	UNIVERSITY OF RUHUNA **FACULTY OF MANAGEMENT AND FINANCE**	No. of Pages : 04 No. of Questions: 05 Total Marks: 70

ENT 3122- Entrepreneurial Finance

BACHELOR OF BUSINESS ADMINISTRATION DEGREE 3000 LEVEL	*Three Hours*
FIRST SEMESTER END EXAMINATION -DECEMBER 2015 /JANUARY2016	

Instructions

- Answer all questions

01.

i. Explain how trade credit can be used to shift part of the financing burden to others?

(5 marks)

ii. Use the following data extracted from the books of Vinu's venture that started its operations in year 2015.

Sales Rs. 320,000

Initial Equity Rs. 100,000

Earnings Before Interest and Tax (EBIT) Rs. 58,400

Turnover = 2

Pay-out ratio 65%

Tax rate 25%

Interest rate 12%

You are required to;

a. Calculate the sustainable growth rate, g*.
b. What level of initial debt capital required if the targeted sales of the venture at the end of 5^{th} year are to reach Rs. 575,000/=.
c. If the firm would like to achieve 18% growth with no change in initial equity investment and target sales of Rs. 575,000/=, how many years would be required?
d. How does the sustainable growth rate change in response to decreasing of return on sales (ROS) by 20%?

(9 marks)

(Total marks 14)

02.

i. Explain how the financial projections in a business plan might be used by a prospective investor.

(5 marks)

ii. Consider the following pattern of historical sales of a venture that began operations ten years ago.

Year	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Sales (Rs. '000)	225	212	205	198	189	200	195	188	172	165

You are required to forecast the sales for the year 2016 by using the least squares method.

(9 marks)

(Total marks 14)

03.

i. Consider the following information extracted from the books of Manvidu enterprise.

Raw material consumption	Rs. 4,750,000
Cost of Production	Rs. 5,255,000
Cost of goods sold	Rs. 4,925,000
Credit sales	Rs. 5,325,000
Credit purchase	Rs. 4,655,000
Debtors	Rs. 735,000
Creditors	Rs. 455,000
Inventory	
Raw material	Rs. 825,000
Work in process	Rs. 330,000
Finished goods	Rs. 540,000

a. Calculate gross operating cycle and the net operating cycle (in days).
b. Interpret your answer.

(9 marks)

ii. Assume Manvidu enterprise is currently employing an "aggressive" working capital policy with regard to the level of current assets it maintains. The firm has decided to switch to more "conservative" working capital policy. What effect will this decision probably have on the firm's profitability and risk?

(5 marks)

(Total marks 14)

04.

i. An entrepreneur is considering investing in a pharmacy. Potential demand of this business may be high, moderate, or low. There is 30% chance of high demand, 45% chance of moderate demand, and 25% chance of low demand. Based on the level of expected demand, the entrepreneur is considering the options of building a large pharmacy, small pharmacy, or not entering to the business at this time. The cost of the large pharmacy is Rs. 1,250,000/= and the cost of small pharmacy is Rs. 975,000/=. The entrepreneur has Rs. 725,000/= to invest and plans to join an outside investor for the balance. The investor expects 8% of the equity for each Rs. 100,000/= of the investment. At the high demand state, the entrepreneur expects a present value of the future cash flows of the large pharmacy should be Rs. 2,750,000/=, and the present value of the future cash flows of the small pharmacy should be Rs.1,250,000/=. If the medium demand state occurs the present value of the future cash flows of both large and small pharmacy should be Rs. 1,600,000/=. Of the low demand state, the present value of the future cash flows of the large pharmacy is Rs. 550,000/= and the present value of the future cash flows of the small pharmacy is Rs.650,000/=.

a. Draw a decision tree to reflect the structure of decisions that the entrepreneur should consider.

(02 marks)

b. Evaluate the decision tree and the best course of action for this investment.

(05 marks)

ii. Of the above project, assume that, after the initial investment, it can be expanded the small pharmacy to the large size pharmacy by investing an additional Rs.275, 000/=. This additional investment will be received from an outside investor and it is expected 6% of the equity for each Rs. 100,000/= of the investment. The present value of the future cash flows would be Rs. 1,950,000/= at the high demand state and at the moderate demand state it would be Rs. 1,450,000/=.

a. Draw the decision tree to reflect the options of expansion.

(02 marks)

b. Evaluate the alternatives of the above investment.

(05 marks)

(Total marks 14)

05.

i. Briefly explain how adverse selection and moral hazard affect the financial contracting process.

(4 marks)

ii. Briefly explain the cost method and discounted cash flow method in valuing businesses.

(4 marks)

iii. In 2010 ABC Company had sales of Rs. 625 million. Suppose the company is expected to grow at 10% for five years and at 8% thereafter. Based on the past profitability and investment needsof the ABC Company, you expect EBIT to be 11% of sales, increases in net working capital requirements to be 10% of sales growth, capital expenditures should be equal to depreciation expenses, capital structure of 35% of debt capital and 12% interest on long term debt, 18% return on equity to attract investors to the business, and the tax rate to be 25%.

Calculate thevalue of the business

(6 marks)
(Total marks 14)

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