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

YEAR II SEMESTER I (Intake II/III – Group A)
END SEMESTER EXAMINATION – JANUARY 2016

AFM 20530 Business Finance

Date : 25th January 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

Whether business concerns are big or small, they need finance to fulfill their business activities. In the modern world, all activities are concerned with economic activities and very particular to earning profit.

- a. Explain briefly the term “Finance”.

(03 Marks)

- b. Explain briefly the goal in finance in a contemporary business organization.

(04 Marks)

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

(08 Marks)

- d. “Wealth maximization is superior to the profit maximization” Critically evaluate this statement.

(10 Marks)

(Total 25 Marks)

Question No. 02

- a. State five (05) characteristics of equity shares.

(05 Marks)

- b. Discuss advantages and disadvantages of equity as a source of finance when compared to debenture.

(05 Marks)

- c. Furniture PLC is a listed company on Colombo Stock Exchange, which has managed to increase earnings over the last year. As a result, the board of directors has increased the dividend payout ratio (that is, the percentage of profit pay as dividend) 30% for the year ended 31st March, 2014 to 40% for the year ended 31st March, 2015. The company has a cost of equity of 15%. The following information is also available.

Year ended 31 st March;	2014 (’000)	2015 (’000)
Profit after tax	14,800	15,200
No. of ordinary shares	5,000	5,000

The dividend is expected to be increased at the rate 5% per annum. Listed companies similar to Furniture PLC have an earnings yield of 9%.

You are required to;

- i. Calculate the value of an equity share of Furniture PLC using the dividend growth model
(05 Marks)
 - ii. Calculate the value of an equity share of Furniture PLC using the earnings yield method.
(05 Marks)
 - iii. Discuss the weaknesses of the dividend growth model as a way of valuing equity shares.
(05 Marks)
- (Total 25 Marks)**

Question No. 03

Agiya PLC has in issue 10 million shares with a market value of Rs 23/- per share. A dividend of Rs 5.20 per share for the year 2015 has just been paid. The recent dividend paid by the company is given below.

Year	2012	2013	2014	2015
Dividend per share (Rs.)	4.00	4.20	4.80	5.20

Agiya PLC has in issue 9% debentures redeemable in five years’ time with a total nominal value of Rs 6 million. The market value of each Rs 100 debenture is Rs 107. Redemption will be at the nominal value.

The company is planning to invest significant amount of money in a new business area. The project has business risk similar to that of the company and is expected to be financed 80% by equity and 20% by debt, on market value basis. The current risk free rate of return is 7% and average equity risk premium is 6%. The company pays income tax at a rate of 30% per year and has equity beta of 1.2.

You are required to;

a. Calculate cost of equity of Agiya PLC using;

- i. Dividend Growth Model
- ii. Capital Assets Pricing Model

(06 Marks)

b. Discuss whether the dividend growth model or capital assets pricing model should be used to calculate the cost of equity.

(04 Marks)

c. Calculate the cost of debenture.

(05 Marks)

d. Explain why cost of equity is greater than cost of debt.

(04 Marks)

e. Calculate the weighted average cost of capital of Agiya PLC.

(06 Marks)

(Total 25 Marks)

Question No. 04

- a. Explain what do you mean by working capital management?
(03 Marks)
- b. State the two objectives of working capital management and discuss how they conflict with each other.
(06 Marks)
- c. Discuss four (04) factors to be considered when establishing a credit policy.
(08 Marks)
- d. ABC PLC is a retailer, specializing in health foods. One of the products purchased by the company is a vitamin drink called 'A-Energy'. The estimated demand of this product in the next year is 10,000 bottles. The estimated storage cost of a bottle of 'A-Energy' is Rs. 5/- per annum. The vitamin drink is currently purchased at a price of Rs. 4,500 which is expected to be increased by 10% in the next year. The current supplier charges a fixed order processing cost of Rs.1,000 for each order, regardless of the order size.

ABC PLC has recently been approached by another supplier of 'A-Energy' offered at a price of Rs. 4,900. The fixed order processing cost charged by the supplier is Rs. 1,875 per order. Due to packaging differences, annual storage cost of a bottle increases to Rs. 6/-.

You are required to;

- i. Assuming ABC PLC continues to purchase from the existing supplier, calculate the economic order quantity and annual inventory cost.
(04 Marks)
- ii. Calculate the economic order quantity if ABC PLC changes to the new supplier and determine whether it would be financially viable to change to this new supplier.

(04 Marks)

(Total 25 Marks)