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University of Kelaniya - Sri Lanka

Centre for Distance and Continuing Education

Faculty of Commerce & Management Studies

Bachelor of Business Management (General) Degree Third Examination (External) – 2016

April/ May - 2022

BMGT E3065 - Business Finance

Time: 03 hours

Instructions

- i. This paper consists of Part A and Part B.
- ii. No of Questions:
PART A – 15
PART B – 04
- iii. Answer **all the questions**.
- iv. Attach the Part A of the question paper with your answer script.
- iv. You are strictly advised **NOT** to take Part A of the question paper out of the examination hall.

PART A

Question No. 01

Select the most appropriate answer by clearly underlining the answer.

1. Financial Management is concerned with,
 - a) The acquisition, financing, and management of assets with some overall goal in mind
 - b) Maximizing profits with a goal of utilizing available resources
 - c) Utilizing the available resources in the economy in an optimal manner
 - d) The identification of fund requirements of corporate and shareholders

2. The ultimate objective of Financial Management is to;
 - a) Increase the number and types of products or services provided by the firm
 - b) Maximizing shareholder wealth
 - c) Minimizing the amount of taxes paid by the firm
 - d) Maximizing the profits earned by the firm

3. _____ is a statistical measure of the variability of a distribution around its mean?
 - a) Variance
 - b) Expected rate of return
 - c) Standard Deviation
 - d) Coefficient of variation

4. The risk of two securities with different expected return can be compared by using;
 - a) Standard deviation of securities
 - b) Variance of securities
 - c) Coefficient of variation
 - d) None of these

5. The total risk is calculated by adding Unsystematic risk with _____?
- a) Systematic risk
 - b) Market risk
 - c) Country specific risk
 - d) All of these
6. Money has time value because?
- a) Individuals prefer future consumption to present consumption
 - b) Money tomorrow is worth more than money today in terms of purchasing power
 - c) There is no possibility of earning risk-free returns on money invested today
 - d) Money earned today is worth more than the money earned tomorrow because there is a risk-free return
7. On 11th May 2021, Kasun borrowed Rs. 18,000 from his Aunt. If Kasun agreed to pay a 7% annual rate of interest, calculate the total amount he must repay if the loan is for 16 months.
- a) Rs. 19,680
 - b) Rs. 19,260
 - c) Rs. 53,139
 - d) Rs. 37,260
8. If you deposit Rs. 4,000 into an account paying 6% annual interest compounded quarterly, how much money will be in the account after 5 years?
- a) Rs. 5,383.47
 - b) Rs. 5,387.42
 - c) Rs. 4,240
 - d) Rs. 5,300

9. How much money would you need to deposit today at 9% annual interest compounded monthly to have Rs. 12,000 in the account after 6 months?
- a) Rs. 13,080
 - b) Rs. 11,955
 - c) Rs. 12,454
 - d) Rs. 9,215
10. What interest rate do you need to turn Rs. 3,750 into Rs. 20,000 in 38 years?
- a) 4.50%
 - b) 14.04%
 - c) 18.75%
 - d) 14.03%
11. When does an investment proposal should be accepted?
- a) When the return is equal to the rate of return required by the investor
 - b) When the return is more than the rate of return required by an investor
 - c) When the return is less than the rate of return required by an investor
 - d) None of these
12. The theory that explains the investors are willing to accept dividends in an organization is,
- a) Bird in the hand
 - b) Clientele effect
 - c) Tax preference
 - d) Residual dividend
13. Select the most appropriate statement regarding Dividend Discount Models (DDM)
- a) DDM is applicable when company has a dividend history
 - b) DDM is applicable when company has dividend history and dividends are related to earnings
 - c) DDM is applicable with controlling perspective
 - d) DDM is applicable when company has a positive free cash flow

14. According to the following information, what will be the raw material turnover ratio?

	Rs.
Opening stock of raw material	2,000
Closing stock of raw material	1,000
Raw material purchases	14,000
Gross Sales	1,300,000

- a) 10 times
- b) 12 times
- c) 14.5 times
- d) 9.5 times

15. The Jemi (Pvt) Ltd. reports the following information for 2022 and 2021 year-end:

Values in Rs.

Description	2022	2021
Common Stock (at Rs. 10 each)	800,000	800,000
Debt Capital	2,500,000	2,000,000
Net Income for year	870,000	600,000
Retained Earnings	1,475,000	800,000

What is the dividend payout ratio for 2022?

- a) 20.64 %
- b) 22.41 %
- c) 21.0%
- d) 23.04%

(02 marks × 15 questions = 30 Marks)

(Total 30 Marks)

PART B

Question No. 02

a) What are the problems encountered when ownership and management is separated in a business? What actions you suggest mitigating these problems? **(05 Marks)**

b) Sharadha Pvt Ltd is considering a new project of manufacturing bricks and distribution in Sri Lankan market. Following are the details of the project cash flows. Assume the cost of capital of the project is 10%. (All figures are in Rs. MNs)

Years	Cash inflows	Cash outflows
0	-	(100,000)
1	50,000	(30,000)
2	65,000	(35,000)
3	80,000	(40,000)
4	100,000	(60,000)
5	120,000	(70,000)

1. What is the Net Present Value (NPV) of the above project? **(03 Marks)**

2. Should you invest in this project? Comment based on the NPV of the Project.

(02 Marks)

(Total 10 Marks)

Question No. 03

a) Sun Shining PLC (SS PLC) is a business operated as a diversified holding. Dividends for the past 3 years from oldest to most recent are (Rs): 3.00, 3.30, 3.75. Further, the earnings retention ratio is 80% and ROE is 7.5%.

Dividend this year was Rs. 4.00 and required return on equity is 12%. The market price of the SS PLC share is Rs. 90.00.

You are required to:

- i. Calculate the dividend growth rate. **(02 Marks)**
- ii. Calculate the intrinsic value. **(04 Marks)**
- iii. Issue a recommendation on the SS PLC share. **(02 Marks)**

- b) GSK PLC is currently operating at the optimal capital structure. The company is considering a Real Estate Project which requires Rs. 800 Mn investment. The following information relating to the capital structure can be obtained.

Capital	Market Value (Rs.000)
Equity - Common Shares	800,000
Preferred Stock	200,000
Debt	600,000

Board of directors decided to finance the project based on the current weights of the capital structure. Thus, the company will issue common stocks, Preferred stocks for the investors and also will finance the project through debt.

The company paid a dividend of Rs. 5.00 per common share and it is expected to grow at 6%. The current common stock price is Rs. 50.00 per share. A dividend of Rs. 6.00 per share is paid for the Preferred Stocks holders and Preferred Stocks are trading at Rs. 30.00. The Project is planning to take a bank loan at an interest of 18% as the debt financing. The Tax Rate is at 30%.

You are required to;

- i. Explain how the Rs. 800 Mn investment will be funded by Common Stocks, Preferred Stocks and Debt by calculating the amounts raised by each source. **(02 Marks)**
 - ii. Calculate Cost of Equity, Cost of Preferred Stock and after-tax Cost of Debt. **(06 Marks)**
 - iii. Calculate the Weighted Average Cost of Capital (WACC) of the project. **(04 Marks)**
- (Total 20 Marks)**

Question No. 04

a) Briefly explain the following terms.

- i. Signaling theory
- ii. Pecking order theory
- iii. Optimum Capital Structure

(03 × 03 = 09 Marks)

b) Following information has been given for Erislata Company for the year ended 31st December 2021.

Erislata expects to maintain a target capital structure of 40% from debt capital and 60% from equity capital. The net income of the business is Rs. 1,200,000 and there is a forecasted capital expenditure to be borne in the next financial year is 1,600,000.

How much of the net income should the company pay out ratio if the company uses residual dividend policy?

(06 Marks)

c) JJ Mills PLC; an Indonesian clothing manufacturer is considering making an offer to purchase Cotton Plus Private Limited in Sri Lanka. JJ Mills's Vice President has collected the following information:

Extracts from the Statement of Profit or Loss and Other Comprehensive Income for the year ended 31st March 2022: (in Rs:)

Revenue	2,000,000
Cost of Sales	950,000

Extracts from the Statement of Financial Position as of 31st March:

Description	2022	2021
Inventory	200,000	150,000
Trade Receivables	250,000	200,000
Trade Payables	350,000	300,000

You are required to calculate the cash cycle of JJ Mills and comment on the answer.
(Consider the JJ Mills works for 360 days a year)

(05 Marks)

(Total 20 Marks)

Question No. 05

Kevin Toys Ltd is a large-scale toy manufacturing company in Sri Lanka. You have been provided the following draft financial statements of the company.

Statement of Income for the years ended 31st March

(Rs. Millions)

	2022	2021
Turnover	14,100	8,960
Less: Cost of Sales	9,860	6,102
Gross Profit for the Year	4,240	2,858
Less:		
Administration Expenses	1,208	900
Selling and Distribution Expenses	645	522
Other Operating Expenses	120	102
Profit before Interest and Tax	2,267	1,334
Less: Interest Expense	286	345
Add:		
Investment Income	173	80
Rent Income	21	12
Profit before Tax	2,175	1,081
Less: Income Tax	652	324
Profit after Tax	1,522	757

Statement of Financial Position as at 31st March

(Rs. Millions)

	2022	2021
Fixed Assets		
Land and Buildings	8,970	6,610
Property, Plant and Equipment	2,680	1,788
Investments	1,080	670
	12,730	9,068
Current Assets		
Inventory	2,020	1,002
Trade Debtors	488	534
Receivable Investments Income	47	-
Cash & Bank	59	45
	2,614	1,581
Total Assets	15,344	10,649
Financed by		
Share Capital and Reserves		
Ordinary Share Capital (at Rs. 10 each)	8,960	5,500
General Reserve	414	207
Retained Earnings	1,866	780
Non-Current Liabilities		
14 % Debentures	2,043	2,464
	13,283	8,950
Current Liabilities		
Trade Creditors	876	586
Accrued Expenses	809	772

Tax Payable	376	340
	2,061	1,698
Total Capital and Liabilities	15,344	10,649

The market price of an ordinary share of Kevin Toys Ltd as at the end of the year 2022 and 2021 are given below.

	2022	2021
Market Price of an Ordinary Share (Rs.)	20	14

The company has paid a dividend of Rs. 228 million and Rs. 91 million for the year ended 31st March 2022 and 31st March 2021 respectively.

You are required to:

Calculate the following ratios for Kevin Toys Ltd for the year 2021 and 2022, and briefly comment on the financial performance and financial position of the company based on your calculations.

- i) Three (03) Profitability Ratios.
- ii) Two (02) Liquidity Ratios.
- iii) Three (03) Stability Ratios.
- iv) Four (04) Investor Prospect Ratios.

(Total 20 Marks)