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KARACHI UNIVERSITY BUSINESS SCHOOL
University of Karachi
FINAL EXAMINATION, JUNE 2010: AFFILIATED COLLEGES
CORPORATE FINANCE: BA (H) – 643
BS – VII

Date: July 8, 2010

Max Time: 2 Hrs

Max Marks: 60

Note: Attempt any three questions from below. Answers should be relevant and precise.

- Q.1 a. Define oversubscription privilege? How the existing shareholders and the value of the company are be affected by right offering?
- b. Trios most recently sold 100,000 units at \$7.50 each; its variable operating costs are \$ 3 per unit and its fixed operating costs are \$250,000. Annual interest charges total \$80,000, and the firm has 200,000 shares of ordinary equity outstanding. Assume that the firm has a 40 percent tax rate. At what level of sales (in units) would the firm be having EBIT equals zero? Calculate EPS at both current level of sales and at 120,000 unit sales level. Using the current \$750,000 level of sales as a base, calculate the firm's DOL, DFL and DCL.
- Q.2 a. What is financial breakeven analysis? Discuss the limitations of linear breakeven analysis?
- b. As part of your financial planning, you wish to purchase a new car in exactly five years. The car u wish to purchase costs \$14000 today and your research indicates that its price will increase by 2 percent to 4 percent per year over the next five years.
- Estimate the price of the car at the end of five years if inflation is
1. 2 percent per year
 2. 5 percent per year
- How much more expensive will the car be if the rate of inflation is 3 percent higher than 2 percent.
- Q.3 a. Identify the basic functions of a financial manager and explain the importance of these function in the context of organizational success?
- b. Write a brief note on financial markets?
- Q.4 a. Define Capital Rationing? How firm organize investment process?
- b. Critically discuss the CAPM?

- Q.5
- a. Define homemade dividends? Discuss in brief the factors that favor low dividend payout?
 - b. Sunny Industries wishes to accumulate funds to provide a retirement annuity for its vice president, Javed Umer. Mr. Umer by contract will retire at the end of 12 years. On retirement he is entitled to receive an annual end of year payment of \$42,000 for 20 years. If he dies prior to the end of the 20 year period, the annual payments will pass to his heirs. During the 12 year period, Sunny wishes to fund the annuity by making equal end of year payments into an account earning nine percent interest when the risk free rate is 6 percent. Once the 20 year distribution period begins, Sunny plans to move the accumulated monies into an account earning a guaranteed three percent per year higher than during accumulation period. At the end of the distribution period the account balance will equal zero. Note that the first distribution payment will be received at the end of year 13.
How large must Sunny's annual deposits into the account be in the accumulation period to fund fully Mr. Umer's retirement annuity?
- Q.6
- a. Define bankruptcy cost? Discuss briefly the static theory of capital structure?
 - b. Bonds issued by the Tyler food corporation have a par value of Rs. 1000/-but are selling for Rs. 850/- but have 10 years of maturity. The bond is paying interest at a rate of 12 percent. Compute the current yield to maturity using average formula?
 - c. Xerox company had issued preferred shares five years ago carrying a fixed dividend of £8 however with the passage of time the inflation rate goes up by 2% and other factors also changed, as a result yield to maturity goes up to 12 % from 8 %. Identify the original issue price of the shares and also the current price?
- Q.7
- a. Differentiate between private and public bond issues? A private placement is likely to have a higher interest rate than a public issue. Why?
 - b. Gina has just contracted to sell a small parcel of land that she has inherited from her uncle who had a property worth \$48,000, five years ago. The buyer is willing to pay \$18,000 at the closing of the transaction or will pay \$2,000, \$4,000, \$6,000, \$8,000 and \$10,000 at the beginning of each of the next five years. Because Gina does not need money right now, she plans to let it accumulate in an account earning 7 percent annual interest. Given her desire to buy a house at the end of five years after closing on the sale of the lot, she decides on to choose the payment alternatives. What advice you would provide to her if she asks you?