Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/MBA (NEW)/SEM-3 (PT)/MB-207/2009-10

2009

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) When coupon interest rate is less than required yield, it is called

a) premium bond

b) discount bond

c) par value bond

d) none of these.

ii) Which of the following statements is correct in relation to the theory of cost of capital ?

a) Business risk is assumed to be constant

b) Financial risk is assumed to be constant

c) Both (a) and (b)

d) None of these.

iii) Working capital is affected by

a) production policy of the firm

b) credit policy of the firm

c) production cycle of the firm

d) all of these.

iv) Operating cycle increase with the

a) increase in time lag between sale of goods and the receipt of cash

b) decrease in time lag between sale of goods and the receipt of cash

c) influx of foreign fund

d) application of excise.

v) What is the current yield of a 10 year 12 per cent coupon bond, with a par value of Rs. 1,000 and selling for Rs. 950 ?

a) 12% b) 12·24%

c) 12·53% d) 12·63%.

vi) The time length involved in the conversion of raw materials to finished goods is popularly known as

a) the operating cycle b) the production cycle

c) the cash cycle d) the business cycle.

vii) Trading on equity refers to

a) Operating leverage b) Financial leverage

c) Business risk d) Systematic risk.

viii) From the following data determine the degree of operating leverage :

Sales	Rs.	25,00,000
Fixed Cost	Rs.	7,50,000

Variable expenses to sales ratio 50%.

a) 3·5 b) 3

c) 2·5 d) 2.

ix) The type of arrangement which provides hundred per cent finance in advance against export receivable is known as

a) recourse factoring

b) full factoring

c) forfeiting

d) export factoring.

x) Which of the following is not a basic assumption underlying the Modigliani and Miller theory of capital structure ?

a) Absence of taxes

b) Firms are grouped in equivalent risk classes on the basis of business risk

c) Homogeneous expectations from investors

d) Heterogeneous expectations from investors.

xi) Percentage change in ROI/Percentage change in Current Assets is known as

a) Operating leverage

b) Financial leverage

c) Working Capital leverage

d) Capital Turnover ratio.

xii) The focal point of financial management of a firm is

a) to maximize the number and types of products or services provided by the firm

b) to minimize the amount of taxes paid by the firm

c) the creation of value for shareholders

d) maximizing the profits earned by the firm.

GROUP – B

(Short Answer Type Questions)

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

2. What do you mean by risk ? Distinguish between operating risk and financial risk.

3. From the following information extracted from the books of a manufacturing concern, compute the operating cycle in days :

   Period covered 365 days

   Average period of credit allowed by suppliers 16 days

(Rs. '000)

Average total debtors outstanding	480
Raw material consumption	4,400
Total production cost	10,000
Total cost of sales	10,500
Sales for the year	16,000
Value of average stock maintained :	
Raw materials	320
Work-in-progress	350
Finished goods	260

4. The following information is available for a company :

Monthly credit sales	Rs. 10,00,000
Average maturity period	40 days
Factor's fees/commission	1%
Interest rate charged by factor	15%
Collection department's cost (if there is no factoring)	Rs. 4,500 per month
Factor's average remittance period	10 days
The company's cost of raising funds (other than factory)	24%

Calculate the effective interest rate charged by the factor and advise the company ignoring all other factors including risk of default.

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. $3 \times 15 = 45$

7. A firm is engaged in large scale manufacturing. From the following information compute working capital requirement of the firm :

Projected monthly sales : 32,000 units

Salling price / unit : Rs. 10

Expected ratio of cost of sales are : Raw material 40% and wages 30%

Budgeted overhead : Rs. 16,000 per week

Stock will include raw mateial for Rs. 96,000 and 16,000 units of finish goods.

Material will stay in the process for 2 weeks, credit allowed to debtor 5 weeks, credit allowed by creditors one month.

Lag in payment of overhead 2 weeks, wages will be paid at the beginning of week following the week of work.

Cash in hand is 10% of net working capital.

Assume that production is carried out evenly throughout the year. Wages and overhead accrues similarity.

8. *XYZ* Company has currently an equity share capital of Rs. 40 lakhs consisting of 40,000 equity share of Rs. 100 each. The management is planning to raise another Rs. 30 lakhs to finance a major program of expansion through one of the four possible financing plans.

The options are :

i) Entirety through equity shares.

ii) Rs. 15 lakhs in equity shares of Rs. 100 each and the balance is 8% Debentures.

iii) Rs. 10 lakhs in equity shares of Rs. 100 each and the balance through long term borrowing at 9% interest p.a.

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

The company's expected earning before interest and taxes (EBIT) will be Rs. 15 lakhs. Assuming corporate tax of 50%, you are required to determine the EPS and comment on the financial leverage that will be authorized under each of the above scheme of financing.

9. a) What are the major considerations that determine the dividend policy of a company ?

b) *ABC* Ltd. has a capital of Rs. 10 lakhs in equity shares of Rs. 100 each. The shares are currently quoted at par. The company proposes declaration of a dividend of Rs. 10 lakhs per share at the end of the current financial yeal. The capitalization rate for the risk class to which the company belongs is 12%.

What will be the market price of the share at the end of the year, if

i) a dividend is not declared ?

ii) a dividend is declared ?

Assuming that the company pays the dividend and has net profit of Rs. 5,00,000 and makes new investments of Rs. 10 lakhs during the period, how many new shares must be issued ? You may use Modigliani-Miller (M-M) Model. 10 + 5

10. a) What is NPV and what are its limitations ? Evaluate the benefit cost ratio as an investment criterion. Is it superior to the NPV approach ?

b) A firm whose cost of capital is 10% is considering two mutually exclusive projects *X* and *Y*, the details of which are as follows :

	Project X	*Project Y*
	Rs.	*Rs.*
Investment	70,000	70,000
Cash flow year 1	10,000	50,000
Cash flow year 2	20,000	40,000
Cash flow year 3	30,000	20,000
Cash flow year 4	45,000	10,000
Cash flow year 5	60,000	10,000
	2,35,000	2,00,000

Compute the net present value at 10%, profitability index and internal rate of return for the two projects.

Note Year	10%	15%	20%	25%	30%	35%	40%
1	0·909	0·870	0·833	0·800	0·769	0·741	0·714
2	0·826	0·756	0·694	0·640	0·592	0·549	0·510
3	0·751	0·658	0·579	0·512	0·455	0·406	0·364
4	0·683	0·572	0·482	0·410	0·350	0·301	0·260
5	0·621	0·497	0·402	0·328	0·269	0·223	0·186

6 + 9

11. a) Explain the concept of operating and financial leverage. What are the limitations of trading on equity ?

b) A project requires a capital outlay of Rs. 600 lacs for which the funds can either be raised by the issue of equity shares of Rs. 100 each or by the issues of equity shares of the value of Rs. 400 lacs and by the issue of 15% debentures of 200 lacs. Find out the indifference level of EBIT given the tax rate is 35%. 9 + 6