

Reg. No. :

Z 4510

M.B.A. DEGREE EXAMINATION, MAY/JUNE 2008.

Second Semester

BA 1652 — FINANCIAL MANAGEMENT

(Regulation 2005)

Time : Three hours

Maximum : 100 marks

Answer ALL questions.

PART A — (10 × 2 = 20 marks)

1. What are the objectives of Financial Management?
2. What is Rule of 72?
3. What are the components of Capital Budgeting?
4. What is the cost of retained earnings?
5. What is Stock split?
6. What is trading on equity?
7. Draw on operating cycle of Working Capital for a manufacturing company.
8. What is Factoring?
9. What is Operating Lease?
10. Name any two venture Capital firms?

PART B — (5 × 16 = 80 marks)

11. (a) Sagar Industries is planning to introduce a new product with a projected life of 8 years. The project, to be set up in a backward region, qualifies for one time (as its starting) tax-free subsidy from the government of Rs. 20 lakhs. Initial equipment cost will be Rs.140 lakhs and additional equipment costing Rs. 10 lakhs will be needed at the beginning of the third year. At the end of 8 years, the original equipment will have no resale value, but the supplementary equipment can be sold for

Rs. 1 lakh. A working capital of Rs. 15 lakhs will be needed. The sales volume over the eight years period have been forecasted as follows :

Year	Units
1	80,000
2	1,20,000
3-5	3,00,000
6-8	2,00,000

A sale price of Rs. 100 per unit is expected and variable expenses will amount to 40% of sales revenue. Fixed cash operating costs will amount to Rs.16 lakhs per year. In addition, an extensive advertising campaign will be implemented, requiring annual outlays as follows

Year	Rs. (in lakhs)
1	30
2	15
3-5	10
6-8	4

The company is subject to 50% tax rate and considers 12% to be an appropriate after-tax cost of capital for this project. The company follows the straight-line method of depreciation.

Should the project be accepted? Assume that the company has enough income from its existing products.

Or

- (b) (i) How do you arrive at IRR? (4)
- (ii) How do you arrive at cash flow? (4)
- (iii) In two projects selection, Project 1 is better as per IRR method; Project 2 is better as per NPV method. How do you choose the best project? And how do you avoid the conflict? (8)
12. (a) (i) What are the major financial decisions? (4)
- (ii) Explain the concept of time value with an illustration (10 + 6)

Or

- (b) (i) Which Investments is a risky one from the following returns?
- | | | | | | |
|------|-----|-----|-----|-----|-----|
| BHEL | 12% | 14% | 16% | 18% | 20% |
| SBI | 12% | 15% | 20% | 16% | 17% |
| RIL | 15% | 21% | 23% | 20% | 16% |
- (ii) What are the different methods of valuing equity shares? (10 + 6)

13. (a) (i) What are the different types of dividend policy? (6 + 10)
- (ii) Determine the market value of equity shares of the company from the following information as per Walter's Model.
- | | |
|------------------------------|--------------|
| Earnings of the Company | Rs. 5,00,000 |
| Dividend paid | Rs. 3,00,000 |
| Number of shares outstanding | Rs. 1,00,000 |
| Price earning ratio | 8 |
| Rate of return on Investment | 15% |
| Cost of capital | 13.2% |

Or

- (b) A company's capital structure consists of the following :

Equity Shares of Rs. 100 each	Rs. 20 lakh
Retained Earnings	Rs. 10 lakh
9% Preference shares	Rs. 12 lakh
7% Debentures	Rs. 8 lakh
Total	Rs. 50 lakh

The company earns 12% on its capital. The Income tax rate is 50%.

The company requires a sum of Rs. 25 lakhs to finance its expansion programme for which following alternatives are available to it :

- (i) Issue of 20,000 equity shares at a premium of Rs. 25 per share
- (ii) Issue of 10% preference shares
- (iii) Issue of 8% debentures.

It is estimated that the P/E ratios in the cases of equity, preference and debentures financing would be 21.4, 17 and 15.7 respectively.

Which of the three financing alternatives would you recommend and why?

14. (a) Purchase Manager places order each time for a lot of 500 numbers of a particular item. From the available data, the following results are obtained.

Inventory Carrying Cost — 40%

Ordering Cost per order — Rs. 600

Cost per unit = Rs. 50

Annual Demand : 1,000

Find out the loss to the organization due to his ordering policy.

Or

- (b) Calculate the amount of working capital requirement for Jolly & Co. Limited from the following Information :

	(Rs. Per unit)
Raw Materials	160
Direct Labour	60
Over heads	120
Total Cost	<u>340</u>
Profit	60
Selling price	<u>400</u>

Raw materials are held in stock on an average for one month. Materials are in process on an average for half-month. Finished goods are in stock on an average for one month.

Credit allowed by suppliers is one month and credit allowed to debtors is two months. Time lag in payment of wages is $1 \frac{1}{2}$ weeks. Time lag in payment of overhead expenses is one month. One fourth of the finished goods are sold against cash.

Cash in hand and at bank is expected to be Rs. 50,000; and expected level of production amounts to 1,04,000 units.

You may assume that production is carried on evenly throughout the year, wages and overheads accrue similarly and a time period of four weeks is equivalent to a month.

15. (a) In the present economic scenario, which source of financing is more advantageous? Why?

Or

- (b) ABC Company Ltd., is faced with two options as under in respect of acquisition of an asset valued Rs. 1,00,000. Either to acquire the asset directly by taking a Bank Loan of Rs. 1,00,000 of the asset value for 5 years end installments at an interest of 15%. (or)

To lease in the asset at yearly rentals of Rs. 320 per Rs. 1,000 of the asset value for 5 years payable at year end.

The following additional informations are available.

- (i) The rate of depreciation of the asset is 15% W.D.V.
- (ii) The company has an effective tax rate of 50%
- (iii) The company employs a discounting rate of 16%

You are to indicate in your report which option is more preferable to the Company.