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INSTITUTE OF MANAGEMENT STUDIES
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END SEMESTER EXAMINATION (APRIL – MAY 2024)
MBA (FINANCIAL ADMINISTRATION) SEMESTER II
FINANCIAL MANAGEMENT

Instructions:

- Sub questions of the main question should be done in continuation.
- No marks will be awarded for reproducing the facts given in the question.
- No marks will be awarded for wrong steps.
- Show calculations and steps wherever necessary.
- Strictly follow word limit wherever given.
- Each question is of 12 marks.

SECTION – A

Attempt any 01 question from this section.

Q.1. A financial analyst regularly involved with the appraisal of the new projects commented "We project the revenues and cost as they are prevailing today and project them for the life of the project and use the discount rate derived from the market conditions. Since the revenue and cost offset each other, we do not need to account for inflation in the capital budgeting proposals". Do you agree with the statement? Give reason for your answer. Your answer should be in bullet points. **[Max 250 Words]**

Q2. If a firm went from zero debt to successively higher levels of debt, why would you expect its stock price to first rise, then hit a peak, and then begin to decline? **[Max 250 Words]**

Q3. Capital rationing is a hypothetical situation for a good successful firm because it would always find sufficient funds from the equity or debt markets so as to accept all profitable ventures that are on hand. Do you agree? Justify your answer. **[Max 250 Words]**

SECTION – B

Attempt any 04 questions from this section.

Q.4.(a) After 10 years Mr. X will start receiving a pension of Rs. 2000/- per annum. The payments are expected to continue for next 16 years. How much is the pension worth now if Mr. X's interest rate is 10%.

Q.4.(b) ABC Ltd. has Rs. 10 crore bonds outstanding. Bank deposit earns 10% per annum. The bonds will be redeemed after 15 years for which purpose ABC Ltd. wishes to create a sinking fund. How much amount should be deposited to the sinking fund each year so that ABC Ltd. would have in the sinking fund Rs. 10 crores to retire its entire issue of bonds?

Q.5. Royal Industries Ltd. a well-established firm in the plastics, is considering the purchase of one of the two manufacturing companies. The financial manager of the company has developed the following information about the two companies. Both the companies have total assets of Rs. 15,00,000.

	X. Ltd.	Y. Ltd.
Sales Revenue	Rs. 30,00,000	Rs. 30,00,000
Cost of Goods Sold	22,50,000	22,50,000
Selling Expense	2,40,000	2,40,000
Administrative Expense	90,000	1,50,000
Depreciation	1,20,000	90,000
EBIT	**3,00,000**	**2,70,000**
Cost Break Ups: Variable Costs		
Cost of Goods Sold	9,00,000	18,00,000
Selling Expenses	1,50,000	1,50,000
Total	**10,50,000**	**19,50,000**

a) Prepare operating statements of both the companies, assuming that sales increase by 20%. The total fixed costs are likely to remain unchanged and the variable costs are a linear function of sales

b) Comment on the riskiness of both the firms.

c) If Royal Industries Ltd. wishes to buy a company which company should it purchase.

Q.6. ABC Ltd. is evaluating a project costing Rs. 800 lakh which is expected to give Profit Before Interest and Tax (PBIT) of Rs. 200 lakh per annum forever. Assume no depreciation and any other non-cash expense. The firm is in 40% tax bracket. **(a)** Using WACC of 12% find the NPV of the project. **(b)** Assuming that the project is funded through perpetual debt of Rs. 400 lakh (50% of original cost) at 10%, recompute the NPV of the project using cost of equity as discount rate.

Q7. A company is considering to raise Rs 2,00,000 to finance modernization of its plant. The following three financing alternatives are feasible:

(i) The company may issue 20,000 shares at Rs 10 per share,

(ii) The company may issue 10,000 shares at Rs l0 per share and 1,000 debentures of Rs 100 denomination bearing a 14 per cent rate of interest.

(iii) The company may issue 5,000 shares at Rs l0 per share and 1500 debentures of Rs 100 denominations bearing a 14 per cent rate of interest.

If the company's profits before interest are (a) Rs 5,000, (b) Rs 12,000, (c) Rs 25,000, what are the respective earnings per share, rate of return on total capital and rates' of return on total equity capital, for each of the three alternatives? Which alternative would you recommend and why? If the corporate tax rate is 35 per cent, what are your answers to the above questions? How do you explain the difference in your answers?

Q8. Combined Metals Ltd. are planning a simultaneous issue of debenture and preference share. The features of the debenture and preference shares are as below:

	Debentures	Preference Shares
Face Value	Rs. 100	Rs. 100
Issue Price	Rs. 99	Rs. 110
Coupon / Dividend Rate	8%	12%
Term	10 years	10 years
Redemption Price	Rs. 110	Rs. 100
Flotation Cost	1%	2%

(a) Assuming a tax rate of 40%, find the cost of debenture and preference share.

(b) What difference does it make to the shareholder if the capital is raised by issuing debenture or preference share? Which is advantageous? Assume EBIT level of Rs 100 and amount raised is Rs. 100.

(c) If the impact on shareholders wealth is not equal by issue of instruments, why should Combined Metals Ltd. issue the disadvantageous instrument?

Q9. (a) Assume that there are two firms A and B which are identical in all respects except that firm A has 12% Rs. 6,00,000 debentures. The Earnings Before Interest And Taxes of both the firms are equal i.e. Rs.1,25,000. The equity capitalization rate of the firm A is slightly higher (16%) than that of firm B (14%) Comment on the same assuming the MM hypothesis.

Q9. (b) The following is the information available for Arvind Regulators: Net Operating Income Rs. 50 lakhs; Interest on debt Rs. 12 lakhs; Cost of equity 18%; Cost of debt 12%. Compute (i) average cost of capital (ii) what happens to average cost of capital if it employs 120 lakh debt to finance a project which earns an operating income of Rs. 40 lakhs. Assume the net operating income NOI method applied and that there are no taxes.