C 61130 (Pages : 4) Name..................................

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SECOND SEMESTER M.B.A. DEGREE EXAMINATION, MAY/JUNE 2019

(CUCSS)

M.B.A.

BUS 2C 11—FINANCIAL MANAGEMENT

(2016 Admissions)

Time : Three Hours Maximum : 36 Weightage

Part A

Answer the following.
Each question carries 1 weightage.

1. How does wealth maximization different from profit maximization ?
2. If capital rationing is not optimal, why would any company use it ?
3. What is an annuity ? What is the difference between ordinary annuity and annuity due ?
4. What is the fundamental goal of firm's credit policy ?
5. What does financial signalling mean in relation to stock split and stock repurchase ?
6. What is meant by cost of capital ?

(6 × 1 = 6 weightage)

Part B

Answer any **four** *questions.*
Each question carries 3 weightage.

7. Discuss the financial manager's role in raising funds and allocating funds ?
8. Describe the traditional view on the optimal capital structure. Compare and contrast with NOI approach and NI approach.
9. Silicon Company currently pays a dividend of Re. 1 per share and has a share price of Rs. 20.
   - (a) If this dividend was expected to grow at a 12 percent rate forever, what is the firm's expected, or required, return on equity using a dividend discount model approach?
   - (b) Instead of the situation in part (a), suppose that the dividend was expected to grow at a 20 percent rate for five years and at 10 percent per year thereafter. Now what is the firm's expected, or required, return on equity ?

Turn over

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10. Arush Corporation currently gives credit terms of net 30 days. It has Rs. 60 million in credit sales, and its average collection period is 45 days. To stimulate demand, the company may give credit terms of net of 60 days. If it does instigate these terms, sales are expected to increase by 15 percent. After the change, the average collection period is expected to be 75 days, with no difference in payment habits between old and new customers.

    Variable costs are Re. 0.80 for every Re. 1.00 of sales, and the company's before-tax required rate of return on investment in receivables is 20 percent. Should the company extend its credit period ? (Assume a 360-day year.)

11. Emkay Company was recently formed to manufacture a new product. It has the following capital structure in market value terms :

	Rs.
Debentures	... 6,000,000
Preferred stock	... 2,000,000
Common stock (320,000 shares)	... 8,000,000
	16,000,000

    The company has a marginal tax rate of 40 percent and the required return on equity is about 17percent. The Company's debt is currently yielding 13 percent, and its preferred stock is yielding 12 percent. Compute the firm's present weighted average cost of capital.

12. "The assumptions underlying the MM dividend irrelevance theory are unrealistic." Explain and illustrate.

(4 × 3 = 12 weightage)

Part C

Answer any **three** *questions.*
Each question carries 4 weightage.

13. Greaves Ltd. is considering the finalization of the capital structure. Accordingly, the firm expects the EBIT of Rs. 1,50,000 per annum on an investment Rs. 5,00,000. The company has access to raise funds of varying amounts by issuing equity share capital, 12% preference share and 10 % debenture or any combination thereof. Suppose, it analyzes the following four options to raise the required funds of Rs. 5,00,000.

    (a) By issuing equity share capital at par.

    (b) 50 % funds by equity share capital and 50 % funds by preference shares.

    (c) 5 % funds by equity share capital, 25 % by preference shares and 25 % by issue of 10% debentures.

    (d) 25 % funds by equity share capital, 25 % as preference share and 50% by the issue of 10% debentures.

    Assuming that Assuming Ltd. belongs to 35 % tax bracket, compute the EPS under the above four options.

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14. Is an increase in the collection period necessarily bad ? Discuss.

15. Amber Company is considering a new product line to supplement its range line. It is anticipated that the new product line will involve cash investment of Rs. 7,00,000 at time 0 and Rs. 10,00,000 in year 1. After-tax cash inflows of Rs. 2,50,000 are expected in year 2, Rs. 3,00,000 in year 3, Rs. 3,50,000 in year 4, and Rs. 4,00,000 each year thereafter through year 10. Though the product line might be viable after year 10, the company prefers to be conservative and end all calculations at that time.

    (a) If the required rate of return is 15 percent, what is the net present value of the project ? Is it acceptable ?

    (b) What is its internal rate of return ?

    (c) What would be the case if the required rate of return was 10 percent ?

    (d) What is the project's payback period ?

16. Anjani Limited and Bright Limited are identical except for capital structures. Anjani has 50 percent debt and 50 percent equity financing, whereas Bright has 20 percent debt and 80 percent equity financing. (All percentages are in market value terms.) The borrowing rate for both companies is 13 percent in a no-tax world, and capital markets are assumed to be perfect. The earnings of both companies are not expected to grow, and all earnings are paid out to shareholders in the form of dividends.

    If you own 2 percent of the common stock of Anjani, what is your Rupee return if the firm has net operating income of Rs. 360,000 and the overall capitalization rate of the firm, k_0, is 18 percent ? What is the implied equity capitalization rate, ke ?

17. Should companies in the same industry have approximately the same required rates of return on investment projects ? Why or why not ?

(3 × 4 = 12 weightage)

Part D

Compulsory *question.*
6 weightage.

18. Datamatics Company expects with some degree of certainty to generate the following net income and to have the following capital expenditures during the next five years (in thousands of Rupees) :

Year	:	1	2	3	4	5
Net income	:	2,000	1,500	2,500	2,300	1,800
Capital expenditure	:	1,000	1,500	2,000	1,500	2,000

The company currently has 1 million shares of common stock outstanding and pays annual dividends of Re. 1 per share.

Turn over

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(a) Determine dividends per share and external financing required in each year if dividend policy is treated as a residual decision.

(b) Determine the amounts of external financing that will be necessary in each year if the present annual dividend per share is maintained.

(c) Determine dividends per share and the amounts of external financing that will be necessary if a dividend-payout ratio of 50 percent is maintained.

(d) Under which of the three dividend policies are aggregate dividends (total dividends over five years) maximized ?

($1 \times 6 = 6$ weightage)

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