II Semester M.B.A. (Day/Evening) Degree Examination, June/July 2007
(Updated Scheme)
MANAGEMENT
Paper 2.2 : Financial Management

Time : 3 Hours Max. Marks : 75

SECTION – A

1. Answer **any six** of the following : **(6×2=12)**
   a) State the arguments against 'profit maximization' as a goal of financial management.
   b) What is Venture Capital Financing ?
   c) An investor has invested in the shares of ABC Ltd., which expects no growth in dividends. ABC Ltd., has paid a dividend of Rs. 3 per share. If the required rate of return is 14 per cent, what would be the value of the share ?
   d) An investor deposits Rs. 1,000 in a saving institution. Each payment is made at the end of the year. If the payments deposited earn 6% interest compounded annually, how much amount will he receive at the end of 10 years ?
   e) List the methods of measuring and evaluating 'risk in capital budgeting'.
   f) Name the various floats, which necessitates 'management of cash'.
   g) List any six factors influencing the requirement of working capital.
   h) What is the proposition of MM Hypothesis in the context of Dividend Decisions ?
   i) What is private placement ?

SECTION – B

Answer **any four** of the following : **(4×5=20)**

2. Explain the proposition made by Gordon regarding dividend policy.
3. Explain the Acceptability Criterion under various techniques of Capital Budgeting.
4. A company issues a new 15% debentures of Rs. 1,000 face value to be redeemed after 10 years. The debentures are expected to be sold at 5% discount. It will also involve flotation cost of 5%. The company's tax rate is 30%. What would be the cost of debt ?
5. AB Limited provides you with the following figures :

Profits before Interest and tax	Rs. 3,00,000
Interest on Debentures @ 12%	Rs. 60,000
Tax Rate	50%

Number of Equity Shares (Rs. 10 each)	40,000
Earning per Share	Rs. 3
Ruling price in the market	Rs. 30
Price/Earnings Ratio	10

The company has undistributed reserves of Rs. 6,00,000. The company needs Rs. 2,00,000 for expansion. This amount will earn at the same rate as funds already employed. You are informed that a debt equity ratio i.e., debt/(debt + equity) higher than 35% will push the P/E ratio down to 8 and raise the interest rate on additional amount borrowed to 14%. You are required to ascertain the probable price of the share :

a) If the additional funds are raised as debt; and

b) If the amount is raised by issuing equity shares.

6. The Go-Go Ltd's most recent balance sheet is as follows :

Liabilities	Rs.	Assets	Rs.
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		
Total	**2,00,000**	**Total**	**2,00,000**

The company's total assets turnover ratio is 3, its fixed operating costs are Rs. 1,00,000 and its variable operating cost ratio is 40%. The income tax rate is 50%.

a) Calculate for the company, all the three types of leverages.

b) Determine the likely level of EBIT if the EPS is

i) Re. 1 ii) Rs. 3 iii) Nil

7. A firm has current sales of Rs. 2,56,48,750. The firm has unutilized capacity. In order to boost its sales, it is considering a relaxation in its credit policy. The proposed terms of credit will be 60 days credit against the present policy of 45 days. As a result, the bad debts will increase from 1.5% to 2% of sales. The firm's sales are expected to increase by 10%. The variable operating costs are 72% of the sales. The firm's corporate tax rate is 35% and it requires an after tax return of 15% on its investments. Should the firm change its credit period ?

SECTION – C

Answer **any three** of the following : **(3×10=30)**

8. Explain the factors influencing Capital Structure Decisions of a Business Enterprise.

9. Explain the various sources of short-term finance for a business enterprise, evaluating the pros and cons of each.

10. You are the management accountant of Ganesha Ltd. The following information is made available to you :

    a) Budgeted production – 6,00,000 units.

    b) Details of stock holding: Raw materials – 2 months; Work-in-progress – 0.5 month; Finished goods – 1 month.

    c) Credit granted by customers – 2 months, credit availed from suppliers – 1 month.

    d) Minimum cash balance required at all times – Rs. 25,000.

    e) Cost structure of the product is as under :

	Rs.
Raw materials	10.00
Direct labour	2.50
Overheads (of which depreciation – Re. 0.25)	7.50
Total costs	20.00
Profit margin	5.00
Selling Price	25.00

From the above you are required to forecast the working capital requirements of the company.

11. Three companies A, B and C are in the same business and hence have similar operating risks. However, the capital structure of each firm is different.

	A	B	C
Equity Share Capital (Face Value of Rs. 10 per share) Rs.	4,00,000	2,50,000	5,00,000
Market Value per share (Rs.)	15	20	12
Dividend per share (Rs.)	2.70	4	2.88
Debentures (Rs.)	Nil	1,00,000	2,50,000
Market Value per debenture (Rs.)		125	80
Interest rate		10	8

Assume the current levels of dividends are generally expected to continue indefinitely and the income-tax rate is 30 per cent. You are required to compute the weighted average cost of capital of each company.