



Uva Wellassa University

Faculty of Management

Degree of Bachelors of Business Management in Entrepreneurship and Management

Year 2 Semester 1 Examination – December/January 2008/2009

EMG 261-2 Investment Management

Time : 20 minutes
Answer all questions
Total marks 15

Index No.

Each question has one correct answer only. Indicate it by underlining the correct answer.

Part C

Total marks 50

Answer All Questions

1. You are a financial analyst for the ABC Company. The director of capital budgeting has asked you to analyze two proposed capital investments, Projects X and Y. Each project has a cost of Rs 10000, and the cost of the capital for each project is 12 percent. The projects expected net cash flows are as follows;

Year	Expected Net Cash Flows	
	Project X (Rs)	Project Y (Rs)
0	-10,000	-10,000
1	6,500	3,500
2	3,000	3,500
3	3,000	3,500
4	1,000	3,500

You are required to

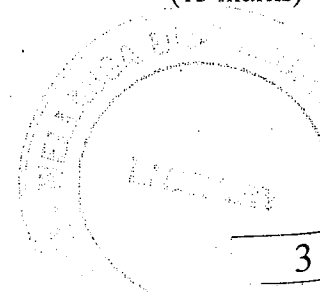
- i) Calculate each project's Payback period, Net Present Value (NPV), and Internal Rate of Return (IRR)
- ii) Which project or projects should be accepted if they are independent?
- iii) Which project should be accepted if they are mutually exclusive?

(15 marks)

2. i) Thomson and Thomson Industries bond has a 10 percent coupon rate and a Rs 1000 face value. Interest is paid semiannually, and the bond has 20 years to maturity. If investors require a 12 percent yield, what is the bond's value? What is the effective annual yield on the bond?

- ii) Imation Company bond carries an 8 percent coupon, paid semiannually. The par value is Rs 1000, and the bond matures in six years. If the currently sells for Rs 911.37, what is its yield to maturity? What is the effective annual yield?

(15 marks)



3. You are looking at a three year project with a projected net income of Rs 2,000 in 1 year, Rs 4,000 in year 2, and Rs 6,000 in year 3. The cost is Rs 12,000, which will be depreciated straight-line to zero over the three-year life of the project. What is the Average Accounting Return (AAR)? (10 marks)

4. Write short notes on following topics (10 marks)

- i) Benefits of investing in equity
- ii) Characteristics of a good share market
- iii) Central Depositors Systems
- iv) ASPI and MPI Indices



Part C

(Total marks for part C is 50)

Answer 4 questions including question number 1

1. Ringo plc is a manufacturing company of confectionery, based in Kandy. It has recently merged with a sugar refiner, Indian Sugar Supplies plc (ISS). For some weeks, the accountants in the two companies have been discussing investment appraisal techniques.

Ringo traditionally uses payback and the return on average capital employed, while ISS has used NPV for a number of years.

The discussion on appraisal technique has now reached a crisis as a decision is required on a proposal to invest Rs 1.8 million on a new chocolate-coating machine in order to move into the chocolate biscuit market. The financial details are as follows:

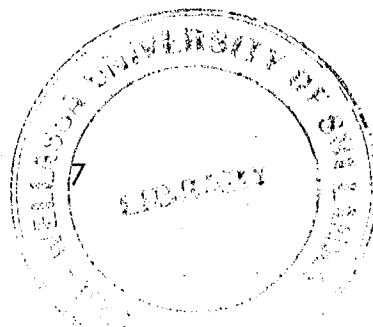
Outlay	Rs 1.8 million at t_0
Life	10 years
Net cash flow	Year 1 – 6 + Rs 500 000 / year Year 7 – 10 + Rs 300 000 / year
Scrap value	Rs 0.5 million

The company uses straight line depreciation and has a target rate of return 18% and payback criterion of five years

You are required

- Calculate the project's NPV?
- Calculate the project's payback?
- In order to try and resolve the conflict between the two managements you suggest that the company uses discounted payback as a compromise. Estimate the projects discounted payback and write a memo to the chairman outlining its advantages and disadvantages?

(20 marks)



2.
 - a) An Entity may obtain a listing by using three methods at Colombo Stock Exchange Briefly explain three methods.
 - b) What are the listing requirements of the Main Board and the Second Board?
 - c) What is Return on Investment? What you can earn if you invest on shares? Briefly explain all the opportunities?

3.
 - a) Briefly explain the functions of Central Depository System (CDS)?
 - b) What facts influence the market behaviour?
 - c) What is Demutualisation?

4. Briefly explain the followings with hypothetical figures?
 - a) Average Accounting Return
 - b) Profitability Index
 - c) Discounted Cash Flows

5.
 - a) What is inflation? Graphically show the difference of one time price jump against inflation
 - b) "Inflation can result either an increase in aggregate demand (AD) or a decrease in aggregated supply (AS)." Are you agreed with the statement? Explain the two concepts in the statement and show its effect graphically?

Part C

(Total marks for part C is 50 - Question 1 carries 20 marks)

Answer 4 questions including question number 1

1. Ross Ltd is considering the selection of one of a pair of mutually exclusive investment projects. Both would involve purchasing machinery with a life of five years.

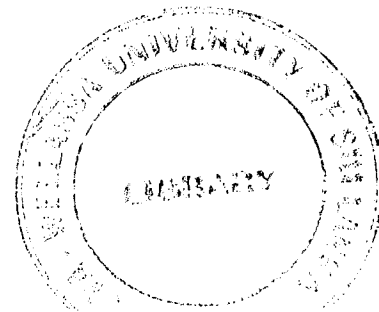
Project 1 would generate annual cash flows (receipts less payments) of Rs. 200,000; the machinery would cost Rs. 556,000 and have a scrap value of Rs. 56,000.

Project 2 would generate annual cash flows of Rs. 500,000; the machinery would cost Rs. 1,616,000 and have a scrap value of Rs. 301,000.

Ross Ltd uses the straight-line method of providing for depreciation. Its cost of capital is 14% per annum. Assume that annual cash flows arise on the anniversaries of the initial outlay, that there will be no price changes over the project lives and that acceptance of one of the projects will not alter the required amount of working capital. Ignore taxation.

You are required to:

- a) Calculate for each project:
 - i) The accounting rate of return (ratio over project life of average accounting profit to average book value of investment) to nearest 1%.
 - ii) The Net Present Value
 - iii) The payback period to one decimal place.
 - b) Giving reasons state which project you should select?
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2. A firm has net income of Rs 920,000 and total equity of Rs 3.12 million. There are 100,000 shares of common stock outstanding. Each share is currently selling for Rs 12.75.
 - i) What is the P/E ratio?
 - ii) What is the market-to-book ratio?



3.
 - a) What are the benefits of investing in equity?
 - b) Briefly explain the functions of a stock broker?

4.
 - i) Briefly explain the advantages and disadvantages of using Internal Rate of Return (IRR) as a tool of investment criteria?
 - ii) A bond has a 19% coupon rate, matures in 15 years and pays interest **semi-annually**. The face value is Rs. 1,000. What is the current price of this bond if the market rate of return is 17.5%?

5. Explain in detail the regulatory framework of capital markets in Sri Lanka?