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08MBA23

Second Semester MBA Degree Examination, May/June 2010
Financial Management

Time: 3 hrs. Max. Marks:100

Note: ***1.Answer any FOUR full questions form Q.No.1 to 7. and Q.No.8 is compulsory.***
2.Use of time value tables is permitted.

1 a. Distinguish between future value and present value. **(03 Marks)**

b. Assume the rate of interest to be 12%. Compute annual percentage/ effective rate, if interest period is i) Annual ii) Semiannual iii) Quarterly. **(07 Marks)**

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

2 a. What is a cash cycle? **(03 Marks)**

b. Explain the three different approaches of financing the working capital. **(07 Marks)**

c. As a financial analyst of a large company, you are required to determine the weighted average cost of capital of the company using i) Book value weights ii) Market value weights. The additional information is given below:
Company's present book value capital structure is

Debentures (Rs. 100 per debenture)	Rs. 8,00,000
Preference share (Rs. 100 per share)	Rs. 2,00,000
Equity share (Rs. 10 per share)	Rs. 10,00,000
	20,00,000

All these securities are traded in capital market. Prices are: Debentures Rs.110 per debenture, Preference shares Rs. 120 per share, equity shares Rs.22 per share.

Anticipated external financing opportunities are i) Rs.100 per debenture redeemable at par, 10 year maturity 11% coupon rate, 4% flotation costs, sale price Rs.100. ii) Rs.100 preference share, redeemable at par, 10 year maturity 12% dividend rate, 5% flotation costs, sale price Rs.100. iii) Equity shares, Rs.2 per share flotation costs, sale price = Rs. 22.

In addition, the dividend expected on equity share at the end of the year is Rs. 2 per share; the anticipated growth rate is 7% and the firm has a practice of paying all its earnings in the form of dividend. The corporate tax rate is 35%. **(10 Marks)**

3 a. Distinguish between diversifiable and non-diversifiable risk. **(03 Marks)**

b. What is stable dividend policy? Explain. **(07 Marks)**

c. Estimate the working capital required for the project. Add 10% to the computed figures to allow for contingencies.

Cost sheet	Amount per unit (Rs.)
Raw material	80
Direct labour	30
Overheads	60
Total cost of production	170

Additional information:

Selling price – Rs. 200 per unit | Level of activity – 104000 units.

Work in progress (100% of raw material, 50% of conversion cost) – average 2 weeks.

Raw material in stock - average 4 weeks | Finished goods in stock – average 4 weeks

Credit allowed by suppliers – 4 weeks | Credit allowed to debtors – 8 weeks

Lag in payment of wages – average 1.5 weeks. | Cash at bank – Rs. 25,000

Production is carried out evenly throughout the year. All sales are on credit basis. **(10 Marks)**

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

b. Explain the CAPM approach for computing the cost of equity. Discuss the merits and demerits of the approach. **(07 Marks)**

c. Describe the key legal provisions and key elements of SEBI code on corporate governance. **(10 Marks)**

5 a. What is optimum capital structure? **(03 Marks)**

b. Explain the emerging role of financial managers, in India. **(07 Marks)**

c. A company has to select one of the two alternative projects whose particulars are given below.

Particular	Project A	Project B
Initial outlay	1,18,720	1,00,760
Net cash flow:		
1st Year	1,00,000	10,000
2nd Year	20,000	10,000
3rd Year	10,000	20,000
4th Year	10,000	1,00,000

The company can arrange necessary funds @ 8%. Compute the payback period and NPV of each project. Comment on the result. **(10 Marks)**

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

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

c. A company has a capital of Rs.1,00,000 divided into shares of Rs.10 each. It has expansion plans requiring an investment of another Rs. 50,000. The management is considering the following alternatives for raising this amount:

i) Issue of Rs. 5000 shares of Rs. 10 each

ii) Issue of Rs. 5000, 12% preference shares of Rs. 10 each

iii) Issue of 10% debentures of Rs.50,000.

You are required to calculate the effect of each of the above modes of financing on the EPS. The EBIT is Rs.30,000 p.a. and the tax liability is 50%. EBIT increases by Rs.10,000 after the expansion. **(10 Marks)**

7 a. What do you mean by capital budgeting? State the different kinds of capital budgeting proposals. **(05 Marks)**

b. Calculate the financial leverage and operating leverage, under situations A and B, financial plan I and II respectively, from the following, relating to the operations and capital structure of ABC Ltd.

Production and sales	800 units
Selling price per unit	Rs. 20
Variable cost per unit	Rs. 15
Fixed costs : Situation A -	Rs. 800
Situation B -	Rs. 1500

Capital structure:

	Financial Plan I	Financial Plan II
Equity capital	Rs.5000	Rs.7000
Debt	Rs.5000	Rs.2000
Cost of debt @ 10%		

(15 Marks)

8 Case Study :

A company is currently considering modernization of a machine originally costing Rs.100000 that has current book value of zero. However, it is in good working condition and can be sold for Rs.50,000. Two choices are available. One is to rehabilitate the existing machine at a total cost of Rs.3,60,000 and the other is to replace the existing machine with a new machine costing Rs.3,60,000 and the other is to replace the existing machine with a new machine costing Rs.4,20,000 and requiring Rs.60,000 to install. The rehabilitated machine as well as the new machine would have a six year life and no salvage value. The firm's projected after tax profits under various alternatives are as follows:

Year	Expected after tax		
	Existing machine	Rehabilitated machine	Profits of new machine
1	4,00,000	4,40,000	4,80,000
2	5,00,000	5,80,000	4,40,000
3	6,20,000	7,00,000	7,00,000
4	7,20,000	8,00,000	8,20,000
5	8,20,000	9,00,000	8,60,000
6	10,00,000	10,80,000	10,20,000

The firm is taxed at 55% of income. The company uses straight line depreciation. The company's cost of capital is 12%.

Advise the company, whether, it should rehabilitate the existing machine or replace it with a new machine. Also, state the situation in which the company would like to continue with the existing machine.

PV factor @ 12%

1	0.893
2	0.797
3	0.712
4	0.636
5	0.567
6	0.507

(20 Marks)

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05MBA23

Second Semester MBA Degree Examination, May/June 2010

Financial Management

Time: 3 hrs. Max. Marks:100

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

1 a. What is business and financial risk? **(03 Marks)**
b. Discuss the role of financial managers in modern organizations. **(07 Marks)**
c. Explain the factors influencing options valuation. **(10 Marks)**

2 a. Define financial management. **(03 Marks)**
b. What are the functions of secondary market? Explain. **(07 Marks)**
c. Briefly explain the various evaluation techniques used in capital budgeting. Also, enumerate atleast one merit and one demerit of each. **(10 Marks)**

3 a. What is listing? **(03 Marks)**
b. What are the determinants of working capital? Discuss. **(07 Marks)**
c. A firm's sale, variable costs and fixed costs amount to Rs.75,00,000, Rs.42,00,000 and Rs.6,00,000 respectively. It has borrowed Rs.45,00,000 at 9% and its equity capital totals Rs.55,00,000.
i) What is the firm's ROI?
ii) Does the firm have favourable financial leverage?
iii) If the firm belongs to an industry whose asset turnover is 3, does it have a high or a low asset leverage?
iv) What are the operating, financial and combined leverages?
v) If the sales drop to Rs.5000000, what will be the new EBIT?
vi) At what levels, will the EBT of the firm equal to zero? **(10 Marks)**

4 a. What is capital budgeting? **(03 Marks)**
b. In what ways, the wealth maximization objective is superior to the profit maximization? **(07 Marks)**
c. A new machine is expected to generate the following set of incremental CFAT during its 5 years economic useful life.

Year	1	2	3	4	5
CFAT (Rs.)	10,00,000	12,00,000	15,00,000	8,00,000	5,00,000

The rate of inflation during the period is expected to be 8% and the projects cost of capital in real terms would be 10%. Should the machine be purchased if it costs Rs.25 lakhs? **(10 Marks)**

5 a. What are gross and net working capitals? **(03 Marks)**
b. Explain the steps in financial planning. **(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	400000	380000	5
Preference	100000	110000	8
Equity	600000	1200000	15
Retained earnings	200000		13
	1300000	1690000	

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

6 a. What do you understand by the term constant payout ratio? **(03 Marks)**
b. Explain the CAPM approach for determining the cost of equity and state its assumptions. **(07 Marks)**
c. If the discount/required rate is 10%, compute the present value of the cash flow streams detailed below:
i) Rs.100 at the end of year 1.
ii) Rs.100 at the end of the year 4.
iii) Rs.100 each at the end of the year 3 and 5
iv) Rs.100 for the next 10 years (every year). **(10 Marks)**

7 a. What is underwriting? **(03 Marks)**
b. What are the factors that determine the dividend policy of a firm? Explain. **(07 Marks)**
c. A proforma cost sheet of a company provides the following data:

	Rs.
Cost (per unit):	
Raw materials	52.0
Direct labour	19.5
Overheads	39.5
Total cost/unit	110.5
Profit	19.5
Selling price	130.0

The following additional information is available:
Average raw material in stock = one month, average material in process = half a month, credit allowed by suppliers = one month, credit allowed by debtor = two months, time lag in payment of wages = one and a half weeks, overheads = one month. $\frac{1}{4}$ of sales are on cash basis. Cash balance is expected to be Rs.120000.
You are required to prepare a statement showing the working capital needed to finance a level of activity of 70000 units of output. You may assume that production is carried on evenly throughout the year and wages and overheads accrue similarly. **(10 Marks)**

8 A company is considering an investment proposal to install new milling controls at a cost of Rs.50,000. The facility has a life expectancy of 5 years and no salvage value. The tax rate is 35%. Assume the firm uses straight line depreciation and the same is allowed for tax purposes. The estimated cash flows before depreciation and tax (CFBT) from the investment proposal are as follows:

Year	1	2	3	4	5
CFBT (Rs.)	10,000	10,692	12,769	13,462	20,385

Compute the following:
a. Pay back period
b. Average rate of return
c. Internal rate of return
d. Net present value at 10% discount rate
e. Profitability index at 10% discount rate. **(20 Marks)**

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