FEEDBACK TUTORIAL LETTER

1st SEMESTER 2019

ASSIGNMENT 1

Corporate Finance

CFN411S
Feedback letter

Corporate Finance

Assignment One

Question One

a) Define what is meant by interest rate risk

*Interest risk is the risk that arises for bond owners from the fluctuating interest rates*

b) Assume you are the manager of a N$200 million portfolio of corporate bonds and you believe interest rate will fall. What adjustments should you make to your portfolio based on your beliefs?

Consider the following information to answer questions c, d, and e:

<table>
<thead>
<tr>
<th>Standard deviation</th>
<th>Beta</th>
</tr>
</thead>
<tbody>
<tr>
<td>Security A</td>
<td>40%</td>
</tr>
<tr>
<td>Security B</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td>0.9</td>
</tr>
<tr>
<td></td>
<td>1.5</td>
</tr>
</tbody>
</table>

c) Which security has more total risk? Explain your answer

*Security A*

d) Which security has more systematic risk? Explain your answer

*Security B*

e) Which security should have the higher expected return?

*Security B*

Question Two

Consider a 4 year loan with annual payments; the interest rate is 8 per cent and the principal amount is N$100000.

Required

Calculate the annual payment and create an amortization schedule for this loan

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening balance</th>
<th>Annual Payment</th>
<th>interest</th>
<th>principal</th>
<th>Closing balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>100000.00</td>
<td>3018.90</td>
<td>800.00</td>
<td>2218.90</td>
<td>7781.10</td>
</tr>
<tr>
<td>2</td>
<td>7781.10</td>
<td>3018.90</td>
<td>622.49</td>
<td>2396.41</td>
<td>5384.69</td>
</tr>
<tr>
<td>3</td>
<td>5384.69</td>
<td>3018.90</td>
<td>430.78</td>
<td>2588.12</td>
<td>2796.56</td>
</tr>
<tr>
<td>4</td>
<td>2796.56</td>
<td>3018.90</td>
<td>223.73</td>
<td>2795.17</td>
<td>1.39</td>
</tr>
</tbody>
</table>
Questions Three

a) Describe the concept of disposing a bond at a discount and at a premium and what determines that?

A bond is disposed at a discount if its par value is greater than its market value and disposed at a premium if its par value is lower than the market value. In determining the value, the market value of a bond will be higher if the yield to maturity is lower than the coupon rate.

b) Discuss the difference between book values and market values on the balance sheet and explain which is more important to the financial manager and why?

The accounts on the balance sheet are generally carried at historical cost, not market values. Although the book value of current assets and current liabilities may closely approximate market values, the same cannot be said for the rest of the balance sheet accounts. Ultimately, the financial manager should focus on the firm’s share price, which is a market value measure. Hence, market values are more meaningful than book value.

c) Briefly describe the three basic questions addressed by a financial manager.

Capital budgeting: the financial manager tries to identify investment opportunities that are worth more to the firm than they cost to acquire.
Capital structure: This refers to the specific mixture of long term debt and equity a firm uses to finance its operation.
Working capital management: This refers to a firm’s short term assets and short term liabilities.

d) What should be the goal of the financial manager of a corporation? Why?

The correct goal is to maximise the current value of the outstanding shares. This goal focuses on enhancing the return to shareholders who are the owners of the firm. Other goals, such as maximizing earnings, focus too narrowly on accounting profit and ignore the importance of market values in managerial finance.

Total marks: 70