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Department of Management
School of Management & Business Studies
Jamia Hamdard, New Delhi
MBA (General) - II Semester Examination, April – May 2019
Financial Management; MBA-CG-203

Max Marks: 75 **Time Allowed: 3 Hours**

***Attempt any 5 questions, Scientific Calculators are allowed.**

Question1

(a) Briefly explain the three major decisions of financial management. [15]

Question2

(a) Using the relative standard deviation approach, calculate the modified historical risk premium for India given that the Risk premium in U.S. Market is 4.20%, Standard deviation of Equity returns for India is 24% and the Standard deviation of Equity returns for U.S. is 15%. [5]

(b) Assume that the current level of S&P 500 index is 900, the expected dividend yield on the index for the next period is 2%, and the expected growth rate in earnings and dividends in the long run is 7%. What is the implied equity premium? [5]

(c) In November 2013, the ten year rupee denominated Indian Government Bond Rate was yielding 8.82% and the local currency sovereign rating assigned to the Indian Government in November 2013, by Moody's was Baa3. The default spread for Baa3 rated government bonds is 2.25%. What is the rupee risk free rate? [5]

Question3

You are provided with the projected income statements for a project:

Year	1	2	3	4
Revenues	$10,000	$11,000	$12,000	$13,000
- Cost of Goods Sold	$4,000	$4,400	$4,800	$5,200
- Depreciation	$4,000	$3,000	$2,000	$1,000
= EBIT	$2,000	$3,600	$5,200	$6,800

- The tax rate is 40%.
- The Project required an initial investment of $15,000 and an additional investment of $2,000 at the end of year 2.
- The working capital is anticipated to be 10% of revenues, and the working capital investment has to be made at the beginning of each period.

(a) Estimate the free cash flow to the firm for each of the four years. [4]
(b) Estimate the payback period for investors in the firm. [3]
(c) Estimate the Net Present Value to investors in the firm if the cost of capital is 12%. Would you accept the project? [4]
(d) Estimate the internal rate of return to investors in the firm. Would you accept the project? [4]

Question 4

(a) Explain how Profitability Index (PI) and Modified Internal Rate of Return (MIRR) help in resolving conflicting rankings as given by NPV and IRR decision rules in case of mutually exclusive projects with the help of a suitable example. [15]

Question5

(a) Is there an optimal level of working capital for a business? Explain [5]

(b) Discuss the trade-off associated with a decision to offer credit to customers. [5]

(c) "Keeping large cash balances is always beneficial for the firm". Comment [5]

Question6

(a) Estimate the

(i) Safety Inventory [5]

(ii) Economic order quantity (EOQ) [5]

(iii) Average Inventory [5]

for a new car dealer with the following characteristics:

- The annual expected sale, in units, is 1200 cars; some uncertainty is associated with this forecast, and monthly sales are normally distributed with a mean of 100 cars and a standard deviation of 15 cars.
- The cost per order is $10,000 and it takes 15 days for new cars to be delivered by the manufacturer.
- The carrying cost per car on an annualized basis is $1,000

Question 7

(a) Debt is always cheaper than equity. Therefore, the optimal debt ratio is all debt. How would you respond? [5]

(b) "Debt is irrelevant for firm valuation". Explain [5]

Question 8

(a) Dividend policy is often described as "sticky". What is meant by this description? What might explain the sticky nature of dividends? [5]

(b) A company that historically has had low capital investments and has paid out high dividends is entering a new industry, in which capital expenditure requirements are much higher. What should the firm do to its dividends? What practical problems might it run into? [10]

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