MBA CMRIT

Sub: Financial Management Sub code 17MBA22

IAT – 3, II semester, Date of Exam. 23/5/18.

Solutions / Answer key

1. Define working capital (2).

According to Gestenberg, circulating capital or working capital means current assets of a company that are changed in the ordinary course of business from one form to another, as for example, cash to inventories – Receivables – to cash

b. Explain Dividend and list its types.

The term dividend refers to that portion of profit (after tax) which is distributed among the owners/ shareholders of the firm..

List of types of dividend

cash dividend, Bonus dividend, Property dividend, interim dividend, Scrip dividend, annual dividend etc

c. calculate, FL, OL, and CL from the following data.

	(Rs)
Sales:	200,000
(–) VC. (100,000 unit × 0.70):	70,000
Contribution	130,000
(–) FC.	65000
EBIT	65000
(–) Interest charges.	15000
EBT →	50,000

$$OL = \frac{\text{Contribution}}{EBIT}$$

$$= \frac{130{,}000}{65000} = 2:1$$

$$FL = \frac{EBIT}{EBT} = \frac{65000}{50{,}000} = 1.3$$

$$CL = \frac{C}{EBIT} \times \frac{EBIT}{EBT}$$

$$= \frac{C}{EBT} = \frac{130{,}000}{50{,}000} = 2.6$$

2a) Stock dividend.

Otherwise termed as Bonus dividend. An issue of bonus share is the distribution of shares free of cost to the existing shareholders. In India, bonus shares are issued in addition to the cash dividend and not in lieu of cash dividend.

b. Explain any 6 factors affecting dividend policy.

- → Legal Provisions
- → Magnitude of earnings
- → Desire of Shareholders
- → Nature of industry
- → Taxation policy

detailed explanation is mandatory.

2c..

Existing capital. Tk 10,00,000.

No. of eq shares o/s: (outstanding): 100,000 Eq shares.

10,00,000/10 = ?.

New additional capital: Tk 10,00,000.

can be raised in 3 different financial plans.

All Equity shares.

All debentures carrying 8% interest

Tk 500,000 in equity share (+) Tk 500,000 in 10% Pref. share

<u>Solution</u>

a) All equity share, ie Tk 10,00,000

∴ No. of new equity share outstanding

= Tk 10,00,000/10 = 100,000 E.S.A

EBIT	Tk 60,000
(-) Interest	0
EBT →	60,000
(-) Tax 30%	18000
EAT	42000
(-) Pref. share dividend	0
EAT available to equity shareholders	Tk 42000

$$eps = \frac{EAT}{\text{No. of E.S o/s}}$$

$$= \frac{42000}{100,000 + 100,000\,sh}$$

$$\frac{42000\ Tk}{200,000\ sh}$$

$\boxed{eps = 0.21}$

b) All through debenture @ 8% Interest

Rs 10,00,000 Debenture.

EBIT		60,000
(-) Int $\frac{8}{100} \times 10,00,000$		80,000
	EBT	- 20,000
	(-) Tax 30%	- 6000
	EAT	- 26000

c). Rs 500,000 in equity share + Rs 500,000 in Pref share

No. of equity share o/s

E

Rs $\frac{500,000}{10}$ = 50,000 Equity Share

EBIT	60,000
(-) Interest	0
EBT	60,000
(-) Tax 30%	18000
EAT	42000
(-) Pref share divi	0
EAT available to equity share holder	Rs 40,000

eps = $\frac{\text{EAT}}{\text{No. of Eq sh o/s}}$

$= \frac{\text{Rs } 40,000}{100,000 \text{ E.S} + 50,000 \text{ E.S}}$

$= \frac{\text{Rs } 40,000}{150,000 \text{ E.S}}$

$= 0.27$

Rs 500,000 @ 10 % Pref. share.

EBIT	60,000
(-) Interest	0
EBT	60,000
(-) Tax 30%	18000
EAT	42000
(-) Pref share dividend $10/100 \times 500,000$	50,000
EAT	- 8000

Inference Since the 2 financial plan b, c ends up with negativity. These 2 should be rejected, and the best financial plan available for the Company is to raise Rs 10,00,000 through the means of equity shares only.

3 a) Trading on Equity – Explain

Trading on Equity is also known as financial leverage is the balance between the cost financing operations with equity or debt and the income earned from the operations.

b) Danger of having ~~excess~~ inadequate working capital.

The following are the list of demerits of having inadequate working capital:

- → Difficulty in availability of raw materials.
- → Full utilisation of fixed assets not possible.
- → Difficulty in maintenance of machinery
- → Decrease in credit rating
- → Non utilisation of favorable opportunities.
- → Decrease in sales

c) calculate FL, OL, CL.

			(Rs)
I	Sales	60,000 units × 0.60 =	36,000
	(–) VC	60,000 units × 0.20 =	12000
		C	24,000
		(–) FC.	7000
		EBIT	17000
		(–) Interest	4000
		EBT	13000

P

FL: $\dfrac{EBIT}{EBT} = \dfrac{17000}{13000} = 1.31$

OL: $\dfrac{\text{Contribution}}{EBIT} = \dfrac{24000}{17000} = 1.41$

CL: ~~EB~~ $\dfrac{\text{Contribution}}{EBT} = \dfrac{24000}{13000} = 1.85$

Q

Sales (15000 × 5) :	75000
(−) VC (15000 × 1.50)	22500
Contribution	52500
(−) FC	14000
EBIT	38500
(−) Interest	8000
EBT	30500

OL: $\dfrac{\text{Contribution}}{EBIT} : \dfrac{52500}{38500} = 1.36$

FL: $\dfrac{EBIT}{EBT} = \dfrac{38500}{30500} = 1.26$

CL: $= \dfrac{C}{EBT} : \dfrac{52500}{30500} = 1.72$

R

Sales (10000 unit × 1) :	10,000
(−) VC (10,000 unit × 0.20)	2000
C	8000
(−) FC.	1500
EBIT	6500
(−) Interest.	0
EBT	6500

OL: $= \dfrac{C}{EBIT} : \dfrac{8000}{6500} = 1.23$

FL $= \dfrac{EBIT}{EBT} = \dfrac{6500}{6500} = 1$

CL: $\dfrac{8000}{6500} = 1.23$

Inference: O.L is high in firm Q since contribution > FC
FL is high in firm P. Fixed interest charge is comparatively high.

Part B

4a). calculation of W.C. Requirement.

(Rs)

CA:

Stock of finished Goods:	5000.
stock of Stores and materials:	8000.
Inland credit sales	
$\frac{6}{52} \times 312000$ =	36000
Export credit sales.	
$\frac{1.5}{52} \times 78000$ =	2250
Prepaid Sundry Expenses	
$\frac{1}{4} \times 8000$ =	2000
Total CA	53250

CL:

Lag in payment of Expenses:

Wages: $260,000 \times \frac{1.5}{52}$ =	7500
Stock & materials: $48000 \times \frac{1.5}{12}$ =	6000
Rent & Royalties: $10,000 \times 6/12$ =	5000
Clerical staff: $62400 \times 0.5/12$ =	2600
Managerial salary: $4800 \times 0.5/12$:	200
Miscellaneous $48000 \times 1.5/12$ =	6000
TCL	27300

W.C.: TCA − TCL 25950