NEW

2016

M B A

2nd Semester Examination

FINANCIAL MANAGEMENT

PAPER—MBA-201

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.

1. Answer any *four* questions : 4×5

(a) Distinguish between operating risk and financial risk.

(b) Distinguish between 'capital structure' and 'financial structure' of a firm.

(c) What is the significance of 'cost of capital'?

(d) Distinguish between NI and NOI approach in capital structure.

(e) There are two firms X & Y which are exactly identical

(Turn Over)

except that X does not use any debt in its financing, while Y has Rs. 1,00,000 5%. Debenture in its financing. Both the firms have earnings before interest and tax of Rs. 25,000/- and Ke = 10%, tax rate = 50%. Calculate value of both firms using M.M. approach.

(f) Determine the market value of equity shares of a company Ltd. from the in formation as per Walter's Model :

Earning of the company	Rs. 10,00,000
Dividend paid	Rs. 5,00,000
Cost of capital	Rs. 12%
No. of shares outstanding.	Rs. 1,00,000
Rate of return on investment	Rs. 15%

2. Answer any *two* questions : 2×10

(a) From the following information relating to a company, determine the optimum capital structure : Corporate tax may be taken at 50%.

Debt as % of total capital employed	Before tax cost of debt (%)	Cost of equity (%)
0	12	15
10	12	15
20	12	16
30	13	17
40	15	18
50	16	19
60	18	22
70	21	24

(b) Smita Ltd. has the following capital structure :

	(Rs. in Lakhs)
Equity Share Capital (10 Lakh shares)	100
12% pref. capital (10,000 shares)	10
Retained earnings	120
14% debentures (7,000 debentures)	70
14% term loan	100
	400

The market price per equity shares is Rs. 25. The next expected dividend per share is Rs.2 and is expected to grow at 8%. The preference shares are redeemable after 7 years at par and are currently quoted at Rs.75 per share. The debentures are redeemable after 6 years at per and their current market quotation is Rs. 90 per debenture. The tax rate applicable to the firm is 50%.

You are required to compute weighted average cost of capital of the company using Book Value.

(c) A Ltd. has 1,00,000 shares selling at Rs.150 per share. The company is thinking of paying dividend of Rs.12 per share at the end of the current year. The company's profits for the year are Rs. 20,00,000 and it wishes to make new investments of Rs. 10,00,000. The cost of capital is 15%.

Using MM Model, Calculate :

(i) The market price per share as at the end of the current year :

(a) if dividends are paid, and

(b) if dividends are not paid.

(ii) The number of shares to be issued if dividends are paid. 5+5

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

(a) How is financial management related to other major functional areas of a business?

(b) What do you mean by 'Shareholder–Value'? It is different from 'Owners' Wealth'? Explain.

(c) What are the different ways to curbe Agency Problem in companies?

(d) What do you mean by Working Capital? Briefly explain the Operating Cycle concept of Working Capital.

(e) What is a Capital Budgeting Decision? State its importance to a firm. What are the limitations of applying Pay Back Period method of selecting a project in competitive situation?

(f) Write a note on non-traditional sources of short-term financing of a firm.

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

(a) United Projects Ltd. wants to install a new machine in the place of an exising old one which has become old one. The company made extensive enquiries and from the replies received short-listed two offers. The two models differ in cost, output and anticipated net revenue. The estimated life of both the machines is five years. There will be only negligible salvage value at the end of the fifth year. Further details are as follows :

(Rs. in lakhs)

Machines	*Cost*	*Anticipated after-tax cash flows*				
		Year1	*Year 2*	*Year 3*	*Year 4*	*Year 5*
A	25	-	5	20	14	6
B	40	10	14	16	17	8

The company's cost of capital is 16%. You are required to make an appraisal of the two offers and advise the firm by using the following method : (i) Net Present Value, and (ii) Internal Rate of Return.

The following extract of the Present Value Table (Present Value of Re. 1) is also available :

End of year	*16%*	*18%*	*20%*	*22%*
1	0·862	0·847	0·833	0·820
2	0·743	0·718	0·694	0·672
3	0·641	0·609	0·579	0·551
4	0·552	0·516	0·482	0·451
5	0·476	0·437	0·402	0·370

(b) A company plans to manufacture and sell 400 units of a domestic appliance per month at a price of Rs. 400 each. The ratios of costs to selling price are as follows :

Elements of cost	*% of Selling Price*
Raw Materials	40
Packing Materials	15
Direct Labour	20
Direct Expense	5

Fixed overheads are estimated at Rs. 96,000 per annum.

The following norms are maintained for inventory management :

Ram Materials	30 days
Packing Materials	15 days
Finished Goods	100 units
Work-in-progress	7 days.

Other particulars are given below :

(i) Credit sales represent 80% of total sales and the dealers enjoy 30 working days credit. Balance 20% are cash sales.

(ii) Creditors allow 21 working days credit for payment.

(iii) Lag in payment of overheads and expenses is 15 working days.

(iv) Cash requirements to be 12% of net working capital.

(v) Working days in a year are taken as 300 for budgeting purpose. Prepare a Working Capital Requirement Forecast for the budget year.

(c) What are the different short-term sources of funds ? What are the merits and demerits of Lease financing ? Distinguish between Operating Lease and Finance Lease. 2+4+4

[***Internal Assessment : 20***]