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Second Semester MBA Degree Examination, June 2012

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.

- 1 a. What is time value of money? (03 Marks)
 b. Discuss three broad areas of financial decision making. (07 Marks)
 c. Briefly explain the basic reasons, why profit maximization fails in comparison with wealth maximization. (10 Marks)
- 2 a. What is an intrinsic cost? Give an example. (03 Marks)
 b. Explain the different types of derivatives. (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% Reference shares	Rs. 12 lakhs
7% Debentures	Rs. 8 lakhs
	Rs. 50 lakhs

The company earns 12% on its capital as its EBIT. The income tax rate is 35%. The company requires a sum of Rs. 25 lakhs to finance its expansions programme for which he 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 share.
 iii) Issue of 8% debentures.

Which of the above alternatives would you recommend? Why? The estimated P/E ratio of equity, Preference share and debenture would be 15, 12 and 10 respectively. (10 Marks)

- 3 a. Define swaps. (03 Marks)
 b. Briefly explain the factors affecting dividend policy. (07 Marks)
 c. From the following balance sheet of Venex Ltd., calculate i) Leverages ii) EBIT level if EPS is Rs.6.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Equity capital (Rs.10 per share)	1,80,000	Fixed Asset	4,50,000
10% Debentures	2,40,000	Current Assets	1,50,000
Retained earnings	60,000		
Current liability	1,20,000		
	6,00,000		6,00,000

The company's total assets turnover ratio is 2.5 times. The fixed operating costs are Rs.2,00,000. Variable cost ratio is 40%. Income tax is 50%. The equity shares are issued at Rs.10 per share. (10 Marks)

- 4 a. What is WACC? How is it calculated? (03 Marks)
 b. What is leasing? What are the different types of leasing? (07 Marks)
 c. Following is the cash flow of a project:

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

Assume discount rate is 12%. Calculate the NPV. (10 Marks)

- 5 a. What is sweat equity share? (03 Marks)
 b. Explain the factors affecting capital structure decisions. (07 Marks)

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.

- c. From the following data, compute the duration of the operating cycle for a each of the two years and comment on increase/decrease. Assume 360 days per year. (10 Marks)

Particulars	Year 1	Year 2
Stocks: Raw materials	20,000	27,000
Work in progress	14,000	18,000
Finished goods	21,000	24,000
Purchase of raw materials	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

- 6 a. What is business risk? (03 Marks)

- b. Determine accounting rate of return from the following data:

Original investment	56125
Additional investment in NWC	5000
Estimated life in years	5
Estimated salvage value	3000
Average income tax	55%

Annual income after depreciation of tax:

1 Year	2 Year	3 Year	4 Year	5 Year
3375	5375	7375	9375	11375

(07 Marks)

- c. The target capital structure of a company is 40% equity and 60% debt. The company in consultation with its merchant bankers has come out with the following ranges of new financing from each source and the cost associated with it. Prepare a weighted marginal cost of capital schedule.

Source	Range of finance (Rs. Million)	Cost (%)
Equity	0 – 30	18
	More than 30	20
Debt	0 – 50	10
	More than 50	11

(10 Marks)

- 7 a. What is external financing requirement? (03 Marks)

- b. Explain the various sources of long term financing. (07 Marks)

- c. High Tech ltd. plans to sell 30000 units next year. The expected cost of goods sold is as follows

Raw materials	Rs.100 per unit
Manufacturing expenses	Rs. 30 per unit
Selling and administrative expenses	Rs. 30 per unit
Selling price	Rs.200 per unit

The duration at various stages of the operating cycle is expected as follows:

Raw materials – 2 months Work in progress – 1 months

Finished goods – ½ month Debtors – 1 month

Assume the monthly sales level of 2500 units and calculate investment in current assets.

Also estimate the gross working capital requirement if the desired cash balance is 5% of gross working capital requirement. (10 Marks)

8 Case Study :

Northern Chemicals 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 of depreciation and the same is accepted for 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 Rs.40,000 per year to Rs.76,000 per year. Advice whether the machine should be sold. (20 Marks)
