UNIVERSITY OF KELANIYA – SRI LANKA

Centre for Distance and Continuing Education

FACULTY OF COMMERCE & MANAGEMENT STUDIES

Bachelor of Commerce (Special) Degree First Year Examination (External) – 2012

February 2015

Year IV

BCOM E4025 – Financial Management

No. of questions: Seven (07) **Time: 03 hours**

Answer any five (05) questions.

(01) "All the financial management decisions are aimed at achieving a unique objective". Explain.

(20 marks)

(02)

a). What is time value of money? How does it important?

(04 marks)

b). Distinguish followings

i). Present value of money and future value of money

ii). Simple interest and compound interest

iii). Ordinary annuity and annuity due

(06 marks)

c). Mr. Silva is planning ahead for his son's education. His son is eight now and will start University education in 10 years. How much will they have to set aside at the end of each year to have Rs. 650,000 in 10 years if the annual interest rate is 7%.

(05 marks)

d). If the government of Sri Lanka invests Rs 100 mn at the end of every year for an infinite period at an interest rate of 7%, what is the value of those investments today?

(05 marks)

(Total 20 marks)

(03)

a). What are the characteristics of a sound investment evaluation technique?

(05 Marks)

b). Compare and contrast the Net Present Value method (NPV) and Internal Rate of Return (IRR) method.

(05 Marks)

c). Suppose you are a Finance Executive for the BBC Ltd. The Financial Manager has asked you to analyze two proposed capital investments, project X and Y. The projects' expected cash flows are as follows. The cost of capital for both projects is 10 percent.

Year	Expected net cash flows in Rs '000'	
	Project X	Project Y
0	-100	-100
1	25	-
2	25	-
3	25	-
4	25	-
5	25	150

You are required to,

i). Compute NPV and IRR for both projects

ii). If the projects are mutually exclusive what are your recommendations under each method.

(10 Marks)
(Total 20 marks)

(04)

(a) What do you understand by systematic risk and unsystematic risk ?

(03 Marks)

(b) Describe the meaning and importance of coefficient of variation.

(03 Marks)

(c) ABC company has invested in two shares P and Q. Following are the actual returns received during last 4 years.

Share P	Share Q
10%	-4%
-5%	2%
8%	10%
12%	16%

(i). Calculate the average return and risk of two shares.

(06 marks)

(ii). Company has invested Rs 40,000 in P and Rs 10,000 in Q. Correlation between P & Q is found to be 0.1. If the company has not invested in other securities, what is the return and risk of the portfolio of investment?

(08 marks)
(Total 20 marks)

05) ABC company is operating in the foods and beverage industry and details for the year ended 31st March 2014 is as follows.

	Company	Industry
Current ratio	4 : 1	1.5 :1
Stock turnover ratio	10	18
Debtors turnover ratio	6	12
Total Assets turnover ratio	1	3
Creditors settlement period	40 days	50 days
Debt to equity	60%	40%
Interest cover	3	7
Gross profit margin	25%	40%
Net profit margin	8%	17%
Earning per share	Rs.2.20	Rs.4.00

(a) Comment on the financial performance and financial position of the company. What are the recommendations to improve the financial performance of the company?

(12 marks)

(b) Finance Manager of ABC company has planned to improve the stock turnover ratio by 60%, debtors turnover ratio by 50% next year from the present levels. He also confident that creditors settlement period can be further delayed up to 50 days. Estimated sales of the company for the next year is Rs 10 million and company aims to achieve gross profit margin of 35%. Average cash and bank balance that should be maintained is Rs 50,000. Estimate the working capital requirement and net working capital requirement for the next year.

(08 marks)
(Total 20 marks)

06) The following is an extract of the Statement of Financial Position of CDB (Pvt.) Ltd as at 31/12/2014

Equity	Rs	Rs
Share Capital	3000,000	
(100,000 shares @ 30)		
Reserves	500,000	3,500,000
12% Debentures		500,000
(5,000 Debentures @ 100)		
8% Preference shares		1000,000
(10,000 shares @ 100)		
		5,000,000

Suppose you are working as the Assistant Finance Manager of the company. Company is planning to undertake a project. Chief Finance Officer requested you to calculate the Cost of Capital of the company for the purpose of evaluating the project. You have collected the following information.

Ordinary share is traded in the market at the price of Rs 40 . Company has just declared the dividends of Rs 2 per each share. Chief Finance Officer expects that dividend will grow at 5% for an infinite period.

Debentures had been issued 1 year ago at the price of 95 and the maturity period is 3 years. These debentures are currently traded at the price of 98.

Preference shares are irredeemable and traded at Rs 95 in the market.

Company is subject to 28% of Income tax

You are required to calculate the following

1. Cost of Equity (07 marks)
2. Cost of Debt (07 marks)
3. Cost of Preference Shares (02 marks)
4. Cost of Capital (04 marks)

(Total 20 marks)

(07)

(a) Finance Director of FG company is planning to set a dividend policy for his company. Explain alternative theories related to dividend policy.

(10 marks)

(b) What do you understand by optimal capital structure?

(05 marks)

(c) Following are cost of debt and cost of equity at different levels of debt.

Debt/Assets	Cost of Debt	Cost of equity
20%	8%	12%
40%	9%	13%
60%	9.50%	14%
80%	11%	15%

What is the optimal capital structure?

(05 marks)
(Total 20 marks)