



**University of Kelaniya – Sri Lanka**

***External Examinations Branch***

**Faculty of Commerce & Management Studies**

**Bachelor of Business Management (General) Degree Third Examination  
(External) – 2010  
January 2012**

**BMGT E 3065 – Business Finance**

No. of questions : 05

Time: 03 Hours

Answer all questions.

(01) AKTS Company is a leading apparel company, and the Board of Directors has decided to expand company's operations by establishing a new subsidiary company. Mr. Dias, the Chief Executive Officer (CEO) of the company, suggested that it is appropriate to assign whole responsibility of establishing the proposed new subsidiary to Mr. Senevirathne, the Finance Manager of the company as he has a very good knowledge and experience on the subject. But Mr. Kavirathne, a major share holder of the company raised many questions saying that assigning the whole responsibility of establishing subsidiary to Mr. Senevirathne may not be an appropriate decision as he works towards to achieve his personal objectives rather than achieving organizational objectives. Further, he said that the management of the organization should pay their attention on the shareholders' wealth maximization. But in here, Mr. Sumith, the Sales Manager of the company argued that the best objective of the organization should be the profit maximization.

a) What is the issue behind the case of assigning the responsibility of establishing the new subsidiary to Mr. Senevirathne? State your proposed solution to overcome this issue.

(06 Marks)

b) As the Financial Manager of the company, what are the key decisions should be made by Mr. Senevirathne in establishing the new company?

(06 Marks)

c) Give your comments on the arguments made by Mr. Sumith and Mr. Kavirathne.

(08 Marks)

(Total 20 Marks)

(02) a) A company wishes to borrow Rs.200, 000 for two years from a bank. Bank A will lend the money at 18.4% per year compounded semi-annually. Bank B will lend money at 18.2% per year compounded quarterly. Bank C will lend money at 19.6% compounded annually. From which bank should the company borrow money? Advice to the company.

b) Mrs. Perera has accumulated savings of Rs. 250,000 in a bank over her working lifetime and now is planning to retire. She wishes to withdraw equal installments from these savings for the next 25 years of her life. If she receives 5% on her savings, how much will each installment amount to?

(05 marks)

c) Mr. Arunalu wishes to borrow Rs. 90,000 for the purpose of purchasing a Machine for his factory at a monthly interest of 3%. The Loan is to be repaid in 6 equal monthly installments, payable at the end of the each month. Prepare the loan amortization schedule.

(05 marks)

d) Mr. Amarasooriya is considering the purchase of a five year , Rs.1000 par value bond, bearing a nominal rate of interest of 8% per annum. Mr. Amarasooriya's required rate of return is 9%. What amount should Mr. Amarasooriya be willing to pay now to purchase the bond, if it is matured at par?

(05 marks)

(Total 20 Marks)

(03) The capital structure of Neelagiri Company Ltd. is as follows in year 2010

|  | Rs. ' 000'   |
|--|--------------|
| 1 000 000 Ordinary Shares of Rs. 1.00 each | 1,000        |
| 400,000 Preference Shares of Rs. 0.05 each | 200          |
| 9% Redeemable Debentures (Rs. 100 each)    | 200          |
| 8% Long Term Loan                          | <u>200</u>   |
| Total                                      | <u>1,600</u> |

Current market value of an ordinary share is Rs.1.20 and a dividend of 6% has just been paid. Dividend growth is expected to be at a rate of 11 % per year. Issue costs of these ordinary shares are Rs.0.10 per share. Preference shares have a current market value of Rs.0.70 per share and the rate of dividend is 8%. Current market price of a 9% redeemable debenture is Rs 90 and redeemable in 8 years time. Assume that the corporate tax rate is 30%.

a) Calculate the Weighted Average Cost of Capital for Neelagiri Company Ltd. based on market values.

(15 arks)

- b) “The project Cost of Capital is always greater than firms Weighted Average Cost of Capital”. Do you agree with the above statement? Justify your answer.

(05 marks)

(Total 20 Marks)

- (04) a) You have been given the following information with related to Kandy Tera Ltd.

|                        |              |
|------------------------|--------------|
| Sales price            | Rs. 10       |
| Variable cost per unit | Rs. 6        |
| Fixed operating costs  | Rs. 120,000  |
| Interest payments      | Rs. 40,000   |
| Current activity level | 50,000 units |

You are required to calculate the following degrees of leverage for Kandy Tera Ltd.

- i) Degree of Operating Leverage
- ii) Degree of Financial Leverage
- iii) Degree of Total Leverage

(05 marks)

- b) Describe how an organization can diversify its risk?

(05 marks)

- c) Explain the differences between equity capital and debt capital and describe the advantages and disadvantages of each.

(05 marks)

- d) List and briefly describe the three forms of informational market efficiencies.

(05 marks)

(Total 20 Marks)

- (05) Write short notes on following:

- a) Fundamental Analysis and Technical Analysis
- b) Dividend Policy
- c) EBIT-EPS Analysis
- d) Trade-off Theory and Signaling Theory

(Total 20 Marks)



TABLE 3 THE PRESENT VALUE OF AN IMMEDIATE ANNUAL ANNUITY  
OF RS1 FOR n YEARS

| n  | 6.0     | 7.0     | 8.0     | 9.0    | 10.0   | 11.0   | 12.0   | 14.0   | 15.0   | 16.0   | 18.0   | 20.0   | 25.0   | 30.0   | 35.0   | 40.0   | 45.0   | 50.0   |
|----|---------|---------|---------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| 1  | .9434   | .9346   | .9259   | .9174  | .9091  | .9009  | .8929  | .8772  | .8696  | .8621  | .8475  | .8333  | .8000  | .7692  | .7407  | .7143  | .6897  | .6666  |
| 2  | 1.8334  | 1.8080  | 1.7833  | 1.7591 | 1.7355 | 1.7125 | 1.6901 | 1.6467 | 1.6257 | 1.6052 | 1.5656 | 1.5278 | 1.4400 | 1.3609 | 1.2894 | 1.2245 | 1.1653 | 1.1111 |
| 3  | 2.6730  | 2.6243  | 2.5771  | 2.5313 | 2.4869 | 2.4437 | 2.4018 | 2.3216 | 2.2832 | 2.2459 | 2.1743 | 2.1065 | 1.9520 | 1.8161 | 1.6959 | 1.5889 | 1.4933 | 1.4074 |
| 4  | 3.4651  | 3.3872  | 3.3121  | 3.2397 | 3.1699 | 3.1024 | 3.0373 | 2.9137 | 2.8550 | 2.7982 | 2.6901 | 2.5887 | 2.3616 | 2.1662 | 1.9969 | 1.8492 | 1.7195 | 1.6049 |
| 5  | 4.2124  | 4.1002  | 3.9927  | 3.8897 | 3.7908 | 3.6959 | 3.6048 | 3.4331 | 3.3522 | 3.2743 | 3.1272 | 2.9906 | 2.6893 | 2.4356 | 2.2200 | 2.0352 | 1.8755 | 1.7366 |
| 6  | 4.9173  | 4.7665  | 4.6229  | 4.4859 | 4.3553 | 4.2305 | 4.1114 | 3.8887 | 3.7845 | 3.6847 | 3.4976 | 3.3255 | 2.9514 | 2.6427 | 2.3852 | 2.1680 | 1.9831 | 1.8244 |
| 7  | 5.5824  | 5.3893  | 5.2064  | 5.0330 | 4.8684 | 4.7122 | 4.5638 | 4.2883 | 4.1604 | 4.0386 | 3.8115 | 3.6046 | 3.1611 | 2.8021 | 2.5075 | 2.2628 | 2.0573 | 1.8829 |
| 8  | 6.2098  | 5.9713  | 5.7466  | 5.5348 | 5.3349 | 5.1461 | 4.9676 | 4.6389 | 4.4873 | 4.3436 | 4.0776 | 3.8372 | 3.3289 | 2.9247 | 2.5982 | 2.3306 | 2.1085 | 1.9220 |
| 9  | 6.8017  | 6.5152  | 6.2469  | 5.9952 | 5.7590 | 5.5370 | 5.3282 | 4.9464 | 4.7716 | 4.6065 | 4.3030 | 4.0310 | 3.4631 | 3.0190 | 2.6653 | 2.3790 | 2.1438 | 1.9480 |
| 10 | 7.3601  | 7.0236  | 6.7101  | 6.4177 | 6.1446 | 5.8892 | 5.6502 | 5.2161 | 5.0188 | 4.8332 | 4.4941 | 4.1925 | 3.5705 | 3.0915 | 2.7150 | 2.4136 | 2.1681 | 1.9653 |
| 11 | 7.8869  | 7.4987  | 7.1390  | 6.8052 | 6.4951 | 6.2065 | 5.9377 | 5.4527 | 5.2337 | 5.0286 | 4.6560 | 4.3271 | 3.6564 | 3.1473 | 2.7519 | 2.4383 | 2.1849 | 1.9769 |
| 12 | 8.3838  | 7.9427  | 7.5361  | 7.1607 | 6.8137 | 6.4924 | 6.1944 | 5.6603 | 5.4206 | 5.1971 | 4.7932 | 4.4392 | 3.7251 | 3.1903 | 2.7792 | 2.4559 | 2.1965 | 1.9846 |
| 13 | 8.8527  | 8.3577  | 7.9038  | 7.4869 | 7.1034 | 6.7499 | 6.4235 | 5.8424 | 5.5831 | 5.3423 | 4.9095 | 4.5327 | 3.7801 | 3.2233 | 2.7994 | 2.4685 | 2.2045 | 1.9897 |
| 14 | 9.2950  | 8.7455  | 8.2442  | 7.7862 | 7.3667 | 6.9819 | 6.6282 | 6.0021 | 5.7245 | 5.4675 | 5.0081 | 4.6106 | 3.8241 | 3.2487 | 2.8144 | 2.4775 | 2.2100 | 1.9931 |
| 15 | 9.7122  | 9.1079  | 8.5595  | 8.0607 | 7.6061 | 7.1909 | 6.8109 | 6.1422 | 5.8474 | 5.5755 | 5.0916 | 4.6755 | 3.8593 | 3.2682 | 2.8255 | 2.4839 | 2.2138 | 1.9954 |
| 16 | 10.1059 | 9.4466  | 8.8514  | 8.3126 | 7.8237 | 7.3792 | 6.9740 | 6.2651 | 5.9542 | 5.6685 | 5.1624 | 4.7296 | 3.8874 | 3.2832 | 2.8337 | 2.4885 | 2.2164 | 1.9970 |
| 17 | 10.4773 | 9.7632  | 9.1216  | 8.5436 | 8.0216 | 7.5488 | 7.1196 | 6.3729 | 6.0472 | 5.7487 | 5.2223 | 4.7746 | 3.9099 | 3.2948 | 2.8398 | 2.4918 | 2.2182 | 1.9980 |
| 18 | 10.8276 | 10.0591 | 9.3719  | 8.7556 | 8.2014 | 7.7016 | 7.2497 | 6.4674 | 6.1280 | 5.8178 | 5.2732 | 4.8122 | 3.9279 | 3.3037 | 2.8443 | 2.4941 | 2.2195 | 1.9986 |
| 19 | 11.1581 | 10.3356 | 9.6036  | 8.9501 | 8.3649 | 7.8393 | 7.3658 | 6.5504 | 6.1982 | 5.8775 | 5.3162 | 4.8435 | 3.9424 | 3.3105 | 2.8476 | 2.4958 | 2.2203 | 1.9991 |
| 20 | 11.4699 | 10.5940 | 9.8181  | 9.1285 | 8.5136 | 7.9633 | 7.4694 | 6.6231 | 6.2593 | 5.9288 | 5.3527 | 4.8696 | 3.9539 | 3.3158 | 2.8501 | 2.4970 | 2.2209 | 1.9994 |
| 21 | 11.7641 | 10.8355 | 10.0168 | 9.2922 | 8.6487 | 8.0751 | 7.5620 | 6.6870 | 6.3125 | 5.9731 | 5.3837 | 4.8913 | 3.9631 | 3.3198 | 2.8519 | 2.4979 | 2.2213 | 1.9996 |
| 22 | 12.0416 | 11.0612 | 10.2007 | 9.4424 | 8.7715 | 8.1757 | 7.6446 | 6.7429 | 6.3587 | 6.0113 | 5.4099 | 4.9094 | 3.9705 | 3.3230 | 2.8533 | 2.4985 | 2.2216 | 1.9997 |
| 23 | 12.3034 | 11.2722 | 10.3711 | 9.5802 | 8.8832 | 8.2664 | 7.7184 | 6.7921 | 6.3988 | 6.0442 | 5.4321 | 4.9245 | 3.9764 | 3.3254 | 2.8543 | 2.4989 | 2.2218 | 1.9998 |
| 24 | 12.5504 | 11.4693 | 10.5288 | 9.7066 | 8.9847 | 8.3481 | 7.7843 | 6.8351 | 6.4338 | 6.0726 | 5.4509 | 4.9371 | 3.9811 | 3.3272 | 2.8550 | 2.4992 | 2.2219 | 1.9999 |
| 25 | 12.7834 | 11.6536 | 10.6748 | 9.8226 | 9.0770 | 8.4217 | 7.8431 | 6.8729 | 6.4641 | 6.0971 | 5.4669 | 4.9476 | 3.9849 | 3.3286 | 2.8556 | 2.4994 | 2.2220 | 1.9999 |

TABLE 2 THE PRESENT VALUE OF RS.1 @ 1% FOR n YEARS

| n  | 2.5   | 3.0   | 4.0   | 5.0   | 6.0   | 7.0   | 8.0   | 9.0   | 10.0  | 11.0  | 12.0  | 14.0  | 15.0  | 16.0  | 18.0  | 20.0  | 25.0  | 30.0  | 35.0  | 40.0  | 45.0  | 50.0  |
|----|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 1  | .9756 | .9709 | .9615 | .9524 | .9434 | .9346 | .9259 | .9174 | .9091 | .9009 | .8929 | .8772 | .8696 | .8621 | .8475 | .8333 | .8000 | .7692 | .7407 | .7143 | .6897 | .6667 |
| 2  | .9518 | .9426 | .9246 | .9070 | .8900 | .8734 | .8573 | .8417 | .8264 | .8116 | .7972 | .7695 | .7561 | .7432 | .7182 | .6944 | .6400 | .5917 | .5487 | .5102 | .4756 | .4444 |
| 3  | .9286 | .9151 | .8890 | .8638 | .8396 | .8163 | .7938 | .7722 | .7513 | .7312 | .7118 | .6750 | .6575 | .6407 | .6086 | .5787 | .5120 | .4552 | .4064 | .3644 | .3280 | .2963 |
| 4  | .9060 | .8885 | .8548 | .8227 | .7921 | .7629 | .7350 | .7084 | .6830 | .6587 | .6355 | .5921 | .5718 | .5523 | .5158 | .4823 | .4096 | .3501 | .3011 | .2603 | .2262 | .1975 |
| 5  | .8839 | .8626 | .8219 | .7835 | .7473 | .7130 | .6806 | .6499 | .6209 | .5935 | .5674 | .5194 | .4972 | .4761 | .4371 | .4019 | .3277 | .2693 | .2230 | .1859 | .1560 | .1317 |
| 6  | .8623 | .8375 | .7903 | .7462 | .7050 | .6663 | .6302 | .5963 | .5645 | .5346 | .5066 | .4556 | .4323 | .4104 | .3704 | .3349 | .2621 | .2072 | .1652 | .1328 | .1076 | .0878 |
| 7  | .8413 | .8131 | .7599 | .7107 | .6651 | .6227 | .5835 | .5470 | .5132 | .4817 | .4523 | .3996 | .3759 | .3538 | .3139 | .2791 | .2097 | .1594 | .1224 | .0949 | .0742 | .0585 |
| 8  | .8207 | .7894 | .7307 | .6768 | .6274 | .5820 | .5403 | .5019 | .4665 | .4339 | .4039 | .3506 | .3269 | .3050 | .2660 | .2326 | .1678 | .1226 | .0906 | .0678 | .0512 | .0390 |
| 9  | .8007 | .7664 | .7026 | .6446 | .5919 | .5439 | .5002 | .4604 | .4241 | .3909 | .3606 | .3075 | .2843 | .2630 | .2255 | .1938 | .1342 | .0943 | .0671 | .0484 | .0353 | .0260 |
| 10 | .7812 | .7440 | .6756 | .6139 | .5584 | .5083 | .4632 | .4224 | .3855 | .3522 | .3220 | .2697 | .2472 | .2267 | .1911 | .1615 | .1074 | .0725 | .0497 | .0346 | .0243 | .0173 |
| 11 | .7621 | .7224 | .6496 | .5847 | .5268 | .4751 | .4289 | .3875 | .3505 | .3173 | .2875 | .2366 | .2149 | .1954 | .1619 | .1346 | .0859 | .0558 | .0368 | .0247 | .0168 | .0116 |
| 12 | .7436 | .7014 | .6246 | .5568 | .4970 | .4440 | .3971 | .3555 | .3186 | .2858 | .2567 | .2076 | .1869 | .1685 | .1372 | .1122 | .0687 | .0429 | .0273 | .0176 | .0116 | .0077 |
| 13 | .7254 | .6810 | .6006 | .5303 | .4688 | .4150 | .3677 | .3262 | .2897 | .2575 | .2292 | .1821 | .1625 | .1452 | .1163 | .0935 | .0550 | .0330 | .0202 | .0126 | .0080 | .0051 |
| 14 | .7077 | .6611 | .5775 | .5051 | .4423 | .3878 | .3405 | .2992 | .2633 | .2320 | .2046 | .1597 | .1413 | .1252 | .0985 | .0779 | .0440 | .0254 | .0150 | .0090 | .0055 | .0034 |
| 15 | .6905 | .6419 | .5553 | .4810 | .4173 | .3624 | .3152 | .2745 | .2394 | .2090 | .1827 | .1401 | .1229 | .1079 | .0835 | .0649 | .0352 | .0195 | .0111 | .0064 | .0038 | .0023 |
| 16 | .6736 | .6232 | .5339 | .4581 | .3936 | .3387 | .2919 | .2519 | .2176 | .1883 | .1631 | .1229 | .1069 | .0930 | .0708 | .0541 | .0281 | .0150 | .0082 | .0046 | .0026 | .0015 |
| 17 | .6572 | .6050 | .5134 | .4363 | .3714 | .3166 | .2703 | .2311 | .1978 | .1696 | .1456 | .1078 | .0929 | .0802 | .0600 | .0451 | .0225 | .0116 | .0061 | .0033 | .0017 | .0010 |
| 18 | .6412 | .5874 | .4936 | .4155 | .3503 | .2959 | .2502 | .2120 | .1799 | .1528 | .1300 | .0946 | .0808 | .0691 | .0508 | .0376 | .0180 | .0089 | .0045 | .0023 | .0012 | .0007 |
| 19 | .6255 | .5703 | .4746 | .3957 | .3305 | .2765 | .2317 | .1945 | .1635 | .1377 | .1161 | .0829 | .0703 | .0596 | .0431 | .0313 | .0144 | .0068 | .0033 | .0017 | .0009 | .0005 |
| 20 | .6103 | .5537 | .4564 | .3769 | .3118 | .2584 | .2145 | .1784 | .1486 | .1240 | .1037 | .0728 | .0611 | .0514 | .0365 | .0261 | .0115 | .0053 | .0025 | .0012 | .0006 | .0003 |
| 21 | .5954 | .5375 | .4388 | .3589 | .2942 | .2415 | .1987 | .1637 | .1351 | .1117 | .0926 | .0638 | .0531 | .0443 | .0309 | .0217 | .0092 | .0040 | .0018 | .0009 | .0004 | .0002 |
| 22 | .5809 | .5219 | .4220 | .3418 | .2775 | .2257 | .1839 | .1501 | .1228 | .1007 | .0826 | .0560 | .0462 | .0382 | .0262 | .0181 | .0074 | .0031 | .0014 | .0006 | .0003 | .0001 |
| 23 | .5667 | .5067 | .4057 | .3256 | .2618 | .2109 | .1703 | .1378 | .1117 | .0907 | .0738 | .0491 | .0402 | .0329 | .0222 | .0150 | .0059 | .0024 | .0010 | .0004 | .0002 | .0001 |
| 24 | .5529 | .4919 | .3901 | .3101 | .2470 | .1971 | .1577 | .1264 | .1015 | .0817 | .0659 | .0431 | .0349 | .0284 | .0188 | .0126 | .0047 | .0018 | .0007 | .0003 | .0001 | .0000 |
| 25 | .5394 | .4776 | .3751 | .2953 | .2330 | .1842 | .1460 | .1160 | .0923 | .0736 | .0588 | .0378 | .0304 | .0245 | .0160 | .0105 | .0038 | .0014 | .0006 | .0003 | .0001 | .0000 |