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12MBA25

Second Semester MBA Degree Examination, June/July 2015
Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. ***Answer any FOUR questions from Q.No. 1 to Q.No. 7.***
2. ***Question No. 8 is compulsory.***

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. Explain briefly the factors affecting dividend policy. **(07 Marks)**
c. Briefly explain the basic reasons, why profit maximization fails to be consistent with wealth maximization. **(10 Marks)**

2 a. What are the elements of cash flow stream? **(03 Marks)**
b. Write a note on secondary market. **(07 Marks)**
c. Calculate the following :
i) Suppose you deposit Rs 1000 today in a bank which pays 10% p.a. 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% p.a. rate of interest in how many years will this amount double?
iii) Your father deposits Rs 3,00,000 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 How much can be withdrawn annually for a period of 10 years?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)**

3 a. What is Primary Market? **(03 Marks)**
b. Distinguish between Equity shares and Debentures. **(07 Marks)**
c. XYZ Ltd is considering the purchase of new machine. Two alternative machines (A & B) are suggested each costing Rs 4,00,000 earnings after taxation are expected to be as follows:

Year	1	2	3	4	5
Machine A	40,000	1,20,000	1,60,000	2,40,000	1,60,000
Machine B	1,20,000	1,60,000	2,00,000	1,20,000	80,000
PV @ 10%	0.91	0.83	0.75	0.68	0.62

The cost of capital is 10%. You are required to compare the profitability of the machines and state which alternative of the machines you consider financially preferable as per NPV method. **(10 Marks)**

4 a. What is Behavioral Finance? **(03 Marks)**
b. What are the dangers of excess working capital? **(07 Marks)**
c. ABC Ltd, is presently operating at 60% level producing 36000 units p.a. In view of favorable market conditions it has been decided that from 1/1/2013, the company would operate at 90% capacity. The following information is available.
i) Existing cost – price structure per unit is Raw material Rs 4.00/u, wages Rs 2/u, OH (variable) Rs 2/u, OH's (Fixed) Rs 1/u, Profits Rs 1/unit.
ii) It is expected that the cost of raw materials wages, expenses and sales per unit will remain unchanged for the year 2013.
iii) Raw materials remain in stores for 2 months before these are 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 OH's accrue evenly throughout the production cycle. You are required to estimate the working capital. **(10 Marks)**

5 a. What is CAPM? State its assumptions. **(03 Marks)**
b. Distinguish between capital market and money market. **(07 Marks)**
c. PQR has the following book value capital structure (Rs Crore) **(10 Marks)**

	(Rs Crore)
Equity capital (in shares of Rs 10 each)	Rs 15
12% preference capital (in shares of Rs 100 each)	1
Retained earnings	20
11.5% debentures (of Rs 100 each)	10
11% Term loans	12.5

The next expected dividend on equity shares per share is Rs 3.60, the dividend per share is expected to grown at the rate of 7%. The market price per share is Rs 40. Preference stock, redeemable after 10 years is currently selling at Rs 75 per share. Debentures, redeemable after six years are selling at Rs 80 per debenture. The income tax rate for the company is 40%. You are required to calculate WACC at Book value and at market value weights.

6 a. What is Optimal Capital structure? **(03 Marks)**
b. The following is the income statement of P Ltd for the year 2013. **(07 Marks)**

	(Rs in lakhs)
Sales	50
Less : Variable cost	10
Total	40
Less : Fixed cost	20
EBIT	20
Less : Interest	5
EBT	15
Less Tax	6
EAT	9
Less : Pref. dividend	1
Earnings available to Eq. sh.	8

Find out degree of (a) Operating leverage (b) Financial leverage (c) Combined leverage.
c. The Hardware Co. Ltd has to make a choice between debt issue and equity issue for its expansion programme. Its current position is as follows : **(10 Marks)**

5% debt	Rs 20000	Sales	3,00,000
Eq. capital (Rs 10/share)	Rs 50000	Less : Total cost	2,69,000
Surplus	Rs 30000	EBIT	31,000
		Less : Interest	1,000
		EBT	30,000
		Less : Tax	10,500
Total capital	Rs 1,00,000	EAT	19,500

The expansion programme is estimated to cost Rs 50,000. If this is financed through debt the rate of interest on new debt will be 7% and the price earnings ratio will be 6. If the expansion programe is financed through equity, new shares can be sold at Rs 25/share and the P/E ratio will be 7. The expansion will generate additional sales of Rs 1,50,000 with a return of 10% on sales before interest and taxes. If the company is to follow a policy of maximizing the market value of its shares which form of financing should it choose?

7 a. Ketan Fan Ltd., has the plans of expansion of its activity. It is expected to earn a rate of return of 10% on its investment. The Co. is planning finance its expansion by retaining the profits which otherwise shall be distributed to shareholders. Shareholders are in 60% tax bracket. If the share holder reinvest the dividend they will earn 12% on new investment but have to incure a 2% brokerage on the purchase of new security. What is your advice? **(05 Marks)**

b. "Cash flows of different time periods in absolute terms are incomparable". Discuss. **(05 Marks)**

c. A company wishes to expand production. Two propositions of capital expenditure are being considered each of which requires more or less the same outlay you as the management accountant of the company are required to furnish profitability estimate to guide the board in their decision. Describe briefly the 3 methods used commonly for this purpose. **(05 Marks)**

d. "An investor gains nothing from bonus shares". Examine the statement critically. **(05 Marks)**

8 ABC Co. is evaluating a project for which the following information are :

a. The total outlay of the project is expected to be 450 million. This consists of 450 million of fixed assets and Rs 200 million of current assets.
b. The proposed scheme of finance 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.
c. The term loan is repayable in 10 equal semiannual installments of Rs 20 million each. The first installment will be due after 18 months. The interest rate is 15%.
d. The levels of working capital advance & trade credit will be at Rs 100 million and 50 million respectively till they are paid back at the end of 6 years. The rate of interest is 18% on working capital advance.
e. The expected revenue for the project will be Rs 500 million/year. The operating costs are expected to be Rs 320 million / year.
f. The depreciation rate on the fixed assets will be 33⅓ % as per the WDU method.
g. The net salvage value of fixed assets and current assets at the end of year 6 will be Rs 80 million and Rs 200 million respectively.
h. The tax rate applicable to the firms is 50%.

Project the cashflows. **(20 Marks)**

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