

Uva Wellassa University

Faculty of Management

Degree of Bachelor of Business Management in Entrepreneurship and Management

THIRD YEAR SECOND SEMESTER EXAMINATION – DECEMBER/JANUARY 2017

EMG 461-2 Corporate Finance



Instructions to candidates:

No. of pages : Three (03)
No. of questions : Four (04) Essay
Time : Two (02) Hours
Marks allocated : 100 Marks
Answer **all** questions.

Index No:

01.

- i) Briefly describe the three (03) major decision types in corporate finance? (06 Marks)
- ii) Publicly traded companies are likely to have many different owners. Private companies, however, have relatively few owners. Does this mean that agency problems do not exist for privately held corporations? If so, why? If not, give specific examples of how agency problems could occur in this setting. (06 Marks)
- iii) Briefly explain in what respect is the objective of wealth maximization superior to the profit maximization objective. (06 Marks)
- iv) How the finance department is responsible for devising sustainable and survival operational policies of a company when the economic environment is not all that encouraging? (07 Marks)

(Total Marks-25)

02.

- i) Differentiate the Systematic and Unsystematic Risks with examples. (05 Marks)
- ii) What is Beta? How is it interpreted? (05 Marks)



iii) You are given following information.

State of economy	Probability of state	Return on A %	Return on B %
Recession	.25	-15	15
Normal	.30	15	25
Growth	.45	40	30

- a) What is the expected return for A? for B? (05 Marks)
- b) What is the Standard Deviation for A? for B? (05 Marks)
- c) Suppose you have Rs.1,000,000 in total. If you put Rs.750,000 in stock A and the remainder in Stock B, what will be the expected return and standard deviation of your investment portfolio? (05 Marks)
- (Total Marks-25)

03.

- i) There is no way to determine the exact optimum amount of leverage for a particular company at a particular time. Discuss. (05 Marks)
- ii) Under certain conditions Financial Leverage can improve a firm's ROE and EPS. However, at other times it may worsen ROE and EPS. Discuss. (05 Marks)
- iii) Briefly explain the effect of Financial Leverage on Stock Prices (05 Marks)
- iv) A company's balance sheet shows a total of Rs.30 million long-term debt with a coupon rate of 9 %. The yield to maturity on this debt is 11.11 %, and the debt has a total current market value of Rs.25 million. The balance sheet also shows that the company has 10 million shares of stock and the total of common stock and retained earnings is Rs.30 million. The current stock price is Rs.7.50 per share. The current return required by stockholders, is 12 %. The company has a target capital structure of 40 % debt and 60 % equity. The tax rate is 40%. What weighted average cost of capital should you use to evaluate potential projects of this company? (10 Marks)

(Total Marks-25)

04.

- i) Why is Equity Valuation more difficult than Bond Valuation? Explain. (05 Marks)
- ii) Singha Corporation issues a five-year, 8% coupon bond with a face value of Rs.1,000 and coupon payments made annually. You are required to,
- a) Determine the bond values if it is trading at the 8%, 6% and 10% yields. (03 Marks)
- b) Comment on the price and yield relation you observe. (02 Marks)
- iii) ABC PLC is trading for Rs.50 per share. Next year you expect it to pay a Rs.2 dividend, and dividends have been growing at a 6% rate. What rate of return do investors require from this stock? What is the dividend yield? What is the capital gain yield? (05 Marks)
- iv) Apollo Corporation is currently pays no dividends. The firm plans to begin paying dividends at the end of 3 years from today. The first dividend will be Rs.1.50 and dividends will grow at 6% per year thereafter. Given a required return of 14%, what would you pay for the stock today? (05 Marks)
- v) Suppose Max Corporation is expected to pay a dividend of Rs.1.75 next year. If the required return is 5.47% and the expected growth rate is 3.64%, what is the expected price after 6 years? (05 Marks)

(Total Marks-25)

