

Third Semester MBA Degree Examination, June/July 2011
Advanced 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.

- 1 a. What is Economic Value Added? (03 Marks)
b. What are the matrices of Holding cash? (07 Marks)
c. The following are results expected by XYZ ltd. by Quarters next year, in thousands of rupees.

Particulars	Quarters (Rs in 000)			
	1	2	3	4
Sales	7500	10500	18000	10500
Cash payments:				
Production costs	7000	10000	8000	8500
Selling administrative & other costs	1000	2000	2900	1600
Purchases of plant & other fixed assets	100	1100	2100	2100

The debtors at the end of a Quarter are one-third of sales for the Quarter. The opening balance of debtors is Rs.30,00,000. Cash on hand at the beginning of the year is Rs.6,50,000 and the desired minimum balance is Rs.5,00,000. Borrowings are made at the beginning of the Quarters in which the need will occur in multiples of Rs.10,000 and are repaid at the end of Quarters. Interest charge may be ignored. You are required to prepare: i) A cash budget by Quarters for the year. (10 Marks)

- 2 a. What is ordinary cost in Inventories? (03 Marks)
b. Explain in brief the sources of functioning current assets? (07 Marks)
c. A companies capital structure consists of the following.

Equity Shares of Rs.100 each	Rs.20 lakhs
Retained earnings	Rs.10 lakhs
9% preference shares	Rs.12 lakhs
7% debentures	Rs.8 lakhs
Total	Rs.50 lakhs

The expansion involves additional finances of Rs.25 lakhs if the company wishes to expand which of the figure alternative will company choose if it is ready to take risk.

i) Issue of 20000 equity shares at a premium of Rs.25 per share. ii) Issue of 10% preference shares. iii) Issue of 8% debentures.

Assume tax rate as 50%, EBIT Rs.9,00,000 and on all cost of capital 12%. (10 Marks)

- 3 a. What is working capital leverage? (03 Marks)
b. Explain the procedural aspects of dividends? (07 Marks)
c. Major corporation currently provides 45 days of credit to its customers. Its present sales are Rs.80 million. The firm cost of capital is 13% and the ratio of variable cost to sales is 0.75. Manoj corporation is considering extending its credit period to 60 days such an extension is likely to push up on additional sales would be 10%. The tax tare for Manoj is 35%. What will be the effect of lengthening the credit period on the residual income of Manoj corporation? (10 Marks)
- 4 a. ABC company requires 2400 units on an item per year. The purchase price per unit is Rs.12, order cost is AR s.8 per order and carrying cost is 25% of inventory value. Determine the Economic order Quantity. (05 Marks)

- b. The earnings per share of a company is Rs.8 and the rate of capitalization applicable is 10%. The company has before it an option of adopting. i) 50 ii) 75 iii)100 percent dividend payout ration. Compute the market price of the company's Quoted share as per Walters Model if it can earn a return of; i) 15% ii)10% iii)5% on its retained earnings. (15 Marks)
- 5 a. What is warrant? (03 Marks)
 b. Explain the following: i) Venture capital ii) Privet equity iii) Preferred stock (07 Marks)
 c. A company manufactures a product from a raw-material which is purchased at Rs.60 per kg. The company incurs a handling cost of Rs.360 plus freight of Rs.390 per order. The carrying cost of inventory of raw material is Rs.0.50 per kg per month. In addition, the cost of working capital finance on the investment in inventory of raw material is Rs.9 per kg per annum. The annual production of the product is 1,00,000 units and 2.5 units are obtained from one kg of raw-material Required: i) Calculate the economic order quantity of raw material. ii) If the company of orders on quarterly loses, what percentage of discount in the price of the raw material should the negotiated? (10 Marks)
- 6 a. What is market value added? (03 Marks)
 b. Explain the 5 C's used in tradition credit analysis? (07 Marks)
 c. List the various causes for industrial sickness? (10 Marks)
- 7 a. What is trade credit? (03 Marks)
 b. Royal industries feels a lock-box system can shorten its accounts receivable collection period by 3 days. Credit sales are estimated at Rs.365 lakh per year, billed on a continuous basis. The firms opportunity cost of funds is 15%. The cost of lock box system is Rs.50,000. i) Will you advice 'Royal' to go for lock box system? ii) Will your answer be different if accounts receivable collection period is reduced by 5 days? (07 Marks)
 c. The two companies, U & L, belong to an equivalent risk class. These two firms are identical in entry respect except that U company is unlenered while L has 10% debt of Rs.30 lakh. The other relevant information regarding their valuation & capitalization rates are as follows:
- | Particulars | Firm U | Firm L |
|----------------------------------|-----------|-----------|
| Net operating income(FBIT) | 7,50,000 | 7,50,000 |
| Interest on debt | - | 3,00,000 |
| Earnings to equity share holders | 7,50,000 | 4,50,000 |
| Cost of equity (K_e) | 0.15 | 0.20 |
| Market value of equity (S) | 50,00,000 | 22,50,000 |
| Market value of debt (B) | - | 30,00,000 |
| Market value of firm (S+B) | 50,00,000 | 52,50,000 |
| Overall cost (K_o) | 0.15 | 0.143 |
- An investor owns 10% equity shares of company: Show the arbitrage process and the amount by which he reduces his investment outlay. (10 Marks)
- 8 Case study (Compulsory):
 Company X and company Y are in the same risk class, and are identical in entry respect except that company X uses debt, while company Y does not. The levered firm has Rs.9,00,000 debentures carrying 10% rate of interest. Both the firm assets of Rs 15 lakhs. Assume perfect capital market rational investors and so on; a tax rate of 35% & capitalization rate of 15% for an all equity company.
- a. Compute the value of firm X & Y using the NI approach. (07 Marks)
 b. Compute the value of each firm using net operation income approach. (05 Marks)
 c. Using NOI approach calculates the overall cost of capital of both firms X and Y. (05 Marks)
 d. Which of the two firms has an optimal capita instructor according to NOI approach. (03 Marks)

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