

**OLLSCOIL NA hÉIREANN, GAILLIMH  
THE NATIONAL UNIVERSITY OF IRELAND, GALWAY**

**SUMMER EXAMINATIONS 2000**

**First Examination in Masters of IT (Information Technology)**

**FINANCIAL MANAGEMENT (AY505)**

Prof. Robert W. Scapens  
Prof. Seamus Collins  
Mr. Tim Cormick

Time Allowed: **TWO AND HALF HOURS**

Candidates should answer any three questions.  
All questions carry equal marks.

Separate answer books are to be used

## Question 1

### Boater Plc

#### Profit and loss account for the year ended 31 December

YEAR	<u>2000</u>		<u>1999</u>	
	£000	£000	£000	£000
Turnover		5700		5300
Cost of sales		4330		4000
Gross profit		1370		1300
Administration		735		620
Operating profit		635		680
Interest		220		190
Profit before taxation		415		490
Taxation		175		125
Profit after taxation		240		365
Preference dividends	90		90	
Ordinary dividends	140	230	140	230
Retained profits		10		135

#### Balance Sheet as at 31 December

	<u>2000</u>		<u>1999</u>	
	£000	£000	£000	£000
Fixed assets		5405		4880
Current assets:				
Stock		900		880
Debtors		460		460
Cash		5		60
		1365		1400
Creditors due within one year:				
Trade creditors	425		190	
Bank	nil		800	
Taxation	155		110	
Dividends	230		230	
		810		1330
Net currents assets		555		70
Total assets less current liabilities		5960		4950
Creditors due after one year:				
Debentures	1100		1100	
Bank Loan	1000		0	
		2100		1100
		3860		3850

1 (a) Calculate the following ratios for Boater Plc in 2000 and 1999 and explain whether performance has improved or deteriorated during the year.

Gross Profit Ratio

Return on Capital Employed

Return on Equity

Current Ratio

Quarter Ratio/ Acid Test

Debt: Equity

Interest Cover

Debtor days

Creditor days

Stock turn

(25 marks)

(b) What are your overall conclusions about the performance of the company.

(8 ½ marks)

## Question 2.

Your bank tells you that your business is overtrading and correction measures are due.

1. What is overtrading and how do you identify it? (6 marks)
2. Explain the detrimental consequences of overtrading and how it impinges on the management of the business. (6 marks)
3. Suggest alternative ways of correcting the problem (7 marks)
4. What key ratios would you watch to ensure that it remained under control? (7 marks)
5. What are other common signs of impending business failure? (7½ marks)

### Question 3

The accountant of your company Unaware Ltd has recently been taken ill through overwork. The date is end of 19X7. In his absence his assistant has prepared some calculations of the profitability of a project which are to be discussed soon at the board meeting of your company. His workings, which are set out below, include some errors of principle. You can assume that the statement below includes no arithmetic errors.

	19X7	19X8	19X9	19X0	19X1	19X2
	£000	£000	£000	£000	£000	£000
Sales revenue		<u>450</u>	<u>470</u>	<u>470</u>	<u>470</u>	<u>470</u>
Less costs:						
Materials		126	132	132	132	132
Labour		90	94	94	94	94
Overheads		45	47	47	47	47
Depreciation		120	120	120	120	120
Working capital	180					
Interest on working capital		27	27	27	27	27
Write off of development costs		<u>30</u>	<u>30</u>	<u>30</u>		
Total costs	<u>180</u>	<u>438</u>	<u>450</u>	<u>450</u>	<u>420</u>	<u>420</u>
Profit/(loss)	<u>(180)</u>	<u>12</u>	<u>20</u>	<u>20</u>	<u>50</u>	<u>50</u>

Total profit/(loss) (£28,000) = Return on investment (4.7%)  
 Cost of equipment £600,000

You ascertain the following additional information:

The cost of equipment contains £100,000 being the book value of an old machine. If it was not used for this project it would be scrapped with a zero net realisable value. New equipment costing £500,000 will be purchased on 31 December 19X7. You should assume that all other cash flows occur at the end of the year to which they relate.

The development costs of £90,000 have already been spent.

Overheads have been costed at 50 per cent of direct labour which is the company's normal practice. An independent assessment has suggested that incremental overheads are likely to amount to £30,000 per year.

1. What are the relevant cash flows to evaluate the proposal? (15 marks)
2. What is the net present value using a 12% discount rate and does this justify the investment. (5 marks)
3. What is the payback? (5 marks)
4. List 4 other non-financial factors which might be relevant in assessing whether or not it might be a good investment. (8½ marks)

#### Question 4

Increasingly, Irish chief executives have emphasised the maximisation of shareholder value as their ultimate objective. Others refer frequently to Economic Value Added rather than profit.

##### Part 1:

Explain:

- (a) what is meant by shareholder value; (4 marks)
- (b) what uses it has in the management of a business; (4 marks)
- (c) in what way is it superior to traditional approaches (4 marks)
- (d) what practical difficulties arise in applying shareholder value to a business. (6 marks)

##### Part 2

- (a) What are the traditional ways of valuing shares (7 marks)
- (b) Is a shareholder value approach useful in valuing high tech stock (8½ marks)