MBA(IB)II/05.14.0543

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# MBA (INTERNATIONAL BUSINESS) DEGREE II SEMESTER EXAMINATION MAY 2014

## SMI 2202 FINANCIAL MANAGEMENT

*(Supplementary – Prior to 2012 Admissions)*

Time: 3 Hours Maximum Marks : 50

(5 x 10 = 50)

I. "The profit maximization is not an operationally feasible criterion in judging the efficiency of financial management." Do your agree? In what ways wealth maximization objective is superior to profit maximization?

**OR**

II. Define financial management. What are the basic financial decisions that a financial manager has to take? How do they involve risk return trade off?

III. Consider the following information in respect of Aravind Limited.

| | | |
|---|---|---|
| EBIT | = | ₹1,120 lakhs |
| PBT | = | ₹320 lakhs |
| Fixed Cost | = | ₹700 lakhs |

a. Calculate the degree of operating leverage.

b. Calculate the degree of financial leverage.

c. Calculate the degree of combined leverage.

d. Calculate the percentage change in earnings per share if sales increased by 5%.

**OR**

IV. AB limited estimates the cost of equity and debt components of its capital for different levels of debt and equity mix as follows. The rate of income tax applicable is 50%. Suggest the best debt equity mix to the company.

| Debt as a percentage of total capital | Cost of equity in % | Cost of debt (before tax) in % |
|---|---|---|
| 0 | 16 | 12 |
| 20 | 16 | 12 |
| 40 | 20 | 16 |
| 60 | 24 | 20 |

V. Explain the effect of capital structure decision on the value of the firm when both corporate and personal income taxes are considered.

**OR**

VI. Firm A and firm B are similar except that firm A is unlevered, while firm B has ₹200,000 of 5% debentures outstanding. Assume that tax rate is 40%. NOI is ₹40,000 and the cost of equity is 10%.

(a) Calculate the value of the firm if MM assumptions are met

(b) Suppose value of B is ₹360,000 according to MM theory, do these represent equilibrium value? How will equilibrium be set?

(P.T.O.)

VII. "Risk and uncertainty are quite inherent in capital budgeting decisions" How would a financial manager respond under uncertainty?

**OR**

VIII. A company is planning to buy equipment. Two equipments A and B are under consideration. Equipment A has a cost of ₹75,000 and net cash flow of ₹20,000 per year for six years. A substitute equipment B would cost ₹50,00 and generates net cash flow of ₹14,000 per year for six years. The required rate of return of both equipments is 11%. Calculate the IRR, NPV and PI of the equipments. Which equipment must be accepted? Why?

IX. The proforma cost sheet of a company provides the following data.

| *Particulars* | *Cost per unit in* ₹ |
|---|---|
| Raw materials | 52.00 |
| Direct labour | 19.50 |
| Overheads | 39.00 |
| Total cost per unit | 110.50 |
| Profit | 19.50 |
| Selling price | 130.00 |

The following additional information is also given.

(a) Average raw materials in stock = 1 month
(b) Average materials in process = half a month
(c) Credit allowed by suppliers = 1 month
(d) Credit allowed to debtors = 2 months
(e) Time lag in wage payment = 1 ½ week
(f) Time lag in payment of overheads = 1 month
(g) One fourth of sales are on cash basis.
(h) Cash balance is expected to be ₹120,000

You are required to prepare a statement showing the working capital needed to finance a level of activity of 70,000 units of output. Assume that production is carried on evenly throughout the year and wages and overheads accrue similarly.

**OR**

X. The earnings per share of a company are Rs.10. It has an internal rate of return of 15% and the capitalization rate of its risk class is 12.50%. If Walter's model is used:

(a) What should be the optimum payout ratio?

(b) What should be the price of the share at this payout?

(c) What should be the price of the share if the payout ratio is 20%.

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