

**THE OPEN UNIVERSITY OF SRI LANKA
COMMONWEALTH EXECUTIVE MASTER OF BUSINESS/ PUBLIC
ADMINISTRATION
FINAL EXAMINATION - 2024
AFPA310/ MSPA310/ MCP 2610 - CORPORATE FINANCE
DURATION - 03 HOURS**



Date : 31.08.2024

Time : 9.30am – 12.30pm

Instructions: Answer ALL four (04) questions.

Use of non-programmable calculator is allowed.

Numbering of the answers in your answer script should follow the numbers assigned to the questions in the paper. Illegible handwriting is liable to loose marks.

Question No. 01

- (a) Explain the importance of “Finance” as a business function. **(05 Marks)**
- (b) State four (04) major decisions involved in financial management and explain them briefly. **(06 Marks)**
- (c) Briefly explain the agency problem that may arise from the separation of ownership and control in a company and how it influences the wealth maximization goal. **(06 Marks)**
- (d) “Wealth maximization objective is superior to profit maximization objective”. Do you agree? Discuss. **(08 Marks)**

(Total: 25 Marks)

Question No. 02

- (a) Explain how risk-return trade-off influences investment decisions. **(04 Marks)**
- (b) Explain the difference between systematic risk and unsystematic risk, and the importance of diversification in an investment portfolio. **(06 Marks)**
- (c) ABC Investment PLC is a medium-sized investment firm that specializes in managing portfolios for its clients. Recently, the firm’s portfolio manager has been assigned the task of evaluating the risk and return of several stocks and constructing an optimal portfolio for a high-net-worth client. The client is interested in three specific stocks - Stock X, Stock Y, and Stock Z. The following forecasts have been made in relation to these three stocks.

Economic condition	Probability of occurrence	Stock X	Stock Y	Stock Z
Boom	0.2	15%	25%	12%
Normal	0.3	10%	11%	10%
Recession	0.5	7%	4%	6%

Based on the above information, you are required to;

- (i) Calculate the expected returns of the stocks X, Y and Z. **(03 Marks)**
 - (ii) Calculate the standard deviation of returns of the stocks X, Y and Z. **(06 Marks)**
 - (iii) Explain how the risk and return characteristics of stocks X, Y and Z influence the overall portfolio performance. **(06 Marks)**
- (Total: 25 Marks)**

Question No. 03

- (a) Briefly explain the difference between call option and put option. **(04 Marks)**
- (b) "Derivatives are used by organizations to help manage their risk". Discuss this statement providing appropriate examples. **(06 Marks)**
- (c) LM PLC is currently considering an issue of debentures with a nominal value of Rs 100/- each at an issue price of Rs 92/- per debenture. The debentures are entitled for an annual coupon payment at the rate of 13%, will mature in 5 years. The current yield to maturity on these debentures is estimated to be 17% per annum.

Based on the above information, you are required to;

- (i) Calculate the intrinsic value of a debenture. **(06 Marks)**
 - (ii) If you were an investor evaluating LM PLC's debentures, would you decide to invest in them at the time of issuance? Justify your decision. **(05 Marks)**
 - (iii) Discuss how an increase in market interest rates would impact the valuation of these debentures. **(04 Marks)**
- (Total: 25 Marks)**

Question No. 04

- (a) Explain how financial statement analysis can assist in assessing a company's risk before making investment decisions. **(05 Marks)**
- (b) OMC PLC is in the business of manufacturing and selling men's sportswear in Sri Lanka. The following financial ratios have been calculated from the financial statements of OMC PLC for the last five years.

	2020	2021	2022	2023	2024
Gross margin	21%	23%	23%	27%	30%
Selling and Administrative expenses as a % of sales	10%	12%	16%	22%	25%
Operating assets turnover (times)	1.14	1.04	0.93	0.84	0.67
Trade receivables turnover (times)	5.29	5.35	5.38	4.51	4.11
Inventory turnover (times)	4.43	4.23	4.09	4.37	4.75
Trade payables turnover (times)	15.36	16.78	17.46	10.13	9.84
Property, plant and equipment turnover (times)	1.80	1.60	1.34	1.20	0.91
Long term debt-to-equity (times)	0.75	0.90	1.40	1.82	2.40
Interest coverage	3.41	4.62	4.75	2.15	1.10

Based on the above information, you are required to;

- (a) Perform an analysis of the OMC PLC's profitability, liquidity, solvency, and efficiency of assets utilization over the 2020 – 2024 period. **(10 Marks)**
- (b) Explain two (02) areas that should be a matter of managerial concern. **(04 Marks)**
- (c) OMC PLC is now considering financing its investment in a new production facility through a bank loan. Discuss how this financing decision would impact on the company's profitability and liquidity positions. **(06 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