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) – 2019

September - 2023

BMGT E 3065 – Business Finance

Time : 03 hours

Instructions:

I. This question paper consists of 2 Parts (Part A and B)

II. No of Questions:

Part A – 10

Part B – 04

III. All questions are compulsory.

IV. Attach the answers of Part A to the Answer booklet.

V. Taking the Part A of the question paper outside the examination hall is strictly prohibited.

Part A

Underline the Correct 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) Investment can be defined as,

a) Net additions made to the nation's capital stocks.

b) Person's commitment to buy flat or house.

c) Employment of funds on assets to earn returns.

d) Employment of funds on goods and services that are used in production process.

3) The Time value of money must be considered because,

a) Cash inflows and outflows occur at different point.

b) Inflation greatly reduces the outflows.

c) A rupee received in future is more valuable than a rupee received today.

d) Cash flows are not known with certainty.

4) Money has time value because?

a) Individuals prefer future consumption to present consumption

b) Money today is worth more than money tomorrow in terms of purchasing power

c) There is possibility of earning risk free return on money invested today

d) Money earned today worth more than the money earned tomorrow because there is a risk-free return.

5) A loan of Rs. 10,000 has been issued for 5 years with an interest rate of 8%. Compute the amount to be repaid to the lender based on both simple and compounding interest and identify the value added through compounding.

a) Rs. 4000, Rs. 4693 and Rs. 693

b) Rs. 10,800, Rs. 14,693 and Rs. 3893

c) Rs. 14,000, Rs. 14.693 and Rs. 693

d) Rs. 14,693, Rs. 14,693 and zero

6) Which of the following financial strategies is typically associated with a flexible short-term finance policy?

a) Maintaining a low ratio of current assets to sales.

b) Keeping low cash balances and no investments in marketable securities.

c) Making large investments in inventory.

d) Allowing no credit sales (thus no accounts receivable).

7) Why might a stock price increase at the time of a dividend increase, according to the given information?

a) Investors prefer dividends over capital gains.

b) Dividend increases are a sign of a past performance.

c) Investors expect immediate cash returns.

d) Investors view dividend increases as signals of management's confidence in the future.

Use the below information to calculate questions No 8 and 9.

8) Calculate the Degree of Operating Leverage (DOL) for the year 2019.

	2018 (Rs.)	2019 (Rs.)
Sales	1500	900
EBIT	750	300
EPS	15	4.5

a) 2.25

b) -2.25

c) 0.43

d) -0.43

9) Calculate the Degree of Financial Leverage (DFL) for the year 2019.

a) 3.5

b) -3.5

c) 1.54

d) -1.54

10) Which of the following is not a way to finance a temporary cash deficit for a business?

a) Factoring

b) Commercial paper

c) Long-term bank loan

d) Inventory loans

(Total 20 Marks)

<u>Part B</u>

Question No. 01

a) Differentiate Financial Accounting and Financial Management. (05 Marks)

b) XYZ Company is evaluating two new machines to purchase the best machine for the production purpose. Each machine costs LKR. 250,000 and both have a life of 5 years. The two machines will be depreciated on a straight-line basis. The scrap values of the two machines are as follows.

Machine	A	B
Scrap Value	LKR 7,500	LKR 5,000

Although the first maintenance payment for the Machine A is LKR 25,000 it is expected to rise by 7.5% per annum. The annual maintenance cost of machine B will be higher at a rate of LKR 40,000 in year 1 and it is expected to increase annually by 10.5%.
As the new machines are likely to reduce the variable cost, the contribution will be different depending on which machine is used. The contribution from each machine (excluding maintenance cost) is tabulated as follows, with the inflow of funds assumed to be at the end of each year.

Year	1	2	3	4	5
Contribution - machine A (LKR'000)	85	110	190	210	50
Contribution –machine B (LKR'000)	50	145	75	160	210
Discount Rate 12%	0.893	0.797	0.712	0.636	0.567

The Finance Manager expects the Cost of Capital to be around 12%. Tax can be ignored.
Your are required to calculate for the machine A and B,

i. Net Present Value ?
ii. Discounted Payback ?

iii. Accounting Rate of Return?

iv. Which machine will be selected by the Company? Why?

(15 Marks)

(Total 20 Marks)

Question No. 02

a) Solve the below questions related to Time Value of Money

i. On 11th May 2018, Kasun borrowed Rs. 15,000 from his Aunt. If Kasun agreed to pay a 8% annual rate of interest, calculate the total amount he must repay if the loan is for 18 months.

ii. If you deposit Rs. 7,000 monthly, into an account paying 10.5% annual interest compounded monthly, how much money will be in the account after 7 years?

iii. How much money would you need to deposit today at 18% annual interest compounded quarterly to have Rs. 24,000 in the account after 12months?

iv. If you invest Rs. 2,500 at an annual interest rate of 12.5% compounded continuously, calculate the final amount you will have in the account after 13 years?

(10 Marks)

b) Suppose Security X and Security Y have experienced the following returns and probabilities in the last four years.

Year	Security X		Security Y	
	Probability	**Return(%)**	**Probability**	**Return(%)**
2022	0.12	-20	0.15	-14
2021	0.28	22	0.18	26
2020	0.35	36	0.50	25
2019	0.25	18	0.17	20

You are required to calculate,

i. The Expected Return of Security X and Y?

ii. The Standard Deviation of Security X and Y?

iii. Which investment is more risky?

(10 Marks)

(Total 20 Marks)

Question No. 03

a) Blue High PLC is a leading player in the technology industry, specializing in manufacturing electronic gadgets. Over the past few years, the company has witnessed both challenges and opportunities in the competitive market. As the newly appointed Finance Manager of Blue High PLC, your role is critical in assessing the company's financial health and making strategic decisions for its growth and stability. To achieve this, you are presented with the company's balance sheet, income statement, and some additional information that will guide your analysis.

Blue High PLC

Statement of Financial Position

As at 31st December

	Rs. **2022**	**Rs.** **2021**
Assets		
Current Assets		
Cash	45,000	30,000
Accounts Receivables	30,000	25,500
Inventory	18,000	15,000
Prepaid Expenses	4,500	3,000
Total Current Assets	**97,500**	**73,500**
Property & Equipment		
Land	247,500	184,500
Buildings and Equipment	174,585	192,000
Total Property & Equipment	**422,085**	**376,500**
Total Assets	**519,585**	**450,000**
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts Payable	58,500	60,000
Notes Payable, Short Term	4,500	3,000
Total Current Liabilities	**63,000**	**63,000**
Long Term Liabilities		

Notes Payable, Long-Term	105,000	117,000
Total Liabilities	**168,000**	**180,000**
Shareholders' Equity		
Common Stock, Rs. 1 par Value	41,100	25,500
Additional Paid in Capital	237,150	169,500
Total Paid in Capital	**278,250**	**195,000**
Retained Earnings	73,335	75,000
Total Shareholders' Equity	**351,585**	**270,000**
Total Liabilities and Shareholders' Equity	**519,585**	**450,000**

Blue High PLC

Statement of Profit or Loss

For the Years Ended December 31

	Rs. 2022	**Rs. 2021**
Revenues	741,000	675,000
Cost of Sales	210,000	190,500
Gross Margin	**531,000**	**484,500**
Operating Expenses	405,000	373,500
Net Operating Income	**126,000**	**111,000**
Interest Expense	10,950	12,000
Net Income before Taxes	**115,050**	**99,000**
Less Income Taxes (30%)	34,515	29,700
Net Income	**80,535**	**69,300**

Additional Information.

1. Accounts Receivables

Beginning of Year 2022 Rs. 25,500

End of Year 2022 Rs. 30,000

2. Inventory

Beginning of Year 2022 Rs. 15,000

End of Year 2022 Rs. 18,000

3. Total Assets

Beginning of Year 2022	Rs. 450,000
End of Year 2022	Rs. 519,585

4. Shareholders' Equity

Beginning of Year 2022	Rs. 270,000
End of Year 2022	Rs. 351,585

5. Number of Common Shares outstanding all of 2022 41,100
6. Earnings per Share - 2022 Rs. 2.94
7. Market price - 2022 Rs. 22.5
8. Annual Dividend per Share - 2022 Rs. 3

b) Calculate the following accounting ratios for the year 2022 of Blue High PLC and briefly explain their significance.

i. Return on total assets.

ii. Acid-test ratio.

iii. Accounts receivables turnover.

iv. Interest coverage ratio (times interest earned).

v. Return on common shareholders.

vi. Dividend yield

(12 Marks)

c) Examine the preferences of investors divided by payouts and their consequential effects on stock price and the cost of equity by applying the three theories discussed in the class.

(06 Marks)

d) You are the financial manager of XYZ Corporation, and you have been given the following financial data.

Capital budget: Rs. 1,200,000

Target capital structure: 50% debt, 50% equity

Forecasted net income: Rs. 900,000.

Your goal is to maintain the target capital structure while deciding on the dividend payout.

You are required to,

i. Calculate how much of the Rs. 900,000 in forecasted net income should be paid out as dividends.

ii. Calculate how would a rise in forecasted net income to Rs. 1,200,000 affects the dividend.

(02 Marks)

(Total 20 Marks)

Question No. 04

a) As the finance manager of "Sky Above Company", you have been entrusted with the responsibility of managing the company's working capital.

'Rs. million

Item	Beginning	Ending	Average
Inventory	3000	4500	3750
Accounts receivable	2400	3000	2700
Accounts payable	1125	1500	1312.5

'Rs. million

Net sales	17250
Cost of goods sold	12300

Utilizing the provided information, calculate the operating cycle and cash cycle and briefly explain your answer.

(10 Marks)

b) How do the determinants of beta influence the variability in the risk and return of individual stocks when different company betas are considered? Provide an explanation of the key factors that determine a stock's beta and discuss how changes in these determinants can impact the risk and return characteristics of stocks.

(05 Marks)

c) Company XYZ is a publicly traded company in the manufacturing sector. The risk-free rate is currently 3%, and the expected market return is 10%. Therefore, given the market risk premium is 7%. The beta of Company XYZ's stock is estimated to be 1.2.

i. Calculate the cost of equity for Company XYZ using CAPM.

(02 Marks)

The company has both equity and debt in its capital structure. The debt-to-value ratio is 40%. The yield on the company's debt is 6%. The corporate tax rate is 25%.

ii. Estimate the Weighted Average Cost of Capital for Company XYZ.

(03 Marks)

(Total 20 Marks)