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Unit - II

4. Discuss the following statements in detail :
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- (a) "NPV method is always consistent with the objective of maximising the shareholder's wealth by considering time value of money".
- (b) "We are payback primarily as a method of coping with risk".
- (c) "The virtue of the IRR rule is that it does not require the computation of the required rate of return".
- (d) "The ARR (Accounting Rate of Return) rule incorporates the entire stream of income in calculating the Project's Profitability."
5. (a) A company has to make a choice between two projects namely A and B. The initial capital outlay of two projects are Rs.1,35,000 and Rs.2,40,000 respectively for A and B. There will be no scrap value at the end of the life of both the projects. The opportunity cost of capital of the company is 16%. The annual cash inflows are as follows :

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Roll No. _____

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M.B.A. (Semester-II) Examination, 2015

(Common Subject)

FINANCIAL MANAGEMENT

(IMS-023)

Time Allowed : Three Hours] [Maximum Marks : 70

Note : Answer five questions in all. Question No.1 is compulsory and carries 30 marks. Attempt one questions of 10 marks from each unit.

1. Write short notes answers to the following :
3 × 10 = 30
- (a) Organisation chart highlighting the finance function of a company.
- (b) In what ways is the wealth maximisation objective superior to the profit maximisation objective?
- (c) Sinking fund factor (SFF) and Capital recovery factor (CRF).

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- (d) Important steps in Capital budgeting decision.
- (e) Determination of Cost of equity under CAPM (Capital Asset Pricing Model).
- (f) Factors which influence management's decision to pay dividend of a certain amount.
- (g) Indifference point/level of EBIT.
- (h) Role of carrying cost and ordering cost in inventory control.
- (i) The cost of the plant is Rs.4,70,000 and installation charges are Rs.30,000. It has an estimated life of 5 years after which it would be disposed off (scrap value nil). Earnings before Interest and taxes (EBIT) is estimated to be Rs.1,50,000 p.a. Find out the initial and yearly cash flows from the plant, (given tax rate @ 30%).
- (j) A Company issues 8% bonds of Rs. 100 each for Rs.8,00,000. The Company incurs 2% as the floatation cost, find out effective cost of bond under following conditions :
 - (a) if bonds are issued at par redeemable at par

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- (b) if bonds are issued at 10% discount and redeemable at par
(Assume tax rate @ 30%)

Unit - I

- 2. "Financial decision making is the hallmark of financial management". Examine in the light of this statement, the important financial decisions in a firm. 10
- 3. (a) A loan of Rs. 1,00,000 is taken on which interest is payable @10%. However, the repayment is to start only at the end of 4th year from now, what should be the annual payment if the total loan and interest is to be repaid in six installments? 5
- (b) A machine costs Rs. 1,08,000 and its effective life is estimated at 15 years. If the scrap value is Rs.8,000, what should be retained out of profits at the end of each year to accumulate at compound interest rate at 13% p.a., so that a new machine can be purchased after 15 years? 5

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these would be if cash held is Rs.15,000 or Rs.25,000?

9. Prepare an estimate of net working capital requirement for the OMII Ltd; adding 10% for contingencies from the information given below :

Estimated Cost per unit of production Rs.170 includes raw material Rs.80, direct labour Rs. 30 and overheads (exclusive of depreciation) Rs. 60. Selling price is Rs. 200 per unit.

Level of activity per annum 1,04,000 units.

Raw Materials in stock - average 4 weeks

Work-in Progress (assume 50% completion)

→ average 2 weeks

Finished goods in stock → average 4 weeks

Credit allowed by suppliers → average 4 weeks

Credit allowed to debtors → Average 8 weeks

Lag in payment of wages → average 1.5 weeks

and cash at bank is expected to be Rs. 25,000.

next Paragraph You may assume that production is carried on evenly throughout the year

(52 weeks) and wages and overheads accrue similarly.

All sales are on credit basis only. You may state your assumptions, if any.

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Year	Project-A	Project-B
1	-	Rs. 60,000
2	Rs.30,000	Rs.84,000
3	Rs. 1,32,000	Rs. 96,000
4	Rs. 84,000	Rs.1,02,000
5	Rs. 84,000	Rs. 90,000

You are required to calculate for each project :

(i) Discounted Payback Period

(ii) Net Present Value

(iii) Profitability Index 7

- (b) DFLL company is undertaking an investment proposal which costs Rs.50,000. It generates cash inflows of Rs.10,000, Rs. 12,000, Rs. 15,000, Rs.20,000 in years 1 through 4. Assume that the associated α_t factors are estimated to be : $\alpha_0=1.00$, $\alpha_1=0.90$, $\alpha_2=0.70$, $\alpha_3=0.50$ and $\alpha_4=0.30$, and the risk-free discount rate is 10%, compute Net Present Value of the investment proposal. 3

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Unit - III

6. Kabir Foods Limited has The following Capital Structure :

	Book Value	Market Value
(i) Equity Capital (25,000 shares of Rs.10 each	Rs. 2,50,000	Rs. 4,50,000
(ii) 13% Preference share capital (500 shares of Rs. 100 each)	Rs. 50,000	Rs.45,000
(iii) Reserves and surplus	Rs.1,50,000	-
(iv) 12% debentures (1500 debentures of Rs. 100 each)	Rs. 1,50,000	Rs. 1,45,000
	<u>Rs.6,00,000</u>	<u>Rs.6,40,000</u>

The expected dividend per share is Rs.1.40 and the dividend per share is expected to grow at a rate of 8% forever. Preference shares are redeemable after 6 years at par whereas debentures are redeemable after 5 years. The tax rate for the company is 40%. You are required to compute specific cost of capital as well as weighted average cost of capital for the existing capital structure using Book Value and Market Value as weights.

7. (a) What do you mean by appropriate Capital Structure? What should generally be

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the features of an appropriate Capital Structure? 3

(b) A firm is considering alternative proposals to finance its expansion plan of Rs.4,00,000. Two such proposals are :

(i) Issue of 15% loans of Rs. 2,00,000 and issue of 2,000 equity shares of 100 each, and

(ii) Issue of 4,000 equity shares of Rs. 100 each

Given the tax rate at 50%, and assuming EBIT of Rs.70,000 and Rs.80,000 which alternative is better? Also compute the indifference level of EBIT of the two financial plans. 7

Unit-IV

8. (a) Discuss the Walter's model and Gordon's model vis-a-vis dividend policy. 5

(b) Find out the optimum cash balance as per Baumols Model for the following :

Annual Cash needed - Rs.2,40,000

Transaction Cost - Rs.100 per conversion

Interest rates : 12% (P.a.)

What are the opportunity costs of holding cash.

The transaction cost and the total costs. What