Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/MBA/SEM-2 (FT)/MB-207/2013

2013

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 alternatives for any *ten* of the following :

$10 \times 1 = 10$

i) Which of the following is not true regarding the Degree of Operating Leverage (DOL) ?

a) DOL is undefined at the operating BEP.

b) If the quantity produced is less than the operating break-even point, DOL will be negative

c) At the operating break-even point, the quantity produced is computed as the ratio of fixed costs and contribution per unit

d) If the quantity produced is greater than the operating break-even point, DOL will be positive and increases as quantity produced increases.

ii) M/s Venus Ltd. sold its business as an operating one and realized Rs. 4 crores. The amount realised can be termed as

a) Liquidation value

b) Replacement value

c) Going concern value

d) Market value.

iii) Key financial functions of a firm include the following *except*

a) Investment decision

b) Make or buy decision

c) Dividend decision

d) Financing decision.

iv) Determining timing of cash flows is not important for financial decisions in

a) Capital budgeting decision

b) Financing decision

c) Dividend decision

d) Recruitment decision.

v) Which of the following approaches to compute the cost of equity capital assumes that actual returns will be in line with the excepted returns ?

a) Realized Yield Approach

b) Bond Yield Plus Risk Premium Approach

c) Earnings-Price Ratio Approach

d) Dividend Capitalization Approach

e) Capital Asset Pricing Model.

vi) If the risk-free return (R_f) is 8%, beta value (β) is 1·8 and market rate of return (K_m) is 14%, the expected rate of return, E(R) , would be

a) 18·8% b) 17·5%

c) 19·8% d) 18·4%.

vii) Given k_0 = 11·88%, k_e = 15% and the weights used in favour of equity, retained earnings and debts are respectively, 40%, 20% and 40%, the after-tax cost of debt is

a) 7·5% b) 7·2%

c) 8·5% d) 8·2%.

viii) A company has a monthly requirement of 266·6666 units. The ordering cost per order is Rs. 200. The raw material cost per unit is Rs. 20. The storage cost is 10% p.a. What would be the EOQ ?

a) 800 units b) 1,200 units

c) 1,600 units d) None of these.

ix) Which of the following is *not* a justifiable reason for using after-tax weighted average cost of capital as the decision criterion ?

a) It is a combination of costs of heterogeneous elements of capital.

b) The after-tax basis is adopted in order to bring in uniformity among various components of cost of capital.

c) The yield to shareholders is the relevant consideration and dividend is paid out of after-tax profits.

d) In financial decisions, cash flows are used as an important decision variable and cash flows are ascertained after deducting tax liability.

x) Which of the following statements is not true in the context of marginal cost of capital ?

a) It is the cost of additional amount financed by a firm.

b) It is the specific cost of capital when capital is raised from one particular source.

c) It is generally higher than the average cost of capital of the firm.

d) It is equivalent to marginal revenue.

xi) In the discussion relating to conceptual aspects of capital structure, we are not concerned with the ……………………. rates of return.

a) Return on investment

b) Cost of debt capital

c) Cost of equity capital

d) Weighted average cost of capital.

xii) Higher operating risk can be taken when

a) fixed cost is rising

b) variable cost is rising

c) income level is rising

d) none of these.

GROUP – B

(Short Answer Type Questions)

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

2. What do you mean by annuity ? In which financial decisions is 'annuity factor' used ?

3. Mr. *X* expects to receive Rs. 1,000 annually for 3 years, each receipt will occur at the end of the year. What is the present value of this stream of benefits, if the discount rate is 10% ?

4. State briefly, the relationship between risk and return as per CAPM analysis.

5. Discuss the uses and applications of pecking order theory.

6. What are the implications of the Walter model ? Briefly analyse the logic behind it.

GROUP – C

(Long Answer Type Questions)

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

7. a) Cadbury's is perhaps the most widely known chocolate brand in India. They had the maximum market share in India in the 1990s. 'Amul' and 'Campco' were the two tiny players. But after liberalization of the Indian Company Nestle and Marsh entered the chocolate market. A number of global brands are also sold in retail stores. The company observed that the distributors and dealers are delaying in payment. The CEO of Cadbury's India Limited wants to know how they can expedite the credit collection procedure of the firm.

   Write your answer with logical reasoning.

b) *XYZ* Corporation is considering relaxing its present credit policy and is in the process of evaluating 2 proposed policies. Currently the firm has annual credit sales of Rs. 50 lakhs, and accounts receivable turnover of 4 times a year. The current level of loss due to bad debts is Rs. 1,50,000. The firm is required to give a return of 25% on the investment in new accounts receivable. The company's variable cost is 70% of the selling price. Given the following information, which is a better option ?

	Present policy	*Option 1*	*Option 2*
Annual credit sale	Rs. 50 lakhs	Rs. 60 lakhs	Rs. 67·50 lakhs
AR turnover (Times)	4	3	2·4
Bad Debt Losses	Rs. 1·50 lakhs	Rs. 3 lakhs	Rs. 4·50 lakhs

7 + 8

8. a) Mr. Chandrasekhar retired in 2003 and right now he is 70 years old. He is expecting that he will live for another ten years. His total savings amounted to Rs. 10,00,000, which he has deposited in State Bank of India. He wants to spend his savings equally over these ten years. If the interest earned on these deposits is 8% per annum for senior citizens, what is the annual withdrawal made over the defined period such that the account balance becomes zero at the end of 10 years ?

(Round off your answer to the nearest integer).

b) The Balance Sheet for M/s. Hitech Ltd. which is a semi-conductor manufacturing firm is given below :

Balance Sheet as on March 31st, 2013

Rs. (in Lakhs)

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital	220	Fixed Assets	450
Retained Earnings	90	Inventories	120
Long-term Loan	210	Accounts Receivable	160
Short-term Borrowings	105	Cash at Bank	70
Accounts Payable	160		
Provisions	15		
	800		800

The sales for the year 2012-2013 were Rs. 12 crore and they are expected to go up by 26% in the year 2013-2014. Last year's net profit margin of 5% and the dividend payout ratio of 40% are expected to remain same in the year 2013-2014. The external funds requirement of the company for the year 2013-2014 is Rs. 117·14 lakhs. The company wants to raise external funds through short-term borrowings and equity (in the same order). If the current ratio should not be less than 1·2, what is the minimum amount of equity to be raised by the company ? 7 + 8

9. a) What do you mean by 'stock dividend' ?

   b) What are the advantages and disadvantages of Stock Split ?

   c) Do you think that dividend stability theory holds good in modern day capital market ?

   d) State the major legal provision regarding payment of dividend as stipulated by the Companies Act, 1956 as amended up to date. 3 + 4 + 4 + 4

10. MNP Ltd. is thinking of replacing its existing machine by a new machine which would cost Rs. 60 lakhs. The company's current production is 80000 units and is expected to increase to 100000 units, if the new machine is bought. The selling price of the product would remain unchanged at Rs. 200 per unit. The following is the cost of producing one unit of product using both the existing and the new machine :

Particulars	*Existing Machine (80000 units) (in Rs.)*	*New Machine (100000 units) (in Rs.)*	*Unit Cost Difference (in Rs.)*
Materials	75·00	63·75	(11·25)
Wages & Salaries	51·25	37·50	(13·75)
Supervision	20·00	25·00	5·00
Repairs & Maintenane	11·25	7·50	(3·75)
Power & Fuel	15·50	14·25	(1·25)
Depreciation	0·25	5·00	4·75
Allocated Corporate Overheads	10·00	12·50	2·50
	183·25	165·50	(17·75)

The existing machine has an accounting book value of Rs. 1,00,000 and it has been fully depreciated for tax purpose. It is estimated that the machine will be useful for 5 years. The supplier of the new machine has offered to accept the old machine for Rs. 2,50,000. However the market price of the old machine today is Rs. 1,50,000 and it is expected to be Rs. 35,000 after 5 years. The new machine has a life of 5 years and a salvage value of Rs. 2,50,000 at the end of its economic life. Assume corporate tax rate at 40% and depreciation is charged on straight line basis for income tax purposes. Further assume that the book profit is treated as ordinary income for tax purpose. The opportunity cost of capital is 15%.

a) Estimate NPV of the replacement decision

b) Estimate the IRR of the replacement decision

c) Should company go ahead with the replacement decision ? Suggest.

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

a) Motives of holding cash

b) Amortization

c) Yield to Maturity

d) NOI approach

e) Degree of operating leverage.