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Third Semester MBA Degree Examination, Dec.2018/Jan.2019

Advanced Financial Management

Time: 3 hrs. Max. Marks:80

Note: 1. ***Answer any FOUR full questions from Q.No.1 to Q.No.7.***
2. ***Question No. 8 is compulsory.***

1 a. What is ABC Analysis? **(02 Marks)**

b. Determine the working capital leverage for the two companies Box Limited and Cox Limited from the information given below. Also comment on it. Assume 20% reduction in current assets.

Particulars	Box Limited	Cox Limited
Current assets	Rs.150 million	Rs.50 million
Net fixed assets	Rs.50 million	Rs.150 million
Total assets	Rs.200 million	Rs.200 million
EBIT	Rs.30 million	Rs.30 million
ROI	15%	15%

(06 Marks)

c. Modern Enterprises requires 90000 units of a certain item annually. It costs Rs.3 per unit. The cost per purchase order is Rs.300 and the inventory carrying cost is Rs.6 per unit per year.
i) What is Economic Order Quantity, if there is no quantity discount?
ii) What should the firm do if supplier offers discounts as below:

Order quantity	Discount %
4,500-5,999	2
6,000 and above	3

(08 Marks)

2 a. State any two relevance theories of dividends. **(02 Marks)**

b. What are the various short term sources of finance? Explain with their features. **(06 Marks)**

c. The two companies, U and L, belong to an equivalent risk class. These two firms are identical in all respects except that firm L has 10%, Rs.5,00,000 debentures. The EBIT of both the firms are equal to Rs.1,00,000. The equity capitalization rate (k_e) of firm L is higher (16%) than that of firm U (12.5%).

Particulars	Firm L	Firm U
EBIT	Rs.1,00,000	Rs.1,00,000
Interest	50,000	-
Earnings to equity holders	50,000	1,00,000
K_e	0.16	0.125
Total market value of equity	3,12,500	8,00,000
Total market value of debt	5,00,000	-
Total market value (V)	8,12,500	8,00,000
K_o	0.123	0.125
Debt equity ratio	1.6	-

An investor owns 10% equity shares of company L. Show the arbitrage process and the amount by which he could reduce his outlay through the use of leverage. **(08 Marks)**

3 a. What are motives of holding cash? **(02 Marks)**

b. State the assumptions of capital structure theories. **(06 Marks)**

c. H Ltd has at present annual sales level of 10000 units at Rs.300 per unit. The variable cost is Rs.200 per unit and fixed cost amount to Rs.3,00,000 per annum. The present credit period allowed by the company is 1 month. The company is considering a proposal to increase the credit period to 2 months and 3 months and has made the following estimates.

Particulars	Existing	Proposed	
Credit period (months)	1	2	3
Increase in sales (%)	-	15	30
Bad debts (%)	1	3	5

There will be increase in fixed cost by Rs.50,000 on account of increase in sales beyond 25% of present level. The company plans a pretax return of 20% on investment in receivables. You are required to calculate the most paying credit policy for the company. **(08 Marks)**

4 a. What is factoring? **(02 Marks)**

b. Two components, A and B are used as follows:
Normal usage : 50 units each per week
Minimum usage : 25 units each per week
Maximum usage : 75 units each per week
Reorder quantity : A – 300 units, B – 500 units
Reorder period : A – 4 to 6 weeks, B – 2 to 4 weeks
Calculate for each component: (i) Reorder level (ii) Minimum level (iii) Maximum level. **(06 Marks)**

c. Assuming no taxes and given EBIT, interest at 10% and equity capitalization rate (K_e) below:

Firms	EBIT	I	K_e (%)
X	Rs.2,00,000	Rs.20,000	12
Y	Rs.3,00,000	60,000	16
Z	Rs.5,00,000	2,00,000	15
W	Rs.6,00,000	2,40,000	18

Calculate the value of each firm and determine the weighted average cost of capital for each firm. **(08 Marks)**

5 a. What are the objectives of inventory management? **(02 Marks)**

b. The Asbestos company belongs to a risk class of which the appropriate capitalization rate is 10%. It currently has 1,00,000 shares selling at Rs.100 each. The firm is contemplating the declaration of a Rs.6 dividend at the end of the current fiscal year, which has just begun. Answer the following questions based on Modigliani and Miller model and the assumptions of no taxes.

i) What will be the price of the shares at the end of the year, if a dividend is not declared? What will it be if it is declared?

ii) Assuming that firm pays dividend, has a net income of Rs.10,00,000 and makes new investments of Rs.20,00,000 during the period, how many new shares must be issued? **(06 Marks)**

c. The following information is available in respect of a firm:
Capitalization rate (K_e) = 0.10
Earnings per share (E) = Rs.10
Assumed rate of return on investment r = 15%. Show the effect of dividend policy on the market price of shares, using Walter's model for different D/P ratios. **(08 Marks)**

6 a. What is deposit float? (02 Marks)
b. Write a note on credit policy variables. (06 Marks)
c. What is net income approach? How does it differ from NOI approach? (08 Marks)

7 a. What are bonus shares? (02 Marks)
b. Explain EBIT-EPS analysis. (06 Marks)
c. The annual cash requirement of A Ltd. is Rs.10 lakhs. The company has marketable securities in lot sizes of Rs.50,000, Rs.1,00,000, Rs.2,50,000 and Rs.5,00,000. Cost of conversion of marketable securities per lot is Rs.1,000. The company can earn 5% yield on its securities.
You are required to prepare a table indicating which lot size will have to be sold by the company. Also show that economic lot size can be obtained by the Baumol model. (08 Marks)

8 **CASE STUDY:**
The following results are expected by XYZ Ltd by quarters next year in thousands of rupees.

Particulars	Quarter			
	1	2	3	4
Sales	7,500	10,500	18,000	10,500
Cash payments:				
Production costs	7,000	10,000	8,000	8,500
Selling, administrative and other costs	1,000	2,000	2,900	1,600
Purchases of plant and other fixed assets	100	1,100	2,100	2,100

The debtors at the end of a quarter are one third of sales for the quarter. The opening balance of debtors is Rs.30,00,000. Cash on hand at the beginning of the year is Rs.6,50,000 and the desired minimum balance is Rs.5,00,000. Borrowings are made at the beginning of quarters in which the need will occur in multiples of Rs.10,000 and are repaid at the end of quarters. Interest charges are ignored. You are required to prepare:
a. Cash budget by quarters for the year.
b. State the amount of loan outstanding at the end of the year. (16 Marks)

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