



# UNIVERSITY OF KELANIYA – SRI LANKA

Centre for Distance and Continuing Education

FACULTY OF COMMERCE & MANAGEMENT STUDIES

Bachelor of Commerce (Special) Degree Fourth Year Examination (External) – 2015/ 2016

May 2022

**BCOM E4025 – Financial Management**

**No. of questions: Six (06)**

**Time: 03 hours**

**Answer any 5 questions**

## **Question No. 01**

- a). “Finance Manager takes different types of decisions in order to maximize the wealth of shareholders.” Explain this statement.

**(10 Marks)**

- b). Explain why the objective of maximizing the wealth of the owners is more important than the objective of maximizing the profit of the organization.

**(10 Marks)**

**(Total 20 Marks)**

## **Question No. 02**

- a). What is time value of money? Why is it important?

**(04 Marks)**

- b). Suppose you were considering depositing your savings in one of three banks, all of which pay 5% interest; bank A compounds annually, bank B compounds semiannually and bank C compounds daily. Which bank would you choose? Why?

**(04 Marks)**

- c). Your uncle Karunarathna is 65 years old. Over the years, he has accumulated savings of Rs. 5,000,000. He estimates that he will live another 15 years at the most and wants to spend his savings by then. If he lives longer than that, he expects that his son will be happy to take care of him. Uncle Karunarathna places his Rs. 5,000,000 into an account earning 12 percent annually and sets it up in such a way that he will be making 15 equal annual withdrawals (the first one occurring 1 year from now) such that his account balance will be zero at the end of 15 years. How much will he be able to withdraw each year?

**(06 Marks)**

- d). Zeos PLC currently pays a Rs. 7.5 dividend per share. Next year's dividend is expected to be Rs. 9 per share. After next year, dividends are expected to increase at a 12 percent annual rate for 4 years and a 5 percent annual rate thereafter, what will the new stock price?

**(06 Marks)**  
**(Total 20 Marks)**

**Question No. 03**

- a). "Debt provides tax shelter benefits therefore, the more debt a company uses, the higher its value and stock price. According to Miller and Modigliani, with taxes, a firm's stock price will be maximized if it uses 100% debt". Do you agree? Explain

**(06 Marks)**

- b). Benjamin PLC is focuses on two mutually exclusive projects. The initial investment in both these projects is Rs. 1,000,000.00 each. The productive lifetime of both the projects is 5 years and it is the policy of the company to depreciate all the assets of the company in a straight-line method.

The expected net cash flows over the next 5 years are expected by the institution after tax are as follows.

Time (Years)	Net Cashflows Rs.				
	1	2	3	4	5
Project A	320,000.00	400,000.00	300,000.00	200,000.00	400,000.00
Project B	360,000.00	360,000.00	360,000.00	360,000.00	360,000.00

If the cost of capital of the institution for investments in the above projects is 15%, Evaluate the following for each project and advise the company on the most appropriate investment.

1. Payback period
2. Average Rate of Return/ Accounting Rate of Return
3. Net Present Value

**(14 Marks)**

**(Total 20 Marks)**

**Question No. 04**

- a). Distinguish between diversifiable and non-diversifiable risk. Give meaningful examples to justify your answer.

**(06 Marks)**

- b). Star Computer system limited has forecasted returns on its share with the following probability distribution.

Return %	Probability
-20	0.05
-10	0.05
-5	0.10
5	0.10
10	0.15
18	0.25
20	0.25
30	0.05

Calculate expected return, variance and standard deviation of returns for Star Computer system limited

**(07 Marks)**

- c). An investor holds two equity shares X and Y and following risk and return details given below;

$$E(R_x) = 24\%$$

$$E(R_y) = 19\%$$

$$\sigma_x = 28\%$$

$$\sigma_y = 23\%$$

The returns of these securities have a positive correlation of 0.6. You are required to calculate the portfolio return and risk.

**(07 Marks)**

**(Total 20 Marks)**

**Question No. 05**

- a). Below is the Comprehensive Income Statement and Statement of Financial Position for Samson Limited for the years 2020 and 2021.

Comprehensive Income Statement

<b>Rs (000)</b>	<b>2021</b>	<b>2020</b>
Sales	98,410	82,888
Cost of Sales	-80,380	-67,784
Gross Profit	18,030	15,104
Operations Expenses	- 9,522	- 8,016
Operations Income	8,508	7,088
Other Income	1,804	1,550
Interest Expenses	- 1,422	- 1,190
<b>Profit before tax</b>	<b>17,398</b>	<b>14,536</b>
Tax	- 2,804	- 2,158
<b>Profit after tax</b>	<b>14,594</b>	<b>12,378</b>

Statement of Financial Position

<b>Rs. (000')</b>	<b>2021</b>	<b>2020</b>
<b>Non-Current Assets</b>		
Non-Current Assets	25,164	17,356
Investment	10,120	1,670
<b>Current Assets</b>		
Stock	918	654
Debtors	8,828	7,270
Receivable	4,434	3,038
Cash and cash equivalents	9,494	8,634
<b>Total Assets</b>	<b>58,958</b>	<b>38,622</b>
Capital	12,970	12,560
Retained earnings	16,178	3,260
<b>Total Capital</b>	<b>29,148</b>	<b>15,820</b>
<b>No current liabilities</b>		
Bank loan	1,538	1,010
<b>Current liabilities</b>		
Creditors	17,790	14,632
Payables	10,482	7,160
<b>Total Capital and Liabilities</b>	<b>58,958</b>	<b>38,622</b>

Calculate the following ratios for the year 2022 using the above information

- i). Current ratio
- ii). Quick ratio
- iii). Inventory turnover ratio
- iv). Gross Profit Ratio
- v). Net Profit Ratio

**(06 Marks)**

- b). Bond X is a premium bond making annual payments. The bond pays a 8% coupon has a YTM of 6%, and has 12 years to maturity. Bond Y is a discount bond making annual payments. This bond pays 4% coupon has a YTM of 7%, and also has 12 years to maturity. If interest rates remain unchanged, what will be the price of these bonds to one year from now? In three years? In 8 years? In 12 years?

**(07 Marks)**

- c). The debt and equity capital costs for the various debt and equity ratios of Pichcha PLC are estimated as follows

<b>Debt Composition</b>	<b>Cost of debt (kd)</b>	<b>Cost of Capital (Ke)</b>
0.00	-	10.0
0.10	4.0	10.1
0.20	4.2	10.3
0.30	4.4	10.8
0.40	4.8	11.4
0.50	5.5	12.5
0.60	6.6	14.5
0.70	8.0	18

What is the optimum capital structure for the Pichcha PLC

**(07 Marks)**

**(Total 20 Marks)**

**Question No. 06**

- a). Explain the relationship between profitability and liquidity in working capital management through an example.

**(06 Marks)**

- b). “Not all shareholders and companies prefer to pay current dividends” Do you agree? Briefly explain your answer.

**(07 Marks)**

- c). Dividend is that a portion of net profits which is distributed among the shareholders. The dividend decision of the firm is crucial important. There are conflicting opinions as far as the impact of dividend decision on the value of the firm. Walter and Gordon introduced two models stating that dividend decision is relevant to firm value.

- i). What is the difference between Walters’ and Gordon models?  
ii). Interpret outputs of Walters’ and Gordon models.

**(07 Marks)**

**(Total 20 Marks)**