MID-WESTERN UNIVERSITY
EXAMINATIONS MANAGEMENT OFFICE
MAKE-UP EXAMINATION: 2020
MASTER OF BUSINESS STUDIES (MBS)
SEMESTER-III

Subject: Financial Management — Course Code: MGMT 535
Full Marks: 60 — Time: 3 Hours

Candidates are required to answer the questions in their own words as far as practicable.

Group A: Very Short Answer Questions (10X1=10 Marks)

*Attempt **ALL** the questions.*

Q1. What are the functions of financial management?
Q2. What do you mean by days sales outstanding?
Q3. Mention any four limitations of ratio analysis.
Q4. Why cost of internal equity becomes less than cost of external equity?
Q5. Mention the process of capital budgeting.
Q6. What do you mean by operating cycle?
Q7. State the significance of cross over rate.
Q8. Write the motives of holding cash.
Q9. What are the factors affecting working capital?
Q10. Mention the procedure of dividend payment.

Group B: Short Answer Questions (3 X 8 = 24 Marks)

*Answer any **THREE** questions.*

Q11. What do you mean by financial management? Explain the importance of financial management. (3+5)

Q12. Suraj Bakery Industry, has sales of Rs 6 million, and asset turnover ratio of 6 for the year, and net profits of Rs 120,000

a. What is the company's return on assets or earning power? (4)

b. The company will install new point-of-sales cash registers through its stores. This equipment is expected to increase efficiency in inventory control, reduce clerical errors and improve record keeping throughout the system. The new equipment will increase the investment in assets by 20% and is expected to increase the net profit margin from 2% now to 3%. No change in sales is expected. What is the effect of the new equipment on the return on assets ratio or earning power? (4)

Q13. On January 1, 2019, the total assets of the Karnali Rafting Company were Rs 80 million. By the end of the year, total assets are expected to be Rs 120 million. (Assume there is no short-term debt.) The firm's capital structure, shown below, is considered to be optimal;

Debt (10% coupon bonds)	Rs 32,000,000
Preferred stock (at 10.5%)	8,000,000
Common equity	40,000,000
	Rs 80,000,000

New bond will have 12 percent coupon rate and will be sold at par. Preferred stock will have a 12.5 percent rate and will be sold at par. Common stock, currently selling at Rs 30 a share, can be sold to net the company Rs 27 a share. Stockholders' required rate of return, estimated to be 12 percent, consists of dividend yield of 4 percent and an expected growth of 8 percent. Retained earnings are estimated to be Rs 5 million (ignoring depreciation). The marginal corporate tax rate is 40 percent.

a. To maintain the present capital structure, how much of the capital budget must be financed by equity? (2)

b. Calculate the cost of each of the equity components. (2)

c. At what level of capital expenditures will there be a break in the MCC schedule? (2)

d. Calculate the MCC both below and above the break in the schedule.(2)

Q14. Berger Color Industry operates a mail-order firm doing business on the western Nepal. Berger Color Industry receives an average of Rs 325,000 in payments per day. On average, it takes 5 days from the time customers' mail check until Berger Color Industry receives and processes them. Berger Color Industry is considering the use of a lockbox system to reduce collection and processing float. The system will cost Rs 7,400 per month and will consist of 10 local depository banks and a concentration bank located in Surkhet. Under this system, customers' checks should be received at the lockbox location 1 day after they are mailed, and daily totals will be transferred to Surkhet using wire transfer consisting Rs 12.25 each. Assume that Berger Color Industry has an opportunity cost of 9 percent and that are 52 x 5 = 260 working days, hence 260 transfers from each lockbox location, in a year.

a. What is the total annual cost of operating the lockbox system? (3.5)

b. What is the total benefit of the lockbox system to Berger Color Industry? (3.5)

c. Should Berger Color Industry initiate the system? (1)

Q15. In 2015 the Surkhet Bakery Industry paid dividends totaling Rs 1456,000. For the past five years, earnings have grown at a constant rate of 10 percent. After-tax income was Rs 3640,000 for 2015. However, in 2016, earnings were Rs 6840,000 with investment of Rs 4500,000. It is predicted that Surkhet Bakery Industry will not be able to maintain this higher level of earnings and will return to previous 10 percent growth rate. Calculate dividends for 2016 if the Surkhet Bakery Industry follows each of the following policies.

a. Its dividend payment is stable and growing. (2)
b. It continues that 2015 dividend payout ratio. (2)
c. It usages a pure residual dividend policy (40 percent of the Rs 4500,000 investment was financed with debt) (2)
d. The investment in 2016 is financed 80 percent with retained earnings and 10 percent with debt. Any earnings not invested are paid out as dividends. (2)

Group C: Long Answer Questions (2 x 13 = 26 Marks)

Answer any TWO Questions.

Q16. What do you mean by dividend policy? Explain the factors affecting dividend policy. In which situation a firm prefers stock repurchase instead of cash dividend. (4+6+3)

Q17. The Surkhet Agrovet Company purchased a machine 5 years ago at a cost of Rs 100,000. It has an expected life of 10 years at the time of purchase and an expected salvage value of Rs 10,000 at the end of 10 years. It is being depreciated by straight line method.

A new machine can be purchased for Rs 170,000 including installation cost. Over its 5-year life, it will reduce cash operating expenses by Rs 60,000 per years. Sales are not expected to change. At the end of its useful life, the machine is estimated to be worthless. MACRS depreciation will be used, and it will be depreciated after its 3-year class rather than its 5-year economic life. The old machine can be sold today for Rs 75,000. The firm's tax rate is 40 percent. The appropriate discount rate is 12 percent.

a. If the new machine is purchased, what is the amount of the initial cash flow at year 0? (4)
b. What incremental operating cash flows will occur at the end of year 1 through 5 as a result of replacing the old machine? (4)
c. What incremental non-operating cash flow will occur at the end of year 5 (if the new machine is purchased)? (1)
d. What is the NPV of this project? Should the firm replace the old machine? (4)

Q18. Nepal telecom, Inc. is considering changing its credit terms from 2/20 net 45, to 3/15 net 45, in order to speed collections. At present 30 percent of Nepal telecom's non-default customers take the 2 percent discount. Under the new terms, discount customers are expected to rise to 50 percent of the non-default customers. Regardless of the credit terms half of the customizers who do not take the discount are expected to pay on time, whereas the remainder will pay 10 days late. The change does not involve a relaxation of credit standards; therefore, bad debt losses are not expected to rise above their present 3 percent level. However, the more generous cash discount terms are expected increase to sales from Rs 3 million to Rs 3.5 million per year. Nepal telecom's variable cost ratio is 80 percent, the interest rate in funds invested in account receivable is 10 percent, and the firm's marginal tax rate is 30 percent.

a. What are the days' sales outstanding before and after the change? (2)
b. Calculate the discount costs before and after the change. (2)
c. Calculate the rupee cost of carrying receivable before and after the change. (2)
d. Calculate the bad debt losses before and after the change. (2)
e. What is the incremental profit from the change in credit terms? Should Nepal telecom change its credit term? (5)

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