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MBA203

Reg. No.

Second Semester M.B.A Degree Examination, December 2005/January 2006

Master of Business Administration

Financial Management

Time: 3 hrs.) (Max.Marks : 100

Note: *1. Answer any FOUR full questions from 1 to 7.*
2. Question No. 8 ie compulsory.
3. Use of Time Value Tables is permitted.

1. **(a)** Distinguish between the objectives of profit maximisation and wealth maximisation. **(3 Marks)**

(b) Describe the major financial management decisions that business firms make. **(7 Marks)**

(c) Explain briefly the structure of Indian Financial System. Point out the emerging trends in the Indian financial system. **(10 Marks)**

2. **(a)** What is meant by time value of money ? **(3 Marks)**

(b) State the different kinds of capital budgeting proposals. How would you rank them for the purpose of their selection ? **(7 Marks)**

(c) Project A and Project B cost a corporation Rs 50,000 and Rs. 25,000 respectively. Their cash flows are given below. You are requested to find out the internal rate of return for each project and decide on that basis which project is more profitable.

Year	Cash Flow (Rs)	
	Project A	Project B
1	5,000	10,000
2	15,000	10,000
3	30,000	10,000
4	20,000	10,000
5	10,000	-

(10 Marks)

3. **(a)** How do we use Beta in the determination of cost of equity ? **(3 Marks)**

(b) Distinguish between internal and external equity and explain how the cost of internal and external equity capital are estimated ? **(7 Marks)**

(c) A Company Ltd., wishes to raise additional finance of Rs 10 lakhs for meeting its investment plans. It has Rs 2,10,000 in the form of retained earnings available for investment purposes. The following are the further details.

i) Debt/ Equity Mix. 30% / 70%

ii) Cost of debt upto Rs 1,80,000 : 10% (Before Tax)

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Cost of debt beyond Rs 1,80,000 : 16% (Before Tax)

iii) Earnings per share - Rs 4=00.

iv) Dividend payout 50% of earnings

v) Expected growth rate in dividend - 10%

vi) Current market price per share - Rs 44/=

vii) Tax rate - 50%

You are required :

(a) to determine the pattern for raising the additional finance

(b) to determine the post-tax average cost of additional debt

(c) to determine the cost of retained earnings and cost of equity

(d) to compute the overall weighted average after - tax cost of additional finance. **(10 Marks)**

4. **(a)** What are the different sources of working capital finance ? **(3 Marks)**

(b) Discuss the factors determining working capital. **(7 Marks)**

(c) Arjun & Co is desirous of purchasing a business and has consulted you and one point on which you are asked to advise them is the average amount of working capital which will be required in the first year's working.

You are given the following estimates and are instructed to add 10% to your computed figure to allow for contingencies.

	Details	Figures for the year (Rs)
1.	Amount blocked up in stocks :	
	Stock of finished goods	5000
	Stock of stores, materials	8000
2.	Average credit sales :	
	Inland sales - 6 weeks credit	3,12,000
	Export sales - $1\frac{1}{2}$ months credit	78,000
3.	Lag in payment of wages and other out goings :	
	Wages - $1\frac{1}{2}$ weeks	2,60,000
	Stock of materials - $1\frac{1}{2}$ months	48,000
	Rent, Royalties - 6 months	10,000
	Clerical Staff - Half month	62,400
	Manager - Half month	4,800
	Miscellaneous Expenses - $1\frac{1}{2}$ month	48,000
4.	Payment in advances	
	Sundry Expenses (paid quarterly in advance)	8,000
5.	Undrawn profit on the average through out the year	11,000

(10 Marks)

5. **(a)** What do you mean by optimal capital structure ? **(3 Marks)**

(b) "Debt is cheaper than equity. The company should therefore borrow as much as possible in order to reduce the overall cost of capital. " Do you agree ? Substantiate your answer. **(7 Marks)**

(c) The capital structure of progressive Co. Ltd consists of an equity share capital of

Contd.... 3

Rs 10 lakhs (shares of Rs 10 per value) and Rs 10 Lakhs of 20% debentures. Sales increased by 25% from 2,00,000 units to 2,50,000 units. The selling price is Rs 10 per unit, variable cost amounts to Rs 6 per unit and fixed expenses amounts to Rs 2,50,000, income tax rate is assumed to be 50%.

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You are required to calculate the following

i) The percentage increase in earnings per share (EPS)

ii) The degree of financial leverage at 2,00,000 unit and 2,50,000 units

iii) The degree of operating coverage at 2,00,000 units and 2.50,000 units. **(10 Marks)**

6. **(a)** State the relationship between EBIT and EPS. **(3 Marks)**

(b) Distinguish between public issue and private placement. Explain the important functions associated with public issue. **(7 Marks)**

(c) The balance sheet of Deepak cable Ltd on December 31, 2000 is shown below :

Liabilities	Rs. in Lakhs	Assets	Rs. in Lakhs
Share Capital	150	Fixed Assets	400
Retained earnings	180	Inventories	200
Team loans	80	Receivables	150
Short term bank borrowings	200	Cash	50
Accounts payable	140		
Provisions	50		
	800		800

The sales of the firm for the year ending on December 31, 2000 were Rs 1000. Its profit margin on sales was 6% and its dividend payout ratio was 50%. The tax rate was 60%.

Deepak cables expects its sales to increase by 30% in the year 2001. The ratio of assets to sales and spontaneous current liabilities to sales would remain unchanged. Likewise the profit margin ratio, the tax rate and the dividend payout ratio would remain unchanged.

You are required :

i) to estimate the external funds requirement for the year 2001

ii) to prepare the following statements assuming that the external funds requirement would be raised equally from term loans and short term bank borowings:

i) projected balances sheet and

ii) projected income statement. **(10 Marks)**

7. **(a)** Explain the significance of dividend decisions in financial management. **(5 Marks)**

(b) A company is currently considering modernisation of a machine originally costing Rs 1,00,000 that has current book value of Rs. zero. However it is in good working condition and can be sold for Rs, 50,000. Two choices are available. One is to rehabilitate the existing machine at a total cost of Rs 3,60,000.and the other is to replace the existing machine with a new machine costing Rs 4,20,000. and requiring Rs 60,000 to install. The rehabilitated machine as well as the new machine would have a six year life and no salvage value. The firm's projected after tax

Contd.... 4

profits under various alternatives are as follows.

Year	Expected after tax profit		
	Existing machine Rs.	Rehabilitated Machine Rs.	Profits New machine Rs.
1	4,00,000	4,40,000	4,80,000
2	5,00,000	5,80,000	4,40,000
3	6,20,000	7,00,000	7,00,000
4	7,20,000	8,00,000	8,20,000
5	8,20,000	9,00,000	8,60,000
6	10,00,000	10,80,000	10,20,000

The firm is taxed at 55% on normal incomes. The company uses straight line depreciation. The company's cost of capital is 12%. Advise the company whether it should rehabilitate the existing or should replace with the new machine. Also state the situation in which the company would like to continue with the existing machine. **(15 Marks)**

8. Mr. Raghu is managing director of Kumar Automobiles Ltd., Bangalore. His main area of business is confined only to South India with a turn over of Rs 50 crores. The company enjoys good credit worthy in the market. The product is widely accepted and has the scope of expanding the business to increase atleast 10% for the next two to three years. The managing director has the desire to enter into untapped market. (North India) with an additional investment of Rs 10 crore. The current debt equity ratio of the company is 3:1. As far as current ratio is concerned, when compared to standard, actual performances is quite satisfactory (2 : 1). The company has a strong middle management, who can strengthen the hands of the managing director. Advise the managing director to raise Rs 10 crore to undertake his expansion programme.

Issues :

i) Do you advise the company to issue fresh equity shares? **(5 Marks)**

ii) If yes justify the suggestion with appropriate plan of action
If the answer is no what other measures do you offer to the Co. ? **(10 Marks)**

iii) Do you have any say in formulating the marketing strategy to tap the new market. **(5 Marks)**

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MBA 203

USN

NEW SCHEME

Second Semester MBA Degree Examination, July 2006
Master of Business Administration
Financial Management

Time: 3 hrs.] [Max. Marks: 100

Note: ***1. Answer any FOUR full questions from first 7 question. Question No 8 is compulsory.***
2. Time value tables will be supplied on request.

1 a. How is the Finance function typically organized in a large organization? **(03 Marks)**

b. Briefly explain the basic reasons why profit / EPS Maximization fails to be considered with wealth maximization. **(07 Marks)**

c. The expected cash flows of a project are as follows:

Year	Cash flow
0	100000
1	20000
2	30000
3	40000
4	50000
5	30000

The cost of capital is 12 per cent. Calculate the following:
(a) net present value, (b) benefit – cost ratio, (c) internal rate of return,
(d) modified internal rate of return, (e) payback period and
(f) discounted payback period **(10 Marks)**

2 a. What is the difference between Future value and present value? **(03 Marks)**

b. An executive is about to retire at the age of 60. His employer has offered him two post – retirement options:
i) Rs. 20,00,000 lump sum
ii) Rs. 2,50,000 for 10 years. Assuming interest at 10 per cent, which is a better option? **(07 Marks)**

c. Teja international is determining the cash flow for a project involving replacement of an old machine. The old machine bought a few years ago has a book value of Rs. 80,00,000 and it can be sold to realize a post tax salvage value of Rs. 900000. It has a remaining life of five years after which its net salvage value is expected to be Rs. 200000. It is being depreciated annually at a rate of 25 percent as per the WDV method. The working capital associated with this machine is Rs. 500000.
The new machine costs Rs.3000000. It is expected to fetch a net salvage value of Rs. 1500000 after five years. The depreciation rate applicable to it is 25 percent under the WDV method. The net working capital required for the new machine is expected to bring a saving of Rs. 650000 annually in manufacturing costs (other than depreciation). The tax rate applicable to the firm is 30 percent.
Estimate the cash flow associated with the replacement project. What is the NPV of the replacement project if the cost of capital is 14 percent? **(10 Marks)**

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3 a. List any 3 differences between debt and Equity. (03 Marks)
b. Discuss the problems associated with IRR. (07 Marks)
c. What is the substance of Miller and Modigliani dividend irrelevance theorem. (10 Marks)

4 a. List the steps involved in calculating Weighted Average cost of capital. (03 Marks)
b. Explain the various principles associated in determining the cost flows of a project (07 Marks)

c. Panyam Company's capital structure in terms of market value is:

Debt	Rs. 30 million
Equity	Rs. 30 million

The company plans to maintain this market – value capital structure. The company has a plan to invest Rs. 15 million next year. This will be financed as follows:

Retained earnings	Rs. 5 million
Additional Equity	Rs. 5 million
Debt	Rs. 5 million

The company's equity stock presently sells for Rs. 30 per share. The next dividend expected is Rs. 3.00. The expected rate of dividend growth is 5 per cent. Additional equity can be issued at Rs. 25 per share. The interest rate applicable to additional debt would be as follows:

First Rs. 2.5 million 14%
Next Rs. 2.2 million 15%

The tax rate for the firm is 30 percent

Required:

a) At what amount of new capital will there be breaks in the marginal cost of capital schedule?
b) What will be the marginal cost of capital in the interval between each of the break? (10 Marks)

5 a. Distinguish between Cash Cycle and Operating Cycle. (03 Marks)
b. Define the following terms in relation to an Equity share – par value, issue price, book value and market value (07 Marks)
c. A proforma cost sheet of a company provides the following data:

Costs (per unit)	
Raw Materials	52.0
Direct labour	19.5
Overheads	39.0
Total Cost (per unit)	110.5
Profit	19.5
Selling Price	130.0

The following is the additional information available:
Average raw material in stock: one month: average materials in process: half a month. Credit allowed by suppliers: one month: credit allowed to debtors: two months. Time lag in payment of wages: one and a half weeks. Overheads: one month. One fourth of sales are on cash basis. Cash balance is expected to be Rs. 1,20,000.
You are required to prepare a statement showing the working capital needed to finance a level of activity of 70,000 units of output. You may assume that production is carried on evenly throughout the year and wages and overheads accrue similarly. (10 Marks)

6 a. How is external funds requirement estimated. (Show Formula) (03 Marks)
b. What is Venture Capital? Explain the various forms of venture Capital. (07 Marks)
c. Discuss the factors that have a bearing on working capital needs (10 Marks)

Contd...3

7 a. "Retained Earnings" is a cost free source of fund. Comment. **(05 Marks)**

b. A manufacturing concern is planning to replace one of its machines. The existing machine is carried in the books at Rs.2,50,000 at present. This machine can be sold for Rs.1,50,000 today. Otherwise this can be used for 5 more years and sold at the end for Rs.40,000.

The new machine costs Rs.8,00,000 and will last for 5 years. After 5 years this can be sold for Rs.1,20,000. The replacement would require additional investment of Rs.50,000 in working capital, which will be fully recovered at the end.

This replacement is expected to result in pre-tax annual savings of Rs.2,40,000 in cash operating expenses throughout the life of the project. The firm depreciates machines @ 20% under WDV method. The tax rate applicable is 30%. Estimate the cash flows for this project and compute NPV using discount rate of 10%. **(15 Marks)**

8 **Case study – Shantilal Sweets.**

In February 1998, Shantilal handed over his business to his son Ratanlal. Shantilal started Shantilal Sweets as a small shop in 1972, which grew over the years to become one of the most known brands in Gujarati sweets and snacks in Cochin. His business consists of two segments – one a retail out let at the shop it self and the second a whole sale segment where he supplies sweets and snacks to various other retail outlets and small shops. As Shantilal maintained high level of quality, the demand from wholesale segment grew steadily and contributed approximately 60% of the total revenue in 1997. There was a committed group of customers who always preferred buying from Shantilal.

In 1972, when Shantilal started the business there were only few engaged in this business. But by 90's the competition became severe both from makers of traditional sweets and bakery products. Shantilal's style was conservative and he preferred to store lot of raw material inventory (mostly gram flour and oil) with a feeling that he should never run out of these items. Since the sweets and snacks are to be sold fresh, the finished goods inventory was not much. Though the business at his shop was fully on cash basis, the customers in the wholesale segment availed credit. Considering the long standing relation with most of these small shop owners, Shantilal was not very strict in collecting the dues. Though the default rate was negligible, many used to make payments only after two to three purchases. On the other hand, Shantilal rarely availed credit on his purchases. This was putting lot of pressure on the fund position. Some financial details for 1997 are given in Table I.

Shantilal has credit arrangement with Mahajanic Co-operative Bank, which had sanctioned a limit of Rs.2 lakhs for working capital. But through out 1997 he had drawn more than Rs.2 lakhs. Since he was a long time customers, the bank did not take any objection to the same. When Ratanlal took over the business, the bank gave him some suggestions to bring down the working capital requirements below Rs.2 lakhs. The bank made two suggestions-one to reduce raw material inventory to 30 days and the second to reduce the credit period to customers to 45 days-other assets and liabilities were acceptable to the bank. But Ratanlal wanted to bring many more changes in the way the business was done. First was to aggressively cut down raw material inventory to 15 day requirements. He felt that this would release lot of funds and sourcing material from local markets may not be difficult. Next was to reduce the credit period offered to customers drastically to 30 days. He decided to press the customers for early payments and to stop further sales to those who do not pay on time. He also decided to negotiate for 30 days credit from the raw material suppliers. He believes that most of the costs will remain more or less same in 1998 and the sales will increase by 10% as compared to 1997.

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Table I	
Average sales per day (1997)	Rs.4,000
% of credit sales to total sale working capital position (1997)	60%
Raw material (45 days requirement)	Rs.67,500
Finished goods (5 days stock)	10,000
Debtors (60 days sales)	144,000
Cash	20,000
Total current Assets	2,41,500
Creditors (10 days credit)	15,000
Other current liabilities	2,000
Total current liabilities	17,000
Net current assets	224,500

Required :

a. What type of working capital policy was Mr. Shantilal following? What are the reasons for high levels of working capital? **(05 Marks)**

b. What type of working capital policy is Ratanlal planning to follow and what are its practical difficulties? **(05 Marks)**

c. Estimate the working capital requirements for 1998 as per the recommendations of the bank. **(05 Marks)**

d. Estimate the working capital requirements for 1998 as per Ratanlal plans. **(05 Marks)**

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MBA203

USN

NEW SCHEME

Second Semester MBA Degree Examination, Dec.06 / Jan.07
Business Administration
Financial Management

Time: 3 hrs.] [Max. Marks:100

Note: *1. Answer any FOUR full questions from Question No.1 to 7.*
2. Question No.8 is compulsory.
3. Use of Time value table is permitted.

1 a. What is rights issue of shares and how is it different from bonus issue? **(03 Marks)**

b. A business man borrowed Rs.25 lakhs at an interest rate of 8% per annum. The loan has to be repaid in equal installments payable at the end of every year for five years. Compute the annual installment and prepare a loan repayment schedule, clearly showing the interest and principal repayment each year. **(07 Marks)**

c. Discuss in detail the profit maximization and wealth maximization objectives of financial management bringing out the arguments in favour and against for each. **(10 Marks)**

2 a. What is accounting rate of return? **(03 Marks)**

b. Briefly explain different factors affecting the working capital requirements of a firm. **(07 Marks)**

c. The beta coefficient of shares of PSP software is 1.20. The risk free rate of return is 8% and the expected return on market is 18%. The pre tax cost of debt for the firm is 15% and the tax rate is 30%. The firm also employs preference capital with a dividend rate of 16%. The target capital structure of the firm suggests 30% equity 30% preference capital and 40% debt. The firm is considering following projects for investment.

Project A – IRR 14%
Project B – IRR 16%
Project C – IRR 18%

i) Compute the cost equity, cost of debt and weighted average cost of capital at the target capital structure.
ii) Based on the above, which all projects should the firm accept and why? **(10 Marks)**

3 a. What is a convertible bond and what is its advantage? **(03 Marks)**

b. The following Balance sheet appeared in the books of a company on 31-12-2001. The sales for the year 2001 was Rs.3000 lakhs and the company made net profit of Rs180 lakhs. Dividend paid amounted to Rs.135 lakhs. Sales are expected to increase by 10% in 2002. (Rs. in lakhs)

Liabilities	Amount	Assets	Amount
Equity capital	1,000	Fixed assets	2,800
Reserves	1,250	Inventory	750
Long term debt	1,350	Debtors	900
Creditors	650	Cash	50
Provisions	250		
Total	4,500		4,500

Contd...2

i) Compute the external fund requirements for the company for 2002, assuming assets to sales ratio and payout ratio remain constant.

ii) In case the company is reluctant to raise additional capital, what is the sustainable growth rate with internal funds for 2002? **(07 Marks)**

c. Is debt financing always risky? Explain by elaborating the advantages and disadvantages of debt financing. **(10 Marks)**

4 a. "Depreciation being a non-fund expense has no relevance in estimating project cash flows". Comment. **(03 Marks)**

b. Boston Corporation stores raw material requirements for 20 days, finished goods for 35 days and extends credit of 60 days to customers. It enjoys 30 days credit, from its suppliers. (Assume 360 days in a year for calculation)

i) Compute the operating cycle and cash cycle of the firm.

ii) If the sales during last year was Rs.25 lakhs and the average percentage of credit sales to total sales is 75%, what was the average investment in debtors?

iii) If the average raw material stock is Rs.240,000 what is the average raw material consumption per day? **(07 Marks)**

c. Briefly explain the Traditional Proposition to capital structure. Compare this with the NI approach and NOI approach. **(10 Marks)**

5 a. What is private placement? **(03 Marks)**

b. Define leasing and hire purchase. Explain the differences between the two. **(07 Marks)**

c. Selling price per unit of a product is Rs.85 and the variable cost is Rs.70. The firm incurs fixed cost of Rs.4,50,000 per annum. The company sold 65,000 units during the last year. The tax rate for the firm is 30%. The capital structure of the company is given below.

i) 50,000 equity shares of Rs.10 each fully paid up : Rs.5,00,000

ii) Debenture carrying interest rate of 12% per annum : Rs.10,00,000

iii) 14% preference shares : Rs.2,00,000.

Compute degree of operating leverage, Degree of financial leverage, Degree of total leverage and EPS. **(10 Marks)**

6 a. What are financial intermediaries and what is their role in a financial system? **(03 Marks)**

b. Briefly explain the factors considered by firms while deciding dividend payout. **(07 Marks)**

c. A company in consultations with its merchant bankers has come up with the following levels of new financing from various sources and the corresponding costs. Determine the breaking points and prepare weighted marginal cost of capital schedule.

Source	%	Range (Rs. Cr)	Cost
Equity	50%	0 to 10 Above 10	16% 17%
Debt	30%	0 to 15 Above 15	7% 8%
Preference	20%	0 to 12 Above 12	12% 13%

The cost of debt given is Post-tax. **(10 Marks)**

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7 a. Show the EBIT for the following set of data (03 Marks)
P= Rs. 10, Q = 20000, U = Rs 6, F = 50000

b. Abascus limited issued 15 year, 14 percent bonds five years ago. The bond which has a face value of Rs. 100 is currently selling for Rs.108

a) What is the pre - tax cost of debt?

b) What is the after – tax cost of debt? (Assume a 35 percent tax rate) (07 Marks)

c. Discuss the factors to be considered in deciding the capital structure of a new firm. (10 Marks)

8 Case Study – in October 2003, Neha Kapoor, a recent MBA graduate and newly appointed assistant to the Financial Controller of Palco Ltd, was given a list of six new investment projects proposed for the following year. It was her job to analyse these projects and to present her findings before the Board of Directors at its annual meeting to be held in 10 days. The project would require an investment of Rs. 2.4 crore.

Palco Ltd., was founded in 1965 by Late Shri. A.V. sinha. It gained recognition as a leading producer of high quality aluminum, with the majority of its sales being made to Japan. During the rapid economic expansion of Japan in 1970s, demand for aluminium boomed, and Palco's sales being made to Japan. During the rapid economic growth recognition of new opportunities in the energy market, Palco began to diversity its products line. While retaining its emphasis on aluminium production. It expanded operations to include uranium mining and the production of electric generators and finally it went into all phases of energy production. By 2003, Palco's sales had reached Rs. 14 crore level, with net profit after taxes attaining a record of Rs. 67 lakh.

As Palco expanded its products line in early 1990's it also formalized its capital budgeting procedure. Until 1992, capital investment projects were selected primarily on the basis of the average return on investment calculations, with individual departments submitting these calculations for projects falling with their division. In 1996, this procedure, was replaced by one using present value as the decision making criterion. This change was made to incorporate cash flows rather than accounting profits into the decision making analysis, in addition to adjusting these flows for the time value of money. At the time, the cost of capital for Palco was determined to be 12 percent, which has been incurred in raising funds from the capital market over the previous 10 years.

It had originally been Neha's assignment to update this rate over the most recent 10-year period and determine the net present value of all the proposed investment opportunities using this newly calculated figure. However, she objected to this procedure, stating that while this calculation gave a good estimate of "the past cost" of capital, changing interest rates and stock prices made this calculation of little value in the present. Neha suggested that currentcost of raising funds in the capital market be weighted by their percentage mark-up of the capital structure. This proposal was received enthusiastically by the Financial Controller of the Board of Directors explaining and justifying this calculation.

To determine a weighted average cost of capital for Palco, it was necessary for Neha to examine the cost associated with each source of funding used. In past, the largest sources of funding had been the issuance of new equity shares and internally generated funds. Through conversations with Financial Controller and other members of the Board of Directors, Neha learnt that the firm, in fact, wished to maintain its current financial structure as shown in Exhibit 1.

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Cash	9000000	Accounts payable	8,50,000
Accounts receivable	3,10,00,00	Short – term debts	1,00,000
Inventories	1,20,00,00	Accrued taxes	11,50,000
Total current assets	5,20,00000	Total current liabilities	1,20,000
Net fixed assets	19,30,0000	Long term debt	72000000
Good will	7000000	Preference shares	48000000
Total assets	7000000	Retained earning	10000000
		Equity shares	11,00000
		Total liabilities to Equity shareholders funds	25,2000000

She further determined that the strong growth patterns that Palco had exhibited over the last ten years were expected to continue indefinitely because of the dwindling supply of US and Japanese domestic oil and the growing importance of other alternative energy resources. Through further investigations, Neha learnt that Palco could issue additional equity shares, which had a par value of Rs. 25 per share and were selling at a current market price of Rs. 45. The expected dividend for the next period would be Rs. 4.4 per share, with expected growth at a rate to be on an average Rs. 2 per share.

Preference shares at 11 percent with 10 years maturity could also be issued with the help of an investment banker with a par value of Rs.100 per share to be redeemed at par. The issue would involve flotation cost of 5 percent.

Finally, Neha learnt that it would be possible for Palco to raise an additional Rs. 20 lakh through a 7 – year loan from Punjab National Bank at 12 percent. Any amount raised over Rs. 20 lakh would cost 15 percent. Short term debt has always been used by Palco to meet working capital expansion. Also, Rs 60 lakh could be raised through a bond issue with 10 years maturity with a 11 percent coupon at the face value. If it becomes necessary to raise more funds via long term debt, Rs. 30 lakh more could be accumulated through the issuance of additional 10 year bonds sold at the face valus, with the coupon rate raised to 12 percent, while additional funds raised via long term debt would necessarily have a 10 year maturity with a 14 percent coupon yield. The flotation cost of issue expected to be 5 percent. The issue price of and would be Rs. 100 to be redeemed at par.

In the past, Palco had calculated a weighted average of these sources of funds to determine its cost of capital. In discussion with the current Financial controller, the point was raised that while this served as an appropriate calculation for external funds, it did not take into account the cost of internally generated funds. The Financial Controller agreed that there should be some cost associated funds. The earning and need to be incorporated in the calculations but didn't have any clue as to what shouid be the cost.

Palco Ltd is subjected to the corporate tax rate of 40 percent

From the facts outlined above, what report would Neha submit to the Board of Directors of Palco Ltd? **(20 Marks)**

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05MBA23

USN

NEW SCHEME

Second Semester MBA Degree Examination, July 2007
Business Administration
Financial Management

Time: 3 hrs.] [Max. Marks:100

Note : ***1. Answer any FOUR questions out of Q.no.1 to Q.No.7. Q.No. 8 Case Study is compulsory.***
2. Present value and future value tables to be provided.

1 a. What is Financial Management? **(03 Marks)**
b. Mention any 4 merits and 3 demerits of discounted cash flow methods. **(07 Marks)**
c. The selected financial data for A,B, and C companies for the year ended 31-12-2005 are as follows :

	A	B	C
Variable expenses as a percentage of sales	66.66	75	50
Interest Expenses	Rs 200	Rs 300	Rs 1,000
Degree of Operating Leverage	5 - 1	6 - 1	2 – 1
Degree of Financial Leverage	3 - 1	4 - 1	2 - 1
Income tax rate	0.50	0.50	0.50

Prepare income statements for A, B and C companies. **(10 Marks)**

2 a. What is Time Value of Money? **(03 Marks)**
b. What are the objectives of Financial Management? **(07 Marks)**
c. From the following capital structure of a company, calculate the overall cost of capital using i) Book value weights and ii) Market value weights.

Source	Book value	Market value
Equity share capital (Rs 10 shares)	Rs 45,000	Rs 90,000
Retained earnings	Rs 15,000	Nil
Preference share capital	Rs 10,000	Rs 10,000
Debentures	Rs 30,000	Rs 30,000

The after tax cost of different sources of finance is as follows :
Equity share capital 14%, Retained earnings 13%, Preference capital 10%, Debentures 5%. **(10 Marks)**

3 a. What are sweat equity shares? **(03 Marks)**
b. Alpha company is contemplating conversion of 500, 14% convertible bonds of Rs 1000 each. Market price of the bond is Rs 1,080. Bond indenture provides that one Bond will be exchanged for 10 shares. Price earnings ratio before redemption is 20:1 and anticipated price earning ratio after redemption is 25:1. Number of shares outstanding prior to redemption are 10,000. EBIT anounts to Rs 2,00,000. The company is in the 35% tax bracket. Should the company convert Bonds to shares? Give reasons. **(07 Marks)**
c. Briefly explain the factors affecting Dividend policy of a company. **(10 Marks)**

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4 a. Differentiate between Trading on equity and financial leverage. (03 Marks)

b. The market price of a Rs 1,000 par value bond carrying a coupon rate of 14% and maturing after 5 years is Rs 1,050. What is the yield to maturity on this bond? What will be the realized yield to maturity if the re-investment rate is 12%. (07 Marks)

c. What is the scope of Financial Management? (10 Marks)

5 a. What is Securitisation? (03 Marks)

b. The following data for X ltd for the year ended 2005 is given below :

Profit and Loss a/c data : (Rs in millions)

Sales 80

Cost of good sold 56

Balance Sheet data : (Rs in millions)

	01-01-2000	31-12-2000
Inventory	9	12
Accounts receivable	12	16
Accounts payable	7	10

What is the length of the operating cycle and the cash cycle? Assume 365 days in a year. (07 Marks)

c. An Engineering company is considering the purchase of a new machine for its immediate expansion needs. There are 3 possible models details of which are as follows :

Particulars	Machine 1	Machine 2	Machine 3
Capital cost (Rs)	3,00,000	3,00,000	3,00,000
Sales at standard prices (Rs)	5,00,000	4,00,000	4,50,000
Net factory cost (Rs)	1,50,000	1,30,000	1,42,000
Administration cost (Rs)	20,000	10,000	15,000
Selling and dist cost (Rs)	10,000	10,000	10,000

The life of machine no 1 is 2 years and it is 3 years for the other two. The scrap value is Rs.40,000, Rs.25,000 and Rs.30,000 respectively. Sales are expected to be at the rates shown for each year during the economic life of the machine. Tax is paid at 50% of the net earnings each year. It is assumed that all the receivables and payables are settled promptly strictly in cash. Interest on loan is 8% Pa. You are required to show which machine would be the most profitable using PAY BACK PERIOD METHOD. (10 Marks)

6 a. What are options? (03 Marks)

b. What is leasing? Briefly explain various types of lease agreements. (07 Marks)

c. After conducting a survey that cost Rs.20,00,000, Z Ltd., decided to undertake a project for putting a new product in the market. The Company's cut off rate is 12%. It was estimated that the project would have a life of 5 years. The project would cost Rs.40,00,000 in Plant and Machinery in addition to working capital of Rs.10,00,000. The scrap value of Machinery at the end of 5 years was estimated at Rs.5,00,000. After providing depreciation on straight line basis profits after tax were as follows:

Year	PAT (Rs)	PV factor@ 12%
1	3,00,000	0.8929
2	8,00,000	0.7972
3	13,00,000	0.7118
4	5,00,000	0.6355
5	4,00,000	0.5674

Ascertain the net present value of the project (10 Marks)

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7 a. What is CAPM? Mention its assumptions. **(05 Marks)**

b. A firm whose cost of capital is 10% is considering two mutually exclusively projects X and Y the details of which are :

PARTICULARS		PROJECT X	PROJECT Y
INVESTMENT	Rs	70,000	70,000
Cash Flow 1 year	Rs	10,000	50,000
Cash Flow 2 year	Rs	20,000	40,000
Cash Flow 3 year	Rs	30,000	20,000
Cash Flow 4 year	Rs	45,000	10,000
Cash Flow 5 year	Rs	60,000	10,000
		1,65,000	1,30,000

Compute the Internal rate of the projects. **(15 Marks)**

8 CASE STUDY (COMPULSORY)

A Company has been operating on single shift basis to manufacture its product with the following cost structure :

Raw Materials	per unit	Rs 12.00
Wages (60% variable)	per unit	Rs 10.00
Overheads (20% variables)	per unit	Rs 10.00
		Rs 32.00
Profit		Rs 4.00
Selling price		Rs 36.00

Sales for the year ending 30-06-05 amounted to Rs 8,64,000

As on 30-06-05 the Company held :

Stock of Raw Materials at cost	Rs 72,000
Work in progress (valued at Prime cost)	Rs 44,000
Finished Goods (valued at Total cost)	Rs 1,44,000
Sundry Debtors	Rs 2,16,000

At present the company receives 2 months credit from the Suppliers of materials and there is a time lag of payment of wages and expenses at half the month.

In view of increased market demand it is proposed to double the production by working an extra shift. It is expected that a 10% discount will be available from the suppliers of Raw Materials in view of the increased volume of production. Extra production can be sold at the existing price. There will not be any change in the credit policy. Credit from the suppliers of materials and the time lag in payment of wages and expenses will continue to remain at present level.

You are asked by the management to ascertain the effects on working capital of introducing shift working. **(20 Marks)**

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05MBA23

Second Semester MBA Degree Examination, June / July 08

Financial Management

Time: 3 hrs. Max. Marks:100

Note : *1. Answer any Four full questions from question No. 1 to question No. 7 and question no. 8 is compulsory.*
2. Use of time value table is permitted.

1 a. State any three ways by which a company can maximum its wealth. **(03 Marks)**
b. Find out present values of the following :
i) Rs. 1,500 receivable in 7 years at a discount rate of 15%.
ii) An annuity of Rs. 1,000 starting immediately and lasting until 9th year at a discount rate of 20%.
iii) An annuity of Rs. 7,600 starting after 1 year for 6 years at an interest rate of 12%.
iv) Operating expenditures of Rs. 1,00,000 per year which are assumed to be incurred continuously rate of interest is 12%. **(07 Marks)**
c. Explain the emerging role of financial managers in India. **(10 Marks)**

2 a. Distinguish between gross working capital and net working capital. **(03 Marks)**
b. Explain the factors affecting capital budgeting /capital investment decisions. **(07 Marks)**
c. Prepare a working capital estimate from the following information.
Production during the previous year was 10,00,000 units. The same level of activity is intended to be maintained during the current year.

The expected ratios of cost to selling prices are-

Raw materials	40%
Direct wages	20%
Overheads	20%

The raw materials ordinarily remain in stores for 3 months before production. Every unit of product remains in the process for 2 months and is assumed to be consisting of 100% raw materials, wages and overheads. Finished goods remain in the warehouse for 3 months. Credit allowed by creditors is 4 months from the date of delivery of raw materials and credit given to debtors is 3 months from the date of dispatch. The estimated cash balance to be held is Rs. 2,00,000. Lag in the payment of wages and overheads is ½ month.
Selling price is Rs. 8 per unit. Both production and sales are in a regular cycle.
You are required to make a provision of 10% for contingencies (except cash). **(10 Marks)**

3 a. What is hire purchase? How it is different from lease? **(03 Marks)**
b. Distinguish between forwards and futures. **(07 Marks)**
c. Write a note on institutional finance available in India. **(10 Marks)**

4 a. What do you mean by trading on equity? Distinguish between trading on equity and financial leverage. **(05 Marks)**

b. As a financial analyst of a large electronics company, you are required to determine the weighted average cost of capital (WACC) of the company using (a) book value weight, and (b) market value weights. The following information is available for your perusal :

The company's present book value capital structure is

Preference shares	(Rs. 100 per share)	Rs.2,00,000
Equity shares	(Rs. 10 per share)	Rs.10,00,000
Debentures	(Rs. 100 per share)	Rs. 8,00,000

Anticipated external financing opportunities are :

i) Rs. 100 per debenture redeemable at par; 10 years maturity, 13% coupon rate, 4% flotation costs, sale price Rs. 100.

ii) Rs. 100 preference shares redeemable at par ; 10 years maturity; 14% dividend rate, 5% flotation costs, sale price Rs.100.

iii) Equity shares; Rs. 2 per share flotation costs, sale price at Rs. 22.

In addition, the dividend expected on the equity shares at the end of current year is Rs. 2 and the earnings are expected to increase by 7% p.a. The firm has policy of paying all its earnings in the form of dividends. The company's corporate tax rate is 50%. **(15 Marks)**

5 a. A company expects to pay dividend of Rs. 5 per share at the end of coming year. The company's present cost of equity capital is 16%. If the anticipated growth rate is 8% and 10%, find out the price of equity share. **(03 Marks)**

b. The following is the income statement of XYZ Ltd. for the year 2007. **(07 Marks)**

		(Rs. in lacs)
Sales		
Less :Variables cost		50.00
Fixed cost		10.00
		20.00
	EBIT	20.00
Less : Interest		05.00
	EBT	15.00
Less : Tax at 40%		06.00
	EAT	09.00
Less : Pref. dividend		01.00
Earnings available to equity share holders		08.00

Find out the degree of (a)operating leverage (b)financial leverage (c)combined leverage.

c. X Ltd. has under consideration the following two projects. The details of which are as under

	Project X	Project Y
Investment in machinery(Rs.)	10,00,000	15,00,000
Working capital (Rs.)	5,00,000	5,00,000
Life of machinery	04 years	06 years
Scrap value of machinery	10%	10%
Tax rate	50%	50%

Income before depreciation and Tax

Years	(Rs)	(Rs)
1	8,00,000	15,00,000
2	8,00,000	9,00,000
3	8,00,000	15,00,000
4	8,00,000	8,00,000
5	–	6,00,000
6	–	3,00,000

You are required to calculate ARR and suggest which project is to be preferred. **(10 Marks)**

6 a. What are sweat equity shares? **(03 Marks)**

b. State the benefits of adequate working capital and dangers of inadequate working capital. **(07 Marks)**

c. Explain the features, advantages and limitations of debentures as a long – term source of financing. Why do firms prefer debentures to equity shares? **(10 Marks)**

7 a. What is capital structure? What are the major determinants of capital structure? **(03 Marks)**

b. Explain the various factors affecting dividend policy. **(07 Marks)**

c. The balance sheet of Chandan Co. Ltd. as on 31/03/2007 is as follows : **(10 Marks)**

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capital	20,00,000	Fixed Assets	10,00,000
Creditors	2,80,000	Stock	5,00,000
P and L A/c	1,20,000	debtors	2,00,000
		Cash at Bank	7,00,000
	24,00,000		24,00,000

The purchases and sales are estimated for the year ended 31/03/2008 is as under.

	Up to 28/02/08	March 2008
Purchases	28,20,000	2,20,000
Sales	38,40,000	4,00,000

The management decided to invest Rs. 2,00,000 in purchase of fixed assets which are depreciated at 10% on cost. The time-lag for payment to trade creditors for purchases and receipts from sales is one month. The business earns a gross profit of 25% of turnover. The sundry expenses are 10% of the turnover. The amount of depreciation is not included in these expenses. Draft a projected income statement and balance sheet for the period ended 31/03/08, assuming that creditors are all trade creditors for purchases and debtors for sales and there is no other item of current assets and liabilities apart from stock and cash and bank balance.

8 CASE STUDY[compulsory] :

a. AB Ltd. needs Rs. 10,00,000 for expansion. The expansion is expected to yield an annual EBIT 1,60,000. In choosing a financial plan, AB Ltd. has an objective of maximizing earnings per share. It is considering the possibility of issuing equity shares and raising debt of Rs. 1,00,000 or Rs. 4,00,000 or Rs. 6,00,000. The current market price per share is Rs.25 and is expected to drop to Rs. 20, if the funds are borrowed in excess of Rs. 5,00,000. Funds can be borrowed at the rates indicated below.

i) Upto Rs. 1,00,000 at 8%
ii) Over Rs. 1,00,000 and up to Rs.5,00,000 at 12%
iii) Over Rs 6,00,000 at 18%.

Assume a tax rate of 50%. Determine the EPS for three financing alternatives and suggest which plan is to be preferred. **(12 Marks)**

b. Bhagawat Electronics Ltd. is planning to introduce mechanization to replace the labour force. Two alternatives are available, advice the management to select the machine under pay-back period method.

Particulars	Machine X	Machine Y
Cost of machine (Rs.)	50,000	40,000
Estimated life of the machine	10 years	8 years
Estimated savings in scrap p.a. (Rs)	1,000	1,000
Estimated maintenance of materials p.a (Rs.)	2,500	3,100
Estimated cost of materials p.a. (Rs.)	2,000	3,000
Additional cost supervision (Rs.)	1,500	2,000
Estimated savings in wages (Rs.)	10,000	12,500

Depreciation will be taken on straight line basis. Assume a tax rate of 50%. **(08 Marks)**

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05MBA23

Second Semester MBA Degree Examination, Dec.08/Jan.09

Financial Management

Time: 3 hrs. Max. Marks:100

Note : ***1. Answer any FOUR full questions from Q.No. 1 to 7, Q.No.8 is compulsory.***
2. Time value tables can be used.
3. Show working notes wherever necessary.

1 a. What is Financial Management and how is it different from accounting function? **(03 Marks)**
b. What is the role of financial system in any economy? **(07 Marks)**
c. Write a note on Long term sources of funds, which can be raised within India. **(10 Marks)**

2 a. What is Marginal cost of capital? Why is it relevant? **(03 Marks)**
b. Write a note on working capital policy. **(07 Marks)**
c. i) A Bank finances a car purchase up to Rs. 2,50,000 at 12% interest per annum, for a period of 5 yrs. How much equated monthly installments can be fixed in this case?
ii) Mr. Ram receives pension of Rs. 10,000 p.a for 10 yrs from now for investing Rs. 60,000 today. What is the rate of return earned by him?
iii) Mr. Raja requires Rs. 10 lakhs after 5 years. He considers the following 2 options.
a) To invest a single amount at 10% rate.
b) To invest annually at a rate of 10% compounded annually.
How much he need to invest in both the cases? **(10 Marks)**

3 a. What do you mean by operating leverage? **(03 Marks)**
b. Critically evaluate the discounted cash flow techniques in analyzing investment projects. **(07 Marks)**
c. Balance sheet of ABC LTD as on 31st March 2005

Liabilities	Rs. in lakhs	Assets	Rs. in lakhs
Equity Share Capital	2,200	Fixed Assets	4,600
12% Preference	800	Current Assets	1370
14% Debentures	1500	Discount on issue of Debentures	30
Reserves	500		
Current liabilities	1,000		
	6,000		6,000

Note:- i) Dividends are distributed at a rate of 40% on a share of Rs. 10. The current price is Rs. 80. The growth in dividend is 8%.
ii) Face value of both debentures and preference is Rs. 100, and are repaid after 8 years and 6 years respectively at a premium of 10%.
iii) Assume debenture is issued in the current years and no discount is written – off.
iv) Tax rate applicable is 30%.
v) Compute weighted average cost of capital of ABC LTD. **(10 Marks)**

4 a. What is financial planning? **(03 Marks)**
b. What are the factors which affect the capital structure decisions of a firm? **(07 Marks)**
c. Consider the cash flows of the following investment decisions and Rank them on Net present value, Profitability index payback period and Accounting rate of return method.

Investments	c_0	c_1	c_2	c_3	c_4	c_5
A	20,000	7,000	6,000	6,000	5,000	4,000
B	20,000	5,000	6,000	7,000	7,000	8,000

The required rate of return is 10% **(10 Marks)**

5 a. Write a note on various types of derivatives. **(10 Marks)**

b. Nextgen enterprises are considering a replacement project. The old machine has a book value of Rs. 40,000 and it can be sold to realize salvage value of Rs. 50,000. It still has useful life of 5 years, after which its salvage value is expected to be Rs. 16,000. Revenue generated by this machine is Rs. 150000 at a cost of Rs. 80,000 and working capital need of Rs. 40,000.

The new machine costs Rs. 1,60,000. It is expected to fetch a salvage value of Rs. 80,000 after 5 years. The new machine also generates revenue of Rs. 1,50,000 at a cost of Rs.50,000 and working capital required is 50,000. The tax rate applicable is 40%. Firm charges depreciation at 25% on written down value basis. **(10 Marks)**

6 a. Why do you think that a profit earned by the firm does not reflect the true cash position of the business? **(05 Marks)**

b. What are the factors affecting dividend policy of the company? **(05Marks)**

c. Write a note of Components of cash flow while estimating project cash flows. **(10 Marks)**

7 a. A firm sells products for Rs.1000 p.u. It has variable costs of Rs.400 p.u. and fixed operating costs of Rs.5,00,000 per year. Show how EBIT would change if the firm sells 1,000 units and 2,000 units. **(03 Marks)**

b. ABC LTD needs Rs.10 lakhs for expansion. The expansion is expected to yield 16% on investment (Before interest and tax payment). Firm is planning to raise funds through debt and equity and the objective is to maximize the EPS. It the firm borrows in excess of 4,00,000, the cost of debts would go up to 12% from 10% and the MPS would drop from Rs.25 to Rs.20. The tax rate applicable is 50%. Determine EPS at three alternatives of financing mix i) Rs.3,00,000 debt ii)Rs.5,00,000 debt iii)Rs.7,00,000 debt in the capital structure. **(07 Marks)**

c. Consider the following two mutually exclusive projects.

Projects	C0	C1	C2	C3
X	-115	100	0	55
Y	-115	0	82	100

Compute Modified internal rate of Return considering the following.

i) Opportunity cost of 10%. ii) IRR of the projects. **(10 Marks)**

8 Case

The following data is observed from the reports of a limited company, as on 31 Mar.-2006

Liabilities	Rs. in crore	Assets	Rs. in crore
Share capital (Face value Rs.10 p.s.)	600	Fixed Assets	1,400
Reserves	200		
Term loan – 12%	400	Current Assets	650
Current liabilities E provisions	850		
Total	2050		2050

a. Company is planning for an expansion project for which another 300 crores are required in the year 2008. The concern of the management had been increasing cost of capital. Estimated cost of equity of the firm is 22%. When Balance sheet was to be prepared on 31 March 2007, the Finance manager was in a dilemma whether to retain profit or not? What do you suggest? Tax rate applicable is 40%.

b. Comment on the working capital policy of the firm based on the information provided in the Balance sheet. If the sales are Rs.1580 crores compute necessary ratios to support your analysis.

c. It the EBIT estimated between 2008 are Rs.312, Rs.400, Rs.500 crore, estimate EBIT – EPS analysis for the new project investment of Rs.300 crore. Consider two options for this a) All equity option b) All debt option. Existing debt should be considered for interest calculation. What financing option do you suggest? Why?

d. The company has declared dividends of Rs.1·8, Rs.2·1 Rs.2·0, Rs.2·5 & Rs.3·2 between 2002 – 2006 What is compounded Annual growth rate in dividends per share? **(20 Marks)**

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05MBA23

Second Semester MBA Degree Examination, June / July 08

Financial Management

Time: 3 hrs. Max. Marks:100

Note : *1. Answer any Four full questions from question No. 1 to question No. 7 and question no. 8 is compulsory.*
2. Use of time value table is permitted.

1 a. State any three ways by which a company can maximum its wealth. **(03 Marks)**

b. Find out present values of the following :

i) Rs. 1,500 receivable in 7 years at a discount rate of 15%.

ii) An annuity of Rs. 1,000 starting immediately and lasting until 9th year at a discount rate of 20%.

iii) An annuity of Rs. 7,600 starting after 1 year for 6 years at an interest rate of 12%.

iv) Operating expenditures of Rs. 1,00,000 per year which are assumed to be incurred continuously rate of interest is 12%. **(07 Marks)**

c. Explain the emerging role of financial managers in India. **(10 Marks)**

2 a. Distinguish between gross working capital and net working capital. **(03 Marks)**

b. Explain the factors affecting capital budgeting /capital investment decisions. **(07 Marks)**

c. Prepare a working capital estimate from the following information.

Production during the previous year was 10,00,000 units. The same level of activity is intended to be maintained during the current year.

The expected ratios of cost to selling prices are-

Raw materials	40%
Direct wages	20%
Overheads	20%

The raw materials ordinarily remain in stores for 3 months before production. Every unit of product remains in the process for 2 months and is assumed to be consisting of 100% raw materials, wages and overheads. Finished goods remain in the warehouse for 3 months. Credit allowed by creditors is 4 months from the date of delivery of raw materials and credit given to debtors is 3 months from the date of dispatch. The estimated cash balance to be held is Rs. 2,00,000. Lag in the payment of wages and overheads is ½ month.

Selling price is Rs. 8 per unit. Both production and sales are in a regular cycle.

You are required to make a provision of 10% for contingencies (except cash). **(10 Marks)**

3 a. What is hire purchase? How it is different from lease? **(03 Marks)**

b. Distinguish between forwards and futures. **(07 Marks)**

c. Write a note on institutional finance available in India. **(10 Marks)**

4 a. What do you mean by trading on equity? Distinguish between trading on equity and financial leverage. **(05 Marks)**

b. As a financial analyst of a large electronics company, you are required to determine the weighted average cost of capital (WACC) of the company using (a) book value weight, and (b) market value weights. The following information is available for your perusal :

The company's present book value capital structure is

Preference shares	(Rs. 100 per share)	Rs.2,00,000
Equity shares	(Rs. 10 per share)	Rs.10,00,000
Debentures	(Rs. 100 per share)	Rs. 8,00,000

Anticipated external financing opportunities are :

i) Rs. 100 per debenture redeemable at par; 10 years maturity, 13% coupon rate, 4% flotation costs, sale price Rs. 100.

ii) Rs. 100 preference shares redeemable at par ; 10 years maturity; 14% dividend rate, 5% flotation costs, sale price Rs.100.

iii) Equity shares; Rs. 2 per share flotation costs, sale price at Rs. 22.

In addition, the dividend expected on the equity shares at the end of current year is Rs. 2 and the earnings are expected to increase by 7% p.a. The firm has policy of paying all its earnings in the form of dividends. The company's corporate tax rate is 50%. **(15 Marks)**

5 a. A company expects to pay dividend of Rs. 5 per share at the end of coming year. The company's present cost of equity capital is 16%. If the anticipated growth rate is 8% and 10%, find out the price of equity share. **(03 Marks)**

b. The following is the income statement of XYZ Ltd. for the year 2007. **(07 Marks)**

(Rs. in lacs)

Sales		50.00
Less :Variables cost		10.00
Fixed cost		20.00
	EBIT	20.00
Less : Interest		05.00
	EBT	15.00
Less : Tax at 40%		06.00
	EAT	09.00
Less : Pref. dividend		01.00
Earnings available to equity share holders		08.00

Find out the degree of (a)operating leverage (b)financial leverage (c)combined leverage.

c. X Ltd. has under consideration the following two projects. The details of which are as under

	Project X	Project Y
Investment in machinery(Rs.)	10,00,000	15,00,000
Working capital (Rs.)	5,00,000	5,00,000
Life of machinery	04 years	06 years
Scrap value of machinery	10%	10%
Tax rate	50%	50%

Income before depreciation and Tax

Years	(Rs)	(Rs)
1	8,00,000	15,00,000
2	8,00,000	9,00,000
3	8,00,000	15,00,000
4	8,00,000	8,00,000
5	–	6,00,000
6	–	3,00,000

You are required to calculate ARR and suggest which project is to be preferred. **(10 Marks)**

6 a. What are sweat equity shares? **(03 Marks)**

b. State the benefits of adequate working capital and dangers of inadequate working capital. **(07 Marks)**

c. Explain the features, advantages and limitations of debentures as a long – term source of financing. Why do firms prefer debentures to equity shares? **(10 Marks)**

7 a. What is capital structure? What are the major determinants of capital structure? **(03 Marks)**

b. Explain the various factors affecting dividend policy. **(07 Marks)**

c. The balance sheet of Chandan Co. Ltd. as on 31/03/2007 is as follows : **(10 Marks)**

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capital	20,00,000	Fixed Assets	10,00,000
Creditors	2,80,000	Stock	5,00,000
P and L A/c	1,20,000	debtors	2,00,000
		Cash at Bank	7,00,000
	24,00,000		24,00,000

The purchases and sales are estimated for the year ended 31/03/2008 is as under.

	Up to 28/02/08	March 2008
Purchases	28,20,000	2,20,000
Sales	38,40,000	4,00,000

The management decided to invest Rs. 2,00,000 in purchase of fixed assets which are depreciated at 10% on cost. The time-lag for payment to trade creditors for purchases and receipts from sales is one month. The business earns a gross profit of 25% of turnover. The sundry expenses are 10% of the turnover. The amount of depreciation is not included in these expenses. Draft a projected income statement and balance sheet for the period ended 31/03/08, assuming that creditors are all trade creditors for purchases and debtors for sales and there is no other item of current assets and liabilities apart from stock and cash and bank balance.

8 CASE STUDY[compulsory] :

a. AB Ltd. needs Rs. 10,00,000 for expansion. The expansion is expected to yield an annual EBIT 1,60,000. In choosing a financial plan, AB Ltd. has an objective of maximizing earnings per share. It is considering the possibility of issuing equity shares and raising debt of Rs. 1,00,000 or Rs. 4,00,000 or Rs. 6,00,000. The current market price per share is Rs.25 and is expected to drop to Rs. 20, if the funds are borrowed in excess of Rs. 5,00,000. Funds can be borrowed at the rates indicated below.

i) Upto Rs. 1,00,000 at 8%

ii) Over Rs. 1,00,000 and up to Rs.5,00,000 at 12%

iii) Over Rs 6,00,000 at 18%.

Assume a tax rate of 50%. Determine the EPS for three financing alternatives and suggest which plan is to be preferred. **(12 Marks)**

b. Bhagawat Electronics Ltd. is planning to introduce mechanization to replace the labour force. Two alternatives are available, advice the management to select the machine under pay-back period method.

Particulars	Machine X	Machine Y
Cost of machine (Rs.)	50,000	40,000
Estimated life of the machine	10 years	8 years
Estimated savings in scrap p.a. (Rs)	1,000	1,000
Estimated maintenance of materials p.a (Rs.)	2,500	3,100
Estimated cost of materials p.a. (Rs.)	2,000	3,000
Additional cost supervision (Rs.)	1,500	2,000
Estimated savings in wages (Rs.)	10,000	12,500

Depreciation will be taken on straight line basis. Assume a tax rate of 50%. **(08 Marks)**

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08MBA23

Second Semester MBA Degree Examination, June-July 2009
Financial Management

Time: 3 hrs. Max. Marks:100

Note: *1. Answer any FOUR of Q.No. 1 to 7. Q.No. 8 is compulsory.*
2. Students to be provided with present value and future value tables.

1 a. What is Financial Management? **(03 Marks)**
b. Mention any 4 merits and demerits of pay back period method. **(07 Marks)**
c. The following figures relate to 2 companies.

	P Ltd.	Q. Ltd.
	(Rs. in lakhs)	
Sales	500	1,000
Variable costs	200	300
Contribution	300	700
Fixed costs	150	400
EBIT	150	300
Interest	50	100
Profit before tax	100	200

You are required to
i) Calculate the operating, financial and combined leverage for the two companies
ii) Comment on the relative risk position of them. **(10 Marks)**

2 a. What is Time value of money? **(03 Marks)**
b. What are objectives of Financial Management? **(07 Marks)**
c. From the following capital structure of a company, calculate the overall cost of capital using i) Book value weights and ii) Market value weights.

Source	Book value	Market value
Equity share capital (Rs.10 shares)	Rs.45,000	Rs.90,000
Retained earnings	Rs.15,000	Nil
Preference share capital	Rs.10,000	Rs.10,000
Debentures	Rs.30,000	Rs,30,000

The after tax cost of different source of finance is as follows: Equity share capital 14%, Retained earnings 13%, preference capital 10%, Debentures 5%. **(10 Marks)**

3 a. Define operating leverage. **(03 Marks)**
b. State the factors which determine the dividend policy of a firm. **(07 Marks)**
c. Oriental Ltd. Has currently an ordinary share capital of Rs.25 lakhs, consisting of 25,000 shares of Rs.100/- each. The management is planning to raise another Rs.20 lakhs to finance major expansion programme, through one of four possible financial plans,
i) Entirely through ordinary shares.
ii) Rs.10 lakhs through ordinary shares and Rs.10 lakhs in 8% long term loan.
iii) Rs.5 lakhs through ordinary shares and Rs.15 lakhs through 9% loan (LT)
iv) Rs.10 lakhs through ordinary shares and Rs.10 lakhs through preference shares with 5% dividend.

The company's expected earnings before interest and taxes (EBIT) will be Rs.8 lakhs. Assuming a corporate tax rate of 50% determine the EPS in each alternative and comment, which alternative is best and why? **(10 Marks)**

4 a. B Ltd. issues Rs.1,00,000, 9% debentures at a premium of 10%. The costs of floatation are 2%. The tax rate applicable is 60%. Compute cost of debt-capital. **(03 Marks)**
b. Alpha Co. is contemplating conversion of 500, 14% convertible bonds of Rs.1,000 each. Market price of the bond is Rs.1,080. Bond indenture provides that one bond will be exchanged for 10 shares. Price earning ratio before redemption is 20:1 and anticipated price – earning ratio after redemption is 25:1. Number of shares outstanding prior to redemption are 10,000. EBIT amounts to Rs.2,00,000. The Co. is in the 35% tax bracket. Should the company bond into shares? Give reasons. **(07 Marks)**
c. Define working capital. What are the factors influencing working capital? **(10 Marks)**

5 a. What is business risk and financial risk? **(03 Marks)**

b. The following data for X Ltd. for the year ended 2007 is given below:

P&L a/c data (Rs. in millions)

Sales 80

Cost of goods sold 56

B/S data (Rs. in millions)

	01.01.2007	31.12.2007
Inventory	9	12
Accounts receivable	12	16
Accounts payable	7	10

What is the length of the operating cycle and cash cycle? Assume 365 days in a year. **(07 Marks)**

c. PQR Ltd. sells goods on a gross profit of 25%,depreciation is taken into account as a part of cost of production. The following annual figures are given to you.

	Rs.
Sales (2 months credit)	18,00,000
Material consumed (1 month credit)	4,50,000
Wages (1 month lag in payment)	3,60,000
Cash manufacturing expenses (1 month lag in payment)	4,80,000
Administration expenses (1 month lag in payment)	1,20,000
Sales promotion expenses (paid currently in advance)	60,000
Income tax payable in 4 installments of which one lies in next year	1,50,000

The company keeps one month's stock of each raw material and finished goods. It also keeps Rs.1,00,000 in cash. Estimate the working capital requirements of the Co. assuming 15% safety margin. **(10 Marks)**

6 a. What do you mean by Forex market? **(03 Marks)**

b. What is the concept of corporate governance? Why has it become so important in India? **(07 Marks)**

c. As a financial manager of TAJLTD, Hubli, you have to advise the board of directors on choosing between two competing project proposals, which require an equal investment of Rs.1,00,000 and expected to generate cash flows as under:

Year	PV factor at 10%	Project – I	Project – II
-	-	(Rs.)	(Rs.)
2001	0.909	48,000	20,000
2002	0.826	32,000	24,000
2003	0.751	20,000	36,000
2004	0.683	Nil	48,000
2005	0.621	24,000	16,000
2006	0.564	12,000	8,000

Which project proposal should be recommended and why? Assume cost of capital to be10% p.a. The present value factor at 10% p.a are given in the table. Evaluate the projects by NPV method. **(10 Marks)**

7 a. What is CAPM? Mention its assumptions. **(05 Marks)**

b. Aasmann Ltd. has currently under examination a project which will yield the following returns over the life of the project:

Year	Gross yield (Rs.)
1	80,000
2	80,000
3	90,000
4	90,000
5	83,000

Cost of machinery to be installed mounts to Rs.2,00,000 and the machine is to be depreciated at 20% p.a at w.p.v. basis. Income tax rate is 50%. The salvage value of machine is zero. If the average cost of raising capital is 11% would you recommend accepting the project under the internal rate of return method? **(15 Marks)**

8 a. Beta Ltd. is considering the purchase of a new machine. Two alternative machines (A and B) are suggested each costing Rs. 4,00,000. Earnings after taxation are expected to be as follows: **(10 Marks)**

		Cash flow (Rs.)	
Year	Pv of Rs. 1 @ 10%	Machine A	Machine B
-	-	-	-
1	0.91	40,000	1,20,000
2	0.83	1,20,000	1,60,000
3	0.75	1,60,000	2,00,000
4	0.68	2,40,000	1,20,000
5	0.62	1,60,000	80,000

The Co's target return on capital is10%. Youare required to compare the profit ability of the machines and state which alternative of the machines you consider financiallypreferable. Adopt NPV method and profitability index method. **(05 Marks)**

b. You are given the following information relating to ABC Ltd. for the years of recent performance of an asset.
Initial cash outlay Rs. 50,000
Life of the asset 5 years
Estimated annual cash flow Rs. 12,500.
Calculate i) Pay back period; ii) IRR. **(05 Marks)**

c. Marks Ltd. is launching a new project for the manufacturing of a unique component at full capacity of 24,000 units, the cost will be as follows:

	Cost p.u (Rs.)
Material	80
Labour of variable expenses	40
Fixed manufacturing and Administration expenses	20
Depreciation	10
	150

The selling price p.u is expected at Rs.200 and the selling expenses p.u will be Rs.10, 80% of which is variable. In the first two years production and sales are expected to be as follows:

Year	Production	Sales
1	15,000 units	14,000 units
2	20,000 units	18,000 units

To assess working capital requirement, the following additional information is given:

a. Stock of raw material – 3 months average consumption.
b. Work – in – progress – nil
c. Debtors – 1 month average sales of the year
d. Creditors for supply of materials 2 months average purchases of the year.
e. Creditors for expenses – 1 month average of all expenses during the year.
f. Cash balance – Rs. 20,000

Stock of financial goods is taken at average cost and debtors may be calculated at selling price.

You are required to prepare for the 2 years:

i) A projected statement of profit / Loss
ii) A projected statement of working capital requirements. **(10 Marks)**

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05MBA23

Second Semester MBA Degree Examination, June-July 2009
Financial Management

Time: 3 hrs. Max. Marks:100

Note:1. ***Answer any FOUR full questions from Q No.1 to Q.7.***
2. ***Question No.8 is compulsory.***
3. ***Use of Time value tables permitted.***

1 a. What is product cannibalization? How is it treated while estimating project cash flows? **(03 Marks)**

b. i) Mr. Rajesh wants to deposit an amount of Rs.200000 in a scheme offering 12% interest per annum. What is the amount of money that he can withdraw annually for the next 10 years? Starting one year from now, if he wants to withdraw an equal amount every year in such a way that the amount deposited whittles down to zero at the end of 10 years?

ii) The winner of a competition is offered any one of the following three prizes. Which one should he choose if he expects 12% returns?
- Rs.100000 today.
- Rs.200000 after 5 years.
- Rs.13500 starting one year from now every year forever. **(07 Marks)**

c. What is leasing? What are the reasons for leasing and how is it different from hire purchase? **(10 Marks)**

2 a. What is preferential allotment of shares? **(03 Marks)**

b. Briefly explain the functions of a treasurer and controller in an organization. **(07 Marks)**

c. A company has target debt-equity ratio of 1 : 1. It is considering a project requiring Rs.75 lakhs investment at the beginning. The project is expected to generate post tax cash flows of Rs.10 lakhs every year for the next 10 years. The firm is considering financing this project using fresh issue of equity and debt in the target debt equity ratio. The fresh equity has a cost of 20% with floatation cost of 8%. The debt carries a cost of 8% (post-tax) with floatation cost of 2%.

i) What is the WACC?
ii) What is the weighted average floatation cost?
iii) What is the NPV of the project if floatation cost is adjusted to the initial investment?
iv) Should the project be accepted? **(10 Marks)**

3 a. Who is a debenture trustee and what is his role? **(03 Marks)**

b. Briefly explain the pros and cons of payback period method of capital budgeting. **(07 Marks)**

c. The finance manager of a manufacturing company wants to estimate the working capital requirements for the next year. The estimated output for the next year is 182500 units. The per unit cost and price is given below:

Raw material :	Rs.15
Labour cost :	Rs.10
Overheads:	Rs.8
Total cost:	Rs.33
Selling price:	Rs.40

The firm wants to maintain 15 days stock of raw material and 30 days stock of finished goods. The stock of WIP would be 5 days production with 50% average completion. Debtors valued at sales price would be equal to 30 days sales. The minimum cash balance required is Rs.50000. There is a lag in payment of wages of 7 days and 10 days in payment of overheads. Suppliers allow 30 days credit. Assuming 365 days production in a year. Compute the working capital requirements. **(10 Marks)**

4 a. What is an option contract and how is a call option different from put option? **(03 Marks)**

b. What is bonus issue of shares? Briefly explain the reasons for bonus issue and its impact on shareholders. **(07 Marks)**

c. The balance sheet of a firm as on 31-3-2007 is given below. The sales during 2006-07 was Rs.200 lakhs. Profit margin on sales was 10% and dividend payout ratio was 50%. The tax rate is 30%. The firm expects a 40% growth in sales in 2007-08. The ratio of assets to sales, spontaneous current liabilities to sales, profit margin, tax rate and payout ratio would remain the same. Compute the external fund requirements for the next year. Assuming that the entire EFR is financed through long term loan. Prepare the balance sheet as on 31-03-2008. **(10 Marks)**

Balance sheet on 31-03-2007 (In Rs.lakhs)			
Share capital	55	Fixed assets	60
Retained profit	30	Inventory	35
Lt. Loans	15	Debtors	20
ST Bank loans	10	Cash	5
Creditors	8		
Provisions	2		
TOTAL	120	TOTAL	120

5 a. "Retained earnings is a cost free source of fund". Comment. **(03 Marks)**

b. Briefly explain the advantages and disadvantages of issuing fresh equity shares for raising funds. **(07 Marks)**

c. The selling price and variable cost of a product per unit are Rs.85 and Rs.60 respectively. The annual fixed cost is Rs.250000. The firm sells 30000 units per annum. The capital structure of the firm consists of long-term debt of Rs.15 lakhs carrying 10% interest. 14% preference shares worth Rs.5 lakhs; and 50000 equity shares of Rs.10 each fully paid up. The tax rate is 30%. Compute degree of operating leverage financial leverage, total leverage and EPS. Using DOL compute the new EBIT if the number of units sold i) decreases by 10% from the current level and ii) increases by 20% from the current level. **(10 Marks)**

6 a. What is GDR? **(03 Marks)**

b. Briefly explain the various factors affecting the working capital requirements of a firm. **(07 Marks)**

c. A project involves initial investment of Rs.485000. The after tax cash flows from the project are given below. Compute the NPV if the cost of capital is 12% and recommend its suitability. What is the Modified Internal Rate of Return (MIRR) if the cash flows are re-invested @ 12%? **(10 Marks)**

Year	1	2	3	4	5	6
Cash flows	85400	96500	132600	216000	124000	98500

7 a. The current market price of a bond issue by a firm is Rs.976. The face value of the bond is Rs.1000 and it has 6 years to maturity. The interest rate on this bond is 14% per annum. Compute yield to maturity. **(03 Marks)**

b. What are limitations of profit maximization as a goal of financial management? How is wealth maximization a better goal? **(07 Marks)**

c. What is the significance of a strong financial system in a growing economy? Explain in detail the functions of a financial system. **(10 Marks)**

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05MBA23

Second Semester MBA Degree Examination, Dec.09/Jan.10
Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. *Answer any FOUR full questions from the Q.No.1 to Q.No.7.*
2. *Question No. 8 is compulsory.*
3. *Present value and Future value tables to be provided.*

Important Note: 1. On completing your answers, compulsorily draw diagonal cross lines on the remaining blank pages. 2. Any revealing of identification, appeal to evaluator and/or equations written eg, 42+8=50, will be treated as malpractice.

1 a. What is wealth maximization? **(03 Marks)**

b. i) An investor deposits Rs.100 in a bank account for 5 years at 8 percent interest. Find out the amount which he will have in his account if interest is compounded annually, semi-annually and quarterly.

ii) Munna Limited has Rs.1000000 bonds outstanding. Bank deposits earn 10 percent per annum. The bonds will be redeemed after 15 years for which purpose Munna Limited wishes to create a sinking fund. How much amount should be deposited to the sinking fund each year so that Munna Limited would have in the sinking fund Rs.1000000 to retire the entire issue of bonds?

iii) ABC Ltd. has borrowed Rs.5000000 from Canbank Home Finance Ltd. to finance the purchase of a house for 15 years. The rate of interest on such loans is 12 percent per annum. Compute the amount of annual installment. **(07 Marks)**

c. Explain the various functions of finance. **(10 Marks)**

2 a. What is meant by depreciation tax shield? **(03 Marks)**

b. What do you understand by cost of capital? Discuss its significance. **(07 Marks)**

c. From the following capital structure of Pippy Ltd, determine weighted average cost of capital based on market value weights:

	Rs.
Equity shares (100000 shares)	3800000
Preference share	800000
Debentures	5000000
Bank loan (long term)	1800000
Bank loan (short term)	1400000

Additional information:

i) Equity shares include the existing 60000 shares having current market value of Rs.40 per share and the balance is net proceeds from the new issue in the current year (issue price of the share, Rs.40; floatation cost per share, Rs.5). The projected EPS and DPS for the current year are Rs.8 and Rs.5 respectively.

ii) Dividend indicated on preference shares is 12 percent.

iii) Pre-tax cost of debentures is 11 percent.

iv) Interest on bank loan is 12 percent (long-term) and 11.5 percent (short term).

v) Corporate tax is 35 percent and dividend tax is 10 percent.

vi) Market value of preference shares is Rs.850000. **(10 Marks)**

3 a. What are the tree elements of the cash flow stream of a project? **(03 Marks)**

b. What is Financial Planning? Explain the steps involved in Financial Planning. **(07 Marks)**

3 c. Paramount Ltd. is evaluating a project that has the following cash flow stream associated with it.

Year	Cash outflows (Rs. in million)	Cash inflows (Rs. in million)
0	120	-
1	80	-
2	-	20
3	-	60
4	-	80
5	-	100
6	-	120

Calculate modified internal rate of return. The cost of capital for paramount is 15 percent.
(10 Marks)

4 a. Write a note on stability of dividend. **(03 Marks)**

b. A firm whose cost of capital is 10% is considering two mutually exclusive projects X and Y, the details of which are given below:

	Year	Project X	Project Y
Cost	0	Rs.100000	Rs.100000
Cash inflows	1	Rs.10000	Rs.50000
	2	Rs.20000	Rs.40000
	3	Rs.30000	Rs.20000
	4	Rs.45000	Rs.10000
	5	Rs.60000	Rs.10000

Which project should be selected on the basis of NPV?
The discount factor at 10% is as under. **(07 Marks)**

Year	1	2	3	4	5
D.F.	0.909	0.826	0.751	0.683	0.621

c. Briefly explain the factors that determine the working capital needs of a firm. **(10 Marks)**

5 a. What is trading on equity? **(03 Marks)**

b. What are term loans? Describe briefly the features of term loans. **(07 Marks)**

c. Kuthi Entertainers Ltd. has the following balance sheet and income statement information.

Balance sheet as on March 31.

Liabilities	Rs.	Assets	Rs.
Equity capital (Rs.10 per share)	800000	Net fixed assets	1000000
10% Debt	600000	Current assets	900000
Retained earnings	350000		
Current liabilities	150000		
	1900000		1900000

Income statement for the year ending March.

	Rs.
Sales	340000
Operating expenses (including Rs.60000 depreciation)	120000
EBIT	220000
Less: Interest	60000
Earnings before Tax (EBT)	160000
Less : Taxes	56000
Net earnings (EAT)	104000

Q.NO.5 (c) Contd...

i) Determine the degree of operating, financial and combined leverages at the current sales level if all operating expenses, other than depreciation are variable costs.

ii) If total assets remain at the same level but sales increase by 20 percent, what will be the earnings per share (EPS) in the new situation? **(10 Marks)**

6 a. What are Global Depository Receipts? **(03 Marks)**

b. Explain the factors affecting dividend policy. **(07 Marks)**

c. From the following data compute the duration of the operating cycle for the year 2006.

Particulars	Year 2006
Stocks:	
Raw material	Rs.20000
Work in process	Rs.14000
Finished goods	Rs.21000
Purchased of raw materials	Rs.96000
Cost of goods sold	Rs.140000
Sales	Rs.160000
Debtors	Rs.32000
Creditors	Rs.16000

Assume 360 days per year for computations purposes. **(10 Marks)**

7 a. What are forward contracts? Differentiate between forward and futures contracts. **(05 Marks)**

b. Pentagon Electronics Ltd., an electronic goods manufacturing company is producing a large range of electronic goods. It has under consideration two projects X and Y each costing Rs.120 lakhs. The projects are mutually exclusive and the company is considering the question of selecting one of the two. Cash flows before depreciation and tax (CFBT) have been worked out for both the projects and the details are given below. X has a life of 8 years and Y has a life of 6 years. Both will have zero salvage value at the end of their operational lives.

At the end of the year	Net cash inflow (CFBT)		PV of Rupee at 15%
	Project X (Rs. in lakhs)	Project Y (Rs. in lakhs)	
1	25	40	0.870
2	35	60	0.756
3	45	80	0.658
4	65	50	0.572
5	65	30	0.497
6	55	20	0.432
7	35	-	0.376
8	15	-	0.327

The company is already making profits and its tax rate is 50%. The cost of capital of the company is 15%. The company follows straight line method of depreciating assets. Advise the company regarding the selection of the project. Use NPV method. **(15 Marks)**

8 **Case Study**:

Pilly Garments Ltd., a newly formed company has applied for a loan to a commercial bank for financing its working capital requirements. You are requested by the bank to prepare an estimate of the requirements of the working capital for the company. Add 10 percent to your estimated figure to cover unforeseen contingencies. The information about the projected profit and loss account of this company is as under:

	Rs.
Sales	2100000
Cost of goods sold	1530000
Gross Profit	570000
Administrative expenses	140000
Selling expenses	130000
Profit before tax	300000
Provision for tax	100000

Cost of goods sold has been derived as follows:

	Rs.
Materials used	840000
Wages and manufacturing expenses	625000
Depreciation	235000
	1700000
Less: Stock of finished goods (10% not yet sold)	170000
	1530000

The figures given above relate only to goods that have been finished and not to work in progress; goods equal to 15 percent of the year's production (in terms of physical units) are in progress on an average, requiring full materials but only 40 percent of other expenses. The company believes in keeping two months consumption of materials in stock. The desired cash balance is Rs.40000.

Average time lag in payment of all expenses is 1 month; suppliers of materials extend 1.5 months credit; sales are 20 percent cash, rest are at two months credit. 70 percent of the income tax has to be paid in advance in quarterly installments.

You can make such other assumptions as you deem necessary for estimating working capital requirements. **(20 Marks)**

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08MBA23

Second Semester MBA Degree Examination, Dec.09-Jan.10
Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. *Answer any FOUR full questions from Q.no. 1 to 7. Q.No. 8 is compulsory.*
2. *Time value tables can be used.*
3. *Show working notes wherever necessary.*

1 a. In what ways the objective of Wealth Maximization is superior to Profit Maximization? **(03 Marks)**

b. What are the dangers of Excess Working Capital? **(07 Marks)**

c. National Electronics Ltd., is producing a large range of electronics goods. It has under consideration two projects 'X' and 'Y' each costing Rs 120 lacs.
The projects are mutually exclusive and the company is considering the question of selecting one of two. Profits have been worked out for both the projects and the details are given below. 'X' has a life of 8 years and 'Y' has life of 6 years. Both will have zero salvage value at the end of their operational lives. The company is already making profits and its tax rate is 50%. The cost of capital of the company is 15%.

Year	Profits before Depreciation and Tax	
	Project X	Project Y
1	25,00,000	40,00,000
2	35,00,000	60,00,000
3	45,00,000	80,00,000
4	65,00,000	50,00,000
5	65,00,000	30,00,000
6	55,00,000	20,00,000
7	35,00,000	-
8	15,00,000	-

The Company follows straight line method of depreciation. Find out NPV of both the projects. **(10 Marks)**

2 a. What do you mean by Permanent and Temporary working capital? **(03 Marks)**

b. Calculate the following : i) Compute the future values of
- An initial Rs 10,000 compounded annually for 10 years at 10% and
- An annuity of Rs 10,000 for 10 years at 10%.

ii) An investor deposits Rs 10,000 in a bank account for 5 years at 8% interest. Find out the amount which he will have in his account if interest is compounded
- Annually ▪ Quarterly **(07 Marks)**

c. Explain the scope of subject Financial Management. **(10 Marks)**

3 a. What do you mean by Corporate Governance? **(03 Marks)**

b. Write a note on Indian Financial System. **(07 Marks)**

c. Write a note on Long – term sources of funds, which can be raised within India. **(10 Marks)**

4 a. Hero Ltd., issues 15.1 irredeemable preference shares of the face value of Rs 100 each. Compute the cost of preferred stock. What will be the cost of preferred stock, if it is issued at i) 5% premium and ii) 10% discount. **(03 Marks)**

b. Explain the factors affecting dividend policy. **(07 Marks)**

c. Grow More Ltd., is presently operating at 60% level, producing 36,000 units per annum. In view of favorable market conditions, it has been decided that from 1-1-2009, the company would operate at 90% capacity. The following information is available.

i) Existing cost – price structure per unit is given below :

Raw Material	Wages	Overheads (variable)	Overheads (fixed)	Profits
Rs 4.00	Rs. 2.00	Rs. 2.00	Rs. 1.00	Rs. 1.00

ii) It is expected that the cost of raw materials, wages rate, expenses and sales per unit will remain unchanged in 2009.

iii) Raw materials remain in stores for 2 months before these are issued production. These units remain in the process for 1 month.

iv) Finished goods remain in godown for 2 months.

v) Credit allowed to debtors is 2 months. Credit allowed by creditors is 3 months.

vi) Lag in wages amount overheads payment is 1 month. It may be assumed that wages and overheads accrue evenly throughout the production cycle.

You are required to calculate the working capital requirements on an estimated basis to sustain the increased production level. Assumptions made if any, should be clearly indicated. **(10 Marks)**

5 a. What are the principles of cash flow estimation? **(03 Marks)**

b. Explain the stages in the capital budgeting process. **(07 Marks)**

c. ABC Ltd., has the following capital structure.

4,000 Equity shares of Rs 100 each	Rs 4,00,000
10% preference shares	Rs 1,00,000
11% Debentures	Rs 5,00,000

The current market price of the share is Rs 102. The company is expected to declare a dividend of Rs 10 at the end of the current year. With an expected growth ate of 10%. The applicable tax rate is 50%.

i) Find out the cost of equity capital and WACC, and ii) Assuming that the company can raise Rs 3,00,000 12% debentures. Find out the new WACC if

- dividend rate is increased from 10 to 12%
- growth rate is reduced from 10 to 8%
- Market price is reduced to Rs 98. **(10 Marks)**

6 a. Why do you think that the money has time value? Give reasons. **(03 Marks)**

b. The capital structure of the progressive Ltd., consists of ordinary share capital of Rs 10,00,000 (shares of Rs 100 each) and Rs 10,00,000 of 10% debentures. The selling price is Rs 10 per unit ; Variable costs amounts to Rs 6 per unit and fixed expenses amount to Rs 2,00,000. The income tax rate is assumed to be 50%. The sales level is expected to increase from 1,00,000 units to 1,20,000 units.

i) You are required to calculate ▪ The percentage of increase in EPS ▪ The degree of Financial leverage at 1,00,000 units and 1,20,000 units. ▪ The degree of operating leverage at 1,00,000 units and 1,20,000 units.

ii) Comment on the behaviour of Operating leverage and Financial leverage in relation to increase in production from 1,00,000 units 1,20,000 units. **(07 Marks)**

c. Explain the Recommendations of Kumara Mangalam Birla committee on Corporate governance. **(10 Marks)**

7 a. Distinguish between Financial leverage and Trading on Equity. **(05 Marks)**

b. From the following, prepare Income statements of A, B and C. Briefly comment on each firm's performance. **(15 Marks)**

Particulars	Firm 'A'	Firm 'B'	Firm 'C'
Financial Leverage	3 : 1	4 : 1	2 : 1
Interest (Rs)	200	300	1,000
Operating Leverage	4 : 1	5 : 1	3 : 1
Variable cost as a % of Sales	66.67%	75%	50%
Income – tax rate	45%	45%	45%

8 a. "Is risk and return are related"? Discuss. **(05 Marks)**

b. A Cosmetic Company is considering to introduce a new lotion. The manufacturing equipment will cost Rs 5,60,000. The expected life of the equipment is 8 years. The Company is thinking of selling the lotion in a single standard pack of 50 grams at Rs 12 each pack. It is estimated that variable cost per pack would be Rs 6 and annual fixed cost Rs 4,50,000. Fixed cost includes depreciation (on original cost method) of Rs 70,000 and allocated overheads of Rs 30,000. The company expects to sell 1,00,000 packs of the lotion each year. Assume that tax rate is 45%. Calculate the annual cashflows. **(05 Marks)**

c. Chandan Ltd's Profit and Loss A/c and Balance sheet for the year ended 31-12-2008 are given below. You are required to compute operating cycle.

Dr Trading and Profit & Loss A/c for the year ended 31-12-2008 Cr

To, Opening Stock		By, Sales (Credit)	1,00,000
Raw Materials	10,000	By, Closing Stock	
Work in progress	30,000	Raw Materials	11,000
Finished goods	5,000	Work in progress	30,500
To, Purchases (Credit)	35,000	Finished goods	8,500
To, Wages and Manufacturing Expenses.	15,000		
To, Gross profit c/d	55,000		
	1,50,000		1,50,000
To, Administrative Expenses	15,000	By, Gross Profit b/d	55,000
To, Selling and Distribution expenses	10,000		
To, Net Profit	30,000		
	55,000		55,000

Balance Sheet as on 31/12/2008

Liabilities	Amt (Rs)	Assets	Amt (Rs)
Share capital		Fixed Assets	1,00,000
(16,000 shares of Rs 10 each)	1,60,000	Closing Stock	
Profit & Loss A/c	30,000	Raw Materials	11,000
Creditors	10,000	Work in progress	30,500
		Finished goods	8,500
		Debtors	30,500
		Cash and Bank	19,500
	2,00,000		2,00,000

Opening debtors and Opening creditors were Rs 6,500 and Rs 5,000 respectively. **(10 Marks)**

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