K. J. SOMAIYA INSTITUTE OF MANAGEMENT STUDIES AND RESEARCH

Program:PGDM, 3rd Trimester (Batch 2016-2018)

Subject: Financial Management
(End Term Examination)

Maximum Marks: 100
Duration: 3 hours

Date: 27/03/2017

Notes:
1. All questions carry equal marks. There are 6 questions
2. Answer all questions
3. Make suitable assumptions if required and state them
4. It is an OPEN BOOKS examination and students are allowed to use ONLY OWN books, notebooks and calculators.

Question 1

1. Which of the following companies are likely to have high short-term financing needs ? Why ?
a. a clothing retailer
b. a professional sports team
c. an electricity producing company
d. a company that operates toll roads
e. a restaurant chain

Question 2

The ratios for Fixate Co. are given for the years 2014 and 2015 along with industry average ratios for 2015

Ratio	2014	2015	2015 Industry
Liquidity			
Current	3.8	3.6	4.1
Quick	1.9	1.5	2.1
Asset Management			
Inventory Turnover	5.9x	4.6x	7.4x
Days Sales Outstanding	41.7 days	43.2 days	32.1 days
Fixed Asset Turnover	4.1x	3.9x	4.0x
Total Assets Turnover	1.9x	1.8x	2.1x
Debt Management			
Debt to Total Assets	48.0%	50.90%	42.00%
Times Interest Earned	5.3x	3.3x	6.5x
Profitability			
Net Profit Margin	4.11%	3.60%	4.90%
Return on Assets	7.87%	6.40%	10.30%
Return on Equity	15.1%	13.00%	17.70%
Market Value			

Price to Earnings	10.5	10.6	15.0
Market to Book	1.6	1.4	2.5

a. Briefly comment on Fixate's 2015 financial position. Do you see any obvious strengths or weaknesses

b. Compare Fixate's ratios for 2014 and 2015 and comment on whether the financial position improved or deteriorated in 2015.

c. What other information may be useful in projecting whether Fixate's financial position is expected to improve or deteriorate in the future ?

Question 3

How would each of the following affect the after tax cost of debt, cost of equity and WACC

a. The corporate tax rate is lowered.

b. The Reserve bank of India tightens credit.

c. The firm uses more debt; that is, it increases its debt/assets ratio.

d. The dividend payout ratio is increased.

e. The firm doubles the amount of capital it raises during the year.

f. The firm expands into a risky new area.

g. The firm merges with another firm whose earnings are countercyclical both to those of the first firm and to the stock market.

h. The stock market falls drastically, and the firm's stock falls along with the rest.

i. Investors become more risk averse.

j. The firm is an electric utility with a large investment in nuclear plants. Several states propose a ban on nuclear power generation.

Question 4

Compton Foundry is considering replacing an old machine that is used in the forging process with brand new machine. The new machine which costs Rs. 300,000 will be fully depreciated over its estimated useful life of five years using straight line method. Shipping, transportation, and installation will cost an additional Rs. 50,000. Net working capital will have to be immediately increased by Rs.10,000. The company's chief financial officer (CFO) also estimates that the company will be able sell the new machine at the end of year 5 for $50,000.

The old machine was originally purchased for a total cost of Rs. 2,00,000 eight years ago and is being fully depreciated on a straight-line basis over ten years. The old machine can be sold at salvage today for $50,000.

If the new machine purchased, chief financial officer estimates that annual revenues will increase from $480,000 to $620,000 and operating costs will drop from $120,000 to $110,000. In addition, the new machine will require in infusion of additional net working capital in years 2 and 3 of $5,000 each year. The company's marginal tax rate is 40% and its required rate of return is 15%.

Estimate all cash flows in years zero through 5

Question 5

Your bank manager said 'Companies must juggle the cost of holding cash with the costs of not having enough.' Explain the issues involved

Question 6

East Lansing Appliances (ELA) expects to have sales this year of Rs.15 million under its current credit policy. The present terms are net 30; the days sales outstanding (DSO) is 60 days; and the bad debt loss percentage is 5 percent.
Since ELA wants to improve its profitability, the treasurer has proposed that the company has to change its credit terms to (1/15, net 30). This change would reduce expected sales by Rs.500,000, but it would also shorten the DSO on the remaining sales to 30 days. Expected bad debt losses on the remaining sales would fall to 3 percent. The variable cost percentage is 60 percent, and the cost of capital is 15 percent.
Should the company change the credit policy?

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