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12MBA25

Second Semester MBA Degree Examination, June/July 2014

Financial Management

Time: 3 hrs. Max. Marks: 100

Note: 1. *Answer any THREE full questions from Q.No.1 to Q.No.6.*
2. *Q.No.7 and Q.No.8 are compulsory.*
3. *Use of P.V. tables is permitted.*

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 do you mean by capital rationing? **(03 Marks)**

b. Briefly explain the approaches to financial mix of current assets. **(07 Marks)**

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

Type of capital	Book value (Rs.)	Market value (Rs.)	Specific costs (%)
Debt	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
	13,00,000	16,90,000	

Determine the weighted average cost of capital using:
i) Book value weights and ii) Market value weights **(10 Marks)**

2 a. An investor deposits Rs.100 in a bank account for 5 years at 8% interest. Find out the amount which he will have in his account if interest is compounded quarterly. **(03 Marks)**

b. What do you mean by hybrid financing? Explain the features of preference shares as an instrument of hybrid financing. **(07 Marks)**

c. While preparing a project report on behalf of a client you have collected the following facts. Estimate the net working capital required for that project. Add 10% to your computed figure to allow contingencies:

Particulars	Amt. per unit
Estimated cost per unit of production:	
Raw material	Rs. 80
Direct labour	30
Overheads (excluding depreciation of Rs.10 per unit)	60
Total cash cost	170

Additional information:

Selling price = Rs.200 per unit
Level of activity = 104000 units of production p.a.
Raw materials in stock, average 4 weeks
Work in progress (assume 50% completion stage in respect of conversion costs and 100% completion in respect of materials) average 2 weeks.
Finished goods in stock, average 4 weeks.
Credit allowed by suppliers – average 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 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)**

3 a. What do you mean by CAPM approach? (03 Marks)
b. What do you mean by leasing? Briefly explain the types of leasing. (07 Marks)
c. What are the objectives of financial management? Why is profit/EPS maximization fails to be consistent with wealth maximization? (10 Marks)

4 a. What do you mean by a derivative? Give an example. (03 Marks)
b. A company has 10% perpetual debt of Rs.100000. The tax rate is 35%. Determine the cost of capital (before tax as well as after tax) assuming the debt is issued at:
i) par,
ii) 10% discount,
iii) 10% premium (07 Marks)
c. Describe the Indian financial system briefly. What are its functions? (10 Marks)

5 a. Distinguish between Angel investing and private equity. (03 Marks)
b. You want to take a world tour which costs Rs.10,00,000, the cost of which is expected to remain unchanged in nominal terms. You are willing to save annually Rs.80000 to fulfill your desire. How long will you have to wait if your savings earn a return of 14% p.a.? (07 Marks)
c. Shiva electronics plans to use equity and debt in the following proportions:
Equity = 40
Debt = 60
Based on its discussions with its merchant bankers and lenders Shiva Electronics estimates the cost of its sources of finance for various levels of usage as follows:

Source of Finance (Rs. in million)	Range of New Financing	Cost (%)
Equity	0 – 30	18%
	More than 30	20%
Debt	0 – 50	10%
	More than 50	11%

From the above data, prepare weighted marginal cost of capital schedule. (10 Marks)

6 a. Distinguish between a merger and an acquisition with examples. (03 Marks)
b. The following is the balance sheet of 'V' Ltd. as on 31/03/2014.

Liabilities	Amt (Rs.)	Assets	Amt (Rs.)
Equity capital (Rs.10 per share)	1,80,000	Fixed assets	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 is 2.5 times. The fixed operating costs are Rs.2 lakhs. Variable operating cost ratio is 40%. Income tax rate is 50%. Calculate three leverages. (07 Marks)
c. A company is considering an investment proposal to install a new machine. The project will cost Rs.50,000 and will have a life of 5 years and no salvage value. Tax rate is 50%, the company follows straight-line method of depreciation. The net earnings before depreciation and tax is as follows:

Year:	1	2	3	4	5
EBDT (Rs.):	10,000	11,000	14,000	15,000	25,000

Evaluate the project using: i) PBP, ii) ARR, ii) NPV at 10% and iv) PI at 10% discount factor. (10 Marks)

7 a. An executive is about to retire at the age of 60. His employer has offered him two post retirement options: i) Rs.20,00,000 lumpsum, ii) Rs.2,50,000 for 10 years. Assuming 10% interest which is a better option? **(05 Marks)**

b. You are an investment analyst and are approached by a firm seeking your help in designing its capital structure. What factors would you consider while designing the capital structure for the company? **(05 Marks)**

c. As a part of expansion strategy, your company is planning to set up a subsidiary in USA. What are the sources that you would consider for raising the additional capital? **(05 Marks)**

d. You have Rs.10,00,000 of savings and are evaluating two companies to invest in the share capital. Company 'X' follows a stable dividend policy whereas company 'Y' follows a constant dividend payout ratio. Which one do you choose? Why? **(05 Marks)**

8 Naveen enterprises is considering a capital project about which the following information is available:

i) The investment outlay on the project will be Rs.100 million. This consists of Rs.80 million on plant and machinery and Rs.20 million on net working capital. The entire outlay will be incurred at the beginning of the project.

ii) The project will be financed with Rs.45 million of equity capital, Rs.5 million of preference capital, and Rs.50 million of debt capital. Preference capital will carry a dividend rate of 15%, debt capital will carry an interest rate of 15%.

iii) The life of the project is expected to be 5 years. At the end of 5 years, fixed assets will fetch a net salvage value of Rs.30 million whereas net working capital will be liquidated at its book value.

iv) The project is expected to increase revenues of the firm by Rs.120 million per year. The increase in costs on account of the project is expected to be Rs.80 million per year (this includes all items of cost other than depreciation, interest and tax). The effective tax rate will be 30%.

v) Plant and machinery will be depreciated at the rate of 25% per year as per the written down value method. Hence, the depreciation charges will be:

First year = Rs.20.00 million
Second year = Rs.15.00 million
Third year = Rs.11.25 million
Fourth year = Rs.8.44 million
Fifth year = Rs.6.33 million

From the above information, estimate the projects cash flows. **(20 Marks)**

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