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Second Semester MBA Degree Examination, Dec.2013/Jan.2014
Financial Management

Time: 3 hrs.

Max. Marks: 100

- Note:** 1. Answer any **THREE** full questions from Q.No.1 to 6.
 2. Q.No.7 and Q.No.8 are compulsory.
 3. Use of time value tables is permitted.

- 1 a. Mention any three factors influencing capital structure. (03 Marks)
- b. Calculate operating leverage, financial leverage and composite leverage from the following data: (07 Marks)

Sales (10000 units) = ₹ 2,00,000
 Fixed cost = ₹ 65000

Variable cost per unit = ₹ 0.70
 Interest charges = ₹ 15000

- c. From the following information you are required to estimate the net working capital:

	Cost per unit (₹)
Raw materials	400
Direct labor	150
Overhead (excluding depreciation)	200
	<hr/> 850

Additional information:

Selling price = ₹ 1000 per unit

Output = 52000 unit P.A.

Raw materials stock = Average 4 weeks

Work-in-progress = Average 2 weeks

[Assume 50% completion stage with full material consumption]

Finished goods in stock = Average 4 weeks

Credit allowed to debtors = Average 4 weeks

Credit allowed to creditors = Average 8 weeks

Cash at bank is expected to be ₹ 50,000.

Assume that production is sustained at an even pace during the 52 weeks of the year. All sales are on credit basis. State any other assumption you might have made while computing.

(10 Marks)

- 2 a. What are the 3 functions of financial management? (03 Marks)
- b. Explain the factors affecting dividend policy of an organization. (07 Marks)
- c. Consider the cash flows of the following investment decision and rank them on net present value. Profitability index payback period and accounting rate of return method.

Investment	C ₀	C ₁	C ₂	C ₃	C ₄	C ₅
A	20000	7000	6000	6000	5000	4000
B	20000	5000	6000	7000	7000	8000

The required rate of return is 10%.

(10 Marks)

- 3 a. A firm sells products for ₹ 1000 P.A. It has variable costs of ₹ 400 P.A and fixed operating cost of ₹ 5,00,000 per year. Show how EBIT would change if the firm sells 1000 units and 2000 units. (03 Marks)
- b. Write a brief note on the Indian financial system, its institutions and markets. (07 Marks)
- c. An investor hold the following portfolio:

Share	Beta	Investment
Alpha	0.6	₹ 300000
Beta	1.0	₹ 180000
Carrot	1.2	₹ 120000

What is the expected rate of return on this portfolio, if the risk free is 6% and the expected return on market portfolio is 15%? (10 Marks)

- 4 a. What is Red prospect and Green shoe option? (03 Marks)
- b. Explain in brief the types of Hybrid financing. (07 Marks)
- c. i) A bank finance a car purchase up to ₹ 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) An executive is about to retire at the age of 60. His employer has offered him two post retirement options.
(a) 20,00,000 ₹ lumpsum (b) ₹ 2,50,000 Rs for 10 years. Assuming 10% interest, which is a better option.
- iii) Mr. Raja requires ₹ 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)

- 5 a. What is working capital management? Explain operating cycle. (05 Marks)
- b. As a financial analyst of a large electronics company, you are required to determine the weighted average cost of capital of the company using (a) book value weight (b) market value weight. The following information is available for your perusal.

The company's present book value capital structure is

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

All these securities are traded in the capital market recent prices are:

Debentures, ₹ 110 per debenture, Preference shares, ₹ 120 per share and equity shares ₹ 22 per share.

Anticipated external financing opportunities are:

- (i) ₹ 100 per debenture redeemable at par; 10 year maturity, 11% coupon rate, 4 percent flotation cost, sale price ₹ 100.
- (ii) ₹ 100 preference share redeemable at par; 10 year maturity, 12% dividend rate, 5% flotation costs, sale price ₹ 100.
- (iii) Equity shares : ₹ 2 per share flotation costs, sale price = ₹ 22.

In addition, the dividend expected on the equity share at the end of the year is ₹ 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 percent. (15 Marks)

- 6 a. "Retained earnings is a cost free source of fund". Comment. (05 Marks)
- b. Bring out the difference between mergers and acquisitions. (05 Marks)
- c. Define derivatives. Explain the different types of derivatives. (10 Marks)
- a. MSR Ltd. is in existence for the past 120 years. Majority of its shareholders are in the age group of 70-80, who are very traditional. The finance manager thinks of giving a higher dividend though his ROCE is greater than its cost of capital. Do you agree with him? (05 Marks)
- b. ABC Ltd. is planning to invest in a project. The manager has used the accounting information (PAT) from the projected financial statements and calculated NPV and decided to go ahead with the investment. But the managing director is not convinced about the decision. Which other tool(s) would the manager use? Why? (05 Marks)
- c. RDP Ltd. has taken a loan from ICICI for its capital project. While claiming exemption they have taken the entire equated annual installment as expense. Is this treatment correct? Justify. (05 Marks)
- d. NMS Ltd. is worried about a very high level of operating leverage and is planning to reduce the total leverage to the maximum possible extent. How can they achieve this objective? (05 Marks)

8 Case Study:

Ojus Enterprises is determining 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 ₹ 400,000 and it can be sold to realize a post tax salvage value of ₹ 500,000. It has a remaining life of five years after which its net salvage value is expected to be ₹ 160,000. It is being depreciated annually at a rate of 25 percent under the written down value method. The working capital required for the old machine is ₹ 400,000.

The new machine costs ₹ 16,00,000. It is expected to fetch a net salvage of ₹ 8,00,000 after 5 years when it will no longer be required. The depreciation rate applicable to it is 25% under the written down value method. The net working capital required for the new machine is ₹ 5,00,000. The new machine is expected to bring a saving of ₹ 3,00,000 annually in manufacturing costs (other than depreciation). The tax rate applicable to the firm is 40%.

Question:

Should the old machine be replaced by the new machine (Assuming cost of capital to be 10%) (20 Marks)

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