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Q 6510

M.B.A. DEGREE EXAMINATION, MAY/JUNE 2006.

Second Semester

BA 1652 — FINANCIAL MANAGEMENT

Time : Three hours

Maximum : 100 marks

Answer ALL questions.

PART A — (10 × 2 = 20 marks)

1. Define Financial Management.
2. What is portfolio return?
3. What is Interest Tax Shield?
4. Define IRR.
5. What is trading on equity?
6. What are share splits?
7. What is fluctuating working capital?
8. What is a commercial paper?
9. What is Leasing?
10. What is book building?

PART B — (5 × 16 = 80 marks)

11. (i) A company is considering two mutually exclusive projects. Both require an initial investment of Rs. 50,000 each can have a life of five years. The cost of capital of the company is 10% and tax rate is 50%. The depreciation is charged on straight line method. The estimated net cash inflows (before depreciation and tax) of the two projects are as follows :

Year	Project A	Project B
1	Rs. 20,000	Rs. 30,000
2	Rs. 22,000	Rs. 27,000
3	Rs. 28,000	Rs. 22,000
4	Rs. 25,000	Rs. 25,000
5	Rs. 30,000	Rs. 20,000

Which project should be accepted as per NPV and IRR methods? (Table showing Present Value Factor of an Annuity of Re. 1 may be provided on request) (13)

- (ii) An ordinary share selling at a current market price of Rs. 120, and paying a current dividend of Rs. 9 per share, which is expected to grow at a rate of 8%. Compute the after – tax cost of capital. (3)
12. (a) What are the basic financial decisions? How do they involve risk-return trade-off?

Or

- (b) (i) A company expects to pay a dividend of Rs. 7 next year that is expected to grow at 6%. It retains 30% of earnings. Assume a capitalization rate of 10%. You are required to calculate the expected earnings per share next year, return on equity and the value of growth opportunities. (3 + 3 + 7 = 13)
- (ii) If the rate of interest on Rs. 1,000 par value perpetual bond is 8%, and its price is Rs. 800. What is its yield to maturity? (3)
13. (a) What are the factors which influence the dividend policy of a firm?

Or

- (b) A company needs Rs. 10,00,000 for expansion. The expansion is expected to yield an annual EBIT of Rs. 1,60,000. In choosing a financial plan, the company has an objective of maximizing earnings per share. It is considering the possibility of issuing equity shares and raising debt of Rs. 1,00,000 or Rs. 4,00,000 or Rs. 6,00,000. The current market price per share is Rs. 25 and is expected to drop to Rs. 20 if the funds are borrowed in excess of Rs. 5,00,000. Funds can be borrowed at the rates indicated below :

- (i) up to Rs. 1,00,000 at 8%
- (ii) over Rs. 1,00,000 up to Rs. 5,00,000 at 12%
- (iii) over Rs. 5,00,000 at 18%.

Assume a tax rate of 50%. Determine the EPS for the three financing alternatives. Which is the best one?

14. (a) The proforma cost sheet of a company provides the following data :

	Rs.
Cost per Unit :	
Raw materials	52.0
Direct Labour	19.5
Overheads	39.0
Total cost per unit	<u>110.5</u>
Profit	<u>19.5</u>
Selling price	<u>130.0</u>

The following is the additional information available :

Average raw material in stock : one month; average materials in process : half a month. Credit allowed by suppliers : one month; Credit period allowed to debtors : two months. Time lag in payment of wages : one and a half weeks. Overheads : one month. One-fourth of sales are on cash basis. Cash balance is expected to be Rs. 1,20,000.

You are required to prepare a statement showing the working capital needed to finance a level of activity of 70,000 units of output. You may assume that production is carried on evenly throughout the year and wages and overheads accrue similarly.

Or

- (b) Explain the objectives of credit policy. What is an optimum credit policy? Discuss.
15. (a) What is a debenture? Explain the features of a debenture. What are the pros and cons of debentures from the company's and investors' point of view?

Or

- (b) Define venture capital. What are its features? Explain the process of venture capital financing.