AC-25114 Seat No._________

M. B. A. Examination

April/May – 2003

Financial Management

Time : **2** Hours] [Total Marks : **50**

Instructions : (1) There are **four** questions. Figures to the **right** of the question indicate the marks for the question.
(2) Use of calculator and present value tables is permitted.

1 Answer any **two** :

(a) Explain the three major areas of financial decisions in a firm. **7**

(b) Explain the important functions performed by primary and secondary markets. **7**

(c) Solve the following :

(1) The following information is available for *Gayatri Infotech Ltd* : **4**

Profit After Tax	: Rs. 400 lakh
No. of Shares outstanding	: 20 lakh
Return on Investments	: 20%
Return required by shareholders	: 16%
Dividend pay out ratio	: 40%

What will be the ideal price of the share as per the Gordon model ? If the current market price is 210, is the share under or overvalued ?

(2) What is the present value of an income stream that generates Rs. 3,000 each year from years 1 to 3 and Rs. 7,000 each year from years 4 to 10, if the discount rate is 10% p.a. ? **3**

(d) Solve the following :

(1) The stock of *Vivek Ltd*. performs well relative to other stocks during recessionary period. The stock of *Rai Ltd*. on the other hand, does well during growth periods. Both the stocks are currently selling for Rs. 50 per share. The rupee return (dividend plus price change) of these stocks for the next year would be as follows : **4**

	Economic Condition			
	High growth	Low growth	Stagnation	Recession
Probability	0.3	0.3	0.2	0.2
Return on Vivek Ltd.	10%	1%	20%	40%
Return on Ria Ltd.	50%	30%	3%	1%

Calculate the expected return and standard deviation of :

(1) Rs. 1,000 in equity stock of Vivek Ltd.

(2) Rs. 1,000 in equity stock of Rai Ltd.

(3) Rs. 500 in Vivek Ltd. and Rs. 500 in Rai Ltd.

(2) *Dewaliya Company Pvt. Ltd*. issues new 15 percent debentures of Rs. 1,000 face value to be redeemed after 10 years at par. It will involve flotation costs of 2.5 percent. What would be its post–tax cost of debt if the company's tax rate were 35% ? **3**

2 Answer the following :

(a) What are the motives for holding cash ? What is the optimal cash balance for a firm ? **6**

(b) *Rasik Music Co. Ltd*. reported the following income statement for the year 2002–03 : **6**

		Rs. in lakh
Sales		150.0
Less : Operating Expenses		
Raw Materials	60.0	
Wages & Salaries	30.0	
Depreciation	15.0	
General administration & Selling exp.	15.0	
Total operating expenses		120.0
EBIT		30.0
Less : Interest expenses		7.5
PBT		22.5
Less : Income Tax		10.0
PAT		12.5
Less : Preferred dividends		2.5
Equity Earnings		10.0
EPS (2,50,000 shares outstanding)		Rs. 4.00

All depreciation and 60% of the firm's general, administrative, and selling expenses are fixed costs and the remainders of the firm's expenses are variable costs :

(a) Based on these data determine the firm's DOL, DFL and DTL.

(b) Assuming that next year's sales increase by 15% fixed operating and financial costs remain constant, and the variable cost ratio and tax rate also remain constant, forecast next year's EPS based on the leverage information you have.

OR

2 Answer the following :

(a) Why is it desirable to have a stable dividend rate ? Is it possible to have a stable dividend rate under residual dividend policy ? **6**

(b) *M/s. Sabkuchchh Milega Ltd.* have recently set up a retail outlet in Ahmedabad. To get a better control on the cash flows, they require you to prepare a cash budget for the quarter from April to June, 2003 : **6**

– Sales are expected to be Rs. 10,00,000 in Apr. and Rs. 12,00,000 in May and Rs. 13,00,000 in Jun. All sales will be in cash.

– The estimated purchases are : Rs. 5,00,000 in Apr., Rs. 5,55,000 in May and Rs. 6,50,000 in June. Payments of purchases will be made after a lag of one month. Outstanding on account of purchasing in March last are Rs. 4,45,000.

– The interest cost per month is Rs. 2,50,000.

– Salaries and other expenses, payable in cash, are expected to be Rs. 2,50,000 in Apr., Rs. 2,75,000 in May and Rs. 3,00,000 in June.

– The plan to spend Rs. 3,75,000 on the interiors in cash in May.

– They would incur an outflow of Rs. 3,00,000 as advance tax in the month of June.

– The cash balance at present is Rs. 75,000. The target cash balance is Rs. 50,000. What will be the surplus and deficit of cash in relation to the target cash balance ?

3 Answer the following :

(a) What are the reasons behind mergers and acquisitions taking place ? **6**

(b) Explain the following concepts : **6**

(1) EOQ model

(2) Purchasing power party.

OR

3 Answer the following :

(a) What are the various risk exposures that companies face in international dealings ? **6**

(b) Explain : **6**

(1) Systematic and unsystematic risk

(2) Limitations of profit maximization objectives.

4 LPB Ltd. has a proposal for manufacturing car televisions. The project would involve cost of plant of Rs. 550 lakh, installation cost of Rs. 50 lakh and working capital margin of Rs. 125 lakh. The annul capacity of the plant is to manufacture 20,000 sets. The price per set would be Rs. 12,000. The variable costs ratio is expected to be 65 percent. The fixed cost per annum would be Rs. 300 lakh (without including depreciation). The company would have to incur promotion expenditure of Rs. 120 lakh in the first year. Depreciation is considered on SLM basis for tax as well as reporting purposes. The plant has an economic life of 5 years after which the salvage value of the plant would be Rs. 100 lakh, while the working capital margin would be fully recoverable. The capacity utilization of the plant during the five years is: 25%, 55%, 90%, 100% and 100% respectively. **12**

The current risk free rate of interest in the economy is 6.5%, while the market risk premium on equity is 8%. The beta for equity of similar television manufacturing companies is 1.25. The rate at which the bank lends to similar companies is 11% and the corporate tax rate is 35% :

(1) The company may finance the project with a debt equity ratio of 1, if the bank grants the loan.

(2) If the bank refuses to grant the loan, the company may finance the entire project with equity.

Find out if the company should accept the project proposal in both the cases.