

UNIVERSITY OF RUHUNA

Master of Business Management Degree Programme

Second Semester End Examination - May/ June 2019

MBM 12073 - Financial Management

Answer all questions.

Time : 03 Hours

Total Marks 60

Calculators are allowed.

01.

- a. Briefly discuss the functions of financial manager and importance of financial management decisions.
(03 Marks)
- b. Briefly describe how finance relates to some of the non-finance operational areas of the business organization.
(03 Marks)
- c. A firm borrowed Rs. 600,000/= from a commercial bank under the interest rate of 15% interest compounded annually to purchase a machine. This loan is to be paid in equal installments at the end of each year over the next five years. Prepare a loan repayment schedule.
(04 Marks)
(Total Marks 10)

02.

- a. Briefly explain the relationship between risk and return of a investment with suitable examples.
(03 Marks)
- b. Alfa PLC's bond has a 12% coupon rate and face value is Rs. 1,000/=. The bond has 20 years to maturity. If investors require 15% yield, under the following situations, calculate the bond value of today.
 - i. If interest is paid annually
 - ii. If interest is paid quarterly
(04 Marks)
- c. Using an appropriate graph, describe the relationship between bond maturity and interest rate risk.
(03 Marks)
(Total Marks 10)

03.

- a. Among the financial management decisions, decisions on cost of capital are very much crucial. Explain with suitable examples.

(04 Marks)

- b. Beta PLC has the following information related to cost of capital of the company.

Current selling price of an equity share	Rs. 120
Current growth rate of the dividend	5.0%
Most recently paid dividend (D_0)	Rs. 6.00
Current selling price of a preference share	Rs. 30.00
Dividend payment for a preference share	Rs. 3.60
Cost of debt after tax	8.0%
The marginal tax rate of the company	30%

The company has the following capital structure as at 31st March 2019.

	Rs.' 000
Ordinary shares	10,000
Preference shares	2,000
Debt capital	3,000

Using above information you are required to estimate Beta Company's weighted average cost of capital (WACC).

(06 Marks)

(Total Marks 10)

04.

- a. Briefly explain the nature and importance of capital budgeting decisions in an organization. (03 Marks)
- b. Crown Investment Company is considering an investment project. Initial investment is required for the project is Rs. million 740. Project has a life expectancy of 5 years and the scrap value at the end of project is Rs.million 40.

Assume the company uses straight line depreciation method and ignores the tax. The company's cost of capital is 12%. The estimated net profit after depreciation from the investment project is as follows.

Year	Net profit after Depreciation (Rs.million)
1	110
2	50
3	30
4	(10)
5	(50)

Required

- i. Calculate payback period for the project.
 - ii. Calculate accounting rate of return for the project.
 - iii. Calculate Net present value (NPV) for the project.
 - iv. Advice to the management of the company about the acceptance of the project (07 Marks)
- (Total Marks 10)

05.

- a. Briefly explain the concept of working capital management and determinants of working capital needs of a company. (02 Marks)

- b. The following information has been extracted from the books of Dakshina Lanka PLC as at 31st March 2018/2019.

	As at 01 st April 2018 (Rs. "000")	As at 31 st March 2019 (Rs. "000")
Inventories :- raw materials	3,240	3,780
work-in-process	1,080	2,160
finished goods	2,430	2,160
<u>Accruals expenses</u>		
Manufacturing Wages and salaries	270	540
Other manufacturing expenses	378	298
Accounts receivable	2,700	4,050
Trade Creditors	1,080	2,160

The following transactions have occurred during the year ended 31st March 2019.

	Rs. '000
Raw materials purchases	10,800
Machine depreciation	900
Sales	21,600
Manufacturing Wages and salaries	1,080
Other manufacturing expenses	1,350

You may assume 360 working days in a year and all purchases and sales are on credit basis only.

Required

Determine the gross operating cycle (GOC) and net operating cycle (NOC)

(04 Marks)

- c. Nandana PLC sells goods in the local market and earns a gross profit of 20% on sales.

The company's annual transactions are as follows.

	Rs. "000
Credit sales	6,750
Raw materials purchased	2,700
Materials consumed	2,400
Manufacturing Wages	2,160
Other manufacturing expenses	2,700
Selling and distribution expenses	432
Administration and other expenses	720
Machine Depreciation	270

The additional information is as follows.

- i. Credit allowed to customers is one month and credit given by suppliers of materials is two months.
- ii. Manufacturing wages are paid ½ month in arrears and other manufacturing and administration expenses are paid one month in arrears.
- iii. Selling and distribution expenses are paid 03 months in advance.
- iv. The company wishes to keep one month inventory of raw materials and also of finished goods.
- v. The company believes in keeping cash of Rs.one million.

Required

Prepare a statement showing the working capital requirement of the company.

(04 Marks)

(Total Marks 10)

06.

- a. Ruwanpura PLC with net operating earning Rs. 02 million is attempting to evaluate a number of possible capital structures given below.

NOI ("000")	2,000	2,000	2,000	2,000	2,000	2,000
INT						
NI						
Ke %	10.5	11.0	11.6	12.4	13.5	16.0
Kd %	4.0	4.0	4.6	5.0	5.6	6.0
S						
D	2,000	4,000	6,000	8,000	10,000	12,000
V						
Ko						

Required

Which of the capital structure will you recommend and why give reasons (use Traditional approach)

(04 Marks)

b. Kadima PLC needs Rs. 10 million to build a new Factory. It is considering three alternative ways of financing assets:

- To issue only ordinary shares at Rs.25 per share.
- To issue Rs.5 million debentures at 15% rate of interest and issue ordinary shares at Rs.25 per share for the balance.
- To issue 7.5 million debentures at 15% rate of interest and issue ordinary shares at Rs.25 per share for the balance.

The following are the estimates of the earnings from the new factory.

Earnings before Interest and tax ("000)

1200 1600 2000 2500

Assume a tax rate is 40 %.

Required

i. Calculate the earnings per share for the second financial alternative.

(02 Marks)

ii. Calculate the indifference points between each of the three financial alternatives.

(04 Marks)

(10 Marks)
