Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/MBA/SEM-2(FT)/MB-207/2012

2012

FINANCIAL MANAGEMENT

Time Allotted : 3 Hours *Full Marks* : 70

The figures in the margin indicate full marks.

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

GROUP – A

(Multiple Choice Type Questions)

1. Choose the correct alternative for any *ten* of the following: $10 \times 1 = 10$

   i) The inverse of PVIFA Factor is

      a) Annuity Factor

      b) Capital Recovery Factor

      c) Sinking Fund Factor

      d) Yield to Maturity.

   ii) If after-tax cost of debt is 12·60 % and the tax rate is 30 %, calculate the before-tax cost of debt.

      a) 8·82 %

      b) 15 %

      c) 3·78 %

      d) 18 %.

iii) If dividend payout ratio is increased, share prices will also increase and vice versa. This theory was put forward by

a) Walter b) Gordon

c) Graham & Dodd d) Modigliani & Miller.

iv) To resolve any possible clash between results as given by IRR and NPV, which process is used ?

a) Certainty Equivalent

b) Risk Adjusted Discount Rate

c) Discounted Cash Flow

d) Modified Internal Rate of Return.

v) Which of the following statements (in general) is accepted in taking corporate financial decisions ?

a) A low receivables turnover is desirable

b) The lower the total debt-to-equity ratio, the lower the financial risk for a firm

c) An increase in net profit margin with no change in sales or assets means a poor ROI

d) The higher the tax rate for a firm, the lower the interest coverage ratio.

vi) Which of the following would be consistent with a more aggressive approach to financing working capital ?

a) Financing short-term needs with short-term funds

b) Financing permanent inventory build up with long-term debt.

c) Financing seasonal needs with short-term funds

d) Financing some long-term needs with short-term funds.

vii) In deciding the appropriate level of current assets for the firm, management is confronted with

a) a trade-off between profitability and risk

b) a trade-off between liquidity and marketablility

c) a trade-off between equity and debt

d) a trade-off between short-term versus long-term borrowing.

viii) The market price of a share of common stock is determined by

a) the board of directors of the form

b) the stock exchange on which the stock is listed

c) the president of the company

d) individuals buying and selling the stock.

ix) To increase a given present value, the discount rate should be adjusted

a) upward

b) downward

c) with the present WPI

d) with the repo rate.

x) If a bond sells at a high premium, then which of the following relationships hold true ? (P0 represents the price of a bond and YTM is the bond's yield to maturity)

a) P0 < par and YTM > the coupon rate

b) P0 > par and YTM > the coupon rate

c) P0 > par and YTM < the coupon rate

d) P0 < par and YTM < the coupon rate.

xi) Which of the following is an example of a diversifiable risk ?

a) Ability of a company to obtain adequate supply of raw materials

b) Changes in the tax structure

c) Reduction in the purchasing power of money

d) Recession in the economy.

xii) A security is overpriced if its

a) market price < intrinsic value

b) market price = intrinsic value

c) market price > intrinsic value

d) none of these.

GROUP – B

(Short Answer Type Questions)

Answer any *three* of the following. $3 \times 5 = 15$

2. Distinguish between IRR and NPV.

3. Explain the factors determining the cost of capital.

4. a) The current price of a company's share is Rs. 200. The company is expected to pay dividend of Rs. 5 per share next year with a annual growth rate of 10%. If an investor's required rate of return is 12%, should he buy the share ?

b) Calculate the price of an equity share from the following data :

Earning per share (EPS) $\rightarrow$ Rs. 20. Internal rate of return (r) $\rightarrow$ 20%

Equity Capitalization rate $(K_e) \rightarrow$ 20%.

5. The return of securities *A* and *B* are given below :

Probabilities	Security-A	Security-B
0·6	5	0
0·3	2	4
0·1	0	4

Rank the securities. The security has to be selected on the basis of return and risk.

6. A firm has a following capital structure and after-tax costs for the different sources of funds used :

Source of funds	Amount	Proportion (%)	After-tax cost (%)
Debt	15,00,000	25	5
Preference shares	12,00,000	20	10
Equity shares	18,00,000	30	12
Retained earnings	15,00,000	25	11
Total	60,00,000	100	

You are required to compute the weighted average cost of capital.

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. $3 \times 15 = 45$

7. Sonata Gearbox Limited supplies gearbox equipment to automobile companies in Chennai (Hyundai Motors and Ford India Ltd). They have inaugurated their first production unit near Sri-Perumpudoor.

From the following details, you are required to estimate the net working capital requirement.

Production capacity	52,000 units
Selling price	Rs. 100 per unit
Raw materials and Direct labours	30% and 25% respectively
Overhead	Rs. 28,000 per month
Processing time (50% completion stage)	average one month
Inventory holding (Raw materials)	average - 4 weeks
(Finished goods)	average 1 month
Credit period–Customers	average 2 months
– Suppliers	average 4 weeks
Lag in payment of Wages	average 16 days
Expenses	average 4 weeks

25% of purchases are made for cash

Margin money is expected to be 20% of net working capital.

Overhead expenses include depreciation of Rs. 4,000 per month. 15

8. Technotronics Ltd. is considering a new project for manufacture of pocket video games involving capital expenditure of Rs. 600 lakh and working capital of Rs. 150 lakh. The capacity of the plant is for an annual production of Rs. 12 lakh units and capacity utilization during the 6 year working life of the project is expected to be as follows :

Year 1	33·33%	Year 3	90%
Year 2	66·67%	Year 4-6	100%

At the end of 3rd year, an additional investment of Rs. 100 lakh would be required for working capital. The average selling price per unit of the product is expected to be Rs. 200 netting a contribution of 40 %. The annual fixed costs, excluding depreciation are estimated to be Rs. 240 for 1st year, Rs. 360 for 2nd year and Rs. 480 lakh p.a. from 3rd year onwards. The rate of depreciation is 33·33% p.a. and income tax rate must be taken at 35%. Cost of capital is 15%.

Advise the company about the financial viability of the project.

9. Fast Track Limited currently has outstanding 1,00,000 shares selling at Rs. 100 each. The firm is contemplating of declaring a dividend of Rs. 5 per share at the end of the current fiscal year. The capitalization rate for the class of risk to which the firm belongs, is 10%.

   a) What will be the price of each share of Fast Track Ltd. if the dividend is not declared ?

   b) What will be the price of each share of Fast Track Ltd. if the dividend is declared ?

   c) If Fast Track pays the dividend, has net profits of Rs. 10,00,000/- and makes new investments of Rs. 20,00,000/- during the period, how many new shares must be issued ? You may sue the M-M model.

3 + 3 + 9

10. MMC Company currently has an equity share capital of Rs. 40 lakhs, consisting of 40,000 equity shares of

Rs. 100 each. The management is planning to raise an additional, Rs. 30 lakhs to finance a major programme of expansion through one of four possible financing plans. The options are :

a) Entirely through equity issues.

b) Rs. 15 lakhs in equity shares of Rs. 10 each and the balance in 8 per cent debentures.

c) Rs. 10 lakhs in equity shares of Rs. 100 each and the balance through long term borrowings at 9 per cent interest per annum.

d) Rs. 15 lakhs in equity shares of Rs. 100 each and the balance through preference shares with 5 per cent dividend.

The company's expected earnings before Interest and Taxes (EBIT) will be Rs. 15 lakhs. Assuming a corporate tax rate of 50 per cent, you are required to determine the EPS and comment on the financial leverage that will be authorised under each of the above schemes of financing.

11. Write short notes on any *three* of the following : 3×5

a) Stock splits.

b) Operating Leverage.

c) WACC.

d) Preference Share .

e) Wealth maximization.