

www.bcfeducation.com

Composed & Solved by Iftikhar Ali Lecturer Statistics, Finance & Accounting

Paper	Financial Management	Standard	MCOM
Board/University	University of Sargodha	Code	MCM-507
Year	2018 2 nd Annual	Marks	100

Note: Question # 1 is compulsory. Attempt any four questions from the remaining. All questions carry equal marks.

Q No1: Explain the following terms (10 x 2= 20)

- a. Goal of Firm
- b. Financial Environment
- c. Stock Repurchase
- d. Total Leverage
- e. Cost of Capital
- f. Capital Budgeting
- g. Marketable Securities
- h. Working Capital
- i. Systematic Risk
- j. Internal Rate of Return

Q No 2: Write a note on the following:

- i. Short term financing
- ii. Risk & Return in Portfolio Context

Q No 3: (i) Silicon Wafer Company currently pays a dividend of \$1 per share and has a share price of \$20.

- a. If this dividend was expected to grow at a 12 percent rate forever, what is the firm's expected, or required, return on equity using a dividend discount model approach?
- b. Instead of the situation in Part (a), suppose that the dividend was expected to grow at a 20 percent rate for five years and at 10 percent per year thereafter. Now what is the firm's expected, or required, return on equity?

(ii) A \$1,000-face-value bond has a current market price of \$935, an 8 percent coupon rate, and 10 years remaining until maturity. Interest payments are made semiannually. Before you do any calculations, decide whether the yield to maturity is above or below the coupon rate. Why?

- a. What is the implied market-determined semiannual discount rate (i.e., semiannual yield to maturity) on this bond?
- b. Using your answer to Part (a), what is the bond's (i) (nominal annual) yield to maturity? (ii) (Effective annual) yield to maturity?

Q No 4: Briarcliff Stove Company is considering a new product line to supplement its range line. It is anticipated that the new product line will involve cash investment of \$700,000 at time 0 and \$1.0 million in year 1. After-tax cash inflows of \$250,000 are expected in year 2, \$300,000 in year 3, \$350,000 in year 4, and \$400,000 each year thereafter through year 10. Though the product line might be viable after year 10, the company prefers to be conservative and end all calculations at that time.

- If the required rate of return is 15 percent, what is the net present value of the project? Is it acceptable?
- What is its internal rate of return?
- What would be the case if the required rate of return was 10 percent?
- What is the project's payback period?

Q No 5: XYZ Company currently has total assets of \$3.2 million, of which current assets comprise \$0.2 million. Sales are \$10 million annually, and the before-tax net profit margin (the firm currently has no interest-bearing debt) is 12 percent. Given renewed fears of potential cash insolvency, an overly strict credit policy, and imminent stockouts, the company is considering higher levels of current assets as a buffer against adversity. Specifically, levels of \$0.5 million and \$0.8 million are being considered instead of the \$0.2 million presently held. Any additions to current assets would be financed with new equity capital.

- Determine the total asset turnover, before-tax return on investment, and before-tax net profit margin under the three alternative levels of current assets.
- If the new additions to current assets were financed with long-term debt at 15 percent interest, what would be the before-tax interest "cost" of the two new policies?

Q No 6: (i) Comment on the Dividend Policy and explain how it affects the stakeholders of the company (both internal and external stakeholders).

(ii) Explain the capital structure determinants with examples.

Q No 7: David Ding Baseball Bat Company currently has \$3 million in debt outstanding, bearing an interest rate of 12 percent. It wishes to finance a \$4 million expansion program and is considering three alternatives: additional debt at 14 percent interest (option 1), preferred stock with a 12 percent dividend (option 2), and the sale of common stock at \$16 per share (option 3). The company currently has 800,000 shares of common stock outstanding and is in a 40 percent tax bracket.

- If earnings before interest and taxes are currently \$1.5 million, what would be earnings per share for the three alternatives, assuming no immediate increase in operating profit?
- Develop a break-even, or indifference, chart for these alternatives. What are the approximate indifference points? To check one of these points, mathematically determine the indifference point between the debt plan and the common stock plan. What are the horizontal axis intercepts?
- Compute the degree of financial leverage (DFL) for each alternative at the expected EBIT level of \$1.5 million.
- Which alternative do you prefer? How much would EBIT need to increase before the next alternative would be "better" (in terms of EPS)?