

Uva Wellassa University
Faculty of Management

**Degree of Bachelor of Business Management in Entrepreneurship
and Management**

Year 4 Semester I – Examination-December/January 2009/2010

EMG 461-2 Corporate Finance

Index No:

Time : Twenty Minutes

Marks : 15

Answer all questions

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

Part C

Total marks for part C : 50

Answer three questions including question number one

01. i. "The basic rationale for the objective of wealth maximization is that it reflects the most efficient use of society's economic resources and thus leads to a maximization of society's economic wealth"

Comment and critically evaluate the above statement (5 marks)

- ii. a. "Cash flows of two years in absolute terms are incomparable". Discuss and give reasons in support of your answer

- b. Differentiate the "Compounding" and the "Discounting"

(5 Marks)

- iii. a. As a financial consultant, will you advise your client to have term deposit in a commercial bank which pays 8 percent interest compounded semi-annually or 8 percent interest compounded annually? Why?

- b. "The financial manager should take into account of the time value of money in order to make a correct and objective financial decision"

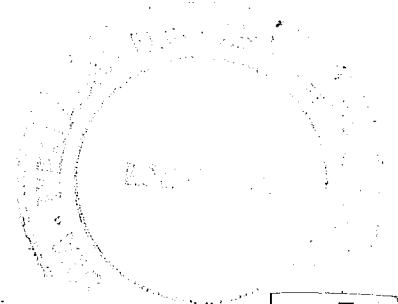
Evaluate the above statement with the help of suitable illustrations.

(5 Marks)

- iv. a. Explain briefly the Capital Assets Pricing Model (CAPM) for stock valuation

- b. "Retained earnings have no costs to the firm". Do you agree or not? Give reasons

(6 Marks)



c. ABC Ltd. has assets of Rs. 160,000 which have been finance with Rs.52,000 of debt and Rs. 90,000 of equity and general reserves of Rs. 18,000. The firm total profit after interest and tax for the last year were Rs.13,500. It pays 8% interest on borrowed funds and is in the 50% tax rate. It has 900 equity shares of Rs.100 each selling at the market price of Rs. 120 per share. Calculate the WACC.

(5 Marks)

(Total marks 26)

02. i. You are given following information.

(Marks 2.5 x 4= 10)

State of economy	Probability of state	Return on A %	Return on B %
Boom	.10	25	18
Growth	.20	10	20
Normal	.50	15	4
Recession	.20	-12	0

- What is the expected return for A? for B?
- What is the Standard Deviation for A? for B?
- What is the expected return on a portfolio of A and B that is 20% invested in A?
- What is the Variance of a portfolio that is 60% invested in A?

ii. How does the investor's preference affect the selection of optimal portfolio? (Marks 2)

(Total Marks 12)

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03. i. a. What is Working Capital management? (2 Marks)
- b. Explain briefly the significance of Working Capital management? (2 Marks)
- c. Explain the tradeoff between liquidity and profitability (2 Marks)

- 6)
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- ii. As a finance director you are required to find out the net working capital of Asha Manufacturing Ltd. The company's cost structure as follows.

Raw Materials	100.00
Direct labour	50.00
Over Head	75.00
Total Cost	225.00
Profit	75.00
Selling Price	300.00

Units produced are 156,000 per year. The raw materials are in stock for **one** month. Credit allows by suppliers is **one** month. Finished goods are in stock for **one** month. Materials are in process for **three** weeks. Time lap in payments from debtors is **three** months. Time lap in payments of wages is **two** weeks. Time lap in payment of over head is **one** month. Cash sales are 20% of the total sales. Cash in hand is Rs. 75,000. Calculate the Working capital requirement. (6 Marks)

(Total Marks 12)

04. i. What are the main characteristics of debentures? (2 Marks)
- ii. Company debentures has a 10 percent coupon rate and a Rs.1000 face value. Interest is paid annually and the debentures have 10 years to mature. If investors require a 12 percent yield, what is the debenture value today? (4 Marks)



iii. Y Company has just paid a cash dividend of Rs.2 per share. Investors require a 16 percent return from investments such as this. If the dividend is expected to grow at a steady rate of 8 percent per year, what is the current value of stock? (4 Marks)

iv. Explain the relationship between market interest rate and value of the bonds.(2 Marks)

(Total Marks 12)