GLOBAL COLLEGE OF MANAGEMENT

Send up Exam 2071

Subject: **Managerial Finance**

Grade: **MBS I Year** F.M.: 50

Time: 2:00 hrs. P.M.: 20

***Candidates are required to give their answers in their own words as far as practicable. The figures in the margin indicate full marks.***

**Group A**

**Short answer questions**

**Attempt any THREE questions. [10X3]**

1. 'Working capital investment and financing policies affect both the profitability and riskiness of a firm'. Do you agree with this statement? Explain. [10]

2. The shareholder equity account of Ripform Co. as on December 30th 2013 are as follows:

| | |
|---|---|
| Common Stock (Rs.10 par, 1,000,000 shares) | Rs.10,000,000 |
| Additional Paid-in capital | 5,000,000 |
| Retained earnings | 5,000,000 |
| Shareholders' equity | Rs.20,000,000 |

On December 31st, 2013, the company split the stock 3 for 1 and then declares a 20 percent stock dividend. The price of the stock on December 30th was Rs.20.

   a. Reformulate the stockholders' capitalization accounts of the firms on 31st December 2013.
   b. Explain the reasons for splitting or reverse splitting the shares by companies.
   c. Does stock dividend distribution have any economic significance to the shareholders? [6 + 2 + 2]

3. The following information is available on the Vainer Corporation. Assuming sales and production are steady throughout the year and a 360-days yea, complete the balance sheet and income statement for the Vainer Corporation.

Balance sheet, December 31, 2013

| Assets | Amount | Liabilities | Amount |
|---|---|---|---|
| Cash and marketable | Rs.500 | Accounts payable | Rs.400 |
| securities | ? | Short term bank loan | ? |
| Account receivables | ? | Accruals | 200 |
| Inventories | ? | Current liabilities | ? |
| Current assets | ? | Long-term debt | ? |
| Net fixed assets | | Common stock and retained earnings | 3,750 |
| | ? | Total liabilities equity | ? |
| Total assets | | | |

Income Statement of 2013

| Particulars | Amount |
|---|---|
| Credit sales | Rs.8,000 |
| Cost of goods sold | ? |
| Gross profit | ? |
| Selling and administrative expenses | ? |
| Interest expenses | 400 |
| Profit before taxes | ? |
| Taxes, at 44% | ? |
| Profit after taxes | ? |

Other information:

| | |
|---|---|
| Current ratio | 3 |
| Depreciation | Rs.500 |
| Net profit and depreciation to long-term debt0. | 40 |
| Net profit margin | 7% |
| Total liabilities to net worth | 1 |
| Average collection period | 45 days |
| Inventory turnover ratio | 3 |

4. Write short notes on ( any two): [5X2]
   a. Informal reorganization
   b. The finance functions
   c. Types of leverage

## Group B

**Comprehensive answer questions** **[20]**
**Attempt any ONE question**

5. KDC corporation uses following capital structure as its optimal capital mix:

| Capital Component | Proportion |
|---|---|
| Debt | 30% |
| Preferred Stock | 20 |
| Equity | 50 |

KDC has Rs.250,000 available in retained earnings. It can raise additional capital under the following terms and conditions:

Debt: it can sell bonds with a coupon rate of 10 percent at face value without any floatation cost up to Rs.300,000. Additional sale of bond is possible only at increased coupon rate of 12 percent which can also be sold at face value without incurring any floatation cost.

Preferred Stock: Unlimited amount can be raised by selling preference shares at a price of Rs.95. KDC should incur floatation cost of Rs. 2 per share. Preference shares will have a dividend rate of 11 percent on face value of Rs.100.

Equity: new shares can be sold in the market at price of Rs.50 per share. A floatation cost of Rs.10 per share must be incurred. Market anticipates a dividend of Rs.5 per share. This dividend is expected to grow at a rate of 5 percent indefinitely.

KDC has three mutually exclusive projects available. Project A requires an initial investment of Rs.400,000, project B requires Rs.900,000 and project C requires Rs.1,200,000. Their IRR is 12 percent, 14 percent and 15 percent respectively.

a) Calculate the component cost of each capital component.
b) Determine the two break points facing KDC.
c) What are the appropriate costs of capital for evaluating the available three projects?
d) Which project should KDC accept?
e) Prepare the MCC schedule of KDC.

6. Kantipur Corporation is considering the replacement of an old machine with a new one. The machine was purchased 5 years ago at a price of Rs.500,000 and has a remaining useful life of 5 more years. The machine is being depreciated using straight line method towards a zero salvage value. It can be disposed now at Rs.300,000 but at the end of next five years, the disposal of machine is expected to provide only Rs.50,000. The new machine costs the firm Rs.600,000 to purchase, and Rs.50,000 to transport and install. It will have a useful life of 5 years at the end of which it can be sold in the market for Rs.30,000. The machine falls in the 5 year property class (MACRS) for depreciation purpose. The replacement requires the firm to increase current assets level by Rs.60,000. But at the same time, current liabilities will also increase by Rs.20,000. The annual revenue of the firm will increase by Rs.150,000 with no change in cash expenses
Kantipur falls in 30 percent tax bracket and its cost of debt is 10 percent and cost of equity is 12.20 percent. It is planning to finance the net investment required by using 40 percent debt and 60 percent equity.

a. Determine the net cash outlay of Kantipur.
b. Calculate the annual operating cash flow of the replacement project.
c. What incremental cash flow will occur at the end of project life from its termination?
d. What is the appropriate discount rate that Kantipur should use in evaluating this project?
e. Calculate the NPV and IRR of the project. Should the old machine be replaced?
f. State some reasons why conflict may arise between NPV and IRR in case of mutually exclusive projects.

*****Good Luck******