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Second Semester MBA Degree Examination, June/July 2014
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 wealth maximization? **(03 Marks)**

b. Discuss the changing role of finance managers. **(07 Marks)**

c. (i) Calculate the present value of ₹ 600. (a) received one years from now; (b) received at the end of fifteen years. Assume 5% time preference rate.

(ii) A company has issued debentures of ₹ 50 lakh to be repaid after 7 years. How much should the company 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 ₹ 1800 for 10 years if you invest ₹ 12,000 today. What rate of return would you earn? **(10 Marks)**

2 a. Distinguish between gross working capital and net working capital. **(03 Marks)**

b. What do you understand by cost of capital? Discuss its significance. **(07 Marks)**

c. A company is considering an investment proposed to install a new machine costing ₹ 500,000. It has no salvage value and the life is 5 years. The company follows SLM of depreciation and tax rate is 30%. From the following details compute (i) NPV@10% and (ii) PI.

Year	1	2	3	4	5
CFBT (₹)	105,000	110,000	140,000	150,000	250,000
DF @ 10%	0.909	0.826	0.751	0.683	0.621

(10 Marks)

3 a. What do you understand by operating leverage and financial leverage? **(03 Marks)**

b. State the factors which determine the dividend policy of a firm. **(07 Marks)**

c. A company is considering the possibility of raising ₹ 500,000 by issuing equity shares, preference shares and debentures. The book values and market values of the issues are as follows:

	Book value (₹)	Market Value (₹)
Equity shares	200,000	300,000
Preference shares	100,000	120,000
Debentures	200,000	180,000
	500,000	600,000

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

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

(ii) 11% ₹ 100 face value preference share will be sold for ₹ 125. However, the company will have to pay ₹ 6 per preference share as underwriting commission.

(iii) The company can sell a 10 year ₹ 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 the following:
(a) Book value weights and (b) Market value weights. **(10 Marks)**

4 a. Discuss the features of optimum capital structure. **(05 Marks)**

b. Calculate operating leverage and financial leverage under situations A, B and C and financial plan I & II.

Installed capacity (units)		1000
Actual production and sales (units)		800
Selling price per unit		15
Variable cost per unit		10
Fixed cost (₹)	Situation A -	1000
	Situation B -	2000
	Situation C -	3000

Capital structure:

	Financial Plan	
	I ₹	II ₹
Equity	5000	7500
Debt	5000	2500

Cost of Debt (for all plans) – 12% **(15 Marks)**

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

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

c. What is the concept of corporate governance? Why has it become so important in India? **(10 Marks)**

6 a. What is commodity market? **(03 Marks)**

b. Explain the stages in Capital Budgeting process. **(07 Marks)**

c. A company is evaluating a project that has the following cash flow stream associated with it.

Year	0	1	2	3	4	5	6
Cash outflows (₹ in lakhs)	120	80	-	-	-	-	-
Cash inflows (₹ in lakhs)	-	-	20	60	80	100	120

Compute modified internal rate of return. The cost of capital is 15%. **(10 Marks)**

7 a. What are systematic risks and unsystematic risks? **(03 Marks)**

b. What is CAPM? Mention its assumptions. **(07 Marks)**

c. A newly established company wishes to determine appropriate capital structure. It can issue 12% Debentures and 10% preference shares and the existing tax is 35%. The company requires ₹ 50 lakhs. The possible capital is

Plan	Debenture Capital (%)	Preference Capital (%)	Equity Capital (%)
1	-	-	100
2	30	-	70
3	30	20	50
4	50	20	30

If EBIT is 12%, calculate EPS under different financial plans. **(10 Marks)**

8 a. Explain the factors affecting working capital requirements of a firm. **(10 Marks)**

b. A Co. Ltd., is presently operating at 60% level, producing 36,000 units p.a. In view of favourable market conditions, it has been decided that from 1-1-2011, the company would operate at 90% capacity. The following information is available.

(i) Existing cost structure per unit

	₹		₹
Raw Materials	4.00	Wages	2.00
Overheads (variable)	2.00	Overheads (fixed)	1.00
Profit	1.00		

(ii) It is expected that cost of raw materials, wages, expenses and sales per unit will remain unchanged in 2011.

(iii) Raw materials remain in stores for 2 months before issued to production. These units remain in the process for 1 month.

(iv) Finished goods remain in godown for 2 months.

(v) Credit allowed to debtors is 2 months. Credit allowed by creditors is 3 months.

(vi) Lag in wages and overheads payment is 1 month. It may be assumed that wages and overheads accrue evenly throughout the production cycle.

You are required to calculate working capital requirements in an estimated basis to sustain the increased production level. Assumptions made, if any, should be clearly indicated. **(10 Marks)**

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