Seat No.: _____ Enrolment No.______

GUJARAT TECHNOLOGICAL UNIVERSITY

M.B.A. Sem-II Examination May 2011

Subject code: 820003 Subject Name: Financial Management

Date:25/05/2011 **Time: 10.30 am – 01.30 pm**
Total Marks: 70

Instructions:

1. **Attempt all questions.**
2. **Make suitable assumptions wherever necessary.**
3. **Figures to the right indicate full marks.**

Q.1 (a) "The importance of finance function as a management activity has increased in modern time" Explain. **07**

(b) The Hero limited has to make a choice between debt issue and equity issue for raising capital for the expansion of its business. Its current position is as follows. **07**

Particulars	Amount in Rs.
Debt 5%	40,000
Equity capital (Rs.10/Share)	1,00,000
Surplus	60,000
Total capitalisation	2,00,000
Sales	6,00,000
Less: Total costs	5,38,000
Income before interest and tax	62,000
Less: Interest	2,000
Income before tax	60,000
Income tax @ 50%	30,000
Income after tax	30,000

The expansion is estimated to cost Rs.1, 00,000. If this is financed through debt, the rate of new debt will be 7% and the price earning ratio will be 6 times. If the expansion is financed through equity shares, the new shares can be sold at Rs.25 per share, and price earning ratio will be 7 times. The expansion will generate additional sales of Rs.3,00,000 with a return of 10% on sales before interest and tax.

If the company is to follow a policy of maximising the market value of its shares, which form of financing should it choose?

Q.2 (a) Explain the factors which determine the amount of working capital in a business. **07**

(b) "Maximisation of profit is regarded as the main objective of investment decision, but it is not as exclusive as maximising shareholders' wealth." Comment. **07**

OR

(b) Why does money have time value? Explain "compounding" and "discounting" terms in time value of money. **07**

Q.3 (a) Asha Limited issued 12 percent callable bonds with a par value of Rs.300. The bond currently selling for Rs.285. Maturity period is 8 years. Due to reduction in interest rates company called back bonds after 4 years and paid Rs.315. Determine YTC. **07**

(b) Ajay limited uses a 10 percent discount rate for project appraisal. It is considering purchasing a machine which, when it comes to the end of its economic life, is expected to be replaced by an identical machine and so on, continuously. The machine has a maximum life of 3 years but, as its productivity declines with age, it could be replaced after either one or two years. The financial details are as follows. **07**

(Rs. In 000')

Year	0	1	2	3
Purchase of Machine	(5000)	-	-	-
Sales	-	4500	4000	3500
Cost	-	(2000)	(1750)	(1750)
Scrap value of machine	-	3300	2000	750

Note: figure in bracket indicates cash outflows.
Decide when the machine is to be replaced.

OR

Q.3 (a) G limited has invested Rs.500 lacs in assets. There are 50 lacs shares outstanding. The par value per share is Rs.10. It earns a rate of 15% on its investment and has a policy of retaining 50% of earnings. If the appropriate discount rate of the company is 10%, what is the price of its shares using the Gordon's model? What will happen to the price of the share if the company has a payout of 80% or 20%? **07**

(b) A company is considering an investment proposal to install a new machine. This project will cost Rs.1,00,000 and will have 5 years life with no salvage value. Tax rate is 50 percent; the company follows straight line method of depreciation. The earnings before depreciation and tax as follows. **07**

Years	1	2	3	4	5
EBDT(Rs.)	20,000	22,000	28,000	30,000	50,000

Evaluate the project using
(1) Pay Back Period
(2) Profitability Index at 10%
(3) Accounting Rate of Return

Q.4 (a) Critically examine the assumptions underlying the Irrelevance hypothesis of Modigliani and Miller (MM) regarding dividend distribution. **07**

(b) Prepare a Cash budget for the months of May, June and July 2009 on the basis of the following information: **07**

(1) Income and Expenditure forecasts:

Months	Credit Sales	Credit Purchases	Wages	Manufacturing Expenses	Office Expenses	Selling Expenses
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
March	1,20,000	72,000	18,000	8,000	4,000	8,000
April	1,24,000	76,000	16,000	6,000	3,000	10,000
May	1,30,000	66,000	20,000	9,000	5,000	9,000
June	1,16,000	70,000	17,000	7,000	4,000	7,000
July	1,12,000	78,000	19,000	8,000	2,000	9,000
August	1,20,000	68,000	16,000	6,000	3,000	9,000

(2) Cash balance on 1st May 2009, Rs.16,000.
(3) Plant costing Rs.32,000 is due for delivery in July, payable 10% on delivery and the balance after 3 months.
(4) Advance tax of Rs.16,000 each is payable in March and June.
(5) Period of credit allowed (i) by suppliers- two months and (ii) to customers- one month.
(6) Time lag in payment of manufacturing expenses- ½ month.
(7) Time lag in payment of office and selling expenses- 1 month.

OR

Q.4 (a) Explain net income approach (NI) and net operating income (NOI) approach of capital structure in brief. **07**

(b) From the following data, prepare a statement showing working capital requirement for the year 2009. **07**

(i) Estimated output for the year 1,30,000 units (52 weeks).
(ii) Stock of raw materials 2 weeks and material in process for 2 weeks, 50%of wages and overheads are incurred.
(iii) Finish goods remain in storage for 2 weeks.
(iv) Creditors 2 weeks.
(v) Debtors 4 weeks.
(vi) Outstanding wages and overheads 2 weeks each.
(vii) Selling price per unit Rs.15.
(viii) Analysis of cost per unit is as bellows.

Raw materials – Rs. 5 per unit.
Labour Rs. 3 per unit
Overheads Rs. 2 per unit.
Profit Rs. 5 per unit.

Assume the operations are evenly spread throughout the year.

Q.5 (a) Give meaning of leasing, hire purchase and venture capital. Distinguish between leasing and hire purchase. **07**

(b) Define working capital. Distinguish between permanent and temporary working capital. **07**

OR

Q.5 (a) What do you understand by term internal rate of return? Is it the same as the value determine under net present value method? **07**

(b) From the following capital structure of Anand Limited, calculate weighted average cost of capital, using (i) book value weights (ii) market value weights. **07**

Particulars	Book value (Rs.)	Market Value (Rs.)
Equity shares, each of Rs.10	90,000	1,80,000
Retained earnings	30,000	-
Preference share capital	20,000	20,000
Debentures	60,000	60,000

The after tax cost of capital for different source is as follows:
Equity share capital: 14%, Retained earnings: 13%, Preference share capital: 10% and Debentures: 5%.

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