FM02 29-04-2013.

MMS-III

Roll No. Financial Management 27/4/13

Total No. of Questions : 5+3=8 Maximum Marks : 30+30=60

Duration (hrs.) : 1.5+1.5=3 Hrs Total No. of Printed Pages = 10

Section , if any : I

Note : Q1 is compulsory and carries 10 Marks
Attempt any 2 questions from Q2, Q3, Q4, Q5 each carry 10 marks
Section I & II to be solved on Separate Answer Books.

Q.1 Explain different types of dividend policies that companies can follow and their advantages and disadvantages to shareholders and company. Explain All or Nothing approach to decide optimum divided payment.

Attempt any Two from the Remaining Four Questions.

Q.2. Attempt any two from (a), (b), (c)

(a) Just System is a company that provides IT services to small and medium sector companies. The firm has been growing at a high rate. The company has strong technical side but finance function of the company until recently was managed by a technical head. Hence company has recently hired a CFO to look into the financial matters of the company. He wants you to look at the the excerpts of financial statements and determine: (5 Marks)

Assets	Rs.in Lakh
Property	13500
Less: Accumulated depreciation	1000
Net Block	12500
Other Fixed Assets	11000
Less: Accumulated depreciation	2700
Net Block	8300
Stock	6600
Trade Receivables	15100
Total	42500
Equities and Other Liabilities	
Trade Creditors	22900
Bank O/D	4420
Equity Share Capital (shares of Rs.10 each)	6000
Reserves and Surplus	4180
Secured Loan @ of 15%	5000
Total	42500

The company made Sales of Rs.1000000 during the year and earned Rs. 300000 as Net profit.
What can you comment on the liquidity of this company? (substantiate your answer by showing calculation)
(Current Ratio=Current Asset/Current Liabilities, Acid Test Ratio = Current Assets-Inventories/Current Liabilities, NWC Ratio = Net Working Capital/ Net Assets)

(b) Financial Manager of a company has been given following Fund Flow Statement and he is interested in analyzing efficiency of his company in managing its funds. You as his junior manager have been given a task to analyze this statement and some additional information has been provided to you. What inputs can you give your Finance Manager with respect to quality of funds, efficiency of the company in managing the funds? (Explain in detail with appropriate reasons) (5 Marks)

Funds Flow Statement	
Sources and Uses of Working Capital	
Sources :	
Issue of fresh Equity shares	150000
Share Premium collected	35000
Funds from Operations	275000
Issue of debentures	25000
Institutional loan	40000
Total Sources	525000
Uses:	
Purchase of Fixed Assets	75000
Purchase of long term Investments	175000
Acquisition of Other Businesses	375000
Repayment of Borrowings	150000
Funds applied	775000
Net decrease in Working Capital	250000

Additional Information:

1. Company had earlier borrowed funds @of 12% p.a. and now after the interest rate cut by RBI, corporate lending rate has come down to 10% p.a.
2. Company is listed on BSE and its share price has increased from Rs. 150 to Rs.250 in the last month.
3. Company is planning to switchover to new technology.

(c) What are different alternatives to paying cash dividend? Explain issue of bonus shares and explain with example whether it affects wealth of the shareholder?
(5 Marks)

Q.3. Attempt any two from (a), (b), (c)

(a) Explain any Two Short term sources of Finance for the company. (5 Marks)
(b) Classify following Activities into Operating, Investing and Financing Activities and based on the classification comment whether the company's quality of cash is appropriate. Give reasons.(construction of Cash flow statement is not required) (5 Marks)

- Company sold goods worth Rs.500000 and earned net profit of Rs.300000
- Company repaid its long term debt Rs.200000 (interest @10%) during the year and then raised fresh debt (interest @8%) Rs. 250000.
- Trade payables have decreased by Rs.6000 in the year.
- Company purchased shares of B ltd. for 200000 against issue of shares.
- Depreciation and Amortization expenses amounted to Rs.40000
- During the year company's inventories increased by Rs. 55000 and Trade receivables decreased by Rs. 20000.
- Company purchased fixed assets worth Rs.200000 and sold old assets for Rs.15000
- Company issued Bonus shares @ 3:1 to its existi ng shareholders.
- Company purchased future and forward contracts worth Rs.300000
- Company purchased government bonds worth Rs.200000

(c) Following is the Cash flow statement of National Ltd. for last three years. Analyze the cash flow from Investing and Financing Activities? Also comment on whether year 2012 was bad for the company since cash declined in the year? Give reasons. (5 Marks)

Cash Flow Statement Rs.in Millions	2012	2011	2010
Net Income	3117	1291	10535
Adjustments for:			
Depreciation	4676	4131	3249
Amortization of goodwill	-	1710	1310
Impairment of intangible assets	668	717	352
Changes in Working Capital :			
Add/Less:			
Accounts Receivable	30	1561	(384)
Inventories	(26)	24	(731)
Accounts Payable	(226)	(673)	978
Other current Assets	(21)	(971)	482
Net Cash flow from Operating Activities	8218	7790	15791
Cash Flow from Investing Activites			
Additions to Plant,equipment and Property	(4703)	(7309)	(6674)
Acquisiton of businesses	(57)	(883)	(2317)
Purchase of Investments	(6309)	(7141)	(17188)
Sale of Investments on maturity	5634	15398	17124
Other investing Activities	(330)	(395)	(980)
Net Cash flow from Investing Activities	(5765)	(330)	(10035)
Cash Flow from Financing Activites			
Short term Debt	(101)	23	138
Long term debt	55	306	77
Repayment of long term debt	(18)	(10)	(46)

Proceeds from sale of shares through Employee Stock plans	681	762	797
Equity Shares	(4014)	(4008)	(4007)
Dividend to stockholders	(533)	(538)	(470)
Net Cash flow from Financing Activities	(3930)	(3465)	(3511)
Net Increase/ (Decrease) in Cash and Cash Equivalent	(1477)	3995	2245

Q.4. Attempt any two from (a), (b), (c)

(a) A company has a choice to invest in 4 different types investments in the market and Investment in subsidiaries earns 12% rate of return, Investment in Mututal fund instruments earn 15% rate of return and Investment in government bonds earn 8% rate of return. The company is growing fast but yet market does not have total confidence in the company and hence, its investors would charge 12% from the company in return for providing capital to the company. In each of the three scenarios what would be the optimum dividend payout for the company? Why? (5 Marks)

(b) Financial Ratios of Company X are given below. Comment on the financial position of the company based on the information given below:

Financial Ratios	Industry	Company
Current Ratio	1.1	1.86
Stock Turnover (Cost of goods sold/Avg. Inventory)	1.4	?
Avg. Collection Period(360/Stock Turnover)	28 days	?
Debt Equity Ratio (Total Debt/Net Worth)	1.5	?
Interest Coverage Ratio	5 times	1.57 times
Asset Turnover Ratio	1.35	0.58
Gross Profit Margin	11.9	8.36
ROE	10.9	7.37

Following information is available on the company:

i. Company has 50000 Equity shares of Rs.10 each. The Reserves and Surplus of the company amounts to Rs.50000. The company has raised long term borrowings of Rs.300000 @ of 10%. Company sold goods worth Rs.500000 on credit. Opening balance of Inventories is Rs.5000 and closing balance is Rs.10000. The tax paid amounted to Rs.20000.

Comment on Operating efficiency of the company vis-à-vis the industry and Also comment on the profitability of the company compared to the industry. (5 Marks)

(c) Explain Quasi Equity Sources of Long term finance in brief. (5 Marks)

Q.5. Attempt any two from (a), (b), (c)

(a) Following is the information of Financial Statements of Pal ltd. The MD of the company wants a report from you in the form of a Fund flow statements as to how the company has managed its funds. (5 Marks)

The following is the summary of financial Statements of Pal ltd.

Balance Sheet as on March	Mar-12	Mar-11
Assets		
Cash	350000	450000
Trade Investments	160000	320000
Accounts Receivables	300000	300600
Stock	255800	185600
Investments in S ltd	300000	_
Buildings net of depreciation	2500000	185000
Machinery net of depreciation	643500	620000
Total Assets	4509300	2061200
Liabilities		
Trade Payables	120000	105200
Bank O/D	40000	25000
Long term loans	1600000	600000
Debentures net of discount	960000	_
Share capital @Rs.10 each	670000	300000
Share Premium	1040000	956000
Reserves and Surplus	79300	75000
Total Liabilities	4509300	2061200

Income Statement for the year is as follows:

Sales	500000
Cost of goods sold and operating Exp. Including depreciation on Building @ Rs. 25200 and Depreciation on Machinery @Rs. 40000	65200
Operating Profit	434800
Gain on sale of machinery	8500
PBT	443300
Income tax paid	155155
Net Profit	288145

Additional Info:

1. Machinery with net book value of Rs.50000 was sold during the year.
2. Shares of S ltd. were acquired after payment of Rs. 250000 in cash and issuance of 5000 shares Star ltd. The share of Star ltd. was selling at Rs. 20 per share at the time.
3. Debentures having face value of Rs. 100 each were issued in Jan 2012 at Rs.96
4. Company issued 32000 shares for a premium of Rs.1.0625 each
5. Company paid Cash dividends of Rs.80000

Prepare a Fund Flow statement showing Uses and Sources of Funds and comment on the quality of Funds.

(b) Explain Gordon's dividend model and Modigliani Dividend Model along with their assumptions and implications. (5 Marks)

(c) A Company wants to look at its efficiency in terms of using assets to produce maximum and its profitability at the same time. The company will employ total assets of Rs.300000 and 30% of them are financed through Equity capital. The company pays 5% interest to service the debt. The direct costs for the year are estimated at Rs.140000 and operating expenditure is Rs.35000. The goods are sold at double of direct cost. Taxes are paid @30%.

What can be said about the profitability of the company, its ability to use assets efficiently? Support your answer with calculation. (5 Marks)

Section II

Note:

(i) Part A is Compulsory.

(ii) Each of the question in Part B have three sub question of 5 mark each. You can attempt any two of them.

(iii) Attempt any two out of Part B

Part A

Q.1] Objective questions (2 Marks Each)

1. Reliance's Beta coefficient is 1.5. The risk free return is 8% and the risk premium is 18% then cost of equity for the stock is

a) 21% b) 22% c) 23% d) 24%

2. What is the *future value* of a 7-year ordinary annuity with annual payments of $700, evaluated at a 10 percent interest rate?

a) $ 6640.9 b)$ 5640.9 c) $7640.9 d) $8640.9

3 & 4. Following is the data pertaining to credit period and respective sales estimations for XYZ company

Particulars	Current	Option 1	Option 2	Option 3
Sales (Lakhs)	250	260	300	350
Fixed Cost	45	45	45	50
Credit period (months)	1.5	2	2.5	3
Bad debts (% of sales)	2	2.5	2.8	5
Cost of credit administration (Lakhs)	3	4	5	6

Given: Contribution to sales ratio is 35%

The best credit period for the company in months is

a) 1.5 b) 2 c) 2.5 d)3

5. A leading life insurance company has come up with a plan which assures you some fixed amount for 10 years against a premium to be paid in single installment today of Rs.49268. The return assured is 8%. The plan assures payments to begin only in the third year i.e. you will not receive any benefits in the first two years. How much minimum yearly benefit would you as a customer would expect so that you break even in your investment.

a) Rs.15000 b) Rs.14000 c) Rs.12000 d) Rs.10000

Part B

Q.1] XYZ ltd is manufacturing company of electronic goods. It has under consideration two projects 'X' and 'Y', each costing Rs.120 Lakhs. The company is considering selecting one of them. X has the operating life of 8 years and Y has operating life of 6 years. Both have zero salvage value at the end of the operating lives. The company is already making profits and its tax rate is 50%. The Cost of capital of the company is 15%. The company follows straight line depreciation.

The expected cash flow & IRR for each of the project is as follows.

Year	IRR	1	2	3	4	5	6	7	8
X	33%	25	35	45	65	65	55	35	15
Y	30%	40	60	80	50	30	20	-	-

Answer any of the two from the following questions for 5 marks each:

(i) Advice the company regarding the selection of the project based on NPV & IRR. Explain discrepancy, if any in the rating of the project based on 2 parameters

(ii) Advice the company regarding the selection of the project based on Profitability Index & IRR. Explain discrepancy, if any in the rating of the project based on 2 parameters

(iii) Advice the company regarding the selection of the project based on Discounted Payback Period & IRR. Explain discrepancy, if any in the rating of the project based on 2 parameters

Q.2]a) The following is the capital structure of Saras ltd as on 31-12-2010.

Equity share – 22000 shares of Rs.100 each Rs.22,00,000

10% Preference shares of Rs. 100 each Rs. 10,00,000

12% Debentures Rs. 18,00,000

The market price of the company's share is Rs.110 and it is expected that a dividend of Rs.10 per share would be declared after 1 year. The dividend growth rate is 6%. Corporate tax rate is 50%.

Assuming that in order to finance an expansion plan the company intends to borrow a fund of Rs.20 lacs bearing 12% rate of interest, what will be the company's revised WACC? This financing decision is expected to increase the dividend from Rs. 10 to Rs.12 and decline the market price of the share from Rs.110 to Rs.105.

Q.2] b) The following information is available of the company:

Particulars	**Amounts**
Monthly Credit Sales	Rs. 1000000
Credit Period Extended	40 Days
factors fees	1 %
Interest Charged by factor	16%
Company's Collection Cost	Rs.4500
Factors average remittance period	10 days
Company's cost of raising funds	22 %

Should the company go for factoring of receivables?

Q.2] c) From the following data, you are required to calculate working capital requirements of AB ltd

Particulars	**Average period of credit**	**Amounts estimated**
Purchase of material	7 weeks	2600000
Wages	4 weeks	1950000
Overheads:		
Rent Rates	4 months	100000
Salaries	1 month	800000
Other OH	2 months	750000
Sales Cash	-	200000
Sales Credit	2 months	6000000
Avg stock & WIP	-	400000
Avg undrawn profit		300000

Q.3] Write short notes:

a) Cash Management

b) Factoring of receivables

c) Any two theories of Capital Structuring of the firm