MMS - II

26.04.2010.

FM02

Financial Management

Roll No:

Total No. of Questions: Five (5)

Total No. of Printed pages: 4

Duration (hrs): 3 hrs

Maximum Marks: 60

Note:

1. **All questions are compulsory.**
2. **Figures to the right indicate marks allotted to the question.**
3. **Working notes should form part of your answer, where applicable.**

Question 1 **Answer any ten questions** (20)

i. In receivables management, what does '3/15 net 45'mean?

ii. In evaluating capital budgeting proposals using profitability index, what is the accept-reject rule?

iii. What is 'float' in cash management?

iv. Cash operating cycle in days/weeks or months is calculated by the formula ___.

v. As per the net income approach to capital structure a firm can ________ (increase/decrease) its value and __________(increase/decrease) its overall cost of capital by _________(increasing/decreasing) the degree of leverage.

vi. As per Walter's dividend model what is the optimum D/P ratio when $r > k$ and $r < k$?

vii. Ordering costs are__________ related to the size of inventory while carrying costs are _________related to the size of inventory. (positively/inversely)

viii. What will be the effect of the following transactions on the amount of working capital:

   a. Cash payment to creditors
   b. Issue of bonus shares to shareholders
   c. Purchase of furniture for cash
   d. Sale of goods on credit

ix. Give two examples of operating activities and financing activities each with reference to preparation of cash flow statement.

x. As per traditional approach what is the relationship between capital structure and value of the firm.

xi. As per Capital Asset Pricing Model (CAPM), what will be the cost of equity if the risk free rate of return is 6%; the firm's beta coefficient is 1.2 and the rate of return on market portfolio of investments in 16%.

xii. Retained earnings is cost free source of capital for a firm as it is internally generated and not raised from outside. State with reasons whether this statement is true or false.

xiii. Method I and II of Maximum Permissible Bank Finance (MPBF) as per Tandon Committee is computed as____________.

Question 2 (8)

Prepare a Cash Flow statement OR Fund flow statement from the following balance sheets of Aradhana Limited.

Balance sheet

	31st Mar 09 Amt (Rs.)	31st Mar 10 Amt (Rs.)		31st Mar 09 Amt (Rs.)	31st Mar 10 Amt (Rs.)
Sources of funds			*Application of funds*		
Share capital	43,00,000	50,00,000	Fixed assets (net)	60,50,000	72,00,000
Reserves and surplus	30,00,000	38,07,000	Long term investments	1,25,000	3,75,000
Loans	3,75,000	6,25,000	Stock	16,25,000	20,00,000
Creditors	13,75,000	11,25,000	Debtors	10,00,000	7,50,000
Outstanding expenses	1,25,000	50,000	Cash	3,75,000	2,82,000
Total	**91,75,000**	**1,06,07,000**	Total	**91,75,000**	**1,06,07,000**

Income statement for the year ended 31st March 2010

Particulars	Amount Rs.
Sales	50,00,000
Less:	
Cost of sales (including depreciation of Rs 50,000)	35,33,750
Selling and administration expenses	2,50,000
Interest on loan	25,000
Net profit for the year before tax	**11,91,250**
Provision for tax	3,41,250
Net profit for the year after tax	**8,50,000**
Less: Dividend	43,000
Amount transferred to balance sheet	**8,07,000**

Question 3 (Answer any two) (10)

A. A company is considering two mutually exclusive investment proposals - proposal A and proposal B. Both the proposals require an initial outlay of Rs. 2,00,000. The life of Machine A is 5 years and that of Machine B is 4 years. The anticipated cash flows after tax are:

Year	Proposal A Rs.	Proposal B Rs.
1	50,000	80,000
2	50,000	80,000
3	50,000	80,000
4	50,000	30,000
5	1,00,000	-

Both the machines have no salvage value. The required rate of return is 10%.
You are required to calculate:

a) Payback period
b) Net present value
c) Recommend the proposal to be accepted, giving reasons.

B. a) What is capital budgeting?
b) Explain the merits and demerits of accounting rate of return method of evaluating an investment proposal

C. From the following information compute the cash conversion cycle in days. Assume 360 days in a year.

	Rupees
Debtors outstanding	3,20,000
Creditors outstanding	1,60,000
Raw material consumption	9,80,000
Total production cost	14,00,000
Total cost of sales	15,00,000
Sales for the year	16,00,000
Stocks:	
Raw material	1,20,000
Work-in-process	1,40,000
Finished goods	2,10,000

Question 4 (answer any two) (10)

A. Calculate the level of earning before interest and tax (EBIT) at which the EPS indifference point between the following financing alternatives will occur.
Equity share capital of Rs.6,00,000 and 12% debentures of Rs.4,00,000
Or
Equity share capital of Rs.4,00,000. 14% preference share capital of Rs.2,00,000 and 125 debentures of Rs.4,00,000.
Assume the corporate tax rate is 35% and par value of equity share is Rs.10 in each case.

B. The cost of capital of a firm is 12%; its earnings per share is Rs. 25. Assuming a rate of return of (i) 8% (ii) 15%, show the effect of dividend policy on the market price of shares, using Walter's model, when D/P ratio is (a) 25% (b) 100%.

C. Tech tools Ltd. has the following book-value capital structure:

	Rs.
Equity share capital (3,00,000 shares)	60,00,000
12% preference shares	20,00,000
9% debentures	20,00,000
	1,00,00,000

The equity share of the company sells for Rs.20. It is expected that the company will pay next year a dividend of Rs.2.50 per equity share, which is expected to grow at 5% p.a. forever. Assume a 35% corporate tax rate.

Compute weighted average cost of capital (WACC) of the company based on the existing capital structure.

D. A company issued 10,000, 9% redeemable debentures of Rs. 100 each, redeemable at a premium of 10% in 10 years. The cost of issue is Rs. 50,000. The company's income tax rate is 30%. What will be the cost of debentures if they were issued a) at par b) at 10% premium.

Question 5 (12)

Write short notes on **any three**:

a) Objectives of financial management
b) Factors affecting Dividend Policy
c) Any two long term sources of finance
d) Any two sources of working capital financehttp://10.1.1.250/
e) Factors affecting working capital requirements

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