Second Semester MBA Degree Examination, June/July 2013

Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. ***Answer any FOUR full questions from Q.No.1 to Q.No.7.***
2. ***Question No. 8 is compulsory.***
3. ***Use of Present value and Future value tables is permitted.***

1 a. What are the three main financial decisions in a firm? **(03 Marks)**
b. Explain the changing role of finance manager. **(07 Marks)**
c. i) A borrower offers 16% nominal rate of interest with quarterly compounding. What is the effective rate of interest?
ii) A finance company advertises that it will pay a lump sum of Rs.44650 at the end of five years to investors who deposit annually Rs.6000 for 5 years. What is the interest rate implicit in this offer?
iii) Mahesh deposits Rs.2,00,000 in a bank account which pays 10 percent interest. How much can he withdraw annually for a period of 15 years? **(10 Marks)**

2 a. What is time value of money? **(03 Marks)**
b. A Ltd. Has 16% preference shares of 25 lakhs. Redeemable after 10 years at a premium of 20%. What would be the cost of preference shares if they are issued at (i) premium of 10%, (ii) discount of 10%? **(07 Marks)**
c. XYZ Ltd. is an established company which requires more funds of Rs.30,00,000 for its expansion scheme. Apart from the original equity capital of Rs.30,00,000 at Rs.100 per share.
The director has the following options to raise the additional funds:
i) All in equity shares
ii) Rs.10,00,000 in equity shares and balance in 8% debentures.
iii) All in form of debentures carrying an interest rate of 8%.
iv) Rs.10,00,000 in 12% preference shares and the balance in equity shares.
The expected EBIT is Rs.8,00,000 and the tax rate applicable is 50%. Advice the company by analyzing the options. **(10 Marks)**

3 a. Explain the merits and demerits of CAPM approach of cost of equity (capital asset pricing model). **(05 Marks)**
b. Following is the Balance Sheet of S Ltd.

Liabilities	Amt	Assets	Amt
Equity share capital	20,00,000	Fixed assets	40,00,000
12% preference share capital	5,00,000	Current assets	20,00,000
Reserves	5,00,000		
Current liabilities	10,00,000		
	60,00,000		60,00,000

The company plans to pay a dividend of Rs.18 on equity shares which is expected to grow annually at 3%. Currently the equity is selling at Rs.150 per share, preference shares at Rs.120 per share and debentures at Rs.96 per debenture. The tax rate applicable is 50%.
The preference shares are redeemable after 5 years at Rs.110 per share and debentures are redeemable after 10 years at par.
Calculate weighted average cost of capital using book value weights and market value weights. **(15 Marks)**

4 a. Explain stable payout ratio in dividend policy. **(03 Marks)**
b. Distinguish between capital market and money market. **(07 Marks)**
c. Explain the factors determining capital structure decision. **(10 Marks)**

5 a. Differentiate between debentures and equity. **(03 Marks)**
b. Calculate the operating cycle of a company which gives the following details:

Raw material consumption per annum	8,42,000
Annual cost of production	14,25,000
Annual cost of sales	15,30,000
Annual sales	19,50,000
Average value of current assets held:	
Raw material	1,24,000
Work-in-progress	72,000
Finished goods	1,22,000
Debtors	2,60,000

The company gets 30 days credit from its suppliers. All sales made by the firm are on credit only. You may take one year as equal to 365 days. **(07 Marks)**
c. Explain the factors determining working capital requirement. **(10 Marks)**

6 a. What do you mean by leverage? List the types of leverage. **(03 Marks)**
b. For the following project calculate internal rate of return. **(07 Marks)**

Particulars	Amount
Initial investments	10,00,000
Cash flows:	
1	1,80,000
2	2,20,000
3	2,60,000
4	3,00,000
5	2,50,000

c. Calculate operating leverage, financial leverage and combined leverage under situation A and B and financial plan 1 and 2. From the following information relating to XYZ ltd.

Particulars	Amt
Installed capacity (units)	1200
Actual production and sales (units)	800
Selling price per unit (Rs.)	15
Variable cost per unit (Rs.)	10
Fixed cost situation A (Rs.)	1000
Fixed cost situation B (Rs.)	2000

Financial plans:

Particulars	1	2
Equity	5000	7500
Debit	5000	2500
Cost of debit	12%	12%

(10 Marks)

7 a. What is Agency problem? **(03 Marks)**
b. Explain the legal provisions of corporate governance under companies act. **(07 Marks)**

7 c. A company provided the following data:

Particulars	Cost per unit
Raw materials	52.00
Direct labour	19.50
Overheads	39.00
	110.50
Profit	19.50
Selling price	130.00

The following additional information is available:

Average raw material in stock one month.
Average materials in process: half-a-month
Average finished goods in stock: one month
Credit allowed by suppliers: one month
Credit allowed to debtors: two months
Time lag allowed in payment of wages: one and half weeks
Overheads: one month
One-fourth of sales are on cash basis
Cash balance is expected to be 1,20,000.

You are required to prepare a statement showing the working capital needed to finance a level of activity of 70,000 units of annual output. The production is carried throughout the year on even basis and wages and overheads occur similarly. (Calculations be made on the basis of 30 day a month and 52 weeks a year) **(10 Marks)**

8 a. ITC ltd. has decided to purchase a machine to augment the company's installed capacity to meet the growing demand for its products. There are three machines under consideration of the management. The relevant details including estimated yearly expenditure and sales are given below. All sales are on cash. Corporate income-tax rate is 40%. Interest on capital may be assumed to be 10%.

Particulars	Machine I	Machine II	Machine II
Initial investment required	3,00,000	3,00,000	3,00,000
Estimates annual sales	5,00,000	4,00,000	4,50,000
Cost of production:			
Direct material	40,000	50,000	48,000
Direct labour	50,000	30,000	36,000
Factory O.H.	60,000	50,000	58,000
Administration cost	20,000	10,000	15,000
Selling & distribution costs	10,000	10,000	10,000

The economic life of machine I is 2 years while it is 3 years for the other two. The scrap values are Rs.40,000, Rs.25,000 and Rs.30,000 respectively, you are required to find out the most profitable investment based on 'payback period method'. **(12 Marks)**

b. ABC company is considering an investment proposal to install a new machine at a cost of Rs.50,000. The machine has a life of 5 years and no salvage value. Tax rate is 35%.

Assume the firm uses straight line method for depreciation. The estimated cash flows before depreciation and tax rate are given below:

Year	1	2	3	4	5
Cash flow before depreciation and tax	10,000	10,692	12,769	13,462	20,385

i) Calculate net present value, assume discount rate to be 10%.
ii) Calculate profitability index at 10% discount rate. **(08 Marks)**

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