PG – 564

II Semester M.B.A. (Day) Degree Examination, June/July 2010
(2007-08 Scheme)
2.2 : FINANCIAL MANAGEMENT

Time : 3 Hours Max. Marks : 75

SECTION – A

1. Answer **any six** from the following : (6×2=12)

   a) Define IRR.

   b) What is operating leverage ?

   c) Define optimal capital structure.

   d) What is Gross Working Capital ?

   e) What is time value of money ?

   f) What is bonus shares ?

   g) What is the Gordon's formula for dividend ?

   h) What do you mean by personal leverage ?

SECTION – B

Answer **any three** of the following : (3×8=24)

2. What are the factors which influence the planning of capital structure ?

3. Briefly explain the Walter model of dividend policy.

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4. A group of new customers with 10 % risk of non-payment wishes to establish business connections with you. This group would require one and a half month of credit and is likely to increase your sales by 60,000 p.a. Production, administrative and selling expenses amount to 80% of sales. You are required to pay income tax @ 50%. Should you accept the offer if the required rate of return is 40% (after tax) ?

   Also state the degree of risk of non-payment that you would be willing to assume if the required rate of return (after tax) were :

   1) 30% 2) 20%

5. XYZ Company has debentures outstanding with 5 years left before maturity. The debentures are currently selling for Rs. 90 (face value is 100 Rs.). The debentures are to be redeemed at 5% premium. The interest is paid annually at a rate of interest of 12%. The firm's tax rate is 35%. Calculate Kd.

6 The Modern Chemicals Ltd. requires Rs. 25,00,000 for a new plant. This plant is expected to yield earnings before interest and taxes of Rs. 5,00,000. While deciding about the financial plan, the company considers the objective of maximising earnings per share. It has three alternatives to finance the project – by raising debt of Rs. 2,50,000 or Rs. 10,00,000 or Rs. 15,00,000 and the balance, in each case, by issuing equity shares. The company's share is currently selling at Rs. 150, but is expected to decline to Rs. 125 in case the funds are borrowed in excess of Rs. 10,00,000. The funds can be borrowed at the rate of 10% upto Rs. 2,50,000, at 15% over Rs. 2,50,000 and upto Rs. 10,00,000 and at 20% over Rs. 10,00,000. The tax rate applicable to the company is 50%. Which form of financing should the company choose ?

SECTION – C

Answer **any two** of the following : **(2×12=24)**

7. Write short notes on :

   a) Credit management

   b) Risk analysis in capital budgeting

   c) Financial leverage.

8. Zenith Industries Ltd. are thinking of investing in a project costing Rs. 20 lakhs. The life of the project is five years and the estimated salvage value of the project is zero. Straight line method of charging depreciation is followed. The tax rate is 50%. The expected cash flows before tax are as follows :

Year	1	2	3	4	5
Estimated cash flow before depreciation and tax (Rs. lakhs)	4	6	8	8	10

You are required to determine the :

i) Payback Period for the investment,

ii) Average Rate of Return on the investment,

iii) Benefit-Cost Ratio.

9. The ZBB Ltd. needs Rs. 5,00,000 for construction of a new plant. The following three financial plans are feasible :

i) The company may issue 50,000 equity shares at Rs. 10 per share.

ii) The company may issue 25,000 equity shares at Rs. 10 per share and 2,500 debentures of Rs. 100 denomination bearing 8% rate of interest.

iii) The company may issue 25,000 equity shares at Rs. 10 per share and 2,500 preference shares at Rs. 100 per share bearing 8% rate of dividend.

If the company's earnings before interest and taxes are Rs. 10,000, Rs. 20,000, Rs. 40,000, Rs. 60,000 and Rs. 1,00,000, what are the earnings per share under each of the three financial plans ? Which alternative would you recommend and why ? Assume corporate tax rate to be 50%.

SECTION – D

10. **Compulsory** : **(1×15=15)**

Company is considering which of two mutually exclusive projects it should undertake. The Finance Director think that the project with the higher NPV should be chosen whereas the Managing Director thinks that the one with the higher IRR should be undertaken especially as both projects have the same initial outlay and length of life. The company anticipates a cost of capital of 10% and the net after-tax cash flows of the projects are as follows :

(Rs. '000)

Year	0	1	2	3	4	5
Cash Flows :						
Project X	(200)	35	80	90	75	20
Project Y	(200)	218	10	10	4	3

Required :

a) Calculate the NPV and IRR of each project.

b) State, with reasons, which project you would recommend.

c) Explain the inconsistency in the ranking of the two projects.

The discount factors are as follows :

Year	0	1	2	3	4	5
Discount Factors : (10%)	1	0.91	0.83	0.75	0.68	0.62
(20%)	1	0.83	0.69	0.58	0.48	0.41