

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## CPA(U) EXAMINATIONS

### LEVEL FOUR

#### CORPORATE FINANCIAL MANAGEMENT - PAPER 18

WEDNESDAY, 19 DECEMBER 2001

#### INSTRUCTIONS TO CANDIDATES

1. Time allowable: **3 hours**
2. Section **A** has **one** compulsory question carrying 60 marks
3. Section **B** has **three** questions and only **two** are to be attempted.  
Each question carries 20 marks.
4. Please, read further instructions on the answer book.

## SECTION A

### Question 1

#### THE SALE OF “SANTA MARIA” HOTEL

The Government of Uganda recently advertised the divestiture of “Santa Maria” Hotel, a state enterprise run by the Ministry of Tourism, Trade and Industry. The hotel mainly served travelling government officials. Due to its recent liberalisation policy, Cabinet decided to sell off this subsidised hotel facility, and instead give “above average” travel allowances to government officials.

The main problem for Cabinet has been to estimate a fair price or valuation for the hotel to help the selling committee negotiate from an informed point of view. Certain data has been collected in preparation for the sale, with the aid of two local experts in finance and the hotel industry.

- (i)   ▪ The “Santa Maria” Hotel was refurbished three months ago at a cost of Shs 2.5 billion and has hardly been used since. The Ministry of Finance paid for the refurbishment.
- Santa Maria was built ten years ago at a cost of Shs 500 million and has been depreciated at a rate of 5% per year, on a straight line basis.
- The Hotel has other fixed assets and fittings with a book value of Shs 85 million. A government valuer has however issued a report confidently stating that those assets would definitely fetch Shs 150 million in the market.
- The experts have advised Government to exclude from the sale the small list of **current assets** and **current liabilities**, which nearly stand at an equal ratio of **1:1** .
- Santa Maria Hotel has a soft long term Bank loan of Shs 200 million standing unpaid since its inception. The loan was used to finance a portion of the initial construction, and would fall immediately due if the hotel is sold.
- The Hotel has been 100% wholly owned by Government, in view of Shs 300 million initial contribution towards construction of Santa Maria Hotel.
- Due to poor management, the financial statements show an accumulated loss of Shs 165 million.
- The Hotel has a capacity of 200 beds with 600 staff on the payroll. For any non-core staff who may not be inherited by the prospective buyer, their termination benefits would be paid separately by Government from a restructuring account kept by the Treasury Department.

- (ii) ■ A market survey has also been carried out by a marketing specialist in the hotel industry, one Gerald Irumba. In view of the increasing popularity of the tourism sector in Uganda, Gerald estimates the hotel's future net earnings as follows:

Year 1: Shs 400 million

Year 2: Shs 600 million

Year 3: Shs 800 million

Year 4: Shs 1,000 million (After confirmed international athletics at Namboole Stadium).

Year 5 up to Year 20: Shs 400 million per annum (Net of any minimum repairs).

- The Hotel industry in East Africa has had an average return on Capital employed of 15%.

**Required:**

- (a) If a local professional valuer has concurred with the government valuer that the "Santa Maria" Hotel building has a market value of only shs 1.8 billion, what minimum price should the selling committee consider for the deal?

In your view, would it be reasonable to accept this price using an asset based valuation?

**(25 marks)**

- (b) If Mr Markson, a Mombasa based hotelier is sure of increasing the estimated annual net earnings in (ii) above by 25% each, and would like to earn 5% above the East African rate of return, what would be his maximum offer price using an earnings based forecast/ valuation?

**(25 marks)**

- (c) Which of the two valuation methods above, should the Government selling committee rather insist on during the sale negotiations, and why?

**(10 marks)**

**(Total 60 marks)**

## **SECTION B**

### **Question 2**

The following is an extract from the financial press (Wall Street Journal - adapted)

IBM announced its 1982 earnings per share (EPS) for the 4th quarter of 1982 on Friday January 21 1983 and it showed that its EPS were up by 28% compared to the 4<sup>th</sup> quarter of the previous year, 1981.

Nevertheless, IBM share price dropped by US\$3.25 to US\$94.625. Securities analysts explained the price drop by noting that an expectedly large part of the increase was due to an accounting restatement required by the Financial Accounting Standards Board's order FAS52.

On Monday, 24 January, 1983, IBM's share price dropped by a further US\$0.75 although overall market indexes were down sharply (2.75%). Later on in the day, IBM issued a statement clarifying the impact of FAS52 on the EPS calculations. IBM's EPS would have been just as high under the principles used by the predecessor accounting standard FAS8.

An analyst at Goldman, Sachs & Co. was quoted as saying that "there was a confusion on Friday as we did not have enough detail; we got it today and the 4<sup>th</sup> quarter, 1982 looks fine".

On Tuesday, 25<sup>th</sup> January 1983, IBM's share price rose by US\$2.125 to US\$96.

### **Required:**

Discuss the implications of the above in the light of your understanding of the efficient markets Hypothesis in stock market behaviour.

**(20 marks)**

**Question 3**

- (a) Mr Edward Kamara is an importer of business textbooks. Mr Kamara's book stocks are running out. He has approached his Bankers Stanbic Bank (U) Ltd for the next consignment of 5,000 books.

The bank has quoted him a spot selling price of US\$1 = UG Shs 1525 – 1575.

The forex total price for the whole consignment is US\$ 100,000

The letter of credit terms for the transaction requires Mr Kamara to pay 40% in advance, and 60% on receipt of the textbooks. Mr. Kamara wants to pay the initial advance of 40% of the price.

**Required:**

How much must Mr Kamara pay his Bankers in Uganda shillings for the initial down-payment required under the letter of credit?

**(6 marks)**

- (b) Stanbic Bank (U) Ltd has also quoted Mr Kamara some forward rates for the US\$ / Ug Sh rate as follows;

Spot - Ug Shs 1525 – 1575

1 month Shs 10 – 20 discount

2 months Shs 20 – 40 discount

3 months Shs 40 – 50 discount

4 months Shs 55 – 60 discount

Mr Kamara expects the books towards the end of the third month from today.

Because of the recent turbulence and slide of the local Uganda currency against the US dollar, Mr Kamara decides to sign a fixed forward agreement with his bankers for settlement of the balance of the price, i.e. the 60%.

**Required:**

Ignoring any transaction charges, how much money, in Uganda Shillings, must Mr. Kamara have on his current account to meet his 60% price obligation by the time the books arrive?

**(10 marks)**

- (c) What is a fixed forward currency contract?

**(4 marks)**

**(Total 20 marks)**

**Question 4**

- (a) South African Textiles Ltd are planning to build two textile factories in Eastern / Central Africa. The two factories would cost about US\$ 12 million. The preferred countries of choice would be Uganda and the Democratic Republic of Congo (DRC).

The External Markets Development Manager of the South African company has expressed some anxiety on **country** and **political risk**.

**Required:**

Explain and distinguish between the two risks mentioned above for project finance, and show their current relevance to South African Textiles Ltd

**(10 marks)**

- (b) You are the Finance Director of your company. You have been requested to make a presentation at a seminar of 50 top Business Executives in the City. The topic is ***“Running an Ethical Enterprise”***.

**Required**

Outline the salient issues you would include in your presentation.

**(10 marks)**

**(Total 20 marks)**