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08MBA23

Second Semester MBA Degree Examination, December 2010
Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. ***Answer any FOUR full questions from the Q.No.1 to 7.***
2. ***Question No. 8 is compulsory.***
3. ***Use of time value table is permitted.***
4. ***Show working notes wherever necessary.***

1 a. Define financial management. **(03 Marks)**
b. Write a note on primary versus secondary markets. **(07 Marks)**
c. Briefly explain the factors affecting dividend policy. **(10 Marks)**

2 a. What do you understand by gross working capital and net working capital? **(03 Marks)**
b. Assuming that a firm pays tax @ 50%, compute the after tax cost of debt capital in the following cases:
i) A debenture is sold at par, interest being 7%.
ii) A 10 year, 8% Rs.1000 per debenture sold at Rs.950 less 4% underwriting commission. **(07 Marks)**
c. Discuss the three broad areas of financial decision making. **(10 Marks)**

3 a. What is agency cost? **(03 Marks)**
b. Briefly explain corporate governance. **(07 Marks)**
c. The following is the balance sheet of Varun Ltd. as on 31-03-2008:

Liabilities	Amount	Assets	Amount
Equity capital	180000	Fixed asset	450000
10% debentures	240000	Current assets	150000
Retained earnings	60000		
Current liability	120000		
Total	600000	Total	600000

The company's total assets turnover ratio is 2.5 times. The fixed operating costs are Rs.200000. Variable cost ratio is 40%. Income tax is 50%. The equity shares are issued at Rs.10 per share. You are required to
i) Calculate leverages.
ii) Determine the likely level of EBIT if EPS is Rs.6. **(10 Marks)**

4 a. What is financial risk? **(03 Marks)**
b. What are the key elements of SEBI code on corporate governance? **(07 Marks)**
c. A company's capital structure consists of the following:

Equity Shares of Rs.100 each	Rs.20 Lakhs
Retained earnings	Rs.10 Lakhs
9% preference shares	Rs.12 Lakhs
7% debentures	Rs.8 Lakhs
	Rs.50 Lakhs

The company earns 12% on its capital. The income-tax rate is 50%. The company requires a sum of Rs.25 lakh to finance its expansions programme for which the following alternatives are available to it:
i) Issue of 20000 equity shares at a premium of Rs.25 per share.
ii) Issue of 10% preference shares.
iii) Issue of 8% debentures.
Which of the three financing alternatives would you recommend and why? **(10 Marks)**

5 a. What is time value of money? (03 Marks)

b. Why is wealth maximization a better goal than profit maximization? (07 Marks)

c. ABC Ltd. has the following book value capital structure:

		Rs. Million
1	Equity capital (10 million shares @ 10 per/share)	100
2	Preference capital – 11% (100000 shares, Rs.100 per share)	10
3	Retained earnings	120
4	Debentures, 13.5% (500000 debentures, Rs.100 each)	50
5	12% loans	80
	Total	360

The next expected dividend per share is Rs.1.50. The dividend per share is expected to grow @ 7%. The market price per share is Rs.20. Preference shares, redeemable after 10 years is currently selling at for Rs.75 per share. Debentures, redeemable after 6 years are selling for Rs.80 per debenture. The tax rate is 50%. Calculate the weighted average cost of capital using,

i) Book value proportions and

ii) Market value proportions. (10 Marks)

6 a. State the three major factors influencing working capital requirement. (03 Marks)

b. Calculate the following:

i) A borrower offers 16% nominal rate of interest with quarterly compounding. What is the effective rate of interest?

ii) What is the present value of Rs.1000000 receivable 30 years from now, if the discount rate is 10%?

iii) Arun deposits Rs.200000 in a bank account which pays 10% interest. How much can he withdraw annually for a period of 15 years? (07 Marks)

c. Brownie Ltd sells its products on a gross profit of 20% on sales. The following information is extracted from its annual accounts for the year ended 31-03-2008:

Sales (3 months credit) = 4000000

Raw materials = 1200000

Wages (15 days in arrears) = 960000

Manufacturing expenses (one month in arrears) = 1200000

Administration expenses (one month in arrears) = 480000

Sales promotion expenses (payable half yearly in advance) = 200000

The company enjoys one month credit from suppliers of raw materials and ½ months finished goods. Cash balance maintained is Rs.100000.

Assuming 10% margin, find out the working capital requirement of Brownie Ltd. (10 Marks)

7 a. Briefly explain CAPM. (05 Marks)

b. A company has to make a choice between two projects namely project A and project B. The initial capital outlay of two projects are Rs.135000 and Rs.240000 respectively for A and B. The opportunity cost of capital is 16% . The annual incomes are as under:

Year	Project A	Project B	Discounting factor @ 16%
1	-	60000	0.862
2	30000	84000	0.743
3	120000	96000	0.641
4	84000	102000	0.552
5	84000	90000	0.476

You are required to calculate for each project.

i) Discounted pay back period.

ii) Profitability index.

iii) Net present value. (15 Marks)

8 **Case Study:**

a. Mr. Goel has estimated that for a new product, the break-even point is 2000 units, if the item is sold for Rs.14 per unit. The variable cost is Rs.9 per unit. Calculate the operating leverage for sales volume of 2500 units and 3000 units, what do you infer from the operating leverages at the sales volume 2500 units and 3000 units? **(05 Marks)**

b. Calculate the operating cycle of a company which gives the following details relating to its operations:

Particulars	Amount (Rs.)
Raw materials consumption p.a.	842000
Annual cost of production	1425000
Annual cost of sales	1530000
Annual sales	1950000
Average value of current assets	
Raw material	124000
Work-in-progress	72000
Finished goods	122000
Debtors	260000

The company gets 30 days credit from its suppliers. All sales are based on credit. You may take one year as equal to 365 days. **(05 Marks)**

c. Seema Ltd issues 12000, 12% preference shares of Rs.100 each. The company pays 2% as flotation cost. Calculate the cost of preference shares assuming to be issued at:

i) Face value or par value.

ii) At a discount of 5%.

iii) At a premium of 10%. **(05 Marks)**

d. Excellent Ltd. has to choose one of the following two mutually exclusive projects. Both the projects have to be depreciated on straight line basis. The tax rate is 50%. The initial investment is Rs.30000 each.

Year	Project 'X' Rs.	Project 'Y' Rs.
1	8400	8400
2	9600	9000
3	14000	8000
4	16000	10000
5	4000	20000

Use the pay back period as the criterion for project selection. **(05 Marks)**

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05MBA23

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Financial Management

Time: 3 hrs. Max. Marks:100

Note: *1. Answer any FOUR full questions from Q.No.1 to 7.*
2. Q.No. 8 is compulsory.
3. Use of PV table and FV tables is permitted.

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. If the interest rate is 12%, what are the doubling periods as per rule of 72 and the rule of 69? **(03 Marks)**

b. Discuss three broad areas of financial decision making. **(07 Marks)**

c. What do you mean by debt financing? What are its merits and demerits? **(10 Marks)**

2 a. What is WACC? How is it calculated? **(03 Marks)**

b. Discuss the factors determining dividend policy. **(07 Marks)**

c. Following are the cash flows of a project:

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

Calculate : i) NPV ii) B.C. ratio and payback period.
Assume discount rate of 12%. **(10 Marks)**

3 a. What is operating leverage? How is it different from financial leverage? **(03 Marks)**

b. Distinguish between stable dividend policy and stable dividend payout policy. **(07 Marks)**

c. i) XYZ Ltd. has borrowed Rs.5,00,000 to be repaid in five equal annual payments (interest and principal). The interest rate is 16% p.a. Compute the amount of cash payment.

ii) The earnings of ABC Ltd. was Rs.3 per share in year 1. It increased over a 10 year period to Rs.4.02. Compute the rate of growth or compound annual rate of growth of the EPS.

iii) Compute present value of a perpetuity of Rs.100 per year if the discount rate is 10%. **(10 Marks)**

4 a. Write three differences between stock split and bonus issue. **(03 Marks)**

b. What is payback period? What are its merits and demerits? **(07 Marks)**

c. A company has on its books the following amounts and specific costs of each type of capital.

Type of capital	Book value	Market value	Specific cost (%)
Debt	4,00,000	3,80,000	5
Preference	1,00,000	1,10,000	8
Equity	6,00,000	-	15
Retained earnings	2,00,000	12,00,000	13
Total	13,00,000	16,90,000	-

Determine WACC using i) Book value weights and ii) market value weights **(10 Marks)**

5 a. Distinguish between operating and cash cycle. **(03 Marks)**

b. What is leasing? What are different types of leasing? **(07 Marks)**

c. The following information is available about Philips Ltd.:
Sales of the year = Rs. 10000 Expected increase in the sales for the next year = 10%
Profit after tax this year = 600 Dividend payout ratio = 60%
Projected surplus funds available next year = 150
Present level of spontaneous current liabilities = 3000.
What is the level of total assets for Philips Ltd? **(10 Marks)**

6 a. What are the methods of preparing proforma profit and loss account? **(03 Marks)**

b. Explain in brief, forward, future and option contracts. **(07 Marks)**

c. The cash flows associated with an investment are given below:

Year	0	1	2	3	4	5
Cash flow	-100000	25000	40000	50000	40000	30000

Calculate i) Payback period and ii) Discounted pay back period assuming 10% discount rate. **(10 Marks)**

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

b. A firm's sales, variable costs and fixed cost amount to Rs.7500000, Rs. 4200000 and Rs.600000 respectively. It has borrowed Rs.4500000 at 9% and its equity capital totals Rs.5500000.

i) What is the firm's ROI?
ii) Does it have favourable financial leverage?
iii) If the firm belongs to an industry whose asset turnover is 3, does it have a high or low asset leverage?
iv) What are operating, financial and combined leverages?
v) If the sales drop to Rs.50,00,000 what will be the new EBIT be?
vi) At what level will the EBT of the firm equal to zero? **(15 Marks)**

8 Case Study:

X Ltd. is desirous to purchase a business and has consulted you. One point on which you are asked to advice 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.

Average amount backed up for stocks:	
Stocks of finished product	5,000
Stock of stores and materials	8,000
Average credit given:	
Inland sales 6 weeks' credit	3,12,000
Export sales 1.5 weeks' credit	78,000
Average time lag in payment of wages and other outgoings	
Wages 1.5 weeks	2,60,000
Stock materials 1.5 months	48,000
Rent & Royalties 6 months	10,000
Clerical staff 0.5 month	62,400
Manager 0.5 month	4,800
Misc. Exp. 1.5 months	48,000
Payment in advance	
Sundry exp. (Paid quarterly in advance)	8,000
Undrawn profits on an average throughout the year	11,000

Set up your calculations for the average amount of working capital required. **(20 Marks)**

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