II Semester M.B.A. (Day) Degree Examination, June 2009
(2007–08 Scheme)
Paper – 2.2 : FINANCIAL MANAGEMENT

Time : 3 Hours   Max. Marks : 75

SECTION – A

1. Answer **any six** questions. **Each** question carries **two** marks : **(6×2=12)**

   a) What is profit maximization ?

   b) What is conservative working capital policy ?

   c) What is specific cost of capital ?

   d) What is optimal capital structure ?

   e) What is operating leverage ?

   f) What is internal rate of return ?

   g) What is rights issue ?

   h) What stable dividend policy ?

   i) State the assumptions of Walter model on dividend policy.

SECTION – B

Answer **any three** of the following questions. **Each** question carries **eight** marks : **(3×8=24)**

2. What are different alternative methods of evaluating investment proposals ?

3. What are the factors which influence the dividend policy of a company ?

4. Alfa Ltd., with net operating earnings of Rs. 3 lakhs is attempting to evaluate a number of capital structures given below. Which of the capital structure will you recommend and why ?

Capital Structure	Debit in Capital Structure	Cost of Debt	Cost of Equity
1	Rs. 3,00,000	10%	12%
2	Rs. 4,00,000	10%	12.5%
3	Rs. 5,00,000	11%	13.5%

5. A firm sells its products for Rs. 10 per unit of which Rs. 7 represents variable costs. Current annual sales are Rs. 12,00,000 entirely on credit. The firm is considering a more liberal extension of credit which will result in slowing process of average collection period from one month to two months. This relaxation in credit terms is expected to produce a 25% increase in sales i.e. Rs. 15,00,000. Advise the firm regarding adoption of new credit policy assuming that the firm's required rate of investment is 25%.

6. ABC Ltd., sells its product at gross profit of 20% on sales. The following information extracted from Company's annual accounts for the year ended 31-3-2009 :

		Rs.
Sales at 3 months credit	:	40,00,000
Raw materials	:	12,00,000
Wages paid (15 days in arrears)	:	9,60,000
Manufacturing expenses (paid one month in arrears)	:	12,00,000
Administration expenses (paid one month in arrears)	:	4,80,000
Sales promotion expenses payable half year in advance	:	2,00,000

The company enjoys one month credit from suppliers of raw materials and maintains two months stock of raw materials and half month finished goods stock. Cash balance is Rs. 1,00,000. Find out net working capital requirements for the company.

SECTION – C

wer **any two** of the following questions. **Each** question carries **twelve** marks.

(2×12=24)

Explain the determinants of working capital.

Alpha Ltd. has an average selling price of Rs. 20 per unit. Its variable costs are Rs. 14 and fixed costs are Rs. 3,40,000. All its assets are financed by equity funds. It pays 35% tax on its income. Gama Ltd. is identical to Alpha Ltd., in all respects but its assets are financed by 50 percent by equity capital and 50 percent by debt, the interest on which amounts to Rs. 40,000.

Determine the degree of operating, financial and combined leverage at 70,000 units sales volume for both the firms and interpret the results.

Suresh Confectionery Ltd., is contemplating the purchase of a machinery. Two machines, A and B are available in the market each costing Rs. 5,00,000. Both have equal life of 5 years. Earnings after taxation are expected to be as under :

Cash flows (After taxation)

Year	Machine A	Machine B
1	Rs. 1,50,000	Rs. 50,000
2	Rs. 2,00,000	Rs. 1,50,000
3	Rs. 2,50,000	Rs. 2,00,000
4	Rs. 1,50,000	Rs. 3,00,000
5	Rs. 1,00,000	Rs. 2,00,000

Indicate which machine will be more profitable investment using the NPV and IRR methods assuming 10% rate of discount.

SECTION – D

(Compulsory) **(1×15=15)**

10. Servex company has the following capital structure as on 31st March 2008 :

Equity capital 2,00,000 shares	Rs. 40,00,000
10% Preference shares	Rs. 10,00,000
14% Debentures	Rs. 30,00,000
	Rs. 80,00,000

The equity shares of the company sells at Rs. 20. It is expected that the company will pay next year a dividend of Rs. 2 per share which will grow at 7 percent for ever. Assume 35% tax rate. Your are required to :

a) Compute a weighted average cost of capital based on the existing capital structure.

b) Compute a new weighted average cost of capital if the company raises an additional Rs. 20,00,000 debt by issuing 15% debentures. This would result in increasing the expected dividend to Rs. 3 and leave the growth rate unchanged, but the price of the equity share will fall to Rs. 15 per share.
