II Semester M.B.A. Degree Examination, July 2017
(2007-08 Scheme)
Paper – 2.2 : FINANCIAL MANAGEMENT

Time : 3 Hours Max. Marks : 75

SECTION – A

1. Answer **any six** of the questions. **Each** question carries **2** marks. **(6×2=12)**
   a) What is IRR ?
   b) Is wealth maximisation a superior objective ? State the reasons.
   c) What is lockbox system ?
   d) What do you mean by float ?
   e) What is NPV profile ?
   f) Suppose you deposited Rs. 10,000 in a bank that offers 12% interest p.a. What is the doubling period ?
   g) State the factors that influence investment in receivables.
   h) What is stock split ?

SECTION – B

Answer **any three** questions. **Each** question carries **8** marks. **(3×8=24)**

2. Explain the sources of working capital finance.
3. Examine the features of an optimal capital structure.
4. Aries Ltd. wishes to raise additional finance of Rs. 10 lakh for meeting its investment plans. It has Rs. 2,10,000 in the form of retained earnings available for investment purposes. The following are the other details :
   a) Debt/Equity mix 30%/70%
   b) Cost of debt upto Rs. 1,80,000 10% (Before Tax)
   c) Cost of debt beyond Rs. 1,80,000 16% (Before Tax)

d) EPS Rs. 4

e) Dividend payout 50% of earnings

f) Expected rate in dividend 10%

g) Current market price Rs. 44

h) Tax rate 50%

You are required :

i) To compute the pattern of raising additional finance.

ii) To determine the pretax and post tax average cost of additional debt.

iii) To determine the cost of retained earnings and cost of equity.

iv) Compute the weighted average after tax of additional finance.

5. X and Y Ltd. is desirous to purchase a business and has consulted you and one point on which you are asked to advise them, is the average of working capital will be required in the first year's working. You are instructed to add 10% to your computed figure to allow for contingencies.

i) Average amount backed up for stocks :

Stock of finished product	5,000
Stock of stores and materials	8,000

ii) Average credit given :

Inland sales, 6 weeks credit	3,12,000
Export sales 1.5 weeks credit	78,000

iii) Average time lag in payment of wages and other outgoings :

Wages, 1.5 months	2,60,000
Stocks and materials, 1.5 months	48,000
Rent and royalties, 6 months	10,000
Clerical staff, 0.5 month	62,400
Manager, 0.5 month	4,800
Miscellaneous expenses, 1.5 months	48,000

iv) Payment in advance :

Sundry expenses (paid quarterly)	8,000

v) Undrawn profits on an average throughout the year 11,000

Setup your calculations for the average amount of working capital required.

6. Suppose a firm borrows Rs. 10,00,000 at an interest rate of 15% and the loan is to be repaid in 6 equal installments at the end of the next 5 years. What is the size of the installments ? Prepare loan amortization schedule.

SECTION – C

Answer **any two** questions. **Each** carries **12** marks. **(2×12=24)**

7. State MM's proposition on capital structure. Illustrate how the arbitrage mechanism works with the help of an example.

8. Astra India Ltd. has currently an ordinary share capital of Rs. 25 lakhs, consisting of 25,000 shares of Rs. 100 each. The management is planning to raise another Rs. 20 lakhs to finance its major expansion programme, one of the four possible financial plans :

   Plan A : Entirely through ordinary shares.

   Plan B : 10 lakhs through ordinary shares and 10 lakhs in 8% long term loan.

   Plan C : 5 lakhs through ordinary shares and 15 lakhs in 9% loan (LT)

   Plan D : 10 lakhs through ordinary shares and 10 lakhs through preference shares with 5% dividend.

   The companies expected Earnings Before Interest and Tax (EBIT) will be Rs. 8 lakhs. Assuming a corporate tax rate of 50%, determine the EPS in each alternative and comment, which alternative is best and why ?

9. The EPS of a company is Rs. 8 and the rate of capitalization is 10%. The company has before it, an option of adopting (i) 50 (ii) 75 (iii) 100% dividend payout ratio. Compute the market price per share of the company's quoted shares per share as per Walter's model if it can earn a return of (a) 15% (b) 10% and (c) 5% on its retained earnings.

SECTION – D

Case study (**Compulsory**) : **(1×15=15)**

10. You are a financial analyst in XYZ Co. Ltd. The director of the capital budgeting has asked to analyse two proposed capital investments, project P and Q. Each project has a cost of Rs. 10,00,000 and the cost of capital for each project is 12%. The project expected net cash flows are as follows :

Expected Net Cash Flows

Year	**Project P**	**Project Q**
0	(10,00,000)	(10,00,000)
1	6,50,000	3,50,000

2	3,00,000	3,50,000
3	3,00,000	3,50,000
4	1,00,000	3,50,000

Required :

a) Calculate each projects payback period, NPV and IRR.

b) Which project or projects should be accepted, if they are independent ?

c) Which project or projects should be accepted, if they are mutually exclusive ?

d) How might a change in cost of capital produce a conflict between NPV and IRR rankings of these two projects ? Would this conflict exist if 'k' were 5% ?

e) Why does this conflict exist ?

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