

**THE OPEN UNIVERSITY OF SRI LANKA**  
**MASTER OF BUSINESS ADMINISTRATION**  
**FINAL EXAMINATION**  
**MSPA310 / MCP26 10 - CORPORATE FINANCE**  
**DURATION - 03 HOURS (ANSWERS SHOULD BE COMPLETED**  
**AND UPLOADED WITHIN THREE (03) HOURS)**



**Date : 28.08.2021**

**Time : 09.30a.m. - 12.30p.m**

***Instructions: Answer any three (03) questions including Question No.1.***  
***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) Risk and return are of important considerations to investors when making their investment decisions of any kind.
- (i) Briefly explain with examples the relationship between ‘Risk’ and ‘Return’ presumed to exist in relation to financial assets. **(04 Marks)**
- (ii) Evaluate whether this presumed relationship between ‘Risk’ and ‘Return’ would exist during the COVID-19 period in relation to stock investments. **(06 Marks)**
- (b) (i) Explain the difference between systematic risk and unsystematic risk. **(04 Marks)**
- (ii) Discuss whether the COVID-19 pandemic can be a systematic or unsystematic risk factor when investing in stocks. **(06 Marks)**
- (c) You are currently considering for an investment of Rs. 24 million in an equity investment portfolio. Your analysis shows that the equity stocks of the following ten companies (as indicated by the stock codes from 0 to 9) are suitable candidates for your investment. Table 1 presents expected returns and standard deviations of returns of these ten stocks. Table 2 shows the correlation coefficients of stock returns between stocks of the companies given row wise and column wise.

Table 1: Expected returns and standard deviations of ten stocks

Stock Code	Expected Return (%)	Standard Deviation of Return (%)
0	11	16
1	21	18
2	13	14
3	8	10
4	25	19
5	11	11
6	17	18
7	20	16
8	17	10
9	19	14

Table 2: Correlation coefficients of stock returns

Stock Code	0	1	2	3	4	5	6	7	8	9
0	1.00	-0.75	0.82	0.63	-0.42	-0.34	-0.58	0.18	-0.92	0.87
1		1.00	0.51	-0.92	0.69	0.61	0.49	0.26	0.41	0.56
2			1.00	0.44	-0.41	0.29	0.51	-0.48	-0.27	0.31
3				1.00	-0.84	-0.94	-0.68	0.71	0.93	-0.66
4					1.00	0.89	-0.51	-0.69	-0.63	0.59
5						1.00	0.38	0.83	-0.59	0.90
6							1.00	-0.58	0.33	0.89
7								1.00	0.61	0.40
8									1.00	-0.36
9										1.00

You are required to select two stocks from the given ten stocks **in order of the digits appeared in your student registration number from right to left**, and answer the following questions based on the above information. (For example, if the student registration number is 17104587, the selected stocks are those stocks with code number 7 and 8).

- (i) Calculate the expected return and risk of the portfolio if the total investment is equally allocated between the selected two stocks. **(06 Marks)**
  - (ii) Evaluate appropriateness of the selected two stocks for risk-diversification. **(06 Marks)**
  - (iii) From the given ten stocks, determine most appropriate two stocks for your investment portfolio with appropriate justifications, and calculate the expected return and the risk of the portfolio. **(08 Marks)**
- (Total: 40 Marks)**

**Question No. 02**

- (a) Explain the term “Finance” as a business function. **(05 Marks)**
- (b) Explain three (03) types of financial decisions involved in a manufacturing business, with appropriate examples. **(09 Marks)**

(c) Differentiate the role of money market from that of capital market by providing appropriate examples. **(08 Marks)**

(d) Discuss four (04) limitations in the “profit maximization” criterion as the financial objective of a business. **(08 Marks)**

**(Total: 30 Marks)**

**Question No. 03**

(a) Explain why equity shares are considered to be riskier than debentures. **(06 Marks)**

(b) A PLC issues Debentures that pay coupon annually at the rate of 13% per year. The debenture’s par value is Rs 100 and has five years to maturity. The yield to maturity is 15% per year.

(i) Calculate the intrinsic value of a debenture?

(ii) Explain why this intrinsic value differs from the par value **(08 Marks)**

(c) XY PLC paid an equity dividend of Rs.12/- per share at the end of the last financial year. The company expects to pay the same amount of dividend for each of the following two years, which would then be increased at the rate of 5% annually. If the investor’s required rate of return is 14% on this equity stock, what is the intrinsic price of the equity stock today? **(10 Marks)**

(d) Discuss two (02) challenges faced when equity shares are valued by using the dividend-based valuation method. **(06 Marks)**

**(Total: 30 Marks)**

**Question No. 04**

The financial statements of AB PLC for the years ending 31<sup>st</sup> March 2020 and 2021 are provided below.

**Statement of Profit and Loss for the year ended 31<sup>st</sup> March,**

<i>(Amounts are in rupees millions)</i>	<b>2021</b>	<b>2020</b>
Sales	10,345	9,762
Cost of sales	<u>(5,435)</u>	<u>(4,784)</u>
Gross Profit	4,910	4,978
Administrative Expenses	(2,105)	(2,345)
Distribution Expenses	(735)	(653)
Interest expense	<u>(520)</u>	<u>(682)</u>
Income before tax	1,550	1,298
Income tax	<u>(460)</u>	<u>(390)</u>
Profit for the year	<u>1,090</u>	<u>908</u>

**Statement of Financial Position as at 31<sup>st</sup> March;**

<i>(Amounts are in rupees millions)</i>	<b>2021</b>	<b>2020</b>
<b>Assets</b>		
<b>Non-current Assets</b>		
Property, plant and equipment	6,235	6,614
Intangible Assets	1,600	1,800
<b>Current Assets</b>		
Inventory	720	852
Trade Receivables	1,275	642
Other current assets	200	180
Cash	<u>530</u>	<u>462</u>
<b>Total Assets</b>	<u>10,560</u>	<u>10,550</u>
<b>Equity</b>		
Common Stocks (500 shares issued)	2,200	2,200
Retained profit	2,230	1,345
<b>Non-current Liabilities</b>		
Finance leases	2,630	1,150
Long-term bank loans	2,810	2,520
<b>Current Liabilities</b>		
Trade Payables	440	2,835
Income tax payable	<u>250</u>	<u>500</u>
<b>Total Equity and Liabilities</b>	<u>10,560</u>	<u>10,550</u>

Using these financial statements, you are required to;

**(a)** Calculate the book value per share as at 31<sup>st</sup> March, 2021, and earnings per share and dividend per share for the year ended 31<sup>st</sup> March, 2021. **(06 Marks)**

**(b)** Analyze and discuss the liquidity position of the company using relevant financial ratios. **(06 Marks)**

**(c)** Analyze and discuss the profitability and the efficiency of assets utilization of the company for the financial year ending 31<sup>st</sup> March, 2021 by using appropriate financial ratios. **(10 Marks)**

**(d)** Based on your liquidity, profitability and efficiency analyses, discuss two (04) areas that the company's management needs to pay special attention in the future.

**(08 Marks)**

**(Total: 30 Marks)**

***All Rights Reserved***