



UNIVERSITY OF RUHUNA
FACULTY OF MANAGEMENT AND FINANCE

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No. of Questions: 06
Total Marks : 70

BACHELOR OF BUSINESS ADMINISTRATION HONOURS DEGREE

4000 LEVEL FIRST SEMESTER END EXAMINATION - AUG/SEP 2023

Three Hours

ACC 41133 - Strategic Finance

Academic Year 2022/2023

Instructions

- ➔ The question paper contains 06 questions.
- ➔ Answer Only 05 questions.
- ➔ Calculators are allowed

Question No.01

(a) (i) What is meant by strategic finance?

(02 marks)

(ii) "The term "capital" can refer to several different concepts in the business world. While most people think of **financial capital**, **human capital** and **social capital** are also important contributors to a company's overall financial health"

Briefly explain above mentioned three types of capital with relevant examples

(03 marks)

(b) The following information has been extracted from the statement of financial position of Kumarasiri Company as at 31st March 2023.

Source of finance	Total value (Rs. Million)	Volume
Ordinary share capital	480	10 Million shares
Retained earnings	180	-
20% Preference share capital	360	18 Million shares
18% Debentures	300	03 Million Debentures

The ordinary shares of the company have a market value of Rs.126.00 per share and the expected dividend per ordinary share is Rs.12.60 which expected to grow at constant rate of 10%. The preference shares of the company are irredeemable and have a market value of Rs.40.00 per share. The debentures are redeemable at a 10% premium after 05 years. The market value of debenture is Rs. 115.00. The annual tax rate of the company is 30%.

Required

- (i) Calculate the cost of equity capital. (K_e)
- (ii) Calculate the cost of preference share capital. (K_p)
- (iii) Calculate the cost of debt capital. (K_d)
- (iv) Calculate the weighted average cost of capital (WACC) of the company using market value

(09 marks)

(Total marks 14)

Question No.02

- (a) What is an ISO currency designator?
(02 marks)
- (b) Briefly describe the impact of foreign currency appreciation and depreciation with respect to receipts and payments.
(03 marks)
- (c) What are the types of foreign exchange risk? Briefly explain.
(03 marks)
- (d) A US exporter sells products in Europe on a cost-plus basis. The selling price is based on a US price of \$ 20 to cover costs and provide a profit margin. The current exchange rate is \$ 1.27/€.
What would be the effect on the exporter's business if the Dollar strengthened to \$ 1.15/€? How to overcome this risk?
(04 marks)
- (e) A treasure can borrow in Swiss Franc at a rate of 5% per annum or in the UK at a rate of 10% per annum. The current rate of exchange is SF 10/£.
What is the forward rate of exchange for delivery in a year's time according to Interest Rate Parity Theory?
(02 marks)

(Total marks 14)

Question No.03

- (a) "The capital budgeting process is the process of planning used to evaluate the potential investments or expenditures whose amount is significant."

Briefly explain this statement while stating the key steps in capital budgeting process.

(03 marks)

- (b) List out three importance of capital budgeting activities in an organization.

(03 marks)

- (c) A company has been using machine "Alpha" for manufacturing of plastic chairs. The machine was purchased 10 years ago at a cost of Rs.15 million. The machine had an expected lifetime of 15 years at the time it was purchased. The salvage value would be zero at the end of the 15 years lifetime period. The machine had been depreciated on the straight-line basis and its present book value is Rs.05 million.

R & D Manager of the company reported that a new machine with latest technology is available in the market and this new machine can be purchased for Rs. 28 million. Further, installation cost of this machine is Rs. 02 million and the expected lifetime of the machine is 05 years.

Due to new technology, less wastage and high efficiency of the new machine it will reduce the cost of labour and raw material from Rs. 16 million to Rs. 08 million per annum. It is estimated that the new machine can be sold for Rs. 04 million at the end of the 05 years.

The current market price of the old machine is Rs. 02 million and if the new machine is acquired, the old machine can be sold to another company at the market value. The working capital requirement will be increased by Rs. 01 million, if the new machine is acquired. this can be recovered at the end of the 5th year. The cost of capital of the company is 12% Ignore the effect of taxes.

Required:

Advice the company, whether it is worth to replace should be the new machine replaced for the existing machine.

(08 marks)

(Total marks 14)

Question No.04

(a) List out three theories that describe the factors affecting the shape of interest yield curve? Describe one of them. (04 marks)

(b) Taylor company's financial projections show an expected cash deficit of \$ 08 million in two months' time which will last for approximately three months. It is now 01st March 2023. The treasurer is concerned that interest rates may rise before 01st May 2023. Protection is required for two months.

A 2 – 5 Forward Rate Agreement at 5.00 – 4.70 is agreed.

Calculate the interest payable if in two months' time the market rate is:

- i. 7% or
- ii. 4% (04 marks)

(c) Briefly explain following concepts.

- i. Currency swaps (02 marks)
 - ii. Levered and unlevered firms (02 marks)
 - iii. Capitalism (02 marks)
- (Total marks 14)

Question No.05

(a) What are the advantages and limitations of risk adjusted discount rate method? (02 marks)

(b) Nipuna PLC wants to select one out of the following projects. Both of the projects will involve an equal investment of Rs. 60,000. Following information are available.

Possible event	Project R		Project S	
	Cash inflows (Rs.)	Probability	Cash inflows (Rs.)	Probability
A	48,000	0.10	144,000	0.10
B	60,000	0.20	120,000	0.15
C	72,000	0.40	96,000	0.50
D	84,000	0.20	72,000	0.15
E	96,000	0.10	48,000	0.10

Required:

By using standard deviation approach, determine more risky project out of project R and project S

(05 marks)

- (c) New Lanka company is considering investing Rs. 500,000 in equipment to produce a new type of Emergency light. Sales of the product are expected to continue for three years, at the end of which the equipment will have a scrap value of Rs. 80,000. Sales revenue of Rs. 600,000 per annum will be generated at a variable cost of Rs. 350,000. Annual fixed costs will increase by Rs. 40,000 and that the company has a cost of capital of 15%.

Required:

- (i) Calculate the net present value (NPV) of this investment.
- (ii) Calculate the sensitivity for initial investment, Scrap value, selling price per unit, variable cost per unit, annual fixed cost, sales volume and cost of capital.

(07 marks)

(Total marks 14)

Question No.06

- (a) Briefly explain the factors determining the capital structure.

(03 marks)

- (b) South Lanka PLC with net operating earnings Rs.2.5 million is attempting to evaluate a number of possible capital structures given below.

Capital Structures	CS - 01	CS - 02	CS - 03	CS - 04
Amount of Debt capital (000)	2,000	5,000	8,000	10,000
Cost of debt capital rate (kd%)	5.0	5.0	5.6	6.0
Cost of Equity capital rate (ke%)	10	10	10.4	11.6

Required

Which of the capital structure will you recommend and why give reasons

(04 marks)

- (c) (i) Briefly discuss the assumptions of Modigliani and Miller (MM) approach.

(02 marks)

- (ii) Explain Modigliani – Miller (MM) approach with tax

(03 marks)

- (iii) What is meant by Arbitrage process?

(02 marks)

(Total marks 14)

RELEVANT TABLE VALUES AND FORMULAS

Present Value Factors for Rs.01 discounted at i rate of interest for n periods. (PVF)

Year	1	2	3	4	5	6	7	8	9	10
10%	0.909	0.826	0.751	0.683	0.620	0.564	0.513	0.466	0.424	0.385
12%	0.892	0.797	0.711	0.635	0.567	0.506	0.452	0.403	0.360	0.322
14%	0.877	0.769	0.675	0.592	0.519	0.455	0.399	0.350	0.307	0.269

$$k_e = \frac{DIV_1}{P_0} + g$$

$$k_e = \frac{DIV_0 (1+g)}{P_0} + g$$

$$k_p = \frac{DIV_p}{P_0}$$

$$k_d = \text{Interest rate } (1-T) \quad IRR = DR(a) + \frac{NPV(a)}{NPV(a) - NPV(b)} \times DR(b) - DR(a)$$

$$WACC (k_o) = k_e \frac{E}{TC} + k_p \frac{P}{TC} + k_d \frac{D}{TC}$$

$$\text{Future Rate of exchange} = S_0 \times \frac{(1+hc)}{(1+hb)}$$

$$\text{Forward Rate of exchange} = S_0 \times \frac{(1+ic)}{(1+ib)}$$