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08MBAFM321

Third Semester MBA Degree Examination, December 2010
Advanced Financial Management

Time: 3 hrs. Max. Marks:100

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

1 a. What is operating cycle and how is it computed? **(03 Marks)**

b. Explain the cost and risk considerations of hedging and conservative approaches of financing the working capital of a firm. **(07 Marks)**

c. Explain different modes of bank finance for the working capital. Briefly explain any one. **(10 Marks)**

2 a. What do you mean by "postal float", "lethargy" and "bank float"? **(03 Marks)**

b. A firm, which purchases raw materials on credit, is required by the credit terms, to make payments within 30 days. On its side, the firm allows its credit buyers to pay within 60 days. Its experience has been that, it takes, on an average, 35 days to pay its accounts payable and 70 days to collect its accounts receivable. Moreover, 85 days lapse between purchase of raw materials and sale of finished goods; that is to say, the average age of inventory is 85 days. What is the firm's cash cycle? Also, estimate the cash turnover. **(07 Marks)**

c. Advani Chemicals Limited estimates its total cash requirement as Rs.2 crore next year. The company's opportunity cost of funds is 15% per annum. The company will have to incur Rs.150 per transaction, when it converts its short-term securities to cash.
Determine the optimum cash balance. How much is the total annual cost of the demand for the optimum cash balance? How many deposits will have to be made during the year? **(10 Marks)**

3 a. What are the costs associated with "accounts receivables"? **(03 Marks)**

b. In order to increase the sale from the normal level of Rs.2.4 lakh per annum, the marketing manager submits a proposal for liberalizing the credit policy as under:

Proposed increase in credit period beyond the normal 30 days	15	30	45	60
Increase in normal sales (Rs.)	12000	18000	21000	24000

The normal credit period is 30 days. The contribution to volume or profit volume ratio is 33.33 percent. The company expects a pre-tax return of 20 percent on investment. Evaluate the above four alternatives and advise the management. (Assume 360 days a year). **(07 Marks)**

c. A bank is analyzing the receivables of Jackson company, in order to identify acceptable collateral for a short-term loan. The company's credit policy is 2/10, net 30. The bank lends 80% on accounts, where, customers are not currently overdue and where the average payment period does not exceed 10 days, past the net period. A schedule of Jackson's receivable has been prepared. How much will the bank lend on a pledge of receivables, if the bank uses a 10% allowance for cash discount and returns? **(10 Marks)**

Account	Amount (Rs.)	Days outstanding	Average payment period historically (in days)
74	25000	15	20
91	9000	45	60
107	11500	22	24
108	2300	9	10
114	18000	50	45
116	29000	16	10
123	14000	27	48
	108000		

4 a. What is "lead time" in inventory management? What role it plays? **(03 Marks)**

b. The following details are available in respect of a firm. Determine the economic order quantity.
Inventory requirement per year = 6000 units
Cost per unit (other than ordering and carrying costs) = Rs.5
Carrying cost per item for one year = Re.1
Cost of placing each order = Rs.60
Alternative order sizes units = 6000, 3000, 2000, 1000, 600 and 200. **(07 Marks)**

c. From the details given below, calculate :
i) Re-ordering level
ii) Minimum level
iii) Maximum level
iv) Danger level.
Number of units to be purchased in a year = 5000
Cost of placing a purchase order = Rs.20
Purchase price per unit inclusive of transportation cost = Rs.50
Annual cost of storage per unit = Rs.5
Lead time : average – 10 days maximum – 15 days
minimum – 6 days emergency purchases – 4 days
Consumption : average – 15 units per day , maximum – 20 units per day. **(10 Marks)**

5 a. State any three assumptions of capital structure theories. **(03 Marks)**

b. A company's expected annual EBIT is Rs.50000. It has Rs.200000, 10% debentures. If the overall capitalization rate is 12.5%, what would be the total value of the firm and cost of equity? **(07 Marks)**

c. Explain the arbitrage process of MM approach of capital structure, with the help of the following data: **(10 Marks)**

Variables	Company A	Company B
Expected annual income (Rs.)	30,000	30,000
Market value of debt (Rs.)	-	1,20,000
Rate of interest on debt (%)	-	0.125
Cost of equity (%)	0.15	0.16
Market value of equity (Rs.)	2,00,000	93,750
Market value of the company (Rs.)	2,00,000	2,13,750

6 a. State any three relevance theories of dividends. **(03 Marks)**

b. What are the legal aspects of dividends in India? **(07 Marks)**

c. The overall cost of capital of a company is 10%. It has currently 25000 outstanding shares selling at Rs.100 each. The firm is contemplating the declaration of dividends of Rs.5 per share at the end of the current financial year. It experts to have a net income of Rs.250000 and has a proposal for making new investments of Rs.500000. Show that under MM assumptions, the payment of dividend does not affect the value of the firm. **(10 Marks)**

7 a. What are secured premium notes? **(03 Marks)**

b. What is venture capital fund? Explain its distinguishing features. **(07 Marks)**

c. "Innovations in financial modeling have resulted into a plethora of hybrid financial instruments". Describe different hybrid financial instruments. **(10 Marks)**

8 Prepare a cash budget for the period January to June, from the following information:

i) The estimated sales and expenses are as follows :

Particulars	Nov'08	Dec'08	Jan'09	Feb'09
Sales (Rs.)	2,00,000	2,20,000	1,20,000	1,00,000
Wages & salaries (Rs)	30,000	30,000	24,000	24,000
Misc. expenses	27,000	27,000	21,000	30,000
Particulars	Mar'09	Apr'09	May'09	June'09
Sales (Rs.)	1,50,000	2,40,000	2,00,000	2,00,000
Wages & salaries (Rs)	24,000	30,000	27,000	27,000
Misc. expenses	24,000	27,000	27,000	27,000

ii) 20% of the sales are on cash and balance on credit.

iii) The firm has a gross margin of 25% on sales.

iv) 50% of the credit sales are collected in the following month after the sales, 30% in the second month and 20% in the third month.

v) Material for the sales of each month, is one month in advance, on a credit for two months.

vi) The time lag for the payment of wages and salaries is one-third of a month and that for miscellaneous expenses, one month.

vii) Debentures worth Rs.40000 were sold in January.

viii) The firm maintains a minimum cash balance of Rs.40000. Funds can be borrowed at 12% per annum in the multiples of Rs.1000, the interest being payable on monthly basis.

ix) Cash balance at the end of December is Rs.60000. **(20 Marks)**

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