

Z 4509

M.B.A. DEGREE EXAMINATION, NOVEMBER/DECEMBER 2006.

Second Semester

BA 1652 — FINANCIAL MANAGEMENT

(Regulation 2005)

Time : Three hours

Maximum : 100 marks

Answer ALL questions.

PART A — (10 × 2 = 20 marks)

1. Comment on the emerging role of the finance manager in India.
2. What is time value of money?
3. Explain the concept of capital rationing.
4. What are the various types of projects?
5. What is indifference point in EBIT-EPS analysis?
6. What is dividend? Explain the various forms of dividend.
7. Define the term working capital. What are the various forms of working capital?
8. What is a CP?
9. What are the various sources of long term finance?
10. Define a lease. What are the various types of leases?

PART B — (5 × 16 = 80 marks)

11. (a) (i) What are the basic financial decisions? How do they involve risk — return trade off? (8)
- (ii) Briefly describe the reasons why profit/EPS maximization fail to be consistent with wealth maximization. (8)

Or

(b) Calculate the level of EBIT at which the indifference point between the following financing alternatives will occur.

- (i) Ordinary share capital of Rs. 10 lakh or 15% debentures of Rs. 5 lakh and ordinary share capital of Rs. 5 lakh
- (ii) Ordinary share capital of Rs. 10 lakh or 13% preference share capital of Rs. 5 lakh and ordinary share capital of Rs. 5 lakh
- (iii) Ordinary share capital of Rs. 10 lakh or ordinary share capital of Rs. 5 lakh, 13% preference share capital of Rs. 2 lakh and 15% debentures of Rs. 3 lakh.

Assume that the corporate tax rate is 50% and the price of the common share in Rs. 10 in each case.

12. (a) (i) ABC Co. is considering two machines, only one of which can be purchased. The available data on the two machines is given below :

(8)

	Machine A	Machine B
Cost (Rs.)	48,000	85,000
Life of the machine	5 years	7 years

Years	Annual savings (after taxation)	
	Machine A (Rs.)	Machine B (Rs.)
1	8,000	18,000
2	10,000	25,000
3	15,000	30,000
4	22,000	40,000
5	30,000	20,000

Neither machine will have any salvage value. The cost of capital is 10%. Compute the profitability index for each machine. Based on the profitability index, which machine should be purchased?

(ii) Under what circumstances do the NPV and IRR methods differ? Which method would you prefer and why? (8)

Or

- (b) The following data is available in respect of two mutually exclusive projects to be considered by the management for investment

Years	Cash inflows before depreciation	
	Project X (Rs.)	Project Y (Rs.)
1	60,000	90,000
2	75,000	1,50,000
3	1,20,000	1,75,000
4	1,80,000	1,25,000
5	2,50,000	50,000

Project X costs Rs. 2,75,000 and Project Y costs Rs. 3,00,000. An investment of this type is expected to earn a discounted rate of return of at least 12%. You are required to determine the more desirable project by

- (i) NPV method
- (ii) PI method
- (iii) Payback period methods. (16)

13. (a) Assuming that a firm pays tax at a 50% tax, compute the after tax cost of capital in the following cases :

- (i) A 8.5% preference share sold at par
- (ii) A perpetual bond sold at par, coupon rate of interest being 7%
- (iii) A ten-year, 8%, Rs. 1,000 par bond sold at Rs. 950 less 4% underwriting commission.
- (iv) A preference share sold at Rs. 100 with a 9% dividend and a redemption price of Rs. 110 if the company redeems it in 5 years.
- (v) 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%. (16)

Or

- (b) (i) Explain the assumptions and implications of the NI approach, NOI approach and the traditional approach. Illustrate your answer with hypothetical examples. (8)
- (ii) What is EBIT-EPS analysis? Illustrate. (8)

14. (a) Define dividend. Explain the various theories of dividend with examples. (16)

Or

- (b) The following information is available in respect of a firm. Capitalization rate = 15%. EPS = Rs. 100. Assumed rate of return on investment is (i) 20% (ii) 15% and (iii) 10%. Show the effect of dividend policy on market price of shares applying Walter's formula when dividend payout ratio is (1) 0% (2) 20% (3) 40% (4) 80% (5) 100%. (16)
15. (a) (i) What is the concept of working capital cycle? What is cash conversion cycle? Why are these concepts important in working capital management? (8)
- (ii) Briefly explain the various factors that determine the working capital needs of a firm? (8)

Or

- (b) A pro forma cost sheet of a company provides the following data :

Rs.

Costs (per unit) :	
Raw material	60
Direct labor	20
Overheads	40
Total costs (per unit)	120
Profit	30
Selling price	150

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 allowed to debtors – two months. Time lag in payment of wages – 2 weeks and for overhead – one month. Half of the sales are on cash basis. Cash balance is expected to be Rs. 2,00,000.

You are required to prepare a statement showing the working capital needed to finance a level of activity of 50,000 units of output. You may assume that production is carried out on evenly throughout the year and wages and overheads accrue similarly. (16)