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**Presidency University**

**Bengaluru**

**School of Management**

**Summer End-Term Examination - Aug 2024**

**Date**: 5th AUG 2024

**Time**: 9:30am – 12:30pm

**Max Marks**: 100

**Weightage**: 50%

**Semester**: II

**Course Code**: MBA2024

**Course Name**: Financial Management

**Department:** SOM

**Instructions:**

1. *Read the all questions carefully and answer accordingly.*
2. *Do not write any information on the question paper other than roll number.*
3. *Question paper consists of 3 parts.*

**PART A**

**Answer any 10 Questions. Each question carries 3 marks. (10Qx 3M= 30)**

1. Profit maximization and wealth maximization are the objectives of financial management. Distinguish between the two. (CO:02 Knowledge)
2. Distinction between ownership and management. State the reason for agency problem and how to reduce it. (CO:01Knowledge)
3. In the context of finance, ethics are particularly important. Reproduce the significance of ethics in finance. (CO:02 Knowledge)
4. When an individual buys a share, they become a part-owner of the company. Recall the type of long term sources of funds mentioned. (CO:02 Knowledge)
5. The shareholders’ value theory believes that the value could be added to equity owners through the market value of the shares and dividends. Recall any three significance of dividend on shareholders’ value. (CO:02 Knowledge)
6. **Suresh who has recently purchased stocks worth Rs. 7,000. Now, he came to realize that the market is currently expected to generate a return of 7% during the next year, while the 10-year treasury bills are trading at 4% per annum. The stocks purchased by him have a beta of 1.5 when compared to the market. Calculate expected rate of return for Aneesh based on the capital asset pricing model.** (CO:03 Knowledge)
7. Madhu has purchased shares of Tata Motors worth Rs. 12,000. The risk free rate in the economy is 6%. Given market risk premium of 12% with a beta of 1.3, **Calculate expected rate of return for Madhusudan based on the capital asset pricing model.** (CO:03 Knowledge)

1. **Ram had purchased in shares of SBI one year back worth Rs. 7,000. During that period, the overall market has grown by 8%, while the stock purchased by him has generated a return of 9%. The relevant 10-year treasury bills are trading at 4.5% per annum. The stocks purchased have a beta of 1.2 when compared to the market. The investor wants to evaluate whether the stock generated adequate return given its risk level. Help the investor to calculate the expected rate of return based on the capital asset pricing model.** (CO:03 Knowledge)
2. Based on the capital asset pricing model and given risk level of the stocks, the expected rate of return of the stocks is 8.7%, while the investor has realized an actual return of 9.0%. Therefore, the investment has generated an adequate return to beat the expected rate of return. (CO:02 Knowledge)
3. Dividend is the reward of the shareholders for the investments made by them in shares of the company. Companies follow different types of dividend policy. A firm should follow a policy of very high-dividend pay-out. Do you agree? Justify your answer. (CO:02 Knowledge)
4. List the impact of dividend decision announcement on the market price of the shares of a company. (CO:02 Knowledge)
5. Dividend is that part of profit after tax which is distributed to the shareholders of the company. Recall any three significance of dividend on shareholders’ value. (CO:03 Knowledge)

**PART B**

**Answer any 4 Questions. Each question carries 10 marks. (4Qx 10M= 40)**

1. Mr. syam is planning for his retirement. He is 45 years old today, and would like to have ₹400000 when he attains the age of 60. He intends to deposit a constant amount of money at 12 percent each year in public provident fund in the state Bank of India to achieve his objective. How much money should Mr. Ram invest at the end of each year, for the next 15 years, to obtain ₹ 300000 at the end of that period? (CO:02 Application)
2. You have just graduated and need money to buy a new car. Your rich uncle Henry will lend you the money as long as you agree to pay him back within four years, and you offer to pay him the rate of interest that he would otherwise get by putting his money in a saving account. Based on your earnings and living expenses, you think you will be able to pay him $10000 in one year and then $8000 each year for the next three years. If uncle Henry would otherwise earn 6% year on saving, how much can you borrow from him? (CO:03 Application)
3. From the following prepare Income statement of company A, B and C(CO:02 Application)

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Company A | Company B | Company C |
| Financial Leverage | 3:1 | 4:1 | 2:1 |
| Interest | Rs.200 | Rs.300 | Rs.1,000 |
| Operating Leverage | 4:1 | 5:1 | 3:1 |
| Variable cost as a percentage of sales | 66.67% | 75% | 50% |
| Income tax rate | 45% | 45% | 45% |

1. Calculate various leverages from the income statement given below: (CO:04 Application)

|  |  |
| --- | --- |
| Particulars | Rs. |
| Sales | 10,50,000 |
| Variable cost | 7,67,000 |
| Fixed cost | 75,000 |
| EBIT | 2,08,000 |
| Interest | 1,10,000 |
| Taxes @30% | 29,400 |
| Net Income | 68,600 |

1. XY Ltd needs ₹50,00,000 for the installation of a new factory. The new factory is expected to yield earnings before interest and tax (EBIT) of ₹1000000. In choosing a financial plan, XY Ltd has an objective of maximizing earnings per share. It is considering the possibilities of issuing ordinary shares and raising debt of ₹500000 or ₹2000000 or ₹3000000. The current market price per share is ₹300 and is expected to drop to ₹250 if the funds are borrowed in excess of ₹2000000. Funds can be borrowed at the following rates

* Upto ₹500000 @ 10%
* Over ₹500000 - ₹2000000 @ 15%
* Over ₹2000000 @ 20%

Assuming a tax rate of 50%, advise the company. (CO:03 Application)

1. Best of Luck Ltd. a profit-making company has a paid up capital of ₹100 lakhs consisting of 10 lakhs of ordinary shares of ₹10 each. It is earning an annual pre-tax profit of ₹ 60 lakhs. The company’s shares are listed and are quoted in the range of ₹50 to ₹80. The management wants to diversify production and has approved a project which will cost ₹ 50 lakhs and which is expected to yield a pre-tax profit of ₹ 40 lakhs per annum. To raise this additional capital the following options are under consideration of the management:
2. To issue equity share capital for the entire additional amount. It is expected that the new shares (face value of ₹10) can be sold at a premium of ₹15.
3. To issue 16% non-convertible debentures of ₹100 each for the entire amount
4. To issue equity capital for ₹25 lakhs (face value of ₹10) and 16% non-convertible debentures for the remaining amount. In this case company can issue shares at a premium of ₹40 each.

Advise which option is the most suitable to raise additional capital, keeping in mind that the management wants to maximize the earnings per share to maintain its goodwill. The company is paying income tax at 50%. (CO:03 Application)

**PART C**

**Answer the following Questions. (2Qx 15M= 30)**

1. The following information is related to JKB Company (JKB) as at 31st March 2023:

* Issued share capital of JKB is Rs.500 million and it comprises with 1,000,000 ordinary shares. JKB is a quoted company and its current share price is Rs. 250/-. The dividend paid for the current year was Rs. 40/- per share and growth rate of annual dividend payment is 5%.
* The retained earnings of JKB were Rs.100 million.
* JKB has issued irredeemable preference shares for a value of Rs. 150 million. This consists of 500,000 preference shares and annual dividend per share is Rs. 25/-. The last traded price of a preference share was Rs.250/-.
* Irredeemable, non-quoted long-term borrowings of JKB were Rs.150 million with annual interest rate of 17%.
* The company pays income tax at the rate of 28% per annum on its profits.

Compute the following:

1. Cost of ordinary share capital.
2. Cost of preference share capital.
3. Cost of debt.
4. Weighted average cost of capital (WACC)at market values (CO:03 Analysis)
5. A firm has to buy 2 machinery for their business expansion. They had a reserve of Rs. 5,00,000 but the cost of machineries are Rs. 6,00,000. Now, they are forced to borrow Rs. 1,00,000 at an interest rate of 15% p.a. and the loan is to be repaid in 5 equal instalments payable at the end of each year. The term of loan is 5 years. Prepare loan amortization schedule. (CO:02 Analysis)