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SCHOOL OF ACCOUNTING AND BUSINESS
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE
PROGRAMME

YEAR II SEMESTER I (Intake II/III – Group B)
END SEMESTER EXAMINATION – APRIL 2016

AFM 20530 Business Finance

Date : 10th April 2016
Time : 9.00 a.m. - 12.00 p.m
Duration : Three (03) hours

Instructions to Candidates:

- Answer **ALL** the questions
- The total marks for the paper is 100.
- The marks for each question are shown in brackets.
- Present Value Table is provided
- Use of scientific calculator is allowed.
- Answers should be written neatly and legibly.

Question No. 01

“Financial management can be defined as the management of the finances of an organization in order to achieve the financial objectives of the organization. The actions of stakeholder groups in pursuit of their expectations can exert influence on strategy, which will limit the achievement of financial objectives.”

- a. Explain briefly the term “Finance” as a business function and the financial objective in a business organization.

(05 Marks)

- b. State major decisions involved in finance as a business function and explain them briefly.

(10 Marks)

- c. Explain the meaning of “Agency Problem” and discuss appropriate mechanisms to minimize agency problem exists between shareholders and managers.

(10 Marks)

(Total 25 Marks)

Question No. 02

- a. Briefly explain “All Share Price Index” and “S&P SL20 Index” of Colombo Stock Exchange (CSE).

(04 Marks)

- b. Distinguish between;

(i) Money market and Capital market

(ii) Primary market and Secondary market

(08 Marks)

- c. Lanka PLC's bond has a 10% coupon rate and a Rs. 1,000 face value. Interest is paid semi-annually, and the bond has 20 years to maturity. If investors require a 12 percent yield per annum, what is the intrinsic value of a Lanka PLC's bond?
(04 Marks)
- d. Isuru PLC just paid a cash dividend of Rs.2/- per share. Investors require an annual return of 16% from an investment such as this. The dividend is expected to grow at a steady rate of 8% per year.
- What is the current value of the stock?
 - Do you buy this share, if it is selling currently at Rs.26.50? Justify your answer.
(04 Marks)
- e. Discuss the weaknesses of the dividend growth model as a method of valuing equity shares.
(05 Marks)
- (Total 25 Marks)**

Question No. 03

- a. What is meant by 'cost of capital' of a business organization?
(03 Marks)
- b. Explain briefly the importance of cost of capital in financial decision making.
(04 Marks)
- c. Dividends paid by CSR PLC over the last five years were as follows.

Year ended 31st March;	Dividend per share (Rs)
2011	2.00
2012	2.16
2013	2.32
2014	2.45
2015	2.65

The following information has been extracted from the Statement of Financial Position of the company as at 31st March, 2015.

	Rs in Mn
Stated capital – Ordinary Shares (10,000,000 shares)	400
Retained earnings	100
12% Debentures of Rs 100/- each	300
Total	800

The ordinary shares and the debentures of the company are currently traded at the prices of Rs 50/- and Rs 105/- each respectively. The debentures have a remaining maturity period of 4 years. The company has recently paid the dividend for the year ended 31st March, 2015. The corporate tax rate is 28%.

You are required to determine the following;

- Average dividend growth rate for the period from year 2011 to 2015.
- The expected dividend for the year ended 31st March, 2016 if this average growth rate is expected to be continued.
- Cost of equity capital
- Cost of debentures
- Weighted average cost of capital of CSR PLC.

(18 Marks)

(Total 25 Marks)

Question No. 04

- Explain the two objectives of working capital management and discuss how they conflict with each other.

(06 Marks)

- Explain the concepts of operating cycle and cash conversion cycle and their importance in managing the working capital of a textile manufacturer and a supermarket.

(08 Marks)

- c. ABC PLC is a retailer, specializing in energy drink. One of the products purchased by the company is an energy drink called 'C-Energy'. The estimated demand of this product in the next year is 120,000 bottles. The estimated annual storage cost of a bottle of 'C-Energy' is 0.2% purchase price. The energy drink is currently purchased at a price of Rs 2,500. Currently, an order for new inventory is placed each month for a cost of Rs. 520/-. Buffer inventory equal to 50% of one month's sales is maintained.

You are required to;

- a. Calculate annual inventory cost under the current ordering policy of ABC PLC.
(03 Marks)
- b. Calculate the economic order quantity (EOQ) and annual inventory cost when the EOQ is ordered.
(04 Marks)
- c. Recommend ABC PLC the quantity of 'C-Energy' to order and discuss the assumptions used in providing the recommendation.
(04 Marks)
- (Total 25 Marks)**