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CS / MBA (NEW) / SEM-2 (FT) / MB-207 / 2011

2011

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 : $10 \times 1 = 10$

   i) Which of the following statements represents the financing decision of a company ?
      a) Procuring new machineries for the R&D activities
      b) Adopting a new technology
      c) Purchasing new building
      d) Designing an optimal capital structure by using suitable financial instruments.

   ii) The nominal rate of interest
      a) is the real rate of interest plus inflation
      b) is also referred to as the prime lending rate
      c) is equal to the effective rate of interest minus inflation
      d) does not consider risk premium.

iii) Characteristic line is the relationship between return on stock and

a) Risk free rate of return
b) Return on market portfolio
c) Return on government bond
d) Return on a blue-chip company.

iv) Which of the following instances relating to the *ABC* Ltd. do not represent unsystematic risk ?

a) An open offer for takeover of the company
b) Workers declare strike in the company
c) Raid on the company for tax evasion
d) Introduction of Minimum Alternate Tax by the government of the country.

v) If the current EPS is Rs. 2·50 the DCL is 3·5 and the sales are expected to increase by 25%, then the forecasted EPS for the next year is

a) Rs. 4·69 b) Rs. 3·86
c) Rs. 7·00 d) Rs. 3·13.

vi) If the required rate of return on Excel Ltd.'s shares is 16%, risk free rate of return is 8% and the rate of return on the market portfolio is 11%, what is the beta of the stock ?

a) 1·67 b) 2·67
c) 0·38 d) 1·00.

vii) The annual demand for an item is 4800 units. The unit cost is Rs. 9 and inventory carrying charges are 45% p.a. If the ordering cost per order is Rs. 300, what is the EOQ ?

a) 545·9 units b) 666·8 units
c) 843·3 units d) 767·4 units.

viii) IRR gives a rate of return that reflects the .... the project.

a) Profitability of b) Negotiability of
c) Return of d) None of these.

ix) Which is not a relevant cost for the project decision ?

a) Sunk cost
b) Period cost
c) Material cost
d) None of these.

x) The term 'inventory' is a wide term and generally includes

a) stock of raw materials
b) semi-finished goods
c) finished goods
d) all of these.

xi) The greater the creditworthiness of the firm in the market lesser is the need for

a) Precautionary balance
b) Credit balance
c) Debit balance
d) none of these.

xii) The process refers to setting off or balancing two transactions which are entered into simultaneously is

a) Arbitrage
b) Capital budgeting
c) Cost of capital
d) None of these.

xiii) The cost associated with sale of security by investors is

a) Floatation cost
b) Transaction cost
c) Variable cost
d) Current cost.

GROUP – B

(Short Answer Type Questions)

Answer any *three* of the following. $3 \times 5 = 15$

2. *X* Ltd. issues one thousand 10 per cent preference shares of Rs. 100 each, at Rs. 95 each redeemable at the end of the tenth year from the year of issue. Calculate the cost of preference share capital.

3. *AB* Ltd. issues hundred 10 per cent Rs. 1,000 debentures at a discount of 2 per cent redeemable after ten years. If the marginal tax rate is 50 per cent, find out the after-tax cost of debentures.

4. A firm borrows Rs. 10,000 at 10% and the loan is to be repaid in three equal yearly instalments (EYI) payable at the end of each of the next three years. The bank charges a 10% interest rate on the balance that is outstanding at the beginning of each year. What is the amount of EYI ? Also show the Loan Amortization Schedule.

5. National Finance Ltd. (NFL) has various deposit schemes which offer the same effective rate of interest as 10 per cent per annum. If you save Rs. 100 at the beginning of every month with NFL in a monthly recurring deposit scheme which has a maturity period of three years then, what will be the maturity value at the end of three years ?

6. What is the rate return for a company if its beta of security is 1·5, risk free rate of return is 8% and the market rate of return is 20% ?

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. 3 × 15 = 45

7. a) You are given returns on share *A* and market returns over the last ten years. Calculate and comment on the result.

Year	1	2	3	4	5	6	7	8	9	10
$\mathbf{R_A}$	11	4	10	5	– 5	10	7·5	5	15	17·5
$\mathbf{R_M}$	10	5	11	5	– 3	7·5	6	3·5	10	15

b) What do you mean by DOL, DFL and DCL ? 10 + 5

8. 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 weeks credit. Two months credit is normally allowed to debtors. Lag in payment of wages is two weeks. There is, usually, one week lag in payment of overheads. ¼th 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

9. a) Garima Herbal Products Limited is considering the purchase of a new mixing machine to replace an existing machine that has a book value of Rs. 1,65,000 and can be sold for Rs. 1,00,000. The estimated salvage value of the old machine is five years would be zero and it is depreciated on a straight-line basis. The new machine will contribute Rs. 3,00,000 as annual cash savings over the old machine. The new machine has a life of five years. The cost of new machine is Rs. 6,50,000 and can be sold for an expected amount of Rs. 90,000 at the end of fifth year. Assuming straight-line method of depreciation and a 35% tax rate, in the fourth year of operation what would be the net cash flows associated with this replacement decision ?

b) Nirmal Constructions Ltd., is considering purchasing machinery. Three companies came forward to supply the machines, whose quotations are as given below :

	A	*B*	*C*
Initial cost (Rs.)	75,000	1,00,000	50,000
Maintenance cost per year (Rs.)	5,000	7,000	4,000
Life (Years)	5	5	5
Salvage value (Rs.)	20,000	24,000	30,000

If the cost of funds is 15%, the annual capital charge for project *B* and the priority of the projects for the Nirmal Construction are respectively. 8 + 7

10. The equity shares of Specialty Foods Ltd. a food processing company, are presently trading at Rs. 96 per share. The company has recently paid a dividend of Rs. 3 per share. A security analyst has projected the following information for the next year :

Scenario	Optimistic	Normal	Pessimistic
Probability	30%	40%	30%
Projected share price	Rs. 110	Rs. 105	Rs. 99
Projected Dividend	Rs. 4	Rs. 3	Rs. 3
Projected market return	15%	12%	8%

You are required to

i) Find out the expected return and risk for the equity shares of the company.

ii) Find out the expected return and risk for the market.

iii) Estimate the beta coefficient for the equity shares of the company and state implication.

11. a) Explain the concept of current yield and yield-to-maturity for a bond.

b) A bond has the undernoted features :

Face Value = Rs. 1000

Coupon rate = 11% p.a. payable annually

Tenure = 3 years

Redemption-Bullet, at per

Current market price = Rs. 1,100

If rate of return expected by the market on a similar security is 10% p.a.

i) Compute its intrinsic value.

ii) Is the bond overvalued or undervalued ?

iii) Compute its current yield.

iv) Set up the equation for YTM of the Bond. 5 + 10

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

a) Risk-return relationship

b) Capital Rationing

c) Permanent & variable working capital

d) Valuation of Common Stock

e) Motives for holding cash.

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