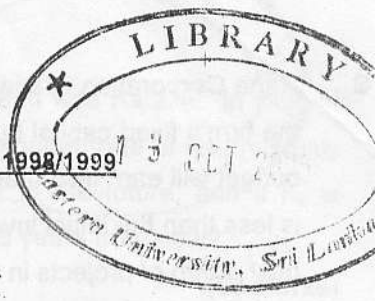


EASTERN UNIVERSITY, SRI LANKA
FACULTY OF COMMERCE AND MANAGEMENT
PART – II EXAMINATION IN BUSINESS ADMINISTRATION 1998/1999
(EXTERNAL DEGREE – MARCH – 2005)
BBA304 – FINANCIAL MANAGEMENT



ANSWER ALL QUESTIONS

TIME : 3 HOURS

- Q. a. What are the types of dividend policies? What are the effects of these policies? (04 Marks)
- b. Complete the balance sheet of KMS Company using the following information for the year ended 31st December 2003.

BALANCE SHEET KMS COMPANY DECEMBER 31, 2003

Cash	30,000	Accounts payable	120,000
Marketable securities	25,000	Notes payable	_____
Accounts receivable	_____	Accruals	20,000
Inventories	_____	Total current liabilities	_____
Total current assets	_____	Long – term debt	_____
Net fixed assets	_____	Stockholders' equity	600,000
Total assets	_____	Total liabilities	_____

The following financial data for 2003 are also available

1. Sales totaled Rs. 1,800,000
2. The gross profit margin was 25%
3. Inventory turnover was 6.0
4. There are 360 days in the year
5. The average collection period was 40 days
6. The current ratio was 1.60
7. The total asset turnover ratio was 1.20
8. The debt ratio was 60%

(16 Marks)

Rana Corporation is attempting to select the best of a group of independent projects competing for the firm's fixed capital budget of Rs.4.5 million. The firm recognizes that any unused portion of this budget will earn less than its 15% cost of capital, thereby resulting in a present value of inflows that is less than the initial investment. The firm has summarized the key data to be used in selecting the best group of projects in the following table.

PROJECT	INITIAL INVESTMENT (Rs)	IRR %	PRESENT VALUE OF INFLOWS AT (15%)
A	5,000,000	17	5,400,000
B	800,000	18	1,100,000
C	2,000,000	19	2,300,000
D	1,500,000	16	1,600,000
E	800,000	22	900,000
F	2,500,000	23	3,000,000
G	1,200,000	20	1,300,000

- Use the internal rate of return approach to select the best group of projects.
- Use the net present value approach to select the best group of projects.
- Compare, contrast, and discuss your findings in (a) and (b).
- Which projects should the firm implement? Why? (20 Marks)

I. Differentiate the Premium bond from discount bond (04 Marks)

II. Petra Manufacturing has just issued a 15 year, 12% coupon interest rate, Rs.1,000 par bond that pays interest annually. The required return is currently at 14%, and the company is certain it will remain at 14% until the bond matures in 15 years.

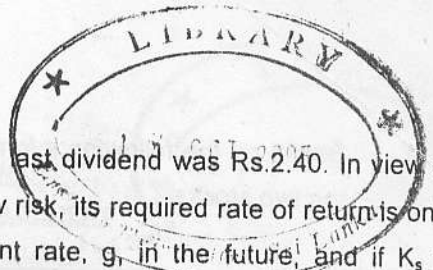
- Assuming that the required return does remain at 14% until maturity, find the value of the bond with

(1) 15 Year	(2) 12 Year	(3) 9 Year
(4) 6 Year	(5) 3 Year	(6) 1 Year to maturity

(04 Marks)

b. Plot your findings on a set of time to maturity (x axis) market value of bond (y axis).

(04 Marks)



Easty Company's current stock price is Rs.36, and its last dividend was Rs.2.40. In view of Easty's strong financial position and its consequent low risk, its required rate of return is only 12%. If dividends are expected to grow at a constant rate, g , in the future, and if K_s is expected to remain at 12%, what is Easty's expected stock price 5 years from now?

(08 Marks)

What is leasing? Define and compare operating lease and financial leases?

(04 Marks)

Naga industries forecasts cash outlays of Rs.1.8 million for its next fiscal year. To minimize investment in the cash account, management intends to apply the Baumol model. A financial analyst for the company has estimated the conversion cost of converting marketable securities to cash (or cash to marketable securities) to be Rs.45 per conversion transaction and the annual opportunity cost of holding cash instead of marketable securities to be 8%.

- Calculate the optimal amount of cash to transfer from marketable securities to cash (i.e., the economic conversion quantity, ECQ). What will be the average cash balance?
- How many transactions will be required for the year?
- Calculate the total cost resulting from use of the ECQ calculated in (a).
- If management makes 12 equal conversions (i.e., one per month), what will be the total conversion cost, the total opportunity cost, and the total cost? Contrast and discuss this value in the light of your finding in (c).

(4 x 2 = 08 Marks)

SETA Corporation uses the Miller – Orr model to manage its cash account. Recently, someone asked how sensitive is the solution for the return point and upper limit to changes in the conversion cost, the variance of daily net cash flows, and the daily opportunity cost rate. The values that are currently being used are, a Rs.50 conversion cost, a Rs.2 million daily net cash flow variance, and a 10% annual opportunity cost.

- Calculate the return point and upper limit using the current values. (04 Marks)
- Simultaneously increase each of the three variable values used in by 50% and recalculate the return point and upper limit. (02 Marks)
- Discuss the sensitivity of the model to changes in the values of the input variables. (02 Marks)

(02 Marks)

Based on the following information, calculate the expected return and standard deviation for the two stocks.

STATE OF ECONOMY	PROBABILITY OF STATE OF ECONOMY	RATE OF RETURN OF STATE OCCURS	
		STOCK X	STOCK Y
Recession	0.30	0.20	-0.15
Normal	0.45	0.25	0.25
Boom	0.25	0.45	0.50

Using the information in the previous problem stated above, suppose you have Rs.60,000 total. If you invest Rs.36,000 in stock X and the remainder in stock Y, what will be the expected return and standard deviation on your portfolio?

(16 Marks)

State the objectives of inventory control?

(04 Marks)