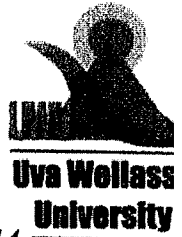


Uva Wellassa University

Faculty of Management

Degree of Bachelor of Business Management in Entrepreneurship and Management

THIRD YEAR SECOND SEMESTER EXAMINATION – AUGUST / SEPTEMBER 2014



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) An organization's financial management plays a critical role in the financial success of a business. Therefore, an organization should consider financial management a key component of the general management of the organization.
- a. How is Finance related to the disciplines of Accounting and Economics?
 - b. Describe the duties of the Financial Manager in a business firm
 - c. Explain the importance of proper Financial Management decisions
- (15 Marks)
- ii) If the use of financial leverage magnifies the earning per share under favorable economic conditions, why do companies not employ very large amount of debt in their capital structures? Explain
- (10 Marks)
- (Total Marks 25)

02.

- i) How do tax considerations affect the cost of debt and the cost of equity? (5 Marks)
- ii) The common stock of Zahara Corporation has a beta of 1.20. The risk-free rate is 6% and the market risk premium is 6%. What is the company's cost of common stock?
- (8 Marks)

iii) Max Corporation has a capital structure which consists of 60% long-term debt and 40% common stock. The company's Chief Financial Officer has obtained the following information.

- The before-tax yield to maturity on the company's bonds is 8%.
- The company's common stock is expected to pay a Rs 3.00 dividend at year end ($D_1 = \text{Rs } 3.00$), and the dividend is expected to grow at a constant rate of 7% a year.
- The common stock currently sells for Rs. 60 a share.
- Assume that the firm will be able to use retained earnings to fund the equity portion of its capital budget.
- The company's tax rate is 40%.

What is the company's weighted average cost of capital (WACC)?

(12 Marks)

(Total Marks 25)

03.

- i) Briefly explain the following bond investment strategies used by investors. (12 Marks)
- a. Matching Strategy
 - b. Laddered Strategy
 - c. Barbell Strategy

ii) Rebel Corporation's debentures have a 10% coupon rate and a Rs.1000 face value. Interest is paid annually and the debentures have 20 years to mature. If investors require a 12% yield, what is the bond's value? (5 Marks)

iii) Apple Corporation's stock is currently trading at Rs.25 per share. The stock's dividend is projected to increase at a constant rate of 7% per year. The required rate of return on the stock is 10%. What is the expected price of the stock 4 years from today?

(8 Marks)

(Total Marks 25)

04.

- i) Compare diversifiable and non-diversifiable risk. Which do you think is more important to financial managers in business firms? (7 Marks)
- ii) "Most investors prefer to hold a diversified portfolio of securities as opposed to placing all of their wealth in a single asset". Discuss. (8 Marks)
- iii) A stock costing Rs.250 pays no dividends. The possible prices that the stock might be sold at the end of the year with the respective probabilities are as follows.

Price (Rs)	Probability
200	0.10
230	0.25
250	0.35
280	0.20
310	0.10

- a. Calculate the expected return.
- b. Calculate the standard deviation of returns

(10 Marks)

(Total Marks 25)

