Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/MBA (NEW)/SEM-2(FT)/MB-207/2010

2010

FINANCIAL MANAGEMENT

Time Allotted : 3 Hours *Full Marks :* 70

The figures in the margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

GROUP – A

(Multiple Choice Type Questions)

1. Choose the correct alternatives for any *ten* of the following : 10 × 1 = 10

   i) Working capital may be

      a) positive b) negative

      c) zero d) all of these.

   ii) Working capital is

      a) the capital invested in the business to meet its day-to-day capital requirements

      b) circulating in nature

      c) the excess of current assets over current liabilities

      d) all of these.

iii) Dividends can be paid

a) out of current profits

b) out of past profits

c) partly out of current profits and partly out of past profits

d) all of these.

iv) In the discussion relating to conceptual aspects of capital structure, we are not concerned with which of the following rates of return ?

a) Return on investment

b) Cost of debt capital

c) Cost of equity capital

d) Weighted average cost of capital.

v) Which of the following is *not* a correct statement in explaining financial leverage ?

a) It is the result of use of fixed income securities

b) It shows the effect of earnings arising out of capitalization

c) At a given level of financing, DFL is measured by : DFL = EBIT/ $\left[EBT - D_p(1-t)\right]$

d) It is not an appropriate measure of financial risk of the firm.

vi) Business risk of the firm is measured by

a) coefficient of variation of EBIT

b) coefficient of variation of EPS

c) degree of total leverage

d) degree of operating leverage.

vii) Total risk of the firm is measured by

a) coefficient of variation of EBIT

b) coefficient of variation of EPS

c) degree of total leverage

d) degree of financial leverage.

viii) Under perfect Capital Market according to Modigliani-Miller hypothesis

a) Total investment value of a corporation depends on the amount of debt capital in its capital structure

b) Total investment value for a corporation depends on the amount of equity capital in the capital structure

c) Total investment value of a corporation depends on the amount of capital in its capital structure

d) Total investment value of a corporation depends on its underlying profitability and risk.

ix) A company paid no tax during a particular year. But its provision for tax item in its books of account increased by Rs. 60,000. We can conclude that

a) working capital is decreased by Rs. 60,000

b) working capital is increased by Rs. 60,000

c) working capital remains the same

d) nothing can be specifically told.

x) Which of the following is not affected by the financial structure and the tax rate of a company ?

a) ROE

b) Net profit margin

c) Earning power

d) EPS.

xi) According to Walter model of dividend decision, a firm should have 100% dividend pay-out ratio when

a) $R = Ke$

b) $R < Ke$

c) $R > Ke$

d) $R \geq Ke$.

GROUP – B

(Short Answer Type Questions)

Answer any *three* of the following. 3 × 5 = 15

2. From the following data, compute the duration of the operation cycle for each of the two years and comment on the increase/decrease :

Particulars	**2009**
Stocks	**Rs.**
Raw materials	20,000
Work-in process	14,000
Finished goods	21,000
Purchase of raw materials	96,000
Cost of goods sold	1,40,000
Sales	1,60,000
Debtors	32,000
Creditors	16,000

Assume 360 days per year for computations purposes.

3. Two assets *A* and *B* have the following risk and return characteristics $R_a = 22$, $R_b = 20$, $\sigma_a = 15$, $\sigma_b = 18$ and $r_{ab} = -1$. Determine the minimum risk portfolio for *A* and *B*.

4. Antique Art Comapny would pay Rs. 2·50 as dividend per share for the next year and expected to grow indefinitely at 12%. What would be the equity value if the investor requires 20% return ?

5. What is diversification in portfolio management ? Explain.

6. Mr. *X* retires at the age of 60 years and his employer gives him a lump sum of Rs. 5,00,000 if he draws some amount annually for the rest of his life, reckoning his expectation of life to be 10 years and rate of interest is 5% p.a. compounded yearly. What is the amount of his annual drawing ?

7. Discuss the different motives of holding cash.

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. $3 \times 15 = 45$

8. a) A company's total investment in assets in Rs. 1,00,000. It has 1,00,000 shares of Rs. 100 each. Its expected rate of return on investment in 30 per cent and the cost of capital is 18 per cent. The company has a policy of retaining 25 per cent of its profits. Determine the value of the firm using Gordon's model.

b) If the expected cash flow from a project is at the rate of Rs. 1,000 for three years at 10 per cent, what is the present value of the annuity if interest is compounded

a) yearly

b) biannually

c) quarterly

d) monthly and

e) continuously ?

Also prepare a statement showing the comparative position and comment on figures. 7 + 8

9. The expected returns from two shares are given below. Calculate average return of both the shares. Which of the two shares are more risky ?

Return from share *A*	Probability of occurrence	Return from share *B*	Probability of occurrence
20	0·10	12	0·30
10	0·40	11	0·30
15	0·50	13	0·40
	1·00		1·00

10. a) What do you mean by weighted average cost of capital and specific cost of capital ?

b) You are given the following particulars with respect to a firm for the year just ended :

Sources	Amount (Rs. in lakh)	After-tax cost of capital
Equity share capital	200	15
Retained earnings	100	?
Long-term debt	200	?
Total	500	

The corporate tax rate is 40 per cent while the average cost of capital of the firm is 11·88 per cent. Determine the cost of retained earnings (K_r) and the cost of debt (K_d) (after-tax and before-tax). Make assumptions wherever necessary. 6 + 9

11. a) The management of Gemini Ltd. has called for a statement showing the working capital needed to finance a level of activity of 1,04,000 units of output for the year. The cost structure for the company's product, for the above mentioned activity level, is given below :

Elements of cost	**Cost per unit (Rs.)**
Raw materials	20
Direct labour	5
Overheads	15
Total cost	40
Profit	10
Selling price	50

Past trends indicate that raw materials are held in stock, on an average, for two months & work-in-progress will approximate to half-a-month's production. Finished goods remain in warehouse, on an average, for a month. Suppliers of materials extend four week's credit. Two month's credit is normally allowed to debtors. Lag in payment of wages is two weeks. There is, usually, one week lag in payment o overheads. $\frac{1}{4}$th of the output are sold in cash. A minimum cash balance of Rs. 25,000 is expected to be maintained. The production pattern is assumed to be even during the year. Prepare the statement of working capital requirement.

b) What do you mean by time value of money ? 12 + 3

12. From the following information, prepare a Cash Budget for the quarter ending 30. 06. 03 :

Month	Sales (Rs.)	Purchases (Rs.)	Wages (Rs.)	Miscellaneous expenses (Rs.)
February	1,20,000	84,000	10,000	7,000
March	1,30,000	1,00,000	12,000	8,000
April	80,000	1,04,000	8,000	6,000
May	1,16,000	1,06,000	10,000	12,000
June	88,000	80,000	8,000	6,000

Additional Information :

i) Cash on hand on 01. 04. 03 Rs. 5,000

ii) Sales — Out of total sales 20% are made in cash. Debtors are allowed to pay their dues within two months from the date of sale. However a 5% discount is allowed if they paid their dues within one month. 70% of the debtors has taken the option.

iii) Purchases — Out of total purchase 75% are credit purchase. Creditors are paid one month after purchase.

iv) Wages — 25% in arrears paid in the followng month.

v) Other expenses are paid at a lag of one month.

vi) Income-tax Rs. 25,000 due on or before 30. 06. 03.

13. Write short notes on any *three* of the following : 3×5

a) Net present value

b) Capital asset pricing model

c) Weighted average cost of capital

d) Yield to maturity of a bond

e) Profitability index.