2008

M B A

2nd Semester Examination

FINANCIAL MANAGEMENT

PAPER—202

Full Marks : 100

Time : 3 Hours

The figures in the right-hand margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

Illustrate the answers wherever necessary.

Write the answers to Questions of each Half in separate books.

(First Half)

(Marks : 50)

1. Answer any *four* questions of the following : 4×5

(a) Briefly discuss the three broad areas of financial decision making.

(b) What do you mean by Commercial Paper? Discuss the required conditions of issuing commercial paper.

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(c) "There is a reciprocal relationship between degree of operating leverage and margin of safety ratio." Examine the validity of this statement.

(d) What are the reasons behind arising Operating Risk ? 'DFL = 1' what does it indicate ?

(e) XYZ Ltd. had the following Balance Sheet for the year ended 31st December, 2007 :

(*Rs. lakhs*)

Liabilities	Amount	Assets	Amount
Equity Capital (1.5 lakh shares of Rs. 10 each)	15	Fixed Assets	40
		Current Assets	20
Reserve & Surplus	3		
15% Debentures	30		
Current liabilities	12		
	60		60

Additional information given :

Fixed Cost per annum	:	Rs. 12 lakhs
Variable operating cost ratio	:	80%
Total Asset Turnover	:	3
Income Tax	:	59%

Required : (i) Earning Per share, (ii) Operating Leverage, (iii) Financial Leverage, (iv) Combined Leverage.

(f) Define Explicit and Implicit cost of capital.

2. Answer any *two* questions : 10×2

(a) (i) What do you mean by Time value of Money ? "One rupee of today is more valuable than tomorrow." — Explain this statement in the light of time value of money. 5

(ii) Company XYZ is establishing a sinking fund to retire Rs. 5,00,000, 8 per cent debentures, 10 years from today. The company plans to put a fixed amount into the fund each year for 10 years. The first payment will be made at the end of the current year. The company anticipates that the funds will earn 6 per cent a year. What equal annual contributions must be made to accumulate Rs. 5,00,000, 10 years from now ? 5

(b) (i) Distinguish between Specific Cost and Weighted Cost of Capital. 3

(ii) Mr. A. Dey, an investor, buys shares of ABC Co. Ltd. on 31.03.05 @ Rs. 50 per share. If the dividend for year ended on 31.03.06 is Rs. 2, the growth rates of dividend are 10% for the first 5 years, 15% for the next 5 years and 12% for an indefinite period after that. Calculate the Present value of the equity share. Is Mr. A Dey's investment Profitable ? Cost of equity share capital is 15%. 7

(c) The key information pertaining to the proposed two new financing plans of Surya-Subha Ltd. is given below :

Sources of funds	*Financing Plan* I (*Rs.*)	II (*Rs.*)
Equity share capital (of Rs. 100 each)	15,00,000	30,00,000
12% Preference share capital (of Rs. 100 each)	25,00,000	—
10% Debentures	5,00,000	—
11% Long term debt	—	15,00,000
	45,00,000	45,00,000

Expected EBIT Rs. 12,50,000.

Corporate tax rate 35%.

(i) Determine the indifference point.

(ii) Ascertain the financial break-even-point and financial margin of safety for financing plan and also identify the plan which dominates over the other.

(iii) Which plan has higher financial risk and why?

3+4+3

[*Internal Assessment : 10 Marks*]

(Second Half)

(Marks : 50)

3. Answer any *four* questions of the following : 5×4

(a) Mathematically illustrate the Traditional Approach in Capital structure.

(b) Shriram Enterprises manufactures a special product "Zed". The following particulars were collected for the year 2007 :

(i) Monthly demand of Zed 1000 units.

(ii) Cost of placing an order Rs. 100.

(iii) Annual carrying cost per unit Rs. 15.

(iv) Maximum usage 75 units per week.

(v) Normal usage 50 units per week.

(vi) Re-order period 4 to 6 weeks.

Compute Re-order level and Re-order quantity.

(c) The earnings per share of a share of the face value of Rs. 100 of PQR Ltd. is Rs. 20. It has a rate of return of 25% capitalisation rate of its risk class is 12.5%. If Walter's model is used :

(i) What should be the optimum payout ratio ?

(ii) What should be the market price per share if the payment ratio is zero ?

(iii) Suppose, the company has a payout of 25% of EPS ; what should be the price per share ?

(d) A company has total assets of Rs. 10 lakhs. Capital structure of the company shows that the company has Rs. 4 lakh of 8% Debentures outstanding till date. The company is in 35% tax-bracket. ROI of the company stands at 15%. Calculate dividend per share of the company assuming that the face value of each outstanding share is Rs. 10.

Will there be any change in the dividend per share if the company pays off the outstanding debentures ?

(e) State the basic assumptions of Gordon's dividend model.

(f) "It is next to impossible to determine the optimal capital structure of a firm empirically". Examine the validity of the statement.

4. Answer any *two* of the following : 10×2

(a) 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% of your computed figure to allow contingencies.

Estimated cost per unit of productions	*Amount per unit* (Rs.)
Raw material	80
Direct labour	30
Overhead	60
Total Cost	170

Additional information :

Selling Price	Rs. 200 per unit
Level of activity	1,04,000 units of production per annum
Raw materials in stock	average 4 weeks
Work in progress (assume 50% completion stage)	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 $1\frac{1}{2}$ weeks

Cash at bank is expected to be Rs. 25,000.

You may assume that productions is carried on evenly throughout the year (52 weeks) and wages overheads accrue similarly. All sales on credit basis only. 10

(b) AB Ltd. has a capital of Rs. 1,00,000 in equity shares of Rs. 100 each. The shares are currently quoted at par. The company proposes to declare a dividend of Rs. 10 per share at the end of the current financial year. The capitalisation rate of the risk class to which the company belongs is 12%.

What will be the market price of the share at the end of the year, if

(i) a dividend is not declared.

(ii) a dividend is declared.

Assuming that the company pays the dividend and has the net profit of Rs. 5,00,000 and makes new investment of Rs. 10,00,000 during the period, how many new shares must be issued?

(Use the MM model) 10

(c) Aritra Technologies Ltd. is considering an investment proposal to instal 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	CFBT (*Rs.*)
1	10,000
2	10,692
3	12,769
4	13,462
5	20,365

Compute : (i) Pay back period.

(ii) Average Rate of return.

(iii) Internal rate of return. 3+2+5

[***Internal Assessment : 10 Marks***]