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**Second Semester MBA Degree Examination, December 2011**  
**Financial Management**

Time: 3 hrs.

Max. Marks:100

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

- 1 a. What are the financial intermediaries? (03 Marks)  
b. State and explain the elements of a financial plan. (07 Marks)  
c. What do you mean by agency problem? Explain the organization of finance functions. (10 Marks)
- 2 a. What is the cost of capital? (03 Marks)  
b. What are derivatives? Explain the difference between forward contracts and futures contracts. (07 Marks)  
c. You are asked to evaluate a 5-year project involving software development. The initial outlay of this project is ₹12000/- Due to the technological uncertainty with respect to industry, higher discount rates are estimated in the future. The cash flow and discount rates are given below:

Year	1	2	3	4	5
Cashflow	₹4000/-	₹5000/-	₹7000/-	₹6000/-	₹5000/-
Discount rate %	14	15	16	18	20

- Calculate the NPV. (10 Marks)
- 3 a. What are the income tax provisions relating to leasing? (03 Marks)  
b. Explain the procedure for obtaining a term loan. (07 Marks)  
c. Calculate the operating leverage for the firms A and B, from the following price and cost data. What conclusions can you draw, with respect to levels of fixed cost the degree of operating leverage result? Explain. Assume 5000 units are sold. (10 Marks)

	Firm	
	A	B
Sales price per unit (p.u.)	₹20	₹70
Variable cost p.u.	₹6	₹50
Fixed operating cost	₹80000	Nil

- 4 a. What do you mean by option contract? (03 Marks)  
b. What are the factors to be considered for determining dividend payout ratio? (07 Marks)  
c. A man borrows ₹80,000 for a musical system at a monthly interest of 1.25%. The loan is to be paid in 12 equal monthly installments, payable at the end of each month. Prepare the loan amortization schedule. (10 Marks)
- 5 a. What is wealth maximization? (03 Marks)  
b. What are the factors influencing the working capital requirement? (07 Marks)  
c. A company has the following capital structure on 31<sup>st</sup> Mar 2010.

Ordinary shares (2,00,000 shares)	4000
10% preference shares	1000
14% debentures	3000
	<u>8000</u>

A share of the company sells for ₹20. It is expected that company will pay next year, a dividend of ₹2/- per share which will grow at 7% forever. Assume a 50% tax rate. You are required to calculate i) the weighted average cost of the capital, based on the existing capital structure. ii) the new WACC, if the company raises additional ₹200000 debt, by issuing 15% debenture. This results in increasing the expected to ₹3/- and leave the growth rate unchanged but the price of the share will fall to ₹15 per share. (10 Marks)

- 6 a. What are agency costs? (03 Marks)
- b. An investor deposits ₹100 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 i) annually ii) semi-annually and iii) quarterly. (07 Marks)
- c. P Ltd. is evaluating a project that has the following cash flow stream associated with it:

Year	0	1	2	3	4	5	6
Cash flow (₹ in million)	-120	-80	20	60	80	100	120

The cost of capital for P Ltd. is 15%. Calculate the MIRR.

(10 Marks)

- 7 a. What do you mean by profitability index? (03 Marks)
- b. A firm's sales, variable costs and fixed costs amount to ₹7500000, ₹4200000 and ₹600000 respectively. It has borrowed ₹4500000 at 9% and its equity capital totals ₹5500000. Calculate the operating, financial and combined leverages of the firm. (07 Marks)
- c. N Ltd. owns a machine with the following characteristics:

Book value	₹1,10,000
Current market value	₹80,000
Expected salvage value at the end of 5 years remaining useful life	Nil
Annual cash operating costs	36,000

The firm's cost of capital is 15%; its tax rate is 35%. The company follows the straight line method for depreciation and the same is accepted for the tax purpose. The management of the company is considering selling the machine. If it does so the total cash operating costs to perform the work now done by the machine will increase by ₹40000 per year to ₹76000 per year. Advise whether the machine should be sold. (10 Marks)

### 8 Case study:

X&Y Ltd. is desirous to purchase a business and has consulted you. 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:

	Particulars	Amount for the year (₹)
i)	Average amount backed up for stocks:	
	Stocks of finished products	5,000
	Stocks of stores and materials	8,000
ii)	Average credit given:	
	Inland sales, 6 weeks' credit	3,12,000
	Export sales, 1.5 weeks' credit	78,000
iii)	Average time lag in payment of wages & other outgoings:	
	Wages, 1.5 weeks	2,60,000
	Stocks and materials, 1.5 months	48,000
	Rent and royalties, 6 months	10,000
	Clerical staff, 0.5 month	62,400
	Manager, 0.5 month	4,800
	Miscellaneous expenses, 1.5 months	48,000
iv)	Payment in advance:	
	Sundry expenses (paid quarterly in advance)	8,000
	Undrawn profits on an average throughout the year	11,000

Setup your calculations for the average amount of working capital required.

(20 Marks)

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