Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/MBA(N)PT/SEM-3(PT)/MB-207/2011-12

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 × 1 = 10

   i) The objective of financial management is to

      a) Generate the maximum net profit

      b) Generate the maximum retained earnings

      c) Generate the maximum wealth for its shareholders

      d) Generate dividend for the shareholders.

   ii) Which of the following is a function of the finance manager ?

      a) Mobilizing funds

      b) Risk-return trade off

      c) Control over the uses of funds

      d) All of these.

iii) For a normal business organization

a) cost of debit capital > cost of equity capital

b) cost of debt capital < cost of equity capital

c) cost of debt capital = cost of equity capital

d) cost of debt capital ≤ cost of equity capital.

iv) During share split, what remains constant is

a) The company's share capital

b) The number of shares outstanding

c) The face value of share

d) The market value of share.

v) A project is financially viable if its

a) IRR ≥ WACC

b) IRR < WACC

c) NPV < 0

d) IRR = Discount factor.

vi) The market price of a share of common stock is determined by

a) the board of directors of the firm

b) the stock exchange on which the stock is listed

c) the president of the company

d) individuals buying and selling the stock.

vii) To increase a given present value, the discount rate should be adjusted

a) upward

b) downward

c) according to the risk-free-retun

d) according to the hyper-inflation rate.

viii) If a bond sells at a high premium, then which of the following relationships hold true ? (P_0 represents the price of a bond and YTM is the bond's yield to maturity).

a) P_0 < par and YTM > the coupon rate

b) P_0 > par and YTM > the coupon rate

c) P_0 > par and YTM < the coupon rate

d) P_0 < par and YTM < the coupon rate.

ix) According to the capital-asset pricing model (CAPM), a security's expected (required) return is equal to the risk-free rate plus a premium

a) equal to the security's beta

b) based on the unsystematic risks of the security

c) based on the total risk of the security

d) based on the systematic risk of the security.

x) Spontaneous financing includes

a) accounts receivable

b) accounts payable

c) short-term loans

d) a line of credit.

xi) Which of the following would be consistent with a more aggressive approach to financing working capital ?

a) Financing short-term needs with short-term funds

b) Financing permanent inventory buildup with long-term debt

c) Financing seasonal needs with short-term funds

d) Financing some long-term needs with short-term funds.

xii) A profitability index of 0·85 for a project means that

a) the present value of benefit is 85% greater than the project's costs

b) the project's NPV is greater than zero

c) the project returns 85 cents in present value for each current dollar invested.

d) the payback period is less than one year.

GROUP – B

(Short Answer Type Questions)

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

2. What do you mean by finance function ?

3. The dividend declared in the first year by a company is Rs. 20 per share and this dividend is likely to grow at a uniform rate of 6% per year. If the rate of return expected by the market on a similar security is 10% p.a. what is the intrinsic value of the share ?

4. Mr *Y* deposits each year Rs. 50,000, Rs. 1,00,000, Rs. 1,50,000, Rs. 2,00,000 and Rs. 2,50,000 in his saving bank account for 5 years at the interest rate of 10%. He wants to know his future value of deposits at the end of 5 years.

5. Alpha Company is contemplating conversion of 500, 14% convertible bonds of Rs. 1,000 each. Market price of the bond is Rs. 1,080. Bond indenture provides that one bond will be exchanged for 10 shares. Price-earning ratio before redemption is 20 : 1 and anticipated price-earning ratio after redemption is 25 : 1. Number of shares outstanding prior to redemption are 10,000. EBIT amounts to Rs. 2,00,000. The company is in the 35% tax bracket. Should the company convert bond into shares ? Give reasons.

6. The book value per share of a company is Rs. 145·50 and its rate of return on equity is 10 per cent. The company follows a dividend policy of 60% pay out. What is the price of its share if the capitalization rate is 12 per cent ?

GROUP – C

(Long Answer Type Questions)

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

7. a) What is working capital ? What are the factors that are taken into account in determining capital needs of the firm ?

   b) Explain how a suitable mix of short-term and long-term finance can be used for financing current assets. 7 + 8

8. a) Cosco Industries have a policy of maintaining Rs. 5,00,000 minimum cash balance. The standard deviation of the company's daily cash flow is Rs. 2,00,000. The interest rate is 14%. The company has to spend Rs. 150 per transaction. Calculate the upper and lower limits and the return point as per Miller-Orr Model.

   b) A firm's annual cash requirement is Rs. 2,00,00,000. The opportunity cost of capital is 15% per annum. Rs. 150 is the per transaction cost for the firm when it converts its short-term securities to cash. Find out the optimum cash balance. What is the annual cost of the demand for the optimum cash balance ? 7 + 8

9. A company, whose cost of capital is 12% p.a., is considering two projects *A* & *B*. The following data are available :

	Project *A* (Rs.)	Project *B* (Rs.)
Original Investment (at time Zero)	1,40,000	1,40,000
Cash inflow :		
Year 1	20,000	20,000
Year 2	40,000	80,000
Year 3	60,000	40,000
Year 4	100,000	20,000
Year 5	110,000	20,000

Working their NPV and IRR and comment which project is better.

10. Subho Ltd. has the following features :

Annual sales	=	Rs.	60,00,000
Variable cost	=	Rs.	40,00,000
Fixed cost	=	Rs.	6,00,000

Marketing group of the company draw up the following strategy for boosting its sales :

	Existing	Proposed Plan-I	Proposed Plan-II
Debtors Turnover Ratio (times)	12	6	4
Increase in sales (%)	—	10	20
Bad Debts (% of sales)	1	2	5

If the company has a pre-tax return of 12% p.a. on investment in receivables, work out its optimum credit period.

11. ABC Ltd. has currently an equity shares capital of Rs. 40 lakhs consisting 40000 equity shares of Rs. 100 each. The management is planning to raise another Rs. 30 lakhs to finance a major programme of expansion through one of four possible financing plans. The options are :

a) Entirely through equity issues

b) Rs. 15 lakhs in equity shares of Rs. 100 each and the balance in 8% debentures

c) Rs. 10 lakhs in equity shares of Rs. 100 each and the balance through long term borrowings at 9% interest per annum.

d) Rs. 15 lakhs in equity shares of Rs. 100 each and the balance through preference shares with 5% dividend.

The company's expected EBIT will be Rs. 25 lakhs. Assuming corporate tax rate of 30%, you are required to determine the EPS and comment on the financial leverage under each of the above scheme of financing.

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

a) Factors affecting dividend policy

b) Weighted average cost of capital

c) Factoring

d) Valuation of common stock

e) Positive and negative working capital.