



00014

**THE OPEN UNIVERSITY OF SRI LANKA**  
**COMMONWEALTH EXECUTIVE MASTER OF BUSIENSS/PUBLIC ADMINISTRATION**  
**FINANAL EXAMINATION – 2010**  
**MCP 2610 – CORPORATE FINANCE**  
**DURATION : THREE (03) HOURS**

**Date : 16.05.2010**

**Time : 1.30 pm- 4.30 pm**

**Instructions :**

**Answer any five (05) questions.**

**Use of nonprogrammable Calculator is allowed.**

**Present Value Table will be provided.**



1. “The main objective of the financial management is to maximize wealth”. Explain this statement and examine the finance functions performed by a finance manager to achieve this goal. (20 marks)
2. Define the term “financial markets” and describe the key role of the financial markets in the Sri Lankan Economy. (20 marks)
3. Lanka Engineering Ltd. (LEL) had the following balance sheets and income statements over the last three years (in thousand)

<b>Assets</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Debtors	60,000	50,000	30,000
Stocks	70,000	50,000	50,000
Plant and Equipment	20,000	15,000	12,000
Building	10,000	10,000	10,000
<b>Total</b>	<b>160,000</b>	<b>125,000</b>	<b>102,000</b>
<b>Liabilities</b>			
Bank	39,000	26,000	11,000
Trade creditors	50,000	30,000	25,000
Profit and loss A/C	15,000	130,000	10,000
Paid up capital (Rs. 10/- shares Rs. 7.50 paid)	56,000	560,000	560,000
<b>Total</b>	<b>160,000</b>	<b>125,000</b>	<b>102,000</b>

Sales	150000	150000	100000
Gross Profit	25000	30000	25000
Net Profit	5000	7000	5000
Dividend paid	3000	4000	4000

The opening stock at the beginning of the year 2007 was Rs. 400,000/-.

You are required to calculate important ratios for the three years and assess the profitability, liquidity, financial position and assets management efficiency of the company.

(20 marks)

4. ABBA Ltd. is using a machine purchased at Rs. 360,000/-. At present the machine is two years' old and has a remaining useful life of 10 years. The company does not expect to realize a salvage value from this machine after 10 years, but if it is sold now, it would receive Rs. 100,000/-.

The management is considering replacing the old machine with a new more efficient machine which costs Rs. 420,000/- and has estimated a salvage value of Rs. 20,000/- after its useful life of 10 years. Due to greater capacity of the new machine, annual sales are expected to go up by Rs. 40,000/-. The operating efficiency of the new machine will produce an expected savings of Rs. 50,000/- a year. The company's tax rate is 55%. The depreciation is calculated on straight line method.

Using NPV technique, determine the economic desirability of the purchase of new machine, assuming the cost of capital of the company is 12%. (20 marks)

5. I. Central industries Ltd. has an outstanding issue of convertible debentures with a Rs. 1000/- par value. They have 12.5% coupon rate and a 10 years maturity. These debentures are convertible into 20 shares of common stock. The required rate of return is 14%.

(a) Calculate the straight value of the debenture (05 marks)

(b) Calculate the conversion value of the debenture when the market price per share is Rs. 30/-. (02 marks)

- (c) What is the minimum value you would expect the debenture to sell for, at a market price of common stock Rs. 40/- per share? (03 marks)
- II. What reasons are given for issuing convertible securities? (05 marks)
- III. Explain the difference between a convertible security and a warrant. (05 marks)
- 6 Explain the risk management techniques used to reduce the financial risk. (20 marks)

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Present Value of \$1

$$PV = \frac{1}{(1+i)^n}$$

Periods	3%	4%	5%	6%	7%	8%	10%	12%	14%	16%	18%	20%	22%	24%	25%	26%	28%	30%	40%
1	.9709	.9615	.9524	.9434	.9346	.9259	.9091	.8929	.8772	.8621	.8475	.8333	.8197	.8065	.8000	.7937	.7813	.7692	.7143
2	.9426	.9246	.9070	.8900	.8734	.8573	.8264	.7972	.7695	.7432	.7182	.6944	.6719	.6504	.6400	.6299	.6104	.5917	.5102
3	.9151	.8890	.8638	.8396	.8163	.7938	.7513	.7118	.6750	.6407	.6086	.5787	.5507	.5245	.5120	.4999	.4768	.4552	.3644
4	.8885	.8548	.8227	.7921	.7629	.7350	.6830	.6355	.5921	.5523	.5158	.4823	.4514	.4230	.4096	.3968	.3725	.3501	.2603
5	.8626	.8219	.7835	.7473	.7130	.6806	.6209	.5674	.5194	.4761	.4371	.4019	.3700	.3411	.3277	.3149	.2910	.2693	.1859
6	.8375	.7903	.7462	.7050	.6663	.6302	.5645	.5066	.4556	.4104	.3704	.3349	.3033	.2751	.2621	.2499	.2274	.2072	.1328
7	.8131	.7599	.7107	.6651	.6227	.5835	.5132	.4523	.3996	.3538	.3139	.2791	.2486	.2218	.2097	.1983	.1776	.1594	.0949
8	.7894	.7307	.6768	.6274	.5820	.5403	.4665	.4039	.3506	.3050	.2660	.2326	.2038	.1789	.1678	.1574	.1388	.1226	.0678
9	.7664	.7026	.6446	.5919	.5439	.5002	.4241	.3606	.3075	.2630	.2255	.1938	.1670	.1443	.1342	.1249	.1084	.0943	.0484
10	.7441	.6756	.6139	.5584	.5083	.4632	.3855	.3220	.2697	.2267	.1911	.1615	.1369	.1164	.1074	.0992	.0847	.0725	.0346
11	.7224	.6496	.5847	.5268	.4751	.4289	.3505	.2875	.2366	.1954	.1619	.1346	.1122	.0938	.0859	.0787	.0662	.0558	.0247
12	.7014	.6246	.5568	.4970	.4440	.3971	.3186	.2567	.2076	.1685	.1372	.1122	.0920	.0757	.0687	.0625	.0517	.0429	.0176
13	.6810	.6006	.5303	.4688	.4150	.3677	.2897	.2292	.1821	.1452	.1163	.0935	.0754	.0610	.0550	.0496	.0404	.0330	.0126
14	.6611	.5775	.5051	.4423	.3878	.3405	.2633	.2046	.1597	.1252	.0985	.0779	.0618	.0492	.0440	.0393	.0316	.0254	.0090
15	.6419	.5553	.4810	.4173	.3624	.3152	.2394	.1827	.1401	.1079	.0835	.0649	.0507	.0397	.0352	.0312	.0247	.0195	.0064
16	.6232	.5339	.4581	.3936	.3387	.2919	.2176	.1631	.1229	.0930	.0708	.0541	.0415	.0320	.0281	.0248	.0193	.0150	.0046
17	.6050	.5134	.4363	.3714	.3166	.2703	.1978	.1456	.1078	.0802	.0600	.0451	.0340	.0258	.0225	.0197	.0150	.0116	.0033
18	.5874	.4936	.4155	.3503	.2959	.2502	.1799	.1300	.0946	.0691	.0508	.0376	.0279	.0208	.0180	.0156	.0118	.0089	.0023
19	.5703	.4746	.3957	.3305	.2765	.2317	.1635	.1161	.0829	.0596	.0431	.0313	.0229	.0168	.0144	.0124	.0092	.0068	.0017
20	.5537	.4564	.3769	.3118	.2584	.2145	.1486	.1037	.0728	.0514	.0365	.0261	.0187	.0135	.0115	.0098	.0072	.0053	.0012
21	.5375	.4388	.3589	.2942	.2415	.1987	.1351	.0926	.0638	.0443	.0309	.0217	.0154	.0109	.0092	.0078	.0056	.0040	.0009
22	.5219	.4220	.3418	.2775	.2257	.1839	.1228	.0826	.0560	.0382	.0262	.0181	.0126	.0088	.0074	.0062	.0044	.0031	.0006
23	.5067	.4057	.3256	.2618	.2109	.1703	.1117	.0738	.0491	.0329	.0222	.0151	.0103	.0071	.0059	.0049	.0034	.0024	.0004
24	.4919	.3901	.3101	.2470	.1971	.1577	.1015	.0659	.0431	.0284	.0188	.0126	.0085	.0057	.0047	.0039	.0027	.0018	.0003
25	.4776	.3751	.2953	.2330	.1842	.1460	.0923	.0588	.0378	.0245	.0160	.0105	.0069	.0046	.0038	.0031	.0021	.0014	.0002
26	.4637	.3607	.2812	.2198	.1722	.1352	.0839	.0525	.0331	.0211	.0135	.0087	.0057	.0037	.0030	.0025	.0016	.0011	.0002
27	.4502	.3468	.2678	.2074	.1609	.1252	.0763	.0469	.0291	.0182	.0115	.0073	.0047	.0030	.0024	.0019	.0013	.0008	.0001
28	.4371	.3335	.2551	.1956	.1504	.1159	.0693	.0419	.0255	.0157	.0097	.0061	.0038	.0024	.0019	.0015	.0010	.0006	.0001
29	.4243	.3207	.2429	.1846	.1406	.1073	.0630	.0374	.0224	.0135	.0082	.0051	.0031	.0020	.0015	.0012	.0008	.0005	.0001
30	.4120	.3083	.2314	.1741	.1314	.0994	.0573	.0334	.0196	.0116	.0070	.0042	.0026	.0016	.0012	.0010	.0006	.0004	.0000
40	.3066	.2083	.1420	.0972	.0668	.0460	.0221	.0107	.0053	.0026	.0013	.0007	.0004	.0002	.0001	.0001	.0001	.0000	.0000

**Table 2**  
Present Value of Ordinary Annuity of \$1

$$PV_A = \frac{1}{i} \left[ 1 - \frac{1}{(1+i)^n} \right]$$

Periods	3%	4%	5%	6%	7%	8%	10%	12%	14%	16%	18%	20%	22%	24%	25%	26%	28%	30%	40%
1	.9709	.9615	.9524	.9434	.9346	.9259	.9091	.8929	.8772	.8621	.8475	.8333	.8197	.8065	.8000	.7937	.7813	.7692	.7143
2	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7355	1.6901	1.6467	1.6052	1.5656	1.5278	1.4915	1.4568	1.4400	1.4235	1.3916	1.3609	1.2245
3	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.4869	2.4018	2.3216	2.2459	2.1743	2.1065	2.0422	1.9813	1.9520	1.9234	1.8684	1.8161	1.5889
4	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.1699	3.0373	2.9137	2.7982	2.6901	2.5887	2.4936	2.4043	2.3616	2.3202	2.2410	2.1662	1.8492
5	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.7908	3.6048	3.4331	3.2743	3.1272	2.9906	2.8636	2.7454	2.6893	2.6351	2.5320	2.4356	2.0352
6	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.3553	4.1114	3.8887	3.6847	3.4976	3.3255	3.1669	3.0205	2.9514	2.8850	2.7594	2.6427	2.1680
7	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	4.8684	4.5638	4.2883	4.0386	3.8115	3.6046	3.4155	3.2423	3.1611	3.0833	2.9370	2.8021	2.2628
8	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.3349	4.9676	4.6389	4.3436	4.0776	3.8372	3.6193	3.4212	3.3289	3.2407	3.0758	2.9247	2.3306
9	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.7590	5.3282	4.9464	4.6065	4.3030	4.0310	3.7863	3.5655	3.4631	3.3657	3.1842	3.0190	2.3790
10	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.1446	5.6502	5.2161	4.8332	4.4941	4.1925	3.9232	3.6819	3.5705	3.4648	3.2689	3.0915	2.4136
11	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.4951	5.9377	5.4527	5.0286	4.6560	4.3271	4.0354	3.7757	3.6564	3.5435	3.3351	3.1473	2.4383
12	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	6.8137	6.1944	5.6603	5.1971	4.7932	4.4392	4.1274	3.8514	3.7251	3.6059	3.3868	3.1903	2.4559
13	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.1034	6.4235	5.8424	5.3423	4.9095	4.5327	4.2028	3.9124	3.7801	3.6555	3.4272	3.2233	2.4685
14	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.3667	6.6282	6.0021	5.4675	5.0081	4.6106	4.2646	3.9616	3.8241	3.6949	3.4587	3.2487	2.4775
15	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	7.6061	6.8109	6.1422	5.5755	5.0916	4.6755	4.3152	4.0013	3.8593	3.7261	3.4834	3.2682	2.4839
16	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	7.8237	6.9740	6.2651	5.6685	5.1624	4.7296	4.3567	4.0333	3.8874	3.7509	3.5026	3.2832	2.4885
17	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.0216	7.1196	6.3729	5.7487	5.2223	4.7746	4.3908	4.0591	3.9099	3.7705	3.5177	3.2948	2.4918
18	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.2014	7.2497	6.4674	5.8178	5.2732	4.8122	4.4187	4.0799	3.9279	3.7861	3.5294	3.3037	2.4941
19	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.3649	7.3658	6.5504	5.8775	5.3162	4.8435	4.4415	4.0967	3.9424	3.7985	3.5386	3.3105	2.4958
20	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	8.5136	7.4694	6.6231	5.9288	5.3527	4.8696	4.4603	4.1103	3.9539	3.8083	3.5458	3.3158	2.4970
21	15.4150	14.0292	12.8212	11.7641	10.8355	10.0168	8.6487	7.5620	6.6870	5.9731	5.3837	4.8913	4.4756	4.1212	3.9631	3.8161	3.5514	3.3198	2.4979
22	15.9369	14.4511	13.1630	12.0416	11.0612	10.2007	8.7715	7.6446	6.7429	6.0113	5.4099	4.9094	4.4882	4.1300	3.9705	3.8223	3.5558	3.3230	2.4985
23	16.4436	14.8568	13.4886	12.3034	11.2722	10.3711	8.8832	7.7184	6.7921	6.0442	5.4321	4.9245	4.4985	4.1371	3.9764	3.8273	3.5592	3.3254	2.4989
24	16.9355	15.2470	13.7986	12.5504	11.4693	10.5288	8.9847	7.7843	6.8351	6.0726	5.4509	4.9371	4.5070	4.1428	3.9811	3.8312	3.5619	3.3272	2.4992
25	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.0770	7.8431	6.8729	6.0971	5.4669	4.9476	4.5139	4.1474	3.9849	3.8342	3.5640	3.3286	2.4994
26	17.8768	15.9828	14.3752	13.0032	11.8258	10.8100	9.1609	7.8957	6.9061	6.1182	5.4804	4.9563	4.5196	4.1511	3.9879	3.8367	3.5656	3.3297	2.4996
27	18.3270	16.3296	14.6430	13.2105	11.9867	10.9352	9.2372	7.9426	6.9352	6.1364	5.4919	4.9636	4.5243	4.1542	3.9903	3.8387	3.5669	3.3305	2.4997
28	18.7641	16.6631	14.8981	13.4062	12.1371	11.0511	9.3066	7.9844	6.9607	6.1520	5.5016	4.9697	4.5281	4.1566	3.9923	3.8402	3.5679	3.3312	2.4998
29	19.1885	16.9837	15.1411	13.5907	12.2777	11.1584	9.3696	8.0218	6.9830	6.1656	5.5098	4.9747	4.5312	4.1585	3.9938	3.8414	3.5687	3.3317	2.4999
30	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	9.4269	8.0552	7.0027	6.1772	5.5168	4.9789	4.5338	4.1601	3.9950	3.8424	3.5693	3.3321	2.4999
40	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	9.7791	8.2438	7.1050	6.2335	5.5482	4.9966	4.5439	4.1659	3.9995	3.8458	3.5712	3.3332	2.5000