Eastern University, Sri Lanka

Faculty of Commerce and Management

Final Year - First Semester Examination in Bachelor of Business Administration/Bachelor of Commerce

2009/2010 (August 2011)

[Proper/Special Repeat]

MGT 4144-Financial Management

Answer All Questions

Calculator is permitted

Time;- Three Hours

Q1 a) A company is currently paying a dividend of Rs 2.00 per share. The dividend is expected to grow at a 15 per cent annual rate for three years, then at 10 per cent rate for the next three years, after which it is expected to grow at a 5 per cent, rate forever.

i) What is the present value of the share if the capitalization rate is 9 per cent?

(04 Marks)

ii) If the share is held for three years, what shall be its present value?

(04 Marks)

b) How would you account for the positive market value of a company's share, which currently pays no dividend?

(05 Marks)

c) A company's current price of share is Rs.60 and dividend per share is Rs.4. If its capitalization rate is 12 per cent, what is the dividend growth rate?

(04 Marks)

d) What are the basic financial decisions? How do they involve risk-return trade-off?

(03 Marks)

(Total 20 Marks)

Q2 a) Equipment A has a cost of Rs 75,000 and net cash flow of Rs 20,000 per year f six years. A substitute equipment B would cost Rs 50,000 and generate net ca flow of Rs 14,000 per year for six years. The required rate of return of bo equipment is 11 per cent. Calculate the IRR and NPV for the equipment A and Which equipment should be accepted and why?

(12 Mark

b) What is meant by the term "Mutually Exclusive Projects"? Explain the conditio when conflicting ranking would be given by the internal rate of return and n present value methods to such projects?

(05 Mark

c) Under what circumstances do the net present value and internal rate of retu methods differ? Which method would be preferred and why?

(03 Mar

(Total 20 Mar

Q3 a) Your father has promised to give you Rs 100,000 in cash on your 25th birthda Today is your 16th birthday. (I) He wants to know two things :

i) If he decides to make annual payments into a fund after one year, how mu will be the value of the annuity if the fund pays 8 per cent?

(04 Mar

ii) If he decides to invest a lump sum in the account after one year and le compound annually, how much will the lump sum be?

(04 Mar

(II) If in (i) the payments are made in the beginning of the year, how much will the value of annuity? (03 Mar

b) A company has issued debentures of Rs.50 lakh to be repaid after 7 years. H much should the company invest in a sinking fund earning 12 per cent in order be able to repay debentures? (05 Mar

c) 'An individual's time preference for money may be expressed as a rate.' Explai

(04 Mar

(Total 20 Mar

Q4 a) 01. A proforma cost sheet of a company provides the following data:

	Rs
Cost (per unit):	
Raw material	52.00
Direct Labour	19.50
Overheads	39.00
Total cost (per unit)	110.50
Profit	19.50
Selling price	130.00

The following is additional information available:

Average raw material in stock: one month; average materials in process: half a month. Credit allowed by suppliers: one month. Credit allowed to debtors: two month. Time lag in payment of wages: one and a half weeks. Overheads: one month. One – fourth of sales are on cash basis. Cash balance is expected to be Rs.120, 000.

You are required to prepare a statement showing the working capital needed to finance a level of activity of 70,000 units of outputs. You may assume that production is carried on evenly throughout the year and wages overheads accrue similarly.

(14 Marks)

b) What is the importance of working capital for a manufacturing firm? What shall be the repercussions if a firm has

i) paucity of working capital?

ii) excess working capital?

(06 Marks)

(Total 20 Marks)

Q5 a) The Servex Company has the following capital structure on 30 June 2010.

	(Rs '000)
Ordinary Shares (200,000 shares)	4,(
10% Preference shares	1,(
14% Debentures	3,(
	8,(

The share of the company sells for Rs 20. It is expected that company w next year a dividend of Rs 2 per share, which will grow at 7 % forever. As 50 per cent tax rate.

You are required to:

i. Compute a weighted average cost of capital based on the existing structure.

ii. Compute the new weighted average cost of capital if the company an additional Rs 2,000,000 debt by issuing 15 per cent debenture would result in increasing the expected dividend to Rs. 3 and le growth rate unchanged, but the price of share will fall to Rs 15 per

iii. Compute the cost of capital if in (ii) above growth rate increases to cent.

(15

b) What are the various concepts of cost of capital? Why would t distinguished in financial management?

(05

(Total 20