II Semester M.B.A. (Day) Degree Examination, July 2011
(2007-08 Scheme)
MANAGEMENT
Paper – 2.2 : Financial Management

Time : 3 Hours Max. Marks : 75

Instructions *: Answer all Sections. Marks are indicated against each Section.*

SECTION – A (6×2=12)

1. Answer **any six** of the following questions. **Each** question carries **two** marks.

   a) What do you understand by Wealth Maximisation ?

   b) Differentiate between Compounding and Discounting.

   c) Define cost of capital.

   d) State the objectives of Inventory Management.

   e) State the sources of working capital financing.

   f) Define combined leverage.

   g) What is Pay Back Period ?

   h) What do you mean by Capital Rationing ?

   i) What is rights issue ?

SECTION – B (3×8=24)

Answer **any three** of the following questions. **Each** question carries **eight** marks.

2. Discuss about the Modigliani-Millers Approach to capital structure theory with all assumptions assumed by them.

3. What is meant by optimum capital structure ? Discuss the basic qualities which a sound capital structure should possess.

4. X Company Ltd. belongs to a risk class for which the approximate capitalization rate is 10 per cent. It currently has an outstanding 30,000 shares, which are selling in market at Rs. 80. The company is expecting a net income of Rs. 4,00,000 and it has a profitable investment project that cost Rs. 6,00,000. The company is interesting to declare a dividend of Rs. 4 per share at the end of the financial year. Show that under MM hypothesis, the payment of dividend does not affect the value of the firm.

P.T.O.

5. ABC Company's recent Balance Sheet is as follows :

Balance Sheet as on 31.03.2011

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Equity share capital (Rs. 10 Per Share)	60,000	Net Fixed Assets	1,50,000
10% Long-term debt	80,000	Current Assets	50,000
Retained earnings	20,000		
Current liabilities	40,000		
Total	**2,00,000**	**Total**	**2,00,000**

The company's total assets turnover ratio is 3, its fixed operating costs are Rs. 1,00,000 and its variable operating costs ratio is 40 percent. The income tax rate is 50 percent.

a) Calculate all the three types of leverage.

b) Determine the likely level of EBIT if EPS is (i) Re.1, (ii) Rs. 3 and (iii) zero.

6. ABC Ltd is considering the revision of its credit policy with a view to increasing its sales and profits. Currently all its sales are on credit and the customers are given one month's time to settle the dues. It has a contribution of 40% on sales and it can raise additional funds at a cost of 20% per annum. The marketing director of the company has given the following options with draft estimates for consideration.

Particulars	Current Position	Option -I	Option-II	Option-III
Sales (Rs. lakhs)	200	210	220	250
Credit period (months)	1	1.5	2	3
Bad debts (% of sales)	2	2.5	3	5
Cost and credit administration (Rs. Lakhs)	1.20	1.30	1.50	3.00

Advice the company to take right decision.

SECTION – C (2×12=24)

Answer **any two** of the following questions. **Each** question carries **twelve** marks.

7. State the different forms of dividend. What factors a company would in general consider before it takes a decision on dividends ?

8. Management of XY Ltd. seeks your assistance on assessing the working capital requirements for an activity level of 1,00,000 units of output for the year 2011. The cost details of the product are as follows.

Particulars	**Cost per unit (Rs.)**
Raw materials	20
Direct Labour	5
Overheads	15
Total Cost	**40**
Profit	10
Selling price	**50**

The other details are :

a) In order to ensure smooth flow of production, two months raw material inventory is to be held in the stores.

b) Finished goods remain in stores for one month.

c) Credit allowed for purchase of raw material is one month.

d) Credit allowed to customers is two months.

e) Cash balance to be maintained is Rs. 25,000

f) Assuming that the product process is uninterrupted and even during the year.

g) Lag in payment of overheads 1 month.

Compute the amount of working capital required for the given level of activity.

9. One project of XYZ Ltd is doing poorly and is being considered for replacement. Three mutually exclusive projects A, B and C have been proposed. The projects are expected to require Rs. 2,00,000 each and have an estimated life of 5 years, 4 years and 3 years respectively, and have no salvage value. The company's required rate of return is 10 per cent. The anticipated cash inflows after taxes for the three projects are as follows :

Year	Cash Inflows after Taxes		
	Project A (Rs.)	**Project B (Rs.)**	**Project C (Rs.)**
1	50,000	80,000	1,00,000
2	50,000	80,000	1,00,000
3	50,000	80,000	10,000
4	50,000	30,000	-
5	1,90,000	-	-

a) Rank each project applying the methods of PB, NPV, IRR and profitability Index.

b) Recommend the project to be adopted and give reasons.

SECTION – D **15**

10. Case Study :

XYZ Ltd, has following book value capital structure :

Particulars	**(Rs. Crores)**
Equity capital (Rs. 10 per share fully paid up at par)	15
11% Preference capital (Rs. 100 pershare, fully paid up at par)	1
Retained earnings	20
13.5 % debentures (of Rs. 100 each)	10
15% term loans.	12.5

The next expected dividend on equity shares per share is Rs. 3.60 and the dividend per share is expected to grow at the rate of 7%. The market price per share is Rs. 40.

Preference stock, redeemable after 10 years is currently selling at Rs. 75 per share. Debenture redeemable after six years are selling at Rs. 80 per debenture.

Required to calculate weighted average cost of capital using

a) Book value proportions

b) Market value proportions.