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08MBA23

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.
3. Present value tables may be used.

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.

1 a. What are investment decisions? **(03 Marks)**

b. State the factors affecting dividend policy. **(07 Marks)**

c. Calculate the following :

i) Suppose you deposit Rs.1000 today in a bank which pays 10% interest compounded annually, how much will the deposit grow to after 8 years and 12 years?

ii) If you deposit Rs.5000 today at 6% rate of interest, in how many years will this amount double?

iii) Your father deposits Rs.300000 on retirement in a bank, which pays 10% p.a. interest. How much can be withdrawn annually for a period of 10 years? **(10 Marks)**

2 a. What is cost of capital? State the problems in determining it. **(03 Marks)**

b. Explain briefly merits and demerits of pay back period. **(07 Marks)**

c. Modern steel mills is considering the possibility of raising Rs.500000 by issuing equity shares, preference shares and debentures. The book values and market values of the issues are as follows:

Particulars	Book value	Market value
Equity shares	200000	300000
Preference shares	100000	120000
Debentures	200000	180000
	500000	600000

The following costs are expected to be incurred on the above mentioned issues of capital. Corporate tax rate is 50%.

i) The company's equity share is currently selling for Rs.150. It is expected that the company will pay a dividend of Rs.8 per share at the end of next year which is expected to grow at a rate of 7%. The company has to incur Rs.5 per share as floatation cost.

ii) The 11% Rs.100 face value preference share will be sold for Rs.125. However, the company will have to pay Rs.6 per preference share as under writing commission.

iii) The company can sell a 10 year Rs.500 face value debentures with a 9% rate of interest. An underwriting fee of 2% on issued price would be incurred to issue the debentures.

Compute the weighted average cost of capital using i) book value weights ii) Market value weights. **(10 Marks)**

3 a. What is CAPM? Mention its assumptions. **(03 Marks)**

b. What are the key activities of a financial manager? **(07 Marks)**

c. Briefly explain the basic reasons, why profit maximization fails to be consistent with wealth maximization. **(10 Marks)**

4 a. Distinguish between diversifiable and nondiversifiable risk. **(03 Marks)**

b. Write a note on secondary market. **(07 Marks)**

c. ABC company is currently on ordinary share capital of Rs.2500000 consisting of 25000 shares of Rs.100 each. The management is planning to raise another Rs.2000000 to finance an expansion programme. The options are

i) Entirely through ordinary shares.

ii) Rs.1000000 lakh through ordinary shares and Rs.1000000 lakh through long term borrowing at 8% p.a.

iii) Rs.500000 through ordinary shares and Rs.1500000 through long term borrowing @9% p.a.

iv) Rs.1000000 lakh through ordinary shares and Rs.1000000 lakh through preference shares with 5% dividend.

The companies expected earning before interest and taxes will be Rs.800000. Assuming tax rate of 50%, determine EP5 and comment which alternative is best and why. **(10 Marks)**

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

b. What are the key elements of SEBI code on corporate governance? **(07 Marks)**

c. From the following, prepare income statements of A, B and C. Briefly comment on each firm's performance.

Particulars	Firm A	Firm B	Firm C
Financial leverage	3:1	4:1	2:1
Interest (Rs.)	200	300	1000
Operating leverage	4:1	5:1	3:1
Variable cost as a % of sales	66.67%	75%	50%
Income-tax rate	45%	45%	45%

(10 Marks)

6 a. What are the elements of cashflow stream? **(03 Marks)**

b. What are the dangers of excess working capital? **(07 Marks)**

c. XYZ Ltd., is presently operating at 60% level, producing 36000 units per annum. In view of favourable market conditions, it has been decided that from 1/1/2009, the company would operate at 90% capacity. The following information is available:

i) Existing cost – price structure per unit is given below:

Raw material = Rs.4.00 Wages = Rs.2.00
Overheads (variable) = Rs.2.00 Overheads (fixed) = Rs.1.00
Profits = Rs.1.00

ii) It is expected that the cost of raw materials, wages, expenses and sales per unit will remain unchanged in 2009.

iii) Raw materials remain in stores for 2 months before these are issued to production. These units remain in the process for one month.

iv) Finished goods remain in godown for two months.

v) Credit allowed to debtors is 2 months. Credit allowed by creditors is three months.

vi) Lag in wages amount and overheads payment is one month. It may be assumed that wages and overheads accrue evenly throughout the production cycle. You are required to calculate the working capital requirements on an estimated basis to sustain the increased production level. Assumptions made, if any, should be clearly indicated. **(10 Marks)**

7 a. Differentiate between operating leverage and financial leverage. **(05 Marks)**

b. Consider the cashflows of the following investment decisions and rank them on net present value, profitability index, payback period and accounting rate of return method.

Investments	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%. **(15 Marks)**

8 Case Study:

Supreme industries is evaluating a project for which the following information has been assembled:

i) The total outlay of the project is expected to be Rs.450 million. This consists of Rs.250 million of fixed assets and Rs.200 million of gross current assets.

ii) The proposed scheme of financing is as follows: Rs.100 million of equity, Rs.200 million of term loans, Rs.100 million of working capital advance and Rs.50 million of trade credit.

iii) The term loan is repayable in 10 equal semi-annual installments of Rs.20 million each. The first installment will be due after 18 months. The interest rate on the term loan will be 15%.

iv) The levels of working capital advance and trade credit will remain at Rs.100 million and Rs.50 million respectively till they are paid back or retired at the end of 6 years. The working capital advance will carry an interest rate of 18%.

v) The expected revenues for the project will be Rs.500 million per year. The operating costs (excluding depreciation and interest) are expected to be Rs.320 million per year. The depreciation rate on the fixed assets will be $33\frac{1}{3}\%$ as per the written down value method.

vi) The net salvage value of fixed assets and current assets, at the end of year 6 (the project life is expected to be 6 years) will be Rs.80 million and Rs.200 million respectively.

vii) The tax rate applicable to the firm is 50%.

Project the cash flows. **(20 Marks)**

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