

**END TERM EXAMINATION**

Second Semester [MBA] May-June 2016

Paper Code: MS-104

Subject: Financial Management

Time: 3 Hours

Maximum Marks: 75

*Note: Attempt any five questions.*

- Q1 (a) Mr. Ritesh is considering to take a life insurance policy of LIC for 20 years. The insurance agent is advising him to take a money-back policy. The Scheme offers money back at the end of 5<sup>th</sup>, 10<sup>th</sup>, 15<sup>th</sup> and 20<sup>th</sup> year to the extent of 25%, 25%, 25% and 50% of the insured amount. The premium he will have to pay is Rs. 62 annually for every Rs. 1000 insured. The insurance agent also informs him that he will get a minimum bonus to the extent of 40% at the end of the insurance term. Mr. Ritesh is of the opinion that the premium for the money back policy is on higher side. If the banks are offering a rate of 100% on the long term deposits, calculate the effective return on the policy and advise Mr. Ritesh. (10)
- (b) Mr. Suresh took a car loan of Rs. 5,00,000 repayable in annual equal installments for 8 years at 11% rate of interest. Find out the amount of annual payable installment. (5)
- Q2 (a) Mr. Ramesh is thinking of investing in equal shares of ABC Ltd. The face value of the shares is Rs. 10. He requires a return of 25% on his investment. ABC Ltd. declared a dividend of Rs. 5.00 per share for the current year and its is expected that the dividend of the company will grow at the rate of 30% for the next five years and after that at 20% for ever. Compute the maximum price which Mr. Ramesh may pay for the shares of ABC Ltd. (10)
- (b) A bond with a face value of Rs. 100 provides 12% annual return and pays Rs 105 at the time of maturity, which is 10 years from now. If investors' required rate of return is 13% at what price should the company issue the bond? (5)
- Q3 A government owned research organization needs sophisticated equipment for its research purposes. Three companies came forward to supply the machine whose quotations are as given below:-  
 Company A: Initial cost is Rs. 62,000 and annual maintenance cost is Rs 4,000 in the first year and increases by Rs. 1000 every year for the next 5 years. At the end of sixth year the machine can be sold for Rs. 12,000.  
 Company B: The initial cost is Rs. 85,000. The maintenance cost is Rs. 3,000 per year. But in the 4<sup>th</sup> year additional Rs. 9,000 should be spent for overhauling. Its scrap value at the end of 7<sup>th</sup> year is Rs. 15,000.  
 Company C: The machine costs Rs. 45,000 but its life is only 3 years with annual maintenance cost of Rs. 2,500. At the end of year 3, the company replaces the old machine with a new machine for Rs. 20,000. The new machine will last for another 2 years with an annual maintenance cost of Rs. 1,000 and a salvage value of Rs. 14,000 which option the organization should go for? Since it is a research organization it does not pay taxes but its cost of funds is 10%. (18)

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- Q4 The managers in an enterprise are responsible for the proper utilisation of the resources under their control. Since the resources are acquired in exchange for money, the decision of the managers will ultimately affect the financial condition of the organisation. In this sense it can be said that the finance function interfaces with major functions of the enterprise as well as the top management. Briefly explain the interface function of the finance function with marketing, and production functions and the top management. (15)
- Q5 (a) XYZ Ltd has a standard deviation of monthly net cash flows of Rs. 200. It's transaction cost of converting cash into marketable securities is Rs. 10 and the interest is 1% per month (12% p.a). The minimum cash balance required by the firm is Rs. 100. Set out the upper, lower and return limit of cash flow the firm. Also find out the average cash balance. Apply Miller-Orr Model. (10)
- (b) 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. 2,00,000, 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% annual 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 the economic lot size which can be obtained by Baumol Model. (5)
- Q6 A project involving an initial investment of Rs. 85 lakh has the following probability distribution of net cash flows during its life of four years.

Year 1		Year 2		Year 3		Rs. in Lakhs	
Net Cash Flow	Probability	Net Cash Flow	Probability	Net Cash Flow	Probability	Net Cash Flow	Probability
15	0.3	19	0.3	16	0.2	15	0.3
24	0.1	26	0.2	21	0.3	28	0.3
32	0.6	38	0.3	40	0.5	32	0.2

The cash flows for the various years are independent of each other. The net present value of the project is expected to be approximately normally distributed. The risk free rate is 8 percent. You are required to find out the probability that the internal rate of return will exceed the risk free rate. (15)

- Q7 Companies U and L are identical in all respects, except that U is unlevered while L is levered. Company L has Rs. 20,00,000 of 8% debentures outstanding. Assume (1) that all the MM assumptions are met, (2) that the tax rate is 40%, (3) that EBIT is Rs. 6,00,000 and that equity-capitalisation rate for company U is 10%. (15)

Required:-

- (a) What would be the value of each firm according to MM's approach  
 (b) Suppose  $V_u = \text{Rs. } 25,00,000$  and  $V_L = 45,00,000$ . According to MM, do they represent equilibrium values? If not explain the process by which equilibrium will be restored?

- Q8 (a) Explain the treatment of interest (paid and received) and dividend (paid and received) in operating cash flows and financing cash flows in view of the AS-3 revised. (10)
- (b) Give the format of cash flow statement under direct method as per AS-3 (Revised). (8)