THE OPEN UNIVERSITY OF SRI LANAKA
MASTER OF BUSINESS ADMINISTRATION IN HUMAN
RESOURCES MANAGEMENT PROGRAMME
ACADEMIC YEAR 2010 – SEMESTER 1
MANAGERIAL FINANCE - MCP 2132
DURATION - 03 HOURS

DATE:15.08.2010	*TIME: 1.30 p.m – 4.30 p.m*

INSTRUCTIONS:

- **Answer any Five (05) questions only.**
- **Non programmable calculators are allowed to use.**
- **Present value tables are attached.**
- **Answer for every question should begin on a new page.**

1. (a) "No matter how big the profit that a firm has reported, what matters is the generation of cash flows from operations with respect to the performance"

   Critically evaluate the above statement

   (5 Marks)

   (b) Following information relates to Gamunu Traders for the year ended 31st March 2010.

   (i) Cash Flow statement

Operating Activities	Rs.
Cash collected from Customers	2,600,000
Cash Paid to Suppliers	2,140,000
Office Rent Paid	-120,000
Administration Expenses	-700,000
Cash Flows from Operations	-360,000
Interest Paid	-30,000
Net Cash Used in Operating Activities	-390,000
Investing activities	
Acquisition of Equipment	-100,000
Purchase of Shares	-100,000
Net cash Applied in Investing Activities	-200,000
Financing Activities	
Capital introduced	800,000
Bank loan	240,000
Repayment of bank loan	-50,000
Net Cash generated from financing activities	990,000
Net Increase in cash and cash equivalent during the year	400,000
Cash and cash equivalent at the beginning	0
Cash and cash equivalent as at 31 March 2010	400,000

Income statement	Rs	Rs
Sales Revenue	4,600,000	
Cost of sales	1,990,000	
		2,610,000
Office rent	60,000	
Depreciation	20,000	
Other Expenses	700,000	
Interest charge	30,000	810,000
Profit for the year		1,800,000

(ii) Balance sheet as at 31st March 2010

Non Current Assets	Rs	Rs
Equipment	80,000	
Investment	100,000	180,000
Current Assets		
Inventory	400,000	
Debtors	2,000,000	
Prepaid Rent	60,000	
Cash	400,000	2,860,000
Total Assets		**3,040,000**
Equity and Liabilities		
Capital	800,000	
Profit for the year	1,800,000	2,600,000
Bank Loan	190,000	
Creditors	250,000	440,000
Total Liabilities and Equity		**3,040,000**

Required
1. Reconciliation of net cash flows from operating activities with the profit for the year ended 31st March
2. Comment on the cash flow adequacy and cash flow efficiency of Gamunu Traders

(15 Marks)

(Total 20 Marks)

2. (a) Newly recruited finance manager of a firm argues that the borrowing as much as possible is the best strategy as it would increase the shareholders value. Comment on the finance manager's view in relation to financing and profitability of a firm.

(5 Marks)

(b) The following information relates to DAD Plc.

(i) The balance sheets for two years

	Rs	Rs
DAD Plc	2010	2009
Property Plant and Equipment	5,000	4,500
Investment	2,000	2,100
Current Assets	1,000	400
Total assets	**8,000**	**7,000**
Stated Capital	8,000	5,000
Reserves	-2,500	-2,200
Loans	1,000	3,400
Current Liabilities	1,500	800
Equity and total liabilities	**8,000**	**7,000**

Required
1. Calculate the gearing position of the company for two years
2. Comment on the management decision of raising more equity and repaying a substantial amount of debt during the year 2010

(15 Marks)
(Total 20 Marks)

3 (a) Explain the use of Trend analysis and Common size financial statements in relation to financial statement analysis

(5 Marks)

(b) Selected information of a firm for three years is given below

	2010	2009	2008
Basic earnings per share (Rs.)	12	10	11
Interest cover (no. of times)	15	10	7
Net assets per share (Rs.)	80	70	55
Dividend payout Ratio (%)	30	25	25
Current Ratio	2.1	2	1.9
Market price per share RS	150	70	120
Revenue Rs millions	50,000	40,000	42,000
Finance Expenses Rs millions	1,500	2,000	1,800
Profit Before Tax Rs millions	7,000	6,500	6,800
Profit for the year Rs millions	6,800	6,000	5,000
Total Assets Rs millions	100,000	90,000	70,000
Equity Rs millions	56,000	50,000	48,000

3

Required

1. Analysis on the profitability of the company by referring to the profit margin and efficiency of asset utilization that the firm maintains
2. Possible reasons for the difference between the market price of a share and the value of net assets per share
3. Do you think that lenders of this company are happy with the current performance or not. Give reasons
4. Comment of the performance of the company from shareholders point of view
5. Comment on the liquidity position of the firm over three years.

(15 Marks)
(Total 20 Marks)

4. Pizza Booth produces and sells one type of pizza which is a specialty product of the chef Antonio De Sicca. Revenue and cost information related to this little Pizza Booth, opened recently, is as follows:

	Rs.
Unit selling price	400
Unit variable cost (ingredients and wrapper)	150
Monthly fixed costs:	
Wages for employees	240,000
Rent	120,000
Utilities (electricity, telephone etc.)	64,000
Depreciation of equipment	24,000
Advertising	150,000
Repairs and maintenance	24,000
Insurance	14,000
Miscellaneous	20,000
Total	656,000

As the recently appointed business analyst you are required to carryout a *sensitivity analysis* on the following lines. Consider each scenario afresh (separately).

(i) Compute the monthly breakeven point in (a) pizzas (b) rupees.

(ii) Re-compute the break even point (pizzas) if fixed costs increase by Rs. 25,000.

(iii) How many pizzas should be sold in order to earn a monthly profit of Rs. 50,000?

(iv) Owing to rigorous competition the monthly sales are likely to drop to 2,000 pizzas. Compute the Profit/ Loss that will be earned/ incurred at this sales level.

(v)   The manager of a local bank wishes the booth to purchase 100 pizzas at a special price of Rs. 250 (for the purpose of a trip). Another near by pastry shop has already expressed its willingness to accept the order at Rs. 250 per pizza. The additional cost (other than the cost of ingredients and wrapper) amounts to Rs. 4,000 approximately.

    (a)   Should the special order be accepted? Why?

    (b)   How low a price could be charged in order to break-even from the special order?

    (c)   Could you furnish a strong reason as to why the special order should not be accepted?

(vi)   Competition in the area has intensified and monthly sales volume dropped to 1,500 pizzas. A temporary closure is proposed. If this is implemented the monthly cost saving will be Rs. 250,000. Should the proposal be accepted? Justify your answer.

(vii)   Comment on the validity of the assumptions underlying the analysis (CVP) carried out so far by you.

(Total 20 Marks)

5.   Consider the following decision making situations carefully and give your responses to **any four** of them. Justify your answers using appropriate cost concepts, relevant calculations and clear explanations.

(a)   Imagine a ship repair yard, Ship Land, which is short of work with many workers idle owing to current recessionary conditions. However, the workers receive a guaranteed wage per month.

    Tenders are invited for an immediate repair to a damaged ship which will take a few weeks to complete. There is rumor that another firm is tendering on the basis of direct material and direct labor plus one half of the normal fixed overhead charge. Should the Ship Land still compete?

(b)   Upul Warusawaithana, contemplating to buy a block of land for Rs. 5,000,000, paid a non-refundable deposit of Rs. 50,000. Now, he finds a better block of land which he can purchase for Rs. 4,500,000. The payment of the deposit encourages him to buy the first block of land. Should he proceed with his thought?

(c)   Assume that a firm is offered a contract for Rs. 3,000,000 to construct air-conditioning ducts in a new office building. The labor and other operating expenses for the job are estimated to be Rs. 2,100,000. The firm has all the materials required to complete the work in its inventory. Assume that the material (primarily sheet metal) originally cost the firm Rs. 1,200,000. However, the price declines of this particular type of sheet metal have resulted in a current market price of Rs. 750,000. The market for sheet metal is unlikely to change in the near future, so no

gains are expected from holding the material in inventory. Should the firm accept the contract?

(d)   Consider the costs associated with the purchase and operation of a café selling Chinese food. The business can be bought for Rs. 1,750,000 and an additional Rs. 250,000 is required for operating expenses.

Sarath has personal savings of Rs. 2,000,000 that he can invest in such an enterprise. Nimal another possible contender must borrow the entire Rs. 2,000,000 from a bank. Both seems to be equally competent to manage it.

Does the fact that Nimal has to pay interest on the borrowings from the bank make his costs of operating greater than that of Sarath's?

(e)   Blossomfiled Brewers produce Real Ale beer made to conform to home-made recipes, and all using basic mash produced at the central plant. Several recipes are available all of which are considered of equal quality. The beer does not transport well, and hence , the brewery operates a number of local plants allowing local management to select the recipe, most appropriate to their own particular circumstances. One location, on a holiday island is considering its cost and revenue estimates of three recipes as given below:

Recipe	A	B	C
Selling price (Rs. Per can)	2,500	2,500	2,500
Basic mash @Rs. 50 per lb	500	750	1,000
Labour@ Rs20 per hr.	1,200	800	400
Other variable costs	450	350	350

Fixed costs per month amount to Rs. 1,000,000.

Studies indicate that market demand is sufficient for the company to sell all the ale that they can produce, the only limitation being the availability of basic mash. Local harbor regulations restrict the amount of basic mash shipped to the island to 60,000 lbs per month.

What is the most profitable option and, the total profit that they could earn?

(Total 20 Marks)

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6. A W Investor wishes to invest in one of the following projects.

Year	Project A (Rs. '000s)	Project B (Rs. '000s)
0	-200,000	-200,000
1	20,000	60,000
2	40,000	60,000
3	60,000	60,000
4	60,000	60,000
5	60,000	40,000
6	68,000	20,000

Required:

(a) Can the two projects be compared directly? Give reasons.

(b) Compute the Payback Period, Net Present Value (NPV) and the Internal Rate of Return (IRR) for the two projects. Assume the cost of capital to be 12%.

(c) Under what circumstances will you select a project based on the Payback Period? Under this method what will your choice be?

(d) Under what circumstances will you select a project based on the NPV? Under this method what will your choice be?

(e) What is the significance of IRR? Interpret in relation to your computed values.

(Total 20 Marks)

Table A-1   Present Value of $1 Due at the End of n Periods:

$$PVIF_{k,n} = \frac{1}{(1+k)^n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8065	.7813	.7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7695	.7561	.7432	.7182	.6944	.6504	.6104	.5739	.5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	.4348	.3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	.5194	.4972	.4761	.4371	.4019	.3411	.2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	.1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	.3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	.0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	.1869	.1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	.3152	.2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	.0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	.0541	.0320	.0193	.0118	.0073
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	.0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486	.1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
21	.8114	.6598	.5375	.4388	.3589	.2942	.2415	.1987	.1637	.1351	.0926	.0638	.0531	.0443	.0309	.0217	.0109	.0056	.0029	.0016
22	.8034	.6468	.5219	.4220	.3418	.2775	.2257	.1839	.1502	.1228	.0826	.0560	.0462	.0382	.0262	.0181	.0088	.0044	.0022	.0012
23	.7954	.6342	.5067	.4057	.3256	.2618	.2109	.1703	.1378	.1117	.0738	.0491	.0402	.0329	.0222	.0151	.0071	.0034	.0017	.0008
24	.7876	.6217	.4919	.3901	.3101	.2470	.1971	.1577	.1264	.1015	.0659	.0431	.0349	.0284	.0188	.0126	.0057	.0027	.0013	.0006
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	.0005
26	.7720	.5976	.4637	.3604	.2812	.2198	.1722	.1352	.1064	.0839	.0525	.0331	.0264	.0211	.0135	.0087	.0037	.0016	.0007	.0003
27	.7644	.5859	.4502	.3468	.2678	.2074	.1609	.1252	.0976	.0763	.0469	.0291	.0230	.0182	.0115	.0073	.0030	.0013	.0006	.0002
28	.7568	.5744	.4371	.3335	.2551	.1956	.1504	.1159	.0895	.0693	.0419	.0255	.0200	.0157	.0097	.0061	.0024	.0010	.0004	.0002
29	.7493	.5631	.4243	.3207	.2429	.1846	.1406	.1073	.0822	.0630	.0374	.0224	.0174	.0135	.0082	.0051	.0020	.0008	.0003	.0001
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
35	.7059	.5000	.3554	.2534	.1813	.1301	.0937	.0676	.0490	.0356	.0189	.0102	.0075	.0055	.0030	.0017	.0005	.0002	.0001	*
40	.6717	.4529	.3066	.2083	.1420	.0972	.0668	.0460	.0318	.0221	.0107	.0053	.0037	.0026	.0013	.0007	.0002	.0001	*	*
45	.6391	.4102	.2644	.1712	.1113	.0727	.0476	.0313	.0207	.0137	.0061	.0027	.0019	.0013	.0006	.0003	.0001	*	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	*	*	*	*
55	.5785	.3365	.1968	.1157	.0683	.0406	.0242	.0145	.0087	.0053	.0020	.0007	.0005	.0003	.0001	*	*	*	*	*

*The factor is zero to four decimal places.