2014

M B A

2nd Semester Examination

FINANCIAL MANAGEMENT

PAPER—MBA-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) Why should be compute cost of capital ? Give reasons.

(b) What are the major functions of Financial management?

(c) Mathematically show that :

$$DFL = EBIT/EBT$$

(d) Briefly write the role of Equity Share as a source of Industrial Financing.

(e) Write short notes on degree of operating leverage and degree of combined leverage.

(f) Distinguish between Operating Lease and Financial Lease.

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

(a) The Well Establish Company's most recent Balance Sheet is as follows :

Liabilities	*Amount* (Rs.)	*Assets*	*Amount* (Rs.)
Equity Share Capital (Rs. 10 per share)	60,000	Net Fixed Assets	1,50,000
		Current Assets	50,000
Retained Earnings	20,000		
10% Long-term debt	80,000		
Current Liabilities	40,000		
	2,00,000		2,00,000

The company's total asset turnover ratio is 3, its fixed operating cost is Rs. 1,00,000 and its variable operating cost ratio is 40%. The income tax ratio is 50%.

(i) Calculate for the company all the three types of leverages.

(ii) Determine the likely level of EBIT if EPS is (a) Re.1, (b) Rs. 3, (c) Zero.

(b) (i) XYZ company has debentures outstanding with 5 years left before maturity. The debentures are currently selling for Rs. 90 (the face value is Rs. 100). The debentures are to be redeemed at 5% premium. The interest is paid annually at a rate of interest of 12%. The firm tax rate is 50%. Calculate Cost of Debt (K_d).

(ii) A company is contemplating an issue of new equity shares. The firm's equity shares are currently selling at R. 125 a share. The historical pattern of dividend payments per share, for the last 5 years is given below :

Year	*Dividend per share* (Rs.)
1	10.70
2	11.45
3	12.25
4	13.11
5	14.03

You are required to determine the following :

(a) Growth rate in dividends;

(b) Cost of equity capital, assuming growth rate determined under situation (a) continues for ever.

Note : [Given that as per compounded Table $(1.3112)^{1/4} = 1.07$]

(iii) A company has on its books the following amounts and specific costs of each type of capital :

Type of Capital	*Book Value*	*Market Value*	*Specific Costs*
	(Rs.)	(Rs.)	
Debt	4,00,000	3,80,000	5%
Preference	1,00,000	1,10,000	8%
Equity	6,00,000		
Retained Earning	2,00,000	12,00,000	13%
Total	13,00,000	16,90,000	

Determine the weighted average cost of capital using Market value Weight.

3+(2+2)+3

(c) (i) Write the major functions of the Industrial Credit and Investment Corporation of India (ICICI) as a supporter of industrial development in India.

(i) A Company's balance Sheet as at 31.3.2014 reflects the following position :

	Rs. Lakhs.	*Rs. Lakhs.*
Current Assets :		
Inventories :		
Raw Materials	500	
Work in Progress	50	
Finished Goods	100	
		650
Receivable		100
Others		50
		800
Current Liabilities :		
Creditors for purchases		300
Other current liabilities		100
		400
		3+7

[Internal Assessment : 10]

(Second Half)

(Marks : 50)

3. Answer any *four* questions : 5×4

(a) Write down the importance of capital structure.

(b) ABC Ltd. has net operating profit of Rs. 2,00,000 and its overall cost of capital is 15% and cost of debt is 12%. The company has used debt capital of Rs. 10,00,000 in its capital structure.

Compute the cost of equity and value of the company under NOI approach.

(c) Krish Technologies Ltd. with earnings per share of Rs. 15 it capitalised at 14% and has a return on investment of 18%. What would be the optimal dividend pay out ratio and the price per equity share at this payout ratio according to Walter's model ?

(d) Classify different types of working capital

(i) on the basis of concept, and

(ii) on the basis of time.

(e) The initial outlay of a project is Rs. 40,000 and it can generate annual cash inflow of Rs. 20,000, Rs. 15,000, Rs. 30,000 and Rs. 10,000 during the life of the project. If the cost of capital is 10%, will the project be accepted under NPV method ?

(f) Firms M and N are similar except that M is unlevered while N has Rs. 3,00,000 of 6% debentures outstanding. Assume that the tax rate is 40%, operating profit is Rs. 60,000 and the cost of equity is 10%.

Calculate the value of the firms if the M M assumptions are met.

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

(a) Jit Ltd. belongs to a risk class for which the equity capitalisation rate is 10%. It currently has 50,000 outstanding equity shares selling at par at Rs. 100 each. The company is contemplating the declaration of Rs. 8 as dividend per share at the end of the current fiscal year which has just started based on the assumptions underlying the M-M theory, answer the following questions.

(i) What will be the price per share at the end of the year

(a) if dividend is not declared, and

(b) if dividend is declared ?

(ii) Assuming that the company pays the dividend, has a net earnings of Rs. 5,00,000 and intends to make a new investment of Rs. 10,00,000 during the period, how many new shares must be issued ?

(iii) Does the payment of dividend affect the value of the company ? 3+3+4

(b) On the basis of the following information relating to Rani Ltd., you are required to ascertain the optimal capital structure.

Debt as % 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

Corporate tax rate is 50%.

(c) a project requires on initial investment of Rs. 20,000. The life of the project is 5 years. The required rate of return and income tax rate are 10% and 50% respectively. The profits before depreciation and taxes generated from the project at the end of 1st, 2nd, 3rd, 4th and 5th years are Rs. 12,000, Rs. 6,000, Rs. 4,000, Rs. 10,000 and Rs. 10,000 respectively. The method of depreciation is straight line. You are required to ascertain :

(a) payback period, and

(b) ARR. 5+5

[*Internal Assessment : 10*]