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SARDAR PATEL UNIVERSITY
MASTER OF BUSINESS ADMINISTRATION EXAMINATION
SECOND SEMESTER

1st May 2008, Thursday

CC-112 Financial Management

Time:11.00 a.m. to 2.00p.m. **Weightage:70%**

Note: It is a closed book examination.
All the questions carry equal weight and Figures to the right indicate the marks.

Q-1: (A) Explain the Following briefly. (08)

1. MPBF as per method II is________
2. Write down the equation of Sinking Fund Factor__________
3. What is Fischer's intersection rate?
4. Du-Pont Equation is__________
5. What do you mean by the term "gearing on Equity"?
6. Spontaneous Financing means?
7. Graphically explain MM- proposition II under Capital Structure.
8. Market risk premium is measured as__________

(B) Comment on MM's Dividend irrelevance Model. Alpha company has a cost of equity capital of 10%, the current market value of the firm is Rs.20,00,000 (@Rs.20 per share). The Values of Investment, Earning & Dividend at the end of the year are Rs.6,80,000, Rs.1,50,000 and Rs.1 per share. Show that under MM assumptions, the payment of dividend dose not affect the value of the firm (with mathematical calculation). (06)

Q-2: (A) From the following balance sheet of XYZ Ltd. Make out statement of changes in working capital, and fund flow statement: (11)

Liabilities	19X1	19X2	Assets	19X1	19X2
Equity shares Capital	3,00,000	4,00,000	Goodwill	1,00,000	80,000
8% Redeemable Preference Capital	1,50,000	1,00,000	Land & Building	2,00,000	1,70,000
Capital Reserve	------	20,000	Plant	80,000	2,00,000
General Reserve	40,000	50,000	Investments	20,000	30,000
Profit & Loss A/c	30,000	48,000	Sundry Debtors	1,40,000	1,70,000
Proposed Dividend	42,000	50,000	Stock	77,000	1,09,000
Sundry Creditors	25,000	47,000	Bills Receivables	20,000	30,000
Bills Payable	20,000	16,000	Cash in Hand	15,000	10,000
Liabilities for expenses	30,000	36,000	Cash at Bank	10,000	8,000
Provision for taxation	40,000	50,000	Preliminary expenses	15,000	10,000
	6,77,000	8,17,000		6,77,000	8,17,000

Additional Data:

(1) A Piece of land has been sold out in 19X2 and profit on sale has been carried to capital reserve.
(2) A machine has been sold for Rs.10,000. The written down value of the machine was Rs.12,000. Depreciation of Rs.10,000 is charged on plant account in 19X2.
(3) The investments are trade investments; Rs.3,000 by way of dividend is received including Rs.1,000 from pre-acquisition profit which has been credited to investment account.
(4) An interim dividend of Rs.20,000 has been paid in 19X2.

(B) What is the CAPM approach for calculating the cost of equity? (03)

Q-3: (A) "The Profit Maximization is not an operationally feasible criterion." Do you agree? Illustrate your answer. (06)

(B) A firm purchases a machinery for Rs.8,00,000 by making a down payment of Rs.1,50,000 and remainder in equal installments of Rs.1,50,000 for six years. What is the rate of interest to the firm?(04)

(C) For A Ltd. Then following data is available: (04)

Particular	Amount (in Rs.)
EBIT	200
Contribution	400
Interest	100

If the company's sales are expected to decline by 5%, determine the percentage change in EPS.

Q-4: (A) The values of the two firms P & Q in accordance with the traditional theory are given below. (05)

Particulars	Firm P Amount (in Rs.)	Firm Q Amount (in Rs.)
Expected net operating income	50,000	50,000
Interest	0	10,000
Net Income	50,000	40,000
Cost of equity	0.10	0.11
Market value of Share	5,00,000	3,60,000
Market value of Debt	0	2,00,000
Total value of firm	5,00,000	5,60,000
Average cost of capital	0.10	0.09
Debt-equity ratio	0	0.556

Compute the values for firms P & Q as per the MM thesis. Assume that
(i) corporate income taxes do not exist and
(ii) the equilibrium value of Ko is 12.5 per cent.

(B) Explain the trade off between risk & return from the level of current assets to fixed assets and short term finance to long-term finance. (05)

(C) A large sized Fertilizer company has been expected to grow at 14% per year for the next four years and then to grow indefinitely at the 5%. The required rate of return on the equity shares is 11%. Assume that the company paid a dividend of Rs.3 per share last year. Determine the market prices of shares today. (04)

Q-5:(A) Pawan Industries Ltd. Is planning to introduce a new product with a projected life of 8 years. The Project, to be set up in a backward region, qualifies for a one time (at its starting) cash-free subsidy from the Government of Rs.20,00,000. Initial Equipment cost will be Rs.1,40,00,000 and additional equipment costing Rs.10,00,000 will be needed at the beginning of the third year. At the end of the 8 years, the original equipment will have no resale value, but the supplementary equipment can be sold for Rs.1,00,000. A working capital of Rs.15 lakh will be needed. The sales volume (units) over the 8-year period has been forecasted as follows: (11)

Year 1	80,000
2	1,20,000
3-5	3,00,000
6-8	2,00,000

A sale price of Rs.100 per unit is expected, and variable expenses will amount to 40% of sales revenue. Fixed cash operating costs will amount to Rs.16,00,000 per year. In addition, an extensive advertising campaign will be implemented, requiring annual outlays as follows:

Particulars	Rs.
Year 1	30,00,000
2	15,00,000
3-5	10,00,000
6-8	4,00,000

The company is subject to 35% tax rate & considers 12 % to be appropriate after cost of capital rate for this type of project. The company follows straight line depreciation method and the same is accepted for tax purposes.

Should the project be accepted? Assume that the company has enough income from its existing products.

) Suraj Company has annual sales of Rs.24,00,000. The selling price per unit is Rs.10 and variable cost is 70% of the selling price. The required rate of return on investment is 20%, average cost Rs.9 per unit, annual collection expenditure, Rs.50,000 and percentage of default, 3 %; credit terms, 2 months. Suraj is considering the change in credit policy by following Programme A, or Programme B. (03)

Particulars	**Programme**	
	M	N
Average collection period (months)	1.5	1
Average collection expenditures (Rs.)	75,000	1,50,000
Percentage of default (%)	2	1

Determine which collection programme should Suraj follow?
