(Please write your Exam Roll No.) Exam Roll No. 709159039 ie

END TERM EXAMINATION

SECOND SEMESTER [MBA] APRIL-MAY 2019

Paper Code: MS-104	Subject: Financial Management (Batch 2017 onwards)
Time: 3 Hours	Maximum Marks: 75

Note: Attempt any five questions. All questions carry equal marks.

Q1 Prepare a Cash Flow statement as per Proforma given in AS-3 (Revised) for the Star Steel Ltd. whose Balance sheets for the the year 2017 and 2018 are as follows:

Liabilities	2017	2018	Assets	2017	2018
Pref. Share Capital	10,00,000	5,00,000	Land & Building	5,00,000	4,75,000
Equity share capital	10,00,000	12,00,000	Machinery	7,00,000	10,00,000
Share Premium	3,00,000	2,70,000	Investment	8,00,000	8,50,000
Capital Redemption Reserve	--	3,00,000	Current Assets	39,50,000	46,50,000
General Reserve	5,00,000	3,00,000	Cash	50,000	25,000
P&L A/C	3,20,000	4,30,000			
Secured Loan	8,80,000	9,70,000			
Current Liabilities	16,00,000	25,00,000			
Proposed Dividend	4,00,000	5,30,000			
	60,00,000	70,00,000		60,00,000	70,00,000

Additional Information:

(i) During the year, Machinery costing Rs. 95,000 and WDV Rs. 17,000 was sold for Rs. 35,000.

(ii) Pref. share capital was redeemed at a premium of 10%, partly out of proceeds of issue of 20,000 Equity shares of Rs10 each issued at 10% premium and partly out of profits otherwise available for dividends.

(iii) Depreciation on Machinery for the year is Rs. 3,00,000.

Q2 (a) "The sole objective of the management when making investment decisions is to maximize the net present value". Discuss.

(b) A company is presently working with an Earnings before interest and taxes (EBIT) of Rs. 15 lacs. Its present borrowing are:

	Rs. (in lacs)
15% term loan	50
Borrowing from Bank @ 20%	33
Public deposit @ 14%	15

The sales of the company are growing and to support this the company proposes to obtain additional borrowings of Rs. 25 lacs. The increase in EBIT is expected to be 20%.

Calculate the change in interest coverage ratio after the additional borrowing and commitment.

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Q3 (a) Companies U and L are identical in every respect except that the former does not use debt in its capital structure, while the latter employs Rs. 6,00,000 of 15% debt. Assuming that (a) all the MM assumptions are met, (b) the corporate tax rate is 50%, (c) the EBIT is Rs. 2,00,000, and (d) the equity capitalization of the unlevered company is 20%, what will be the value of the firms, U and L? Also determine the weighted average cost of capital for both the firms.

(b) MC Ltd. is planning an expansion program which will require Rs. 30 crores and can be funded through one of the three following options:

1. Issue further equity shares of Rs. 100 each at par.
2. Raise a 15% loan, and
3. Issue 12% preference shares.

The present paid up capital is 60 crores and the annual EBIT is Rs. 12 Crores. The tax rate may be taken at 50%. After the expansion plan is adopted, the EBIT is expected to be Rs. 15 crores.

Calculate the EPS under all the three financing options indicating the alternative giving the highest return to the equity shareholders. Also determine the indifference point between the equity share capital and the debt financing (i.e., option 1 and option 2 above).

Q4 (a) The WACC differs from the WMCC. Examine the difference and which one be used in capital budgeting.

(b) "Today's financial managers are seized with the problem of financial distress and are trying to overcome it by innovative means." Comment.

Q5 Indica Lathe Works is considering to replace one of its machine which was purchased 2 years ago at a cost of Rs. 10,00,000. It can be presently sold at its PV value (WDV @ $33_{1/3}$% p.a). It's remaining economic life is 5 years after which it can be scrapped away at its then W.D.V. The cost of the new machine is Rs. 16,00,000 and after 5 years it can be sold at its book value (WDV @ $33_{1/3}$% p.a.). The new machine is expected to reduce operation cost by Rs. 1,50,000 p.a. and increase the revenues by Rs.2,00,000 p.a. Evaluate the replacement proposal given that tax rate is 30% and cost of capital is 10%.

Q6 (a) "The virtue of IRR method is that it does not require the pre-calculation of the required rate of return," Critically examine.

(b) Pioneer Projects Ltd is considering accepting one of two mutually exclusive Projects X and Y. The cash flows and probabilities are estimated as under:

Project X		Project Y	
Probability	Cash flow	Probability	Cash flow
0.10	Rs. 12,000	0.10	Rs. 8,000
0.20	14,000	0.25	12,000
0.40	16,000	0.30	16,000
0.20	18,000	0.25	20,000
0.10	20,000	0.10	24,000

Advise Pioneer Projects Ltd.

Q7 Diamond Engineering Company has 10,00,000 equity shares outstanding at the start of the accounting year 2007. The ruling market price per share is Rs. 150. The Board of Directors of the Company contemplates declaring Rs 8 share as dividend at the end of the current year. The rate of Capitalization appropriate to the risk-class to which the company belongs is 12%.

(a) Based on Modigliani-Miller Approach, calculate the market price per share of the company when the contemplated dividend is (i) declared and (ii) not declared.

(b) How many new shares are to be issued by the company at the end of the accounting year on the assumption that the Net Income for the year is Rs. 2 crores? Investment budget is Rs. 4 crores and (i) the above dividends are distributed and (ii) they are not distributed.

(c) Show that the total market value of the shares at the end of the accounting year will remain the same whether dividends are either distributed or not distributed. Also find out the current market value of the firm under both situations.

Q8 Household Appliances Ltd. deals with consumer durables, having an annual turnover of Rs. 80 lacs, 75% of which are credit sales effected through a large number of dealers while the balance sales are made through show rooms on cash basis. Normal credit allowed is 30 days.

The company proposes to expand its business substantially and there is good demand as well. However, the marketing manager finds that the dealers have difficulty in holding more stocks due to financial problems. He, therefore, proposes a change in the credit policy as follows:

Proposal	Credit Period	Expected Credit Sales
Plan I	60 days	Rs. 70,00,000
Plan II	90 days	Rs. 75,00,000

The products yield an average contribution of 25% on sales. Fixed costs amount to Rs. 5,00,000 per annum. The company expects a pre-tax return of 20% on capital employed.

The finance manager after a review of the proposal has recommended increasing the provision for bad debts from the current 1% to $1_{1/2}$% for plan I and to 2% for plan II.

Evaluate the merits of the new proposals and recommend the best policy.

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