

12



**THE OPEN UNIVERSITY OF SRI LANKA
MASTER OF BUSINESS ADMINISTRATION
FINAL EXAMINATION
MCP 2610/MSPA310 - CORPORATE FINANCE
DURATION - 03 HOURS**

Date : 23. 08. 2020 **Time : 1.30 pm – 4.30 pm**

Instructions: Answer ALL five (05) questions. Numbering of the answers in your answer script should follow the numbers assigned to the questions in the paper. Illegible hand writing is liable to loose marks.

Question No. 01

- (a) What is meant by the term “Finance”? (02 Marks)

 - (b) Explain the importance of “Finance” as a business function. (06 Marks)

 - (c) “Wealth maximization objective is superior to profit maximization objective”. Briefly explain this statement. (06 Marks)

 - (d) Briefly discuss the agency problem that may arise from the separation of ownership and control. (06 Marks)
- (Total Marks 20)**

Question No. 02

- (a) State four (04) characteristics of Corporate Bond. (04 Marks)

- (b) Explain why some bonds sell at a premium over par value while other bonds sell at a discount. (06 Marks)

- (c) ABC PLC issued Rs 100/- unsecured debentures on 1st January 2019. The debentures matures in 10 years, and the coupon is paid annually at the rate 10 percent.
 - (i) If the yield to maturity on these debentures is 12 percent per annum, determine the price of a debenture on 1st January 2019. (06 Marks)

(ii) If the market price of a debenture on 31st December 2019 is Rs 102/-, decide whether it is worth selling these debentures at this time. Justify your answer with appropriate calculations.

(04 Marks)

(Total Marks 20)

Question No. 03

(a) What is meant by a “derivative financial asset”? (03 Marks)

(b) Briefly explain the difference between call option and put option. (04 Marks)

(c) “Derivatives are used by organizations to help manage their risk”. Discuss this statement providing appropriate examples. (06 Marks)

(d) Suppose you bought a three-month call share option at the exercise price of Rs 45/-. The contract includes 10,000 shares of ABC PLC.

You are required to;

(i) Calculate pay-off at expiration of your investment if the shares of ABC PLC sells for Rs 50/- each on the expiration date. Ignore option premium.

(ii) Draw the pay-off diagram for the investment.

(07 Marks)

(Total Marks 20)

Question No. 04

(a) What is meant by “Risk of an investment”? (02 Marks)

(b) How can the risk of an investment be measured? (03 Marks)

(c) Does diversification reduce the risk of an investment? Explain with an example.

(03 Marks)

(d) The shares of ABC PLC and XYZ PLC have the following possible returns with associated probabilities.

ABC PLC		XYZ PLC	
Rate of Return	Probability	Rate of Return	Probability
12%	0.3	10%	0.2
15%	0.3	22%	0.3
10%	0.2	5%	0.4
5%	0.2	-1%	0.1

You are required to calculate;

- Expected return and standard deviation of the return for the shares of ABC PLC and XYZ PLC.
- Expected return and standard deviation of the return for the portfolio of the shares of ABC PLC and XYZ PLC. Assume that 40% of your investment is in shares of ABC PLC while the balance 60% of your investment is in shares of XYZ PLC.

(12 Marks)

(Total Marks 20)

Question No. 05

(a) State four (04) major decisions involved in finance.

(02 Marks)

(b) Discuss how financial statements reflects these four major decisions.

(05 Marks)

(c) The following financial data has been extracted from the Annual Report of LM PLC.

Income Statement for the year ended 31st March;

<i>(Amounts in Rupees Millions)</i>	2019	2020
Sales	510	735
Cost of Sales	(270)	(382)
Gross Profit	240	353
Operating Expenses	(105)	(125)
Interest Expense	(50)	(20)
Profit before tax	85	208
Income Tax	(34)	(83)

Net Profit for the year	51	125
-------------------------	----	-----

Statement of Financial Position as at 31st March;

<i>(Amounts in Rupees Millions)</i>	2019	2020
Non-current Assets	365	470
Current Assets;		
Inventory	50	58
Trade Receivables	40	52
Cash	12	26
Total Assets	<u>467</u>	<u>606</u>
Equity	120	400
Non-current Liabilities	252	100
Current Liabilities	95	106
Total Equity and Liabilities	<u>467</u>	<u>606</u>

You are required to;

- (i) Calculate profitability ratios and comment on the company's profitability for the years ending 31st March, 2019 and 2020. **(05 Marks)**
- (ii) Calculate liquidity and solvency ratios and comment on the quality of the company's financing and working capital management decisions during the years ending 31st March, 2019 and 2020. **(08 Marks)**
- (Total Marks 20)**

All Write Reserved