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.

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Second Semester MBA Degree Examination, December 2012
Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. ***Answer any FOUR questions, from Q.No.1 to Q.No.7.***
2. ***Q.No. 8 is compulsory.***

1 a. What do you mean by corporate Governance? **(03 Marks)**
b. Explain the different sources of long term funds. **(07 Marks)**
c. Explain the objectives of financial management. **(10 Marks)**

2 a. What do you mean by working capital? **(03 Marks)**
b. Rank the following projects using Net present value and Pay back period : **(07 Marks)**

Projects	Initial Investment	Annual Cash flows	Life in Years
A	5,00,000	1,00,000	7 yrs
B	6,00,000	1,50,000	5 yrs
C	6,50,000	1,25,000	9 yrs
D	8,00,000	2,00,000	5 yrs
E	7,50,000	2,20,000	6 yrs

c. XYZ Ltd., is a established company which requires a further sum of Rs 30,00,000 for its expansion scheme. Apart from the original equity capital of Rs 30,00,000 of Rs 100 each. The directors have the following plan for expansion :
i) Whole amount to be raised through equity shares.
ii) Rs 10,00,000 in equity shares and balance amount in 8% debentures.
iii) All in debentures @ 8%.
iv) Rs 10,00,000 in 12% preference shares and balance in equity.
The expected EBIT is Rs 8,00,000 and tax rate applicable is 50%. Analyse the options and select the best option. **(10 Marks)**

3 a. What do you mean by cost of capital? **(03 Marks)**
b. The following information is available for Swagat Ltd., **(07 Marks)**

Particulars	Rs (Million)
Average stock of raw material and stores	200
Average work in process inventory	300
Average finished goods inventory	180
Average accounts receivable	300
Average accounts payable	180
Average raw material and stores purchased on credit and consumed per day	10
Average work – in – process value of raw materials committed per day	12.5
Average cost of goods sold per day	18
Average sales per day	20

You are required to calculate duration of operating cycle.

c. The Balance sheet of ABC company is given below :

Liabilities	Rs	Assets	Rs
Equity capital (Rs 10 per share)	90,000	Net fixed assets	2,25,000
10% long term debt	1,20,000	Current assets	75,000
Retained earnings	30,000		
Current liabilities	60,000		
Total	3,00,000	Total	3,00,000

The Company's total asset turnover ratio is 3, its fixed operating cost is Rs 1,50,000 and its variable operating cost is 50% of sales. The Income tax rate is 50%. You are required to
i) Calculate the different type of leverages for the company.
ii) Determine the likely level of EBIT if EPS is Rs 2. **(10 Marks)**

4 a. What do you mean by capital structure? **(03 Marks)**
b. Differentiate between primary market and secondary market. **(07 Marks)**
c. United Industries Ltd., has an investment budget of Rs 100 lakhs for 2005 – 2006. It has short listed two projects A and B after completing the market and technical appraisals. The management wants to complete financial appraisals before making the investments. Further particulars regarding the two projects are given below :

Particulars	A	B
Investment required (Rs)	100	90
Average annual cash unflows before depreciation and tax (estimate) (Rs)	28	24
Salvage value	-	-
Estimated life (Yrs)	10	10

The company follows straight line method of charging depreciation. Its tax rate is 50%. You are required to calculate payback period and Internal rate of return of the two projects P.V of Annuity of Re. 1 for ten years at different discount rates is given below : **(10 Marks)**

Rate %	10	11	12	13	14	15
Annuity value for 10 years	6.1446	5.8992	5.6502	5.4262	5.2161	5.0188

5 a. What do you mean by forex market? **(03 Marks)**
b. XYZ Ltd., has Rs 10 crore bonds outstanding. Bank deposit earns 10% p.a. The bonds will be redeemed after 15 years for which purpose the company wishes to create a sinking fund. How much amount should be deposited to the sinking fund each year so that XYZ Ltd., would have in the sinking fund Rs 10 crores to retire its entire issue of Bonds? **(07 Marks)**
c. Explain the factors governing capital structure decision. **(10 Marks)**

6 a. Distinguish between diversifiable and non – diversifiable risk. **(03 Marks)**
b. Calculate the expected rate of return for each security using CAPM.

Security	Beta
Alpha	0.6
Theta	1.0
Gama	1.2

The risk free ratio is 6% and the expected return on market is 15%. **(07 Marks)**
c. Explain the factors determining working capital policy. **(10 Marks)**

7 a. What is agency cost? **(03 Marks)**

b. What is stable dividend policy? Explain. **(07 Marks)**

c. As a financial analyst of a large electronics company. You are required to determine the weighted average cost of capital of the company using market value weights. The following information is available :

The company's present book value capital structure is :

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

All these securities are traded in the capital markets. Recent prices are :

Debentures Rs 110 per debenture, preference shares Rs 120 per share and equity shares Rs 22 per share.

Anticipated external financing opportunities are :

i) Rs 100 per debenture redeemable at par ; 10 years maturity 11% coupon rate 4% floatation cost , sale price Rs 100.

ii) Rs 100 preference shares redeemable at par ; 10 years maturity 12% dividend rate , 5% floatation cost, sale price Rs 100.

iii) Equity shares Rs 2 per share floatation costs, sale price Rs 22.

In addition, the dividend expected on the equity share at the end of the year is Rs 2 per share ; the anticipated growth rate in dividends is 7% and the firm has the practice of paying all its earnings in the form of dividends. The corporate tax rate is 35%. **(10 Marks)**

8 **CASE STUDY :**

a. Ojus enterprises is determining the cash flow for a project involving the cash flow for a project involving replacement of an old machine by a new machine. The old machine bought a few years ago has a book value of Rs 4,00,000 and it can be sold to realize a post tax salvage value of Rs 5,00,000. It has a remaining life of five years after which its net salvage value is expected to be Rs 1,60,000. It is being depreciated annually at a rate of 25% under the written down value method. The working capital required for the old machine is Rs 4,00,000. The new machine costs Rs 16,00,000. It is expected to fetch a net salvage value of Rs 8,00,000 after 5 years when it will no longer be required. The depreciation rate applicable to it is 25% under written down value method. The net working capital required for the new machine is Rs 5,00,000. The new machine is expected to bring a saving of Rs 3,00,000 annually in manufacturing costs (other than depreciation). The tax rate applicable to the firm is 40%. Find the incremental after tax cash flows associated with the replacement project. **(15 Marks)**

b. AB Ltd estimates the cost of equity and debt components of its capital for different levels of debt ; equity mix as follows :

Debt as a % age of total capital	Cost of equity	Cost of debt (before tax)
0 %	16 %	12 %
20 %	16 %	12 %
40 %	20 %	16 %

Suggest the best debt ; equity mix for the company. Tax rate is 50%. **(05 Marks)**

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