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**THE OPEN UNIVERSITY OF SRI LANKA  
MASTER OF BUSINESS ADMINISTRATION  
FINAL EXAMINATION  
AFPA310/ MSPA310/ MCP 2610 - CORPORATE FINANCE  
DURATION - 03 HOURS**

**Date : 26. 08. 2023**

**Time : 9.30am – 12.30pm**

*Instructions: Answer ALL four (04) 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.*

*Use of Non programmable calculator is allowed*

**Question No. 01**

- (a) Explain why businesses need finance. **(05 Marks)**
- (b) Explain three (03) types of financial management decisions by providing an example of business transaction that would be relevant for each type of decision. **(06 Marks)**
- (c) Discuss the role of money and capital markets for the financial management decisions as given in part (b) above. **(06 Marks)**
- (d) Discuss four (04) limitations in the “profit maximization” criterion as the financial objective of a business. **(08 Marks)**

**(Total: 25 Marks)**

**Question No. 02**

- (a) Explain the difference between systematic risk and unsystematic risk. **(02 Marks)**
- (b) Briefly explain two (02) systematic risks which recently impacted business operations in Sri Lanka. **(04 Marks)**
- (c) Explain the relationship between diversification and risk. **(06 Marks)**
- (d) You are currently considering for an invest of Rs. 10 million in equity shares. Your analysis reveals that the equity stocks of the following three companies are suitable candidates for your investment. The estimates of the expected returns of these three stocks under possible economic conditions of the country are provided below.

	Economic conditions		
	Stable	Boom	Recession
Probability of occurrence	0.3	0.2	0.5
Expected Return of;			
Alpha PLC	10%	15%	4%
Beta PLC	12%	16%	3%
Teta PLC	8%	10%	6%

**Based on the above information, you are required to;**

- (i) Calculate the expected returns of the stocks of Alpha PLC, Beta PLC and Teta PLC.  
(03 Marks)
- (ii) Calculate the standard deviation of returns of the stocks of Alpha PLC, Beta PLC and Teta PLC.  
(06 Marks)
- (iii) Determine which one of the three stocks that you would choose to invest if you were a risk-averse investor.  
(04 Marks)

**(Total: 25 Marks)**

**Question No. 03**

- (a) Explain dividend and earnings based valuation methods used for the valuation of equity shares.  
(06 Marks)
- (b) Discuss two (02) challenges faced when equity shares are valued by using the dividend-based valuation method.  
(04 Marks)
- (c) ABC PLC issued debentures of the following two types on 31<sup>st</sup> July 2023. Both types of the debentures have the face value of Rs. 100/= each and pay coupon annually. The yield to maturity is 15% per year.

Type	Period	No. of debentures	Coupon rate
A	4 years	1,500,000	18%
B	5 years	900,000	12%

- (i) Calculate the intrinsic values of the debenture type "A" and "B" as at 31<sup>st</sup> July 2023.  
(06 Marks)
- (ii) Explain why the intrinsic values as calculated in part (i) above differ from the face value.  
(04 Marks)

- (d) PQ PLC paid an equity dividend of Rs.8/- per share at the end of the last financial year. The company expects to increase the amount of dividend at the rate of 4% annually. If the investor's required rate of return is 15% on this equity stock, what is the intrinsic price of the equity stock today?

(05 Marks)

(Total: 25 Marks)

**Question No. 04**

- (a) State two (02) differences between equity financing and debt financing. (04 Marks)
- (b) Do companies prefer equity financing over debt financing? Discuss. (05 Marks)
- (c) ABC PLC carries out a business of manufacturing and selling children cloth to retail outlets in Anuradhapura. The following financial information has been extracted from the financial statements of the company for the years ending 31<sup>st</sup> March 2021, 2022, and 2023.

(In Rs. ' 000)	2021	2022	2023
Sales	283,200	211,560	248,810
Cost of sales	146,210	134,355	163,880
Dividend paid	13,785	11,422	10,583
Interest expense	24,530	21,384	22,920

Balances as at 31 <sup>st</sup> March;	2021	2022	2023
Inventory	18,990	17,350	16,550
Trade receivables	19,320	18,725	17,624
Cash	5,385	4,271	3,218
Property, plant and equipment	341,562	311,358	459,438
Trade creditors	9,742	12,358	18,292
Retained earnings	131,618	121,244	132,610
Stated capital – Equity shares	100,000	100,000	100,000
Long-term borrowings	143,897	118,102	245,928

Based on the above financial information, you are required to;

- (i) Prepare an analysis of the company's profitability and liquidity using relevant financial ratios. (08 Marks)
- (ii) Discuss how the following decisions would impact on the company's profitability and liquidity position.
- The investment in new machinery to expand the production capacity.
  - The extension of the credit period given to the customers by 20 days.

(08 Marks)

(Total: 25 Marks)

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## PRESENT VALUE TABLE

Present value of \$1, that is  $(1+r)^{-n}$  where  $r$  = interest rate;  $n$  = number of periods until payment or receipt.

Periods ( $n$ )	Interest rates ( $r$ )									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149

Periods ( $n$ )	Interest rates ( $r$ )									
	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.079	0.065
16	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054
17	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045
18	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038
19	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031
20	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026