CBCS SCHEME

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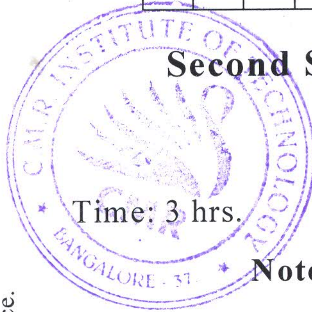
16/17MBA22



Second Semester MBA Degree Examination, Dec.2018/Jan.2019

Financial Management

Time: 3 hrs. Max. Marks:80

Note: 1. ***Answer any FOUR full questions from Q.No.1 to Q.No.7.***
2. ***Question No. 8 is compulsory.***
3. ***P.V table may be used.***

Important Note : 1. On completing your answers, compulsorily draw diagonal cross lines on the remaining blank pages.
2. Any revealing of identification, appeal to evaluator and /or equations written eg, 42+8 = 50, will be treated as malpractice.

1 a. What do you mean by Capital Rationing? **(02 Marks)**

b. Amit equipment has a capital structure target of 60% equity, 15% of preference and 25% of long-term debt. Amit's financial analysts have estimated the after-tax cost of debt, preference cost and cost to equity to be 9%, 15% and 18% respectively. What is the weighted average cost of capital of Amit Equipment? **(06 Marks)**

c. Briefly explain the various sources of financing. **(08 Marks)**

2 a. Differentiate between explicit cost and implicit cost. **(02 Marks)**

b. Briefly explain different factors affecting dividend policy. **(06 Marks)**

c. The Moon company's most recent balance sheet is as follows:

Liabilities	Amount	Assets	Amount
Equity capital (Rs.10 per share)	60,000	Net fixed assets	1,50,000
10% long-term debt	80,000	Current assets	50,000
Retained earnings	20,000		
Current liabilities	40,000		
	2,00,000		2,00,000

The company's total assets turnover ratio is 3 times, its fixed operating costs are Rs.1,00,000 and the variable operating costs ratio is 40%. The income tax is 35%.

i) Calculate all the three types of leverages.
ii) Determine the likely level of EBIT if EPS is Re.1 and Rs.3. **(08 Marks)**

3 a. Compute operating leverage of a firm.
Sales 1,50,000 units @ Rs.1.20 per unit.
Variable cost 40%.
Fixed cost Rs.36,000. **(02 Marks)**

b. A company issues a new 10% debentures of Rs.1000 face value to be redeemed after 10 years. The debenture is expected to be sold at 5% discount. It will also involve floatation costs of 5% of face value. The company's tax rate is 35%. What would be the after tax cost of debt? **(06 Marks)**

c. A proforma cost sheet of a company provides the following particulars:

	Amount per unit
Raw material cost	100
Direct labour	37.50
Overheads cost	75
Total cost	212.50
Profit	37.50
Selling price	250

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The company keeps raw material in stock, on an average for one month; work in progress on an average for one week; and finished goods in stock on an average for two weeks.
The credit allowed by suppliers is three weeks and company allows four weeks credit to its customers. The lag in payment of wages is one week and lag in payment of overheads expenses is two weeks.
The company sells one-fifth of the output against cash and maintains cash-in-hand and bank put together at Rs.37,500.
Required: Prepare a statement showing estimate of working capital needed to finance an activity level of 1,30,000 units of production. Work-in-progress is 80% complete in all respects. Time period of 4 weeks in equivalent to a month. Assume 52 weeks in a year. **(08 Marks)**

4 a. What do you mean by a Warrant? **(02 Marks)**
b. What is meant by CAPM? Outline its different assumptions. **(06 Marks)**
c. i) Mr. Raman needs Rs.1,00,000 for his daughter marriage in 10 years. How much must be deposited at the end of each year in the bank at 10% compound interest in order to have marriage money ready?
ii) If Rs. 30000 is put in a saving account yielding 6% compounded annually and other Rs.10,000 is added each year, how much it will have accrued in ten years?
iii) What is the present value of cash flows of Rs.750 per year forever at an interest rate of 8% and at an interest rate of 10%? **(08 Marks)**

5 a. What is meant by the term financial risk? **(02 Marks)**
b. Compute the operating cycle of Alpha Ltd. from the following:

Particulars	Amount (Rs.)
Stocks	
* Raw materials	38,000
* Work in progress	25,000
*Finished goods	18,000
Purchase of raw materials	1,50,000
Cost of goods sold	2,20,000
Sales	3,50,000
Debtors	50,000
Creditors	25,000

Assume 360 days in a year. **(06 Marks)**
c. What are the objectives of financial management? **(08 Marks)**

6 a. What is the hedging approach of financing working capital funds requirements? **(02 Marks)**
b. What do you mean by payback period? Enumerate its limitations. **(06 Marks)**
c. A project costing Rs.6,50,000 is expected to generate the following cash flows over its useful life. Depreciation is to be provided using straight line method. Calculate Accounting Rate of Return (ARR).

Year		Cash out flow	Cash in flow
0	Initial Investment	(6,50,000)	0
1			1,50,000
2			2,20,000
3			3,00,000
4			2,50,000
5			1,80,000
6			1,12,000
6	Salvage value		20,000

(08 Marks)

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7 a. What is meant by cash cycle? (02 Marks)

b. A project involve initial investment of Rs.5,20,000, cost of capital is 8%. What is the Modified Internal Rate of Return (MIRR) if yearly cash inflows are reinvested at the rate of 14%?

Year	Cash in Flow
1	95,000
2	1,10,000
3	1,48,000
4	2,50,000
5	2,00,000
6	1,50,000

(06 Marks)

c. Determine the EPS (Earning Per Share) of a company which has operating profit (EBIT) of Rs.1,60,000. Its capital structure consists of the following securities.
10% Debentures of Rs.5,00,000.
12% Preference share capital of Rs.1,00,000,
Equity shares of Rs.100 each of Rs.4,00,000.
The company is in the 55% tax bracket.

i) Determine the company's EPS.
ii) Determine the percentage change in EPS, associated with 30% increase and 30% decrease in EBIT. (08 Marks)

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8 ***CASE STUDY* (compulsory):**

A company is manufacturing a consumer product, the demand for which at current price is in excess of its ability to produce. The capacity of a particular machine, now due for replacement, is the limiting factor on production. The possibilities exist either of acquiring a similar machine (Project X) or of purchasing a more expensive machine with greater capacity (Project Y). The cash flows under each alternative have been estimated and given below. The company's opportunity cost of capital is 10% after tax. In deciding between the two alternatives the Managing Director (MD) favors the 'Pay Back Period'. The Chief Accountant, however, thinks that a more specific method should be used and he has calculated for each project:

i) The Net Present Value
ii) The Profitability Index
iii) The discounted Pay Back Period

Having made these calculations, however he finds himself still uncertain about which project to recommend. You are required to make these calculations and to discuss their relevance to the decision to be taken. The relevant cash flows are:

Year	Project X	Project Y
0	(27,000)	(40,000)
1	-	10,000
2	5000	14,000
3	22,000	16,000
4	14,000	17,000
5	14,000	15,000

(16 Marks)

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