Mid-West University

Examinations Management Office

Surkhet, Nepal

Chance Examination-2080

Master of Business Studies (MBS)

Semester - III

Subject: Financial Management	Course Code: MGMT535
Full Marks: 60 Pass Marks: 30	Time: 3:00 Hours

You are required to answer in your own words as far as applicable. Figures in the margins indicate full marks.

SECTION A: CRITICAL THINKING QUESTIONS (10 X 1 = 10 MARKS)

*Answer **ALL** the questions:*

1. Write the concept of financial management?
2. Write the limitations of financial ratio.
3. Rara Network Pvt. Ltd. has current assets of Rs 2 million and current liabilities of Rs 800,000. What is the company's current ratio?
4. Why is WACC calculated?
5. Mention any two major drawbacks of internal rate of return.
6. A company takes 35 days to convert raw materials into finished goods. It allows its customers 45 days credit facility, and the firm generally pays its suppliers in 30 days. What is the cash conversion cycle?
7. What are the motives of holding inventory?
8. Define aggressive policy of working capital.
9. Write the meaning of stock dividend.
10. What do you mean by residual dividend policy?

SECTION B: SHORT ANSWER QUESTIONS (3 X 8 = 24 MARKS)

*Answer any **THREE** questions:*

11. Differentiate between profit maximization and wealth maximization goal of the firm. [8]
12. Describe working capital and also explain the factors influencing working capital of a firm. [3+5]
13. Dulux Paints Corporation has a target capital structure of 60 percent debt and 40 percent common equity. The company's before tax cost of debt is 12 percent and its marginal tax rate is 25%. The current stock price is Rs 22.50; the last dividend was Rs 2; and the dividend is expected to grow at a constant rate of 8%. What will be the firm's cost of common equity and it's WACC? [4+4]
14. The Karnali Mart has sales of Rs 6 million, an asset turnover ratio of 6 for the year, and net profit of Rs 120,000. [4+4]
    a. What is the company's return on assets or earning power?
    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?
15. The CG Corporation expects next year's net income to be Rs 15 million. The firm's debt ratio is currently 40 percent. CG has Rs 12 million of profitable investment opportunities, and it wished to maintain its existing debt ratio. According to the residual distribution model (assuming all payments are in the form of dividends), how large should CG's dividend payout ratio be next year? [8]

SECTION C: LONG ANSWER QUESTIONS (2 X 13 = 26 MARKS)

*Answer any **TWO** questions:*

16. a) Write the meaning of capital budgeting. Why is Net present value (NPV) taken as superior criterion than internal rate of return (IRR) in capital budgeting? [3+4]

    b) Explain the various approach of estimating cost of equity with suitable example. [6]

17. Rara Trekking Company is considering installing a new plant and equipment. The plant and equipment will require cost Rs 700,000. In addition to the price of plant and equipment, Rs 100,000 is required for shipping charge and Rs 30,000 for installation of the plant and equipment. The plant also requires an additional working capital of Rs 28,000. The new production process will generate Rs 500,000 sales revenue in each year for 5 years and require operating cost Rs 275,000 excluding depreciation. The company charges depreciation on straight line basis. The plant will have zero book value at the end of fifth year but it will have Rs 45,000 market value. Company's marginal corporate tax rate is 30%.

    a. What is the initial cash outlay of Rara Trekking Company? [2]

    b. What is the annual operating cash flow of the new plant and equipment? [3]

    c. What is the terminal cash flow of the new plant and equipment? [3]

    d. Should the company install the new plant and equipment if its required rate of return is 14%. [5]

18. Sonapur Mineral Company is attempting to determine the optimal level of current assets for the coming year. Management expects sales to increase to approximately Rs 3 million as a result of an asset expansion presently being undertaken. Fixed assets total Rs 1 million, and the firm wishes to maintain a 70 percent debt ratio. The company's interest cost is currently 10 percent on both short-term and longer-term debt (Which the firm user in its permanent structure). Three alternatives regarding the projected current assets level are available to the firm: [13]

    a. An aggressive policy requiring current assets of only 40 percent of projected sales.

    b. A moderate policy of 50 percent of sales in current sales.

    c. A conservative policy requiring current assets of 70 percent of sales.

    The firm expects to generate earnings before interest and tax at a rate of 15 percent on total sales. What is the expected return on equity under each current assets level? Assumes a 30 percent tax rate.

THE END