Kadi Sarva Vishwavidyalaya
End Term Exam MBA I, Semester-II
Sub: Financial Management (CC 203)

Date: May 10, 2014 **Time: 10 to 12.30** **Marks: 40**

Q. 1 (A) Define authorized, issued, subscribed, and paid-up share capitals. [4]

Q. 1 (B) Explain the concept of gross and net working capital cycles. [4]

OR

Q. 1 (B) A manufacturing company require 50,000 units annually. Calculate Economic order quantity, if ordering cost per order is Rs. 20 and carrying cost per unit is Rs. 0.50. [4]

Q. 2 (A) What do you meant by agency problems? How to mitigate them? [4]

Q. 2 (B) Mr. X wishes to retire 20 years from now and expects to live for 15 years thereafter. He wishes to have a yearly pension of Rs. 2,00,000 for the 15 years after retirement and pension will start one year after retirement. If the interest rate is 8%, what lump sum amount should Mr. X set aside today to facilitate this? [4]

OR

Q. 2 (A) Define yield to maturity and yield to call. How they are different from each other. [4]

Q. 2 (B) Mr. Y has borrowed Rs. 30 lakh from a bank to purchase an apartment. The interest rate is 13% per annum. The bank requires him to make payment of the loan and interest in ten equal installments. How much is each installment? [4]

Q. 3 (A) How is the weighted average cost of capital calculated? What weights should be used in its calculation? [4]

Q. 3 (B) A 7 year, Rs. 100 debenture of a firm can be sold for a net price of Rs. 97.75. The rate of interest is 15% per annum, and bond will be redeemed at 5% premium on maturity. The firm's tax rate is 35%. Compute the after tax cost of debenture. [4]

OR

Q. 3 A company is setting up a new project involving buying of new machinery. The machinery will cost Rs. 50,00,000 with installation cost of Rs. 5,00,000. Depreciation is calculated by the WDV method at 33.33% per year. Initial working capital needed will be Rs. 7,50,000. Additional working capital of Rs. 50,000 will be needed every year. The expected life of project is six years, at the end of which the machinery can be sold for Rs. 10,00,000. The company expects first year sales to be Rs. 34,00,000 and will keep growing by 2% per annum. Expenses are likely to be 45% of the sales proceeds. If the tax rate is 25%, determine project's net cash flow. [8]

Q. 4 (A) Describe the traditional view on the optimum capital structure. Compare and contrast this view with the NOI and NI approaches. [4]

Q. 4 (B) If earning per share of a company is Rs. 10, internal rate of return is 15% and cost of capital is 10%, calculate the prices of share of a company using Walter Model for 0%, 40%, 80% and 100% dividend payout ratio. [4]

OR

Q. 4 Calculates the level of EBIT at which the indifference point between the following financing alternatives will occur:

1. Ordinary share capital of Rs. 10 lakh or 15% debenture of Rs. 5 lakh and ordinary share capital of Rs. 5 lakh.
2. Ordinary share capital of Rs. 10 lakh or 13% preference share capital of Rs. 5 lakh and ordinary share capital of Rs. 5 lakh.
3. Ordinary share capital of Rs. 10 lakh or 13% preference share capital of Rs. 2 lakh, 15% debenture of Rs. 3 lakh and ordinary share capital of Rs. 5 lakh. [8]

Q. 5 Calmex is situated in North India. It specializes in manufacturing overhead water tanks. The management of Calmex has identified a niche market in certain Southern cities that need a particular size of water tank not currently manufactured by the company. The company is therefore thinking of producing a new type of overhead water tank. The survey of the company's marketing department reveals that the company could sell 1,20,000 tanks each year for six years at a price of Rs. 700 each. The company's current facilities cannot be used to manufacture the new-size tanks. Therefore, it will have to buy new machinery. A manufacturer has offered two options to the company. The first option is that the company could buy four small machines with the capacity of manufacturing 30,000 tanks each at Rs. 15 million each. The machine operation and manufacturing cost of each tank will be Rs. 535. Alternatively, Calmex buy a larger machine with a capacity of 1,20,000 units per annum for Rs. 120 million. The machine operation and manufacturing costs of each tank will be Rs. 400. The company has a required rate of return of 12 per cent. Assume that the company does not pay any taxes.

1. Which option should the company accept? Use the most suitable method of evaluation to give your recommendation and explicitly state your assumptions.
2. Why do you think that the method chosen by you is the most suitable method in evaluating the proposed investment? Give the computation of the alternative methods. [8]

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Seat No. ________________

Kadi Sarva VishwaVidyalaya, Gandhinagar
MBA – Semester – II – May 2015 Examination
Financial Management (CC203)

Date: 4-5-2015 **Weightage:** 40% **Duration:** 2½ Hours

Instructions:

1 Make assumptions wherever necessary and state them clearly
2 Working notes must form part of your answers
3. Figures to the right indicate weightage

Q-1 (A) "The profit maximization is not an operationally feasible criterion". Do you agree? Illustrate your views. 4%

(B) How working capital does affect the liquidity and profitability of a business? 4%

OR

(B) Define cost of capital? Explain its significance in financial decision-making. 4%

Q-2 (A) Under what circumstances do the net present value and internal rate of return methods differ? Which method would you prefer and why? 4%

(B) Maharashtra Plastics produces a product which has a monthly demand of 5,000 units. The product requires a component X which is purchased at Rs. 22 per finished product. The ordering cost is Rs. 120 per order and the holding cost is 10% p.a. 4%

You are required to calculate:
(I) Economic order quantity
(II) If the minimum lot size to be supplied is 5,000 units, what is the extra cost, the company has to incur?

OR

Q-2 (A) Explain the nature of the factors which influence the dividend policy of a firm. 4%

(B) Gujarat Chemicals is considering following two mutually exclusive projects, the project cost of capital is estimated as 10%; 4%

Year	Project X	Project Y
0	-105000	-105000
1	15000	75000
2	30000	60000
3	45000	30000
4	67500	15000
5	90000	15000

Compute the Payback period, Net present Value, Profitability Index, Internal Rate of Return and Modified Internal Rate of Return for the two projects and suggest which project should be selected & Why?

Q-3 (A) Explain the assumptions and implications of the NI approach and the NOI approach. Illustrate your answer with hypothetical examples. 4%

(B) The current dividend on an equity share of Supreme Paper Limited is Rs. 3.00 on an earnings per share of Rs. 25. Assume that the dividend will grow at a rate of 15 4%

percent for the next 4 years. Thereafter, the growth rate is expected to fall and stabilize at 10 percent perpetuity. Equity investors require a return of 15 percent from company's equity share. What is the intrinsic value of company's equity share?

OR

Q-3 (A) Explain credit policy variables 4%

(B) You have been asked to prepare a cash budget for the next quarter, January to March, for Dyna Products Pvt. Ltd.: 4%

a) Sales are expected to be: Rs.600,000 in January, Rs. 520,000 in February, and Rs.700,000 in March. 90 per cent of sales are on cash basis.
b) The estimated purchases are: Rs. 480,000 in January, Rs. 440,000 in February, and Rs. 500,000 in March. Payments for purchases will be made after a lag of one month. Outstanding on account of purchases in December were Rs. 420,000.
c) The rent per month is Rs. 16,000 and the directors' personal withdrawal per month is Rs. 24,000.
d) Salaries and other expenses, payable in cash, are expected to be: Rs.30,000 in January, Rs. 30,000 in February, and Rs. 32,000 in March.
e) Company plans to buy two computers worth Rs.80,000 on cash payment in March.
f) The cash balance at present is Rs. 24,000. The target cash balance, however, should be Rs. 40,000.

What will be surplus/ deficit of cash in relation to target cash balance?

Q-4 (A) How is the weighted average cost of capital calculated? What weights should be used in its calculation? 4%

(B) A proforma cost sheet of a company provides the following particulars: 4%

Particulars	Amount per unit
Raw materials	120
Direct labour	45
Overhead	90
Total cost	225
Profit	45
Selling price	300

The following further particulars are available:
Raw materials in stock, on average, one and half month; Materials in process (completion stage, 50 per cent), on average, half a month; Finished goods in stock, on average, one month. Credit allowed by suppliers is half month; Credit allowed to debtors is one months; Average time-lag in payment of wages is 2 weeks and three weeks in overhead expenses; one-third of the output is sold against cash; cash in hand and at bank is desired to be maintained at Rs 2,98,000.

You are required to prepare a statement showing the working capital needed to finance a level of activity of 1,20,000 units of production. You may assume that production is carried on evenly throughout the year, and wages and overheads accrue similarly. For calculation purposes, 4 weeks may be taken as equivalent to a month

OR

Q-4 (A) Explain briefly the different sources of long term finance for a firm. 4%

(B) The values for two Firms A – an unlevered firm and B – a levered firm with Rs. 6,00,000 debt at 6 per cent rate of interest are given as below. An investor holds Rs. 20,000 worth of B's Shares. Show the process by which he can earn same return at a lesser cost and earn more return with the same investment. 4%

Particulars	Firm – A	Firm – B
Net Operating Income	2,00,000	2,00,000
Cost of debt	0	36,000
Net Income	2,00,000	1,64,000
Equity Capitalization Rate	0.111	0.125
Market Value of Equity	18,00,000	13,12,000
Market value of Debt	0	6,00,000
Total Value of Firm	18,00,000	19,12,000
Overall Capitalization Rate	0.111	0.1046

Q-5 The latest balance Sheet of Silver Tech Limited is given below 8%

(Amount in Crores)

Equities and Liabilities	Amount	Assets	Amount
Equity capital	35	Fixed assets	110
Preference capital	2	Investments	8
Reserves & Surplus	52	Current assets, loans & advances	37
Debentures	26		
Current liabilities & Provisions	40		
Total Capital and Liabilities	155	Total Assets	155

The target capital structure of company has 65 percent equity, 10 percent preference, and 25 percent debt. Company is paying 11% dividend on preference share, the current market price of preference share is Rs. 108. Debentures consist of Rs.100 par, 11 percent coupon payable annually, with a maturity of 5 years. The market price of these debentures is Rs.108. Equity stock is currently selling for Rs. 112 per share. Its last dividend was Rs.3.50 per share and the dividend per share is expected to grow at a rate of 9 percent per year in future.

Company's equity beta is 1.5, the risk-free rate is 7 percent, and the market risk premium is 6 percent. The Applicable Tax rate is 33 percent

(i) What is post-tax cost of debt?

(ii) What is weighted average cost of capital using the dividend discount model?

(iii) What is weighted average cost of capital using CAPM?

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