II Semester M.B.A. Degree Examination, July 2016
(2007-08 Scheme)
MANAGEMENT
2.2 : Financial Management

Time : 3 Hours | Max. Marks : 75

***Instruction :** Answer **all** Sections.*

SECTION – A (2×6=12)

1. Answer **any six** of the following questions. **Each** question carries **2** marks.

   a) What is wealth maximization ?

   b) Differentiate between before A.R.R. and I.R.R.

   c) What is financial leverage ?

   d) What is optimum capital structure ?

   e) What is net working capital ?

   f) What is a bonus share ?

   g) What is Concentration banking ?

   h) What is meant by capital rationing ?

SECTION – B (8×3=24)

Answer **any three** of the following questions. **Each** question carries **eight** marks.

2. Discuss the different techniques of capital budgeting.

3. What is working capital policy ? Discuss the different types of working capital policies.

4. The following information is available in respect of rate of return on investment (r), the capitalisation rate (Ke) and EPS (E) of a company.
   Rate of return on investment (r) = 15%, 12% and 10%
   Ke = 12.5 percent
   EPS (E) = Rs. 10
   Determine the value of shares according to Walter's model for the following payout ratios :
   0%, 25%, 50%, 75% and 100%

5. Two firms, A and B, have provided the following information :

	Sales (Rs. in lakhs)	Variable costs (Rs. in lakhs)	Fixed costs (Rs. in lakhs)
Firm A	1800	450	900
Firm B	1500	750	375

You are required to calculate :

i) Profit to sales ratio

ii) Degree of operating leverage for the firms.

iii) Degree of financial leverage.

6. A company sells 40,000 units of its product per year @ Rs. 35 per unit. The average cost per unit is Rs. 31 out of which variable cost per unit is Rs. 28. The average collection period is 60 days. Bad debts losses are 3% on sales and the collection charges amount to Rs. 15,000.

The company is considering the proposal to follow stricter collection policy which would bring down the losses on account of bad debts to 1% of sales and average collection period to 45 days. It would, however, reduce the sales volume by 1000 units and increase collection expenses to Rs. 25,000.

The company requires a rate of return of 20%. Would you recommend the adoption of the new credit policy ? (Assume 360 days in a year for the purpose of your calculation.)

SECTION – C **(2×12=24)**

Answer **any two** of the following questions. **Each** question carries **12** marks.

7. Give a critical appraisal of the Modigliani and Miller approach to the problem of capital structure.

8. The following information has been extracted from the records of a company :

Product cost sheet	**(Rs. per unit)**
Raw materials	45
Direct labour	20
Overheads	40
Total cost	105
Profit	15
Selling price	**120**

a) Raw materials are in stock on an average of two months.

b) The materials are in process on an average for 4 weeks. The degree of completion is 50%.

c) Finished goods stock on an average is for one month.

d) Time lag in payment of wages and overheads is 1½ weeks.

e) Time lag receipt of proceeds from debtors is 2 months.

f) Credit allowed by suppliers is one month.

g) 20% of the output is sold against cash.

h) The company expects to keep a cash balance of Rs. 1,00,000.

i) Take 52 weeks per annum.

The company is poised for a manufacture of 1,44,000 units in the year.

You are required to prepare a statement showing the working capital requirements of the company.

9. JKL Ltd. has the following book-value capital structure as on March 31, 2006.

	(Rs.)
Equity share capital (2,00,000 shares)	40,00,000
11.5% Preference shares	10,00,000
10% Debentures	30,00,000
	80,00,000

The equity share of the company sells for Rs. 20. It is expected that the company will pay next year a dividend of Rs. 2 per equity share, which is expected to grow at 5% p.a. forever. Assume a 35% corporate tax rate.

Required :

i) Compute Weighted Average Cost of Capital (WACC) of the company based on the existing capital structure.

ii) Compute the new WACC, if the company raises an additional Rs. 20 lakhs debt by issuing 12% debentures. This would result in increasing the expected equity dividend to Rs. 2.40 and leave the growth rate unchanged, but the price of equity share will fall to Rs. 16 per share.

SECTION – D (1×15=15)

Note : Answer the following **(compulsory)**. This question carries **15** marks.

10. Astra Zeneca Ltd. is considering two different investment proposals. The details are as under.

	Proposal A (Rs. in lakhs)	**Proposal B (Rs. in lakhs)**
Investment cost	1000	2000
Estimated cash inflows		
1	150	400
2	250	500
3	300	600
4	350	700
5	550	900

a) Suggest the most attractive proposal on the basis of Net present value method considering future incomes are discounted at 10%.

b) What is the ranking of the above proposals based on Payback, ARR and profitability index ?

c) Which of the two proposals would you recommend and why ?