secure a loan.
- Marketable euipment or purchasing such equipment
- Maturity > 1 year
- Repayment schedule set in keeping with equipment economic life.
- Lender ensure equipment market value > Loan Amount
- 2 Sourches:
  i. Chattel Mortgage
  -> Mortgage on specific assets other than land & buildings.
  -> Lender got lien on specific equipment.
  -> If borrower fails to pay, lender can sell the equipment.
  ii. Pledge
  -> Possession is transferred to lender but title remains with
  borrower
  -> Example: Stocks & Bonds

(g) Bond financing
- Long-term debt contracts in: which
  Issuer (borrower) promises to repay buyer (lender) the original
  principal + interest at periodic intervals.
- Promise Agreement between issuer & buyer to trade current cash flow
  with expected future cash flow.
- Issuer promises to pay future cash flow in the form of
  coupon interest payments & principal payment for current cash flow
  (bond price).
- Value of Bond @ Current Period =
  Value of Expected Cash Flow (Coupon Interest + Principal)

3. A town bank usually provides term loans that require repayment in a series of equal installments. If an RM2 million loan is made, what will be the annual end of the year payment if the interest rate is 10% on the loan? The maturity of the loan is 5 years.

PMT = PVA/(PVIFA)i=10%,n=5
= 2 Million/(3.7908)
= RM 527,593.12

4. Set up an amortized table for a loan amounting RM2 million over a 5 years period for the following conditions:
(a) Annual equal payment with interest rate of 10% on the remaining unpaid balance.
(b) Annual equal principal reduction and interest rate is charged on the remaining unpaid balance.
(c) Set up amortized loan schedule for bullet loan.

Refer

5. Firm XYZ is undertaking a long-term investment project that requires an initial investment of RM5 million. To fund this project, the firm arranges a secured longterm loan maturing in 5 years time. The bank will charge a 10% interest rate on the unpaid balance over the maturity period. The first

repayment of the loan will start at the end of year one. What should be the annual installment that the firm needs to provide the lender?

PMT = PVA/(PVIFA)i=10%,n=5
= 5 Million/(3.7908)
= RM 1,318,982.80

6. 6. Assume that you are buying a Mercedes Benz from UMW Malaysia with an onthe-road price of RM250,000. UMW Malaysia also arranges a long-term loan that will charge 5% interest per year. You are required to pay RM20,000 as a down payment.
(a) Determine the annual installment if you are taking a 7 year term repayment plan.
(b) What will be the annual installment be if you are taking a 10 year terms repayment plan.

Refer

7. Percahaya Limited Bhd. issued a 20 years callable bond. The bond was issued 5 years ago with a coupon interest rate of 12% per year, and a face value of RM1,000. The company reserves the right to call off the bond after 15 years from the date of issue with a call premium of RM100. The required return to bond holders is 10%. What is the price of the bond today if the company calls-off the bond 5 years before the maturity?

Call Price (CP) = Principal + Premium
= 1,000 + 100
= RM 1,100

C = 1,000 * 0.12
= RM 120

n = 15 Years - 5 Years = 10 Years

Pb = C (PVIFA i=10%, n=10) + CP (PVIF i=10%, n=10)
= 120 (6.1446) + 1,100 (0.3855)
= 737.352 + 424.05
= RM 1,161.402

8. Write brief notes on the following:
(a) Indenture provision
- Contract between the issuer and the bondholders specifying the issuer's legal requirement.
- Investors need to be aware of some of the provisions that allow the issuer to call-off the contract before its maturity date.
- The indenture provision highlights the lender's right to put-off the bond at a specified price prior to the maturity.

(b) Types of bonds
(i) Coupon Bearing Bonds
(ii) Zero Coupon Bonds
(iii) Junk Bonds
(iv) Callable/Put-able Bonds

(c) Why some bonds are sold at premiums and others sold at discount prices?

The return a bond must offer in order to be a worthwhile investment.
Required yield is set by the market and sets the precedent for how current bond issues will be priced.

- If Coupon Rate higher than Required Yield
Bonds sold at Premiums;

- If Required Yield higher than Coupon Rate
Bonds sold at Discount Prices.

The investor acquiring the bond to be compensated for the lower
coupon rate in the form of accrued interest.
If the bond is not priced at a discount, investors will not purchase
the issue because its yield will be lower than that of the market.

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How to Calculate Market Share

Posted by Jean - 2009/06/30 11:41

Introduction

Any business needs information about how it is operating in comparison to its competitors to survive and thrive. It is not enough to just know what your own sales are from year to year. A decrease in your sales could simply be a function of a decrease in the entire market for your product or service. Alternatively, a decrease in sales compared with your competitors could mean that serious trouble is brewing. Calculating your market share allows you to determine where you stand in your industry. You should calculate your market share on a regular basis as part of your ongoing internal reporting, at least annually, but preferably more often.
Instructions
Difficulty: Moderately Easy
Calculating Market Share

Things You'll Need

* Calculator
* Industry statistics
* Your company's financial statements

Steps 1
Step One
Obtain as much information as possible about the products or services you sell in your area of service. For example, if you sell microchips nationwide, you will need to know how many microchips get sold in the country annually and what the total revenues are for those sales. If you provide lawn care service in your county, you will need to know what consumers in your county spend on lawn care services. If you deal in an industry with many private companies, you may find it somewhat difficult to obtain this information. Research industry groups and business organizations to find out what statistics they have available for your industry. Start with the Chamber of Commerce.

Steps 2
Step Two
Calculate your market share once you have the relevant statistics. There are two ways to calculate your market share, each of which may give you a different result. The first calculation would be based on number of products. For example, if there were 147,000 microchips sold in the United States last year and your company sold 11,200 of them, your market share would be equal to 11,200 divided by 147,000 or 7.6%. That means that your company sold 7.6% of all the microchips sold in the United States last year. The second method of calculation is based on revenues. If the total spent by consumers on lawn care services in your county last year was $312,000 and your revenues last year were $43,600, then your market share would be $43,600 divided by $312,000 or 14%. Calculating based on units and revenues will give you different results where competitors are selling their goods and services for different prices. You will need to decide which measure gives you the best results for your particular industry. In general, products are measured based on units and services are measured based on revenues.

Steps 3
Step Three
Keep track of your market share over time. If you see distinct changes to your market share, find out what is causing it. A decrease in market share could mean that you are losing business to competitors. An increase in market share means you are picking up business but you need to ensure that it is profitable business. Monitoring your market share is an important bellweather to warn you of upcoming trouble.

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Dividend Payout Ratio

Posted by Jean - 2009/06/30 16:45

What Does Dividend Payout Ratio Mean?
The percentage of earnings paid to shareholders in dividends.

Calculated as: = Yearly dividend per share
Earnings Per share

or equivalently:
= Dividend
Net Income

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Inventory Loan

Posted by Jean - 2009/07/16 01:24

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Inventory loan use your inventory to secure a loan.

Inventory loan financing (also known as "Flooring") is the leveraging of inventory using the value of the financed equipment or stock as collateral for the loan. Lenders want to make sure their loans are secure, so this method will improve the chances of getting financed drastically.

Inventory loan financing is a method commonly used when a distributor or reseller needs additional credit and payment terms longer than 30 days in order to maintain a complete stock of inventory for immediate customer availability. Lenders and savvy business people realize that running out of inventory will do nothing, but drive customers away from a business. That is why more and more lenders are willing to allow a business to use their current stock of inventory as collateral for future loans.

A benefit of using this sort of loan is the increase credit capacity based on security in financed inventory/equipment. It also allows distributors and resellers to stock inventory with extended payment terms. Working capital position for the business is also increased. Another extremely important benefit is that it does not count against the customer's credit line.

Have a good plan in place before you speak with a lender about your inventory loan options. Conduct a search in our free business capital search engine today to uncover a matched list of lenders that are ready to help finance your business.

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Differences Between Secured & Unsecured Business L

Posted by Jean - 2009/07/16 10:16

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When you are applying for a bank loan, you have the choice between a secured loan and an unsecured loan - or more likely, your financial lending institution will select one or the other for you.

A secured loan is when the borrower puts up collateral - if the borrower defaults on the loan, the bank has the power to seize the collateral. Real estate is the most common collateral, although stocks and other assets can be used.

An unsecured loan is a loan in which no collateral is pledged by the borrower. These loans are generally only given to businesses and persons that the banks deem as unlikely to default.

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What is a Collateral Loan?

Posted by Jean - 2009/07/16 11:04

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A collateral loan is also called a secured loan. It is a loan obtained from a banking or other financial institution, where in exchange, the creditor may sell that which is offered for collateral if the loan is unpaid. A collateral loan is often offered at a lower interest rate than an unsecured loan, because there is a guarantee of repayment should the borrower default on the loan.

A collateral loan may use different things to secure the loan. Often people use stocks or bonds to establish a collateral

loan. They can use their ownership in property, where a portion of perhaps a home, or a piece of land, is set up as collateral. If the borrower defaults, he must sell the property to pay back the loan, and the lender has rights to sell the property also, even if only a portion of the full value belongs to them. In these cases, a lender would sell the home, and give the previous owner the monies not offered on collateral.

A collateral loan may also be based on expected collateral, like the expected return on a harvested crop, or on an investment. Occasionally, one can use property like high-valued jewelry as collateral, or other high-valued goods. This is rare, as most collateral loans are based on paper assets, or on real estate.

If the collateral given decreases in value and the borrower defaults, he or she will still be responsible to repay the amount at which the collateral was previously assessed. For example, a person borrows $100,000 on a home of the same value. If the home decreases in value, say to $75,000, the borrower must still pay back the full amount, as dictated by the terms of the collateral loan. If a borrower has defaulted on the collateral loan, his or her home will be sold. However, the borrower will still owe the lender $25,000. This may require the borrower to sell more possessions or enter bankruptcy.

In most cases, people will not borrow to the full value of a possession offered as collateral to avoid the circumstances described above. Instead, the collateral loan is usually only a portion of the full value of a possession, or of paper trading like stocks and bonds. People with a number of high value items, properties, or stocks and bonds can of course get larger collateral loans. However, with any loan, it is best to borrow only what one needs, since interest rates will still mean a higher payback than the actual money borrowed.

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