Printed Pages : 8 MBA-027

(Following Paper ID and Roll No. to be filled in your Answer Book)

PAPER ID : 7116 Roll No. | | | | | | | | | | |

M. B. A.

(Second Semester)Theory Examination, 2010-11

FINANCIAL MANAGEMENT

Time : 3 Hours] *[Total Marks : 100*

Note : This question paper contains three Sections. All questions are compulsory.

Section-A

1. Attempt *all* parts of this question. 1×20

State following statements as True or False :

(i) Use of debt to any extent maximises EPS.

(ii) Preference stock is also known as hybrid stock.

(iii) Total risk equals the diversifiable and non diversifiable risk.

(iv) Interest rate and inflation are firm specific risks.

(v) Bill discounting is one of the forms of bank financing.

(vi) Dividend decisions involve financial as well as legal considerations.

(vii) Stock dividend affects the liquidity position of the firm.

(viii) Payment of dividend is prohibited when firm is declared insolvent.

(ix) Capital cost is one of the components of inventory carrying cost.

(x) Letter of credit is one of the modes of payment.

Fill in the blanks with appropriate words :

(xi) Scope of Business finance is wider than the scope of .... finance.

(xii) Maximisation of .... is the main goal of financial management.

(xiii) Equity shareholders expected return is equal to risk free rate plus ....

(xiv) Financial assets are classified into .... and ....

(xv) .... market deals with long term securities.

(xvi) Mutual funds are governed by the ....

(xvii) Ignoring time value of money is one of the limitations of .... maximisation objective.

(xviii) .... is the repayment of loan over a period of time.

(xix) A rupee received today is more .... than a rupee which is received in future.

(xx) Business risk and financial risk are .... specific risks.

Section-B

2. Attempt any *one* part of the following : 1×30

(a) The board of directors of United Groceries is in the process of approving capital budget for the upcoming year. However it faces a dilemma in deciding on acceptable investments, their financing and the amount of dividends to pay on the equity. Amit Tandon, Vice President of finance, has analysed five possible investments as follows :

Project	Needed Funds (Rs. Crore)	Expected IRR(%)
A	100	16
B	40	20
C	80	13
D	200	12
E	60	25

The company has a target capital structure of 70 percent equity and 30 percent debt. It adheres to a stable dividend policy, which calls for a cash dividend of Rs. 50 crore.

Tandon believes that the year will have unusually large cash inflows and that Rs. 250 crore will be available before taking dividend into consideration. The cost of retained earnings is estimated at 16 percent and the after tax cost of debt is estimated at 10 percent. The company has 40 crore shares of equity outstanding with a market price of Rs. 40 per share. An EPS of Rs. 5 is estimated for the upcoming year.

Tandon proposes to the board that all the profitable investments be undertaken, that the D/P ratio remain unchanged and that Rs. 50 crore in dividends be paid. He suggests that excess internal funds be used for a share repurchase with a tender offer of Rs. 50 per share. He present details to the board. including an analysis of participating and non-participating shareholders (assumed to own 100 shares).

Answer the following questions :

(i) Determine the weighted average cost of capital.

(ii) Determine the amount of debt and equity financing.

(iii) What is EPS after the repurchase of shares.

(b) The BCG company expects to have sales of Rs. 1 crore this year under this current operating policies. Its variable costs as percentage of sales are 80 percent, and its cost of capital is 16 percent. Currently the company's credit policy is net 25 (no discount for early payment). However its' DSO is 30 days, and its bad debt loss percentage is 2 percentage. BCG spends Rs. 50,000 per year to collect bad debts and its tax rate is 40 percent.

The credit manager is considering two alternative proposals for changing BCGs' credit policy. Proposal 1 : Lighten the credit period by going from net 25 to net 30. Collection expenditure will remain constant. Under this proposal sales are expected to increase by Rs. 10 lakhs annually and the bad debts loss percentage on new sales is expected to rise to 4 percent (the loss percentage on old sales should not change). In addition the DSO is expected to increase from 30 to 45 days on all sales.

Proposal 2 : Shorten the credit period by going from net 25 to net 20. Again collection expenses will remain constant. The anticipated effects of this change are a decrease in sales of Rs. 10 lakhs per year, a decline in the DSO from 30 to 22 days, and a decline in the bad debt loss percentage to 1 percent on all sales.

Answer the following questions :

(i) Find the expected change in the net income taking into consideration anticipated changes in :

(a) Carrying costs for accounts receivables

(b) The probable bad debt losses for each proposal

(ii) Should a change in credit policy be made ? Why or why not ?

Section-C

Attempt *all* questions : 12½×4

3. (a) What is stock dividend ? Discuss the advantages of stock dividend to the company.

Or

(b) Does the dividend policy affect the value of the firm under the Gordons model' ? Explain.

4. (a) X company has paid a dividend of Rs. 4 per share last year and expected to continue in the future. The company's cost of equity capital is 12.12 percent. Calculate market price per share.

Or

(b) X company wishes to float 12 percent debentures worth Rs. 3 lakhs. The floatation cost is 10 percent. The company's tax rate is 50 percent. The debenture amount will be repaid in 5 equal years instalments commencing at the end of year 1. Calculate the cost of debenture.

5. (a) XYZ Ltd. is considering the purchase of machines. Two machines P & Q each costing Rs. 50,000 are available. Earnings after tax is as follows :

Year	P(Rs)	Q(Rs)
1	15,000	5,000
2	20,000	15,000
3	25,000	20,000
4	15,000	30,000
5	10,000	2,000

Evaluate the two alternatives according to the NPV method. Assuming the cost of capital to be 10 percent, which machine should be selected and why ?

Or

(b) What is sensitivity analysis ? Discuss in detail the assumptions and steps involved in sensitivity analysis.

6. (a) XYZ company is expecting an EBIT of Rs. 10 lakhs. The company has Rs. 40 lakhs 10 percent debt. The equity capitalisation rate is 12.5 percent. Determine the value of the firm and the cost of capital.

Or

(b) The management of XYZ Ltd. has predicted sales of 1 lakh units of a product in the next 12 months. The product cost is Rs. 18 per unit. Its estimated carrying cost is 25 percent of inventory value and ordering cost is Rs. 10per order. What is EOQ ?