4248 Your Roll No. ....

MBA (FT) **A**

Paper F-204— FINANCIAL MANAGEMENT

Time : 3 hours *Maximum Marks* : 70

(Write your Roll No. on the top immediately on receipt of this question paper.)

Attempt any five questions. All questions carry equal marks.

1. Global Systems Inc. Plans to open a new product line next year. The after tax cash inflows of the two plans is listed below. The firm's cost of capital is 15 percent. The initial investment for each plan is Rs5,00,000.

PLAN	YEAR 1	YEAR2	YEAR3	YEAR4	YEAR5
AB	Rs300	Rs325	Rs150	Rs225	Rs100
XY	Rs150	Rs200	Rs300	Rs325	Rs100

a) Construct the NPV profiles for PLAN AB and PLAN XY. Which PLAN has a higher IRR?

b) According to the NPV criterion which PLAN should Global Systems choose?

c) Calculate the cost of capital at which the NPV and the IRR rankings conflict?

d) Which plan should the company choose? Why?

2. a) Discuss the different approaches to working capital management.

b) Distinguish between the Baumol's model and Miller –Orr model of cash management.

3. Imagine that you were hired recently as a financial analyst for a

relatively new, highly leveraged ski manufacturer located in the foothills of Colorado's Rocky Mountains. Your firm manufacturers' only one product, a state-of-the-art snow ski. The company has been operating up to this point without much quantitative knowledge of the business and financial risks it faces.

Ski season just ended, however, so the president of the company has started to focus more on the financial aspects of managing the business. He has set up a meeting for next week with the CFO, to discuss matters such as the business and financial risks faced by the company. Accordingly, the CFO has asked you to prepare an analysis to assist her in her discussions with the president.

As a first step in your work, you compiled the following information regarding the cost structure of the company.

Output level	50,000 units
Operating assets	Rs2,000,000
Operating asset turnover	7 Times
Return on operating assets	35%
Degree of operating leverage	5 times
Interest expense	Rs 400,000
Tax Rate	35%

As the next step, you need to determine the break even point in units of output for the company. One of your strong points has been that you always prepare supporting work papers, which show how you arrive at your conclusions. You know the CFO would like to see such work papers for this analysis to facilitate her review of your work. Thereafter you will have the information you require to prepare an analytical income statement for the company. You are sure that the CFO would like to see this statement; in addition, you know that you need it to be able to answer the following questions. You also know that you are required to prepare a format that is presentable to the president, answers to the questions to serve as a basis for her discussions with the president.

a. What is the degree of financial leverage?
b. What is the degree of combined leverage?
c. What is the firm's break-even point in sales rupees?

d. If sales increase by 40 percent, by what percent would EBT and net income increase?

e. Prepare another analytical income statement, this time to verify the calculations from question.

4. 'A company's optimal capital structure can be U shaped or V shaped. It is the mix of debt and equity that maximizes the price of the company's stock.' Explain. In this context also discuss the Trade off and Pecking order theory.

5. As a member of the Finance Department of Ranch Manufacturing, your supervisor has asked you to compute the appropriate discount rate of use when evaluating the purchase of new packaging equipment for the plant. You have determined the market value of the firm's capital structure as follows:

Source of Capital	Market Values
Bonds	Rs4,000,000
Preferred stock	Rs2,000,000
Common stock	Rs6,000,000

To finance the purchase, Ranch Manufacturing will sell 10-year bonds paying 7 percent per year at the market price of Rs1, 050. Flotation cost for issuing the bonds are 4 percent of the market price. Preferred stock paying a Rs2.00 dividend can be sold for Rs25; the cost of issuing these shares is Rs3 per share. Common stock for Ranch Manufacturing is currently selling for Rs55 per share. The firm paid a Rs3 dividend last year and expects dividends to continue growing at a rate of 10 percent per year. Flotation costs for issuing new common stock will be Rs5 per share and the firm's tax rate is 30 percent. What discount rate should you use to evaluate the equipment purchase?

6. 'Dividend Payout ratios vary systematically across industries. Investment opportunities are comparable within an industry, but vary across industries.' Elucidate in the context of relevant and irrelevant theories of dividend behaviour.