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05MBA23

Second Semester MBA Degree Examination, May/June 2010
Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. *Answer any FOUR full questions from Q.No.1 to 7.*
2. *Question No. 8 is compulsory.*
3. *Use of PV tables is permitted.*

1 a. What is business and financial risk? **(03 Marks)**
b. Discuss the role of financial managers in modern organizations. **(07 Marks)**
c. Explain the factors influencing options valuation. **(10 Marks)**

2 a. Define financial management. **(03 Marks)**
b. What are the functions of secondary market? Explain. **(07 Marks)**
c. Briefly explain the various evaluation techniques used in capital budgeting. Also, enumerate atleast one merit and one demerit of each. **(10 Marks)**

3 a. What is listing? **(03 Marks)**
b. What are the determinants of working capital? Discuss. **(07 Marks)**
c. A firm's sale, variable costs and fixed costs amount to Rs.75,00,000, Rs.42,00,000 and Rs.6,00,000 respectively. It has borrowed Rs.45,00,000 at 9% and its equity capital totals Rs.55,00,000.
i) What is the firm's ROI?
ii) Does the firm have favourable financial leverage?
iii) If the firm belongs to an industry whose asset turnover is 3, does it have a high or a low asset leverage?
iv) What are the operating, financial and combined leverages?
v) If the sales drop to Rs.5000000, what will be the new EBIT?
vi) At what levels, will the EBT of the firm equal to zero? **(10 Marks)**

4 a. What is capital budgeting? **(03 Marks)**
b. In what ways, the wealth maximization objective is superior to the profit maximization? **(07 Marks)**
c. A new machine is expected to generate the following set of incremental CFAT during its 5 years economic useful life.

Year	1	2	3	4	5
CFAT (Rs.)	10,00,000	12,00,000	15,00,000	8,00,000	5,00,000

The rate of inflation during the period is expected to be 8% and the projects cost of capital in real terms would be 10%. Should the machine be purchased if it costs Rs.25 lakhs? **(10 Marks)**

5 a. What are gross and net working capitals? **(03 Marks)**
b. Explain the steps in financial planning. **(07 Marks)**
c. A company has on its books, the following amounts and specific costs of each type of capital:

Type of capital	Book value (Rs.)	Market value (Rs.)	Specific costs (%)
Debt	400000	380000	5
Preference	100000	110000	8
Equity	600000	1200000	15
Retained earnings	200000		13
	1300000	1690000	

Determine the weighted average cost of capital using:
i) Book value weights ii) Market value weights. **(10 Marks)**

6 a. What do you understand by the term constant payout ratio? **(03 Marks)**

b. Explain the CAPM approach for determining the cost of equity and state its assumptions. **(07 Marks)**

c. If the discount/required rate is 10%, compute the present value of the cash flow streams detailed below:

i) Rs.100 at the end of year 1.

ii) Rs.100 at the end of the year 4.

iii) Rs.100 each at the end of the year 3 and 5

iv) Rs.100 for the next 10 years (every year). **(10 Marks)**

7 a. What is underwriting? **(03 Marks)**

b. What are the factors that determine the dividend policy of a firm? Explain. **(07 Marks)**

c. A proforma cost sheet of a company provides the following data:

	Rs.
Cost (per unit):	
Raw materials	52.0
Direct labour	19.5
Overheads	39.5
Total cost/unit	110.5
Profit	19.5
Selling price	130.0

The following additional information is available:

Average raw material in stock = one month, average material in process = half a month, credit allowed by suppliers = one month, credit allowed by debtor = two months, time lag in payment of wages = one and a half weeks, overheads = one month. ¼ of sales are on cash basis. Cash balance is expected to be Rs.120000.

You are required to prepare a statement showing the working capital needed to finance a level of activity of 70000 units of output. You may assume that production is carried on evenly throughout the year and wages and overheads accrue similarly. **(10 Marks)**

8 A company is considering an investment proposal to install new milling controls at a cost of Rs.50,000. The facility has a life expectancy of 5 years and no salvage value. The tax rate is 35%. Assume the firm uses straight line depreciation and the same is allowed for tax purposes. The estimated cash flows before depreciation and tax (CFBT) from the investment proposal are as follows:

Year	1	2	3	4	5
CFBT (Rs.)	10,000	10,692	12,769	13,462	20,385

Compute the following:

a. Pay back period

b. Average rate of return

c. Internal rate of return

d. Net present value at 10% discount rate

e. Profitability index at 10% discount rate. **(20 Marks)**

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