2012

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 : 4×5

(a) Do you think that financing and investment functions are complementary in financial management? Explain.

(b) State the need for measurement of cost of capital.

(c) Evaluate the trade credit as a form of financing current assets.

(d) A company raises its funds by the issue of 1000, 10% debentures of Rs. 100 at a discount of 10% repayable at par after 10 years. If the rate of tax applicable to the company is 50%, what is the cost of debt capital to the company?

(e) 'Calculate degree of operating leverage and degree of financial leverage from the following :

Sales 1, 00, 000 units @ Rs. 2 per unit variable cost per unit : Re 0.70

Fixed Cost : Rs. 1, 00, 000

Interest charges : Rs. 3,668

(f) "Retained earnings have no cost." Explain.

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

(a) Define Financial Management. Narrate its scope. 3+7

(b) On the basis of the following information relating to the companies A, B and C which belong to the same industry, you are required to calculate DOL, DFL and DCL of each firm and comment on the results.

	A	B	C
Output (units)	1,00,000	1,00,000	1,00,000
Selling price per unit (Rs.)	5	5	5
Variable cost per unit (Rs.)	3	2	1.50
Fixed cost (Rs.)	1,00,000	2,00,000	2,50,000
Interest on debt capital (Rs.)	30,000	10,000	NIL

10

(c) (i) Distinguish between business risk and financial risk.

(ii) How would you measure cost of equity using CAPM ?

(iii) Write a short note on time value of money.

4+3+3

[*Internal Assessment : 10*]

(Second Half)

(Marks : 50)

3. Answer any *four* questions : 5×4

(a) For varying levels of delet equity mix, calculate the optimum capital structure through composite cost of

capital. Assume the total capital of the company is 100 lakhs. 2+3

Amount of Debt Capital in total capital	*After tax Cost of debt (%)*	*After tax Cost of equity (%)*
0	6	12
20	6	12
30	7	14
50	8	15
70	8	15
80	10	16

5

(b) Write the accept-reject rule under Pay Back period and Internal Rate of Return method of a long term project. Between the two methods, which method would you prefer ? Why ? 5

(c) From the following information calculate the Internal Rate of Return of the Project. Cost of the Project is 50 lakhs and tax rate is 50%.

Year	*Net Cash Flow (Rs.)*
1	20,00,000
2	22,00,000
3	28,00,000

5

(d) Briefly explain the factors that are taken into account in determining working capital need of a firm.

5

(e) Find out value of the PQR Ltd. from the following information under Walter model.

(i) Profit after Tax — Rs. 15,00,000

(ii) Dividend Payout Ratio — 30%;

(iii) No. of Shares — 50,000 of Rs. 10 each;

(iv) Cost of equity — 10%;

(v) Rate of Return of PQR Ltd. — 12%.

When a company should adopt liberal dividend policy ?

4+1

(f) Calculate Maximum Permissiable Bank Finance for working capital as per recommendation of Tandon Committee from the following information :

(i) Stock of Raw Material = Rs. 12,00,000;

(ii) Stock of Finished Goods = Rs. 6,00,000;

(iii) Stock in work-in-progress = Rs. Nil;

(iv) Debtors were allowed 1 month credit;

(v) Cash in hand and Bank = Rs. 8,000;

(vi) Creditors allowed 15 days credit;

(vii) Yearly sales and purchases were Rs. 2.4 cr. and Rs. 1.8 cr respectively.

(viii) 50% of sales and 100% of purchase were in credit.

(ix) Core current asset was 20%.

5

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

(a) (i) Do you think that Traditional approach in capital structure is a mid-way between Net Income and Net operating Income approach ? Explain.

(ii) Calculate cost of capital and value of the firm for three alternative plans and recommend the optimum capital structure plan.

Total investment	Rs. 1,00,000
EBIT	Rs. 15,000
Cost of Equity :	
upto Rs. 50,000	15%
Rs. 50,001 to Rs. 80,000	18%
Rs. 80,001 to Rs. 1,00,000	20%
Cost of debt :	
upto Rs. 50,000	10%
Rs. 50,001 to Rs. 80,000	13%
Rs. 80,001 to Rs. 1,00,000	15%

Alternative Plans	*Plan I*	*Plan II*	*Plan III*
Equity (Rs.)	80,000	50,000	20,000
Debt (Rs.)	20,000	50,000	80,000

3+7

(b) From the following particulars select the best project using Net Present Value and Profitability Index method. Assume cost of capital of the company is 10% p.a.

	Project A	*Project B*
Initial outlay (Rs.)	90,000	1,00,000
Net Profit after Depreciation and tax		
Year		
1	40,000	35,000
2	32,000	45,000
3	30,000	42,000
4	28,000	38,000
5	35,000	30,000

Useful life of the project	5 years	5 years
Scrap value	Nil	Nil
Depreciation	Straight line method	Straight line method
Tax rate	50%	50%

10

(c) State the Modigliani-Miller hypothesis in dividend policy. What are the assumptions of M-M hypothesis. Prove the hypothesis.

1+3+6

[*Internal Assessment : 10*]