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05MBA23

Second Semester MBA Degree Examination, June/July 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. Q.No. 8 is compulsory.
3. Use of present value and future value table is permitted.

1 a. What is financial management? **(03 Marks)**
b. Explain the scope of financial management. **(07 Marks)**
c. Calculate the following :
i) Compute the future values of an investment of Rs.10,000 compounded semiannually for 10 years at 10% p.a.
ii) A company has issued debentures of Rs. 50 lakhs to be repaid after 7 years. How much the company should invest in a sinking fund earning 12% in order to be able to repay debentures?
iii) A bank has offered to you an annuity of Rs. 1,800 for 10 years if you invest Rs.12,000 today. What is the rate of return would you earn? **(10 Marks)**

2 a. Explain the factors affecting capital budgeting decisions. **(07 Marks)**
b. Distinguish between the NPV method and IRR method of evaluating investment proposals. **(03 Marks)**
c. A company has to choose between two projects namely A and B. The initial capital outlay of two projects are Rs. 135,000 and Rs.240,000 respectively for A and B. The cost of capital of the company is 16%. The annual incomes are as below:

Year	Project A, Rs.	Project B, Rs.	Discounting factor @16%
1	-	60,000	0.862
2	30,000	84,000	0.743
3	132,000	96,000	0.641
4	84,000	102,000	0.552
5	84,000	90,000	0.476

You are required to calculate the net present value for each project. **(10 Marks)**

3 a. Define the cost of capital. Explain its significance in financial decision making. **(07 Marks)**
b. What is the time value of money? **(03 Marks)**
c. XYZ company supplied the following information. Compute the cost of capital based on book values and market value :

Source of finance	Book value (Rs.)	Market value (Rs.)	After tax cost (%)
Equity capital	10,00,000	15,00,000	12
Long term debt	8,00,000	7,50,000	07
Short term debt	2,00,000	2,00,000	04
Total	20,00,000	24,50,000	

(10 Marks)

4 a. Define working capital. What are the factors influencing working capital? **(10 Marks)**

b. From the following data compute the estimated working capital of a company:

Estimated cost per unit of production	Amount per unit, Rs.
Raw material	80
Direct labour	30
Overheads (excluding dep at Rs.10/unit)	60

Additional information: Selling price Rs.200 per unit, Level of activity – 104,000 units of production p.a. Raw materials in stock average 4 weeks. Work in progress (Assume 50% completion stage in respect of conversion cost and 100% completion in respect of materials) average 2 weeks. Finished goods in stock average 4 weeks. Credit allowed by suppliers - 4 weeks. Credit allowed to debtors average 8 weeks. Lag in payment of wages average 1.5 weeks. Cash at bank is expected to be Rs.25,000. You may assume that the production is carried on evenly throughout the year (52 weeks) and wages and overheads accrue similarly. All sales are on credit basis only. **(10 Marks)**

5 a. What is trading on equity? **(03 Marks)**
b. What do you mean by optimum capital structure? Discuss its features. **(07 Marks)**
c. A company has a share capital of Rs.200,000 divided in the shares of Rs.10 each. It has a major expansion programme requiring additional investment of Rs.100,000. The management is considering the following alternatives:
i) Issue of 10% debentures of Rs.100000.
ii) Issue of 10,000 , 15% preference shares of Rs.10 each.
iii) Issue of 10,000 equity shares of Rs. 10 each.
The company's present EBIT is Rs. 60,000 p.a. Calculate the EPS for the above three alternative financial plans presuming
i) EBIT continues to be the same & ii) EBIT increase by Rs.20,000. Tax rate is 50%. **(10 Marks)**

6 a. What do you mean by debt securitization? **(03 Marks)**
b. Write a note on lease financing. **(07 Marks)**
c. Explain the forward contracts and future contract. **(10 Marks)**

7 a. What do you mean by financial planning? **(03 Marks)**
b. Explain the principles governing a sound financial plan. **(07 Marks)**
c. What are the factors affecting financial planning? **(10 Marks)**

8 A company has been producing a chemical product by using machine Z, for the last two years. Now the management of the company is thinking to replace this machine either by X or by Y machine. The following details are furnished to you.

	Z	X	Y
Book value	100,000	-	-
Resale value now	110,000	-	-
Purchase price	-	180,000	200,000
Annual fixed cost (including depreciation)	92,000	108,000	140,000
Variable cost per unit	3	1.50	2.50
Production per hour (units)	8	8	12
Sales units	16,000	16,000	24,000

You are also provided with the following details:
Selling price per unit : Rs. 20 Cost of materials per unit : Rs.10
Annual operating hours : 2000 Working life of each of three machines = 5 years
Salvage value of machines: Z – Rs.10,000 ; X – Rs.15,000 ; Y – Rs.18,000.
The company charges depreciation using straight line method. Assume tax rate 50% and cost of capital 10%.
Using NPV method, you are required to analyse the feasibility of the proposal and make recommendations. **(20 Marks)**

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08MBA23

Second Semester MBA Degree Examination, June/July 2011
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.***
3. ***Present value Tables 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 =, will be treated as malpractice.

1 a. What is difference between Present and Future value? **(03 Marks)**
b. Why is wealth maximization objective superior to profit maximization objective? **(07 Marks)**
c. i) ABC 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 ABC Ltd would have in the sinking fund Rs 10 crore to retire its entire issue of bonds?
ii) A 12 – payment annuity of Rs 10,000 will begin 8 years hence (the first payment occurs at the end of 8 years). What is the present value of this annuity if the discount rate is 14%. **(10 Marks)**

2 a. How is cost of debt computed? How does it differ from cost of preference shares? **(03 Marks)**
b. What is pay back period? What are the merits and demerits of this method? **(07 Marks)**
c. Risk – return features of two securities X and Y are given below :

Portfolio	E(r)	σ	Weights
X (%)	12	16	0.5
Y (%)	20	24	0.5

i) If the desired portfolio standard deviation is 20%, determine the correlation co-efficient that would yield the desired level of risk.
ii) Find the Portfolio standard deviation if X and Y are mixed in 3:1 ratio. Comment on the results.
iii) What should the correlation be, if the desired portfolio standard deviation of 18% and assets are combined in equal proportions? **(10 Marks)**

3 a. State any three differences between debt and equity. **(03 Marks)**
b. What are the factors affecting working capital policy of a firm? **(07 Marks)**
c. A firm's sales, variable cost and fixed cost amount to Rs 75,00,000, Rs 42,00,000 and Rs 6,00,000 respectively. It has borrowed Rs 45,00,000 at 9% and its equity capitals Rs 55,00,000.
i) What is the firm's ROI?
ii) Does it have favourable financial leverage?
iii) What are the operating, financial and combined leverage?
iv) If the sales drop to Rs 50,00,000, what will be the new EBIT be?
v) At what level will the EBT of the firm equal to zero?
vi) If the firm belongs to an industry whose asset turnover is 3, does it have a high or low asset leverage? **(10 Marks)**

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

b. From the following information advise acceptability of a project using IRR method. Investment outlay is Rs 85,000 ; Cost of capital is 15%. **(07 Marks)**

Annual Cash Inflow

Years	1	2	3	4	5
Cash Inflow (Rs)	10,000	20,000	30,000	45,000	60,000

c. Discuss the determinants of dividend policy of a firm. **(10 Marks)**

5 a. What is the difference between operating and financial leverage? **(03 Marks)**

b. What are the advantages and disadvantages of discounted cash flow method? **(07 Marks)**

c. Calculate the explicit cost of debt for each of the following situations :

i) Debentures are sold at par and floatation cost is 5%.

ii) Debentures are sold at premium of 10% and floatation cost is 5% of issue price.

iii) Debentures are sold at discount of 5% and floatation cost is 5% of issue price.

Other Informations : Coupon rate of interest on debentures is 10% ; Face value is Rs 100 ; Maturity period is 10 years and tax rate is 35%. **(10 Marks)**

6 a. What is Internal rate of return? **(03 Marks)**

b. Explain in brief the factors governing capital structure decisions. **(07 Marks)**

c. A company is considering an investment proposal to install a new milling controls at a cost of Rs 50,000. The facility has a life expectancy of 5 years without any savage value. The firm uses SLM of depreciation and the same is used for tax purposes. The tax rate is assumed to be 35%. The estimated cash flows before depreciation and tax (CFBT) from the investment proposal are as follows :

Years	1	2	3	4	5
CFBT (Rs)	10,000	10,692	12,769	13,462	20,385

Compute i) Payback period ii) Average rate of return iii) NPV at 10% discount rate iv) Profitability index at 10% discount rate. **(10 Marks)**

7 a. What is stock split? How does it differ form bonus shares? **(03 Marks)**

b. What is Corporate Governance? What are the corporate governance conditions pertaining to the Board of Directors of listed companies? **(07 Marks)**

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

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

Determine the weighted average cost of capital using i) Book value weight and ii) Market value weights. How are they different? Can you think of a situation where the WACC would be the same using either of the weights? **(10 Marks)**

8 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% to your estimated figure to cover unforeseen contingencies. The information about the projected Profit & Loss A/c of the company is as under.

	Rs
Sales	21,00,000
Cost of goods sold	-15,30,000
Gross Profit	5,70,000
Administrative expenses Rs 1,40,000	
Selling expenses 1,30,000	- 2,70,000
Profit before tax	3,00,000
Provision for tax	1,00,000

Cost of Goods Sold consists of the following

Materials used	8,40,000
Wages & Manufacturing expenses	6,25,000
Depreciation	2,35,000
Total	17,00,000
Less : Stock of finished goods (10% not yet sold)	- 1,70,000
Cost of Goods sold	15,30,000

The figures given above relate only to the goods that have been finished and not to work – in – progress : Goods equal to 15% of the year's production (in terms of physical units) are in progress on an average, requiring full materials but only 40% of other expenses. The company believes in keeping two months consumption of material in stock. Desired cash balance is Rs 40,000.

Average time – log in payment of all expenses is 1 month ; Suppliers of materials extend 1.5 months credit ; Sales are 20% cash ; Rest are at two months credit ; 70% of the income tax has to be paid in advance in quarterly instalments.

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

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10MBA23

Second Semester MBA Degree Examination, June/July 2011
Financial Management

Time: 3 hrs. Max. Marks:100

Note: *1. Answer any FOUR full question from Q-1 to Q-7.*
2. Q-8 is compulsory.
3. PV tables may be provided.

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

b. i) Assume that a deposit is to be made at year zero into an account that will earn 8% compounded annually. It is desired to with draw Rs. 5000 three years from now and Rs. 7000 six years from now. What is the size of the year zero deposit that will produce these future payments?

ii) Find out the present value of an investment which is expected to give a return of Rs. 2500 p.a. indefinitely and the rate of interest is 12% p.a.

iii) A finance company makes an offer to deposit a sum of Rs. 1100 and then receive a return of Rs. 80 p.a. perpetually. Should this offer be accepted if the rate of interest is 8%? Will the decision change if the rate of interest is 5%? **(07 Marks)**

c. Explain the different types of financial decision that form the subject matter of corporate financial management. **(10 Marks)**

2 a. What is cost of capital? **(03 Marks)**

b. Stock A has an expected return of 18% and a standard deviation of 30%. Stock B has an expected return of 12% and a standard deviation of 36%. The correlation between the two stocks is 0.25. If you form a portfolio where you put 40% of your money in A and 60% in B, What is the expected return and standard deviation for the portfolio? **(07 Marks)**

c. The following is the capital structure of Zenith Co. Ltd as on 31-12-2010

	Rs.
Equity shares [10,000 shares of Rs.100 each)	10,00,000
10% Preference shares [of Rs.100 each)	4,00,000
12% Debentures	6,00,000
	20,00,000

The market price of the company's share is Rs.110 and it is expected that a dividend of Rs.10 per share would be declared after one year. The dividend growth rate is 6%

i) If the company is in the 50% tax bracket, compute the weighted average cost of capital.

ii) Assuming that in order to finance an expansion plan, the company intends to borrow a fund of Rs. 10,00,000 bearing 14%, what will be the company's revised weighted average cost of capital? This financing decision is expected to increase dividend from Rs.10 to Rs.12 per share. However, the market price of equity share is expected to decline from Rs.110 to Rs.105 per share. **(10 Marks)**

2. Any revealing of identification, appeal to evaluator and /or equations written eg, 42+8 = 50, will be treated as malpractice.

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

b. From the following data compute the duration of the operating cycle for each of the two years.

	Year 1 (Rs)	Year 2 (Rs)
Stock of raw materials	20,000	27,000
Work in progress	14,000	18,000
Finished goods stock	21,000	24,000
Purchases	96,000	1,35,000
Cost of goods sold	1,40,000	1,80,000
Sales	1,60,000	2,00,000
Debtors	32,000	50,000
Creditors	16,000	18,000

Assume 360 days per year for computational purposes. **(07 Marks)**

c. The data relating to two companies are as given below :

	Company A	Company B
Capital	Rs.6,00,000	Rs.3,50,000
12% Debentures	Rs.4,00,000	Rs.6,50,000
Output (units) per annum	60,000	15,000
Selling price per unit	Rs.30	Rs.250
Fixed costs per annum	Rs.7,00,000	Rs.14,00,000
Variable cost per unit	Rs.10	Rs.75

You are required to calculate the operating leverage, financial leverage and combined leverage of two companies. **(10 Marks)**

4 a. Differentiate between primary and secondary market. **(03 Marks)**

b. Discuss the elements of good corporate governance. **(07 Marks)**

c. A company is considering the replacement of its existing machine which is obsolete and unable to meet the rapidly rising demand for its product. The company is faced with two alternatives :

i) To buy Machine A which is similar to the existing machine which costs Rs.25 lakhs.

ii) To go in for Machine B which is more expensive and has much greater capacity which costs Rs.40 lakhs.

The cash inflows from these machines are as follows :

Year	Machine A (Rs. in lakhs)	Machine B (Rs. in lakhs)
1	-	10
2	5	14
3	20	16
4	14	17
5	14	15

The company's cost of capital is 10%. The finance manager tries to evaluate the machine by calculating the following :

i) NPV

ii) Profitability index

iii) Payback period

At the end of his calculations, however the finance manager is unable to make up his mind as to which machine to recommend.

You are required to make these calculations and in the light there of to advise the finance manager about the proposed investment. **(10 Marks)**

5 a. What is meant by stable dividend policy? **(03 Marks)**

b. Your company has bought a Rs.1,25,800 price of equipment 2 years ago. Its present book value is Rs.87,000. It can be sold today for Rs.1,25,000 (before taxes). However, if kept, it will last five more years and produce expected cash revenues (net of expenses) before taxes of Rs.20,000 for each of the five years. A replacement machine costs Rs.1,80,000 and is expected to produce cash flows (before taxes) of Rs.28,000 for each of the next five years. Straight-line depreciation for 5 years can be employed for both the new and the old machine, the tax rate is 35% and the firms required rate of return is 10%. Furthermore assume that neither machine has salvage value in five years.
Determine the relevant cash flows for each alternative. **(07 Marks)**

c. Discuss the factors influencing the working capital requirements of a firm. **(10 Marks)**

6 a. Differentiate between money market and capital market. **(03 Marks)**

b. Following information is available relating to risk free rate (R_f) and market return (R_m)

Year	R_f (%)	R_m (%)
1	6	14
2	5	3
3	7	21
4	8	26
5	9	3
6	7	11

On the basis of the above information find out the cost of equity capital on the basis of CAPM given that the beta factor is 0.863 **(07 Marks)**

c. Explain the factors affecting dividend policy. **(10 Marks)**

7 a. What is market risk? **(03 Marks)**

b. Explain the different approaches to financing working capital requirements. **(07 Marks)**

c. Discuss the various factors relevant in planning the capital structure of a firm. **(10 Marks)**

8 Case study

Heritage Garment Ltd. is a famous manufacturer of garments. The finance manager of the company is preparing its working capital forecast for the next year. After carefully screening all the documents, he collected the following information.

Production during the previous year was 15,00,000 units. The same level of activity is intended to be maintained during current year. The expected ratios of cost to selling price are :

Raw materials	40%
Direct wages	20%
Overheads	20%

The raw materials ordinarily remain in stores for 3 months before production. Every unit of production remains in the process for 2 months and is assumed to be consisting of 100% raw material, wages and overheads. Finished goods remain in warehouse for 3 months. Credit allowed by creditors is 4 months form the date of the 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.200,000. Lag in payment of wages is half month. Lag in payment of expenses is also half month. Selling price is Rs.10 per unit. Both production and sales are in a regular cycle. Make a provision of 10% for contingency (except cash)

Assuming yourself to be the finance manager for Heritage Garment Ltd. estimate the working capital requirements of the company. **(20 Marks)**

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Important Note : 1.