Level: MBA	Semester: Autumn 2006
Paper: Financial Management (5535)	Maximum Marks: 100
Time Allowed: 3 hrs	Pass Marks: 40

NOTE: ATTEMPT FIVE QUESTIONS. ALL CARRY EQUAL MARKS.

For your convenience, the relevant portion of FVIF/PVIF/PVIFA table is given in the end of the paper.

Q.No.1: Loquat Foods Company is able to borrow at an interest rate of 9% for one year. For the year, market participants expect 4% inflation.

(a) What approximate real rate of return does the lender expect? What is the inflation premium embodied in the nominal interest rate?

(b) If inflation proves to be 2% for the year, does the lender suffer? Does the borrower suffer? Why?

(c) If inflation proves to be 6%, who gains and who losses?

Q.No.2: Delphi Products Corporation currently pays a dividend of $2 per share, and this dividend is expected to grow at a 15% annual rate for three years, then at a 10% rate for the next three years, after which it is expected to grow at a 5% rate forever. What value would you place on the stock if an 18% rate of return was required?

Q.No.3: (a) What are the different motives given by Keynes for holding cash?

(b) What is net float? How might a company "play the float" in its disbursements?

(c) What are the various sources of information you might use to analyze a credit applicant?

Q.No.4: Financial statements for the Begalla Corporation follow.

Begalla Corporation comparative balance sheets at December 31 (in millions)

Assets	2004	2005	Liabilities	2004	2005
Cash & equivalents	$ 4	$ 5	Accounts payable	$ 8	$ 10
Accounts receivable	7	10	Notes payable	5	5
Inventory	12	15	Accrued wages	2	3
			Accrued Taxes	3	2
Total current assets	$23	$30	Total current liabilities	$18	$ 20
Net fixed assets	40	40	Long term debt	20	20
			Common stock	10	10
			Retained earnings	15	20
Total	$63	$70	Total	$63	$70

Begalla Corporation income statement 2005 (in millions)

Sales		$ 95
Cost of goods sold	$50	
Selling, general, & admin expenses	15	
Depreciation	3	
Interest	2	70
Net income before taxes		$ 25
Taxes		10
Net income		$15

Prepare the cash flow statement for Begalla Corporation by using **the direct method as well as the indirect method.**

Q.No.5: Mendez Metal Specialties, Inc. has a seasonal pattern to its business. It borrows under a line of credit from Central Bank at 1% over prime. Its total asset requirements now (at year end) and estimated requirements for the coming year are (in millions):

	NOW	1st Q	2nd Q	3rd Q	4th Q
Total asset requirements	$4.5	$4.8	$5.5	$5.9	$5.0

Q stands for quarter

Assume that these requirements are level throughout the quarter. Presently, the company has $ 4.5 million in equity capital plus long term debt plus the permanent component of current liabilities, and this amount will remain constant throughout the year.

The prime rate presently is 11 %, and the company expects no change in this rate for the next year. Mendez Metal Specialities is also considering issuing intermediate-term debt at an interest rate of 13.5 %. In this regard, three alternative amounts are under consideration: zero, $ 500,000, and $1 million. All additional funds requirements will be borrowed under the company's bank line of credit.

Determine the total dollar borrowing costs for short and intermediate-term debt under each of the three alternatives for the coming year. (Assume that there are no changes in current liabilities other than borrowings). Which alternative is lowest in cost? Is there a consideration other than expected cost that deserves your attention?

Q.No.6: Compare and evaluate the four major capital budgeting techniques.

Q.No.7: On the basis of an analysis of past returns and inflationary expectations, Marta Gomez feels that the expected return on stocks in general is 12%. The risk free rate on short term Treasury securities is now 7%. Gomez is particularly interested in the return prospects for Kessler Electronics Corporation. Based on monthly data for the past five years, she has fitted a characteristic line to the responsiveness of excess returns of the stock to excess return of S & P 500 Index and has found the slope of the line to be 1.67. If financial markets are believed to be efficient, what return can she expect from investing in Kessler Electronics Corporation?

Q.No.8: Hayleigh Mills Company has a $5 million revolving credit agreement with First State Bank of Arkansas. Being a favored customer, the rate is set at 1 percent over the bank's cost of funds, where the cost of funds is approximated as the rate on negotiable certificates of deposit (CDs). In addition, there is a ½ percent commitment fee on the unused portion of the revolving credit. If the CD rate is expected to average 9 percent for the coming year and if the company expects to utilize, on average, 60 percent of the total commitment, what is the expected annual dollar cost of this credit arrangement? What is the percentage cost when both the interest rate and the commitment fee paid are considered? What happens to the percentage cost if, on average, only 20 percent of the total commitment is utilized?

Future/Present Value Table for given interest rate

	PVIF				FVIF	PVIFA
Period (n)	**05%**	**10%**	**15%**	**18%**	**05%**	**05%**
1	0.952	0.909	0.870	0.847	1.050	0.952
2	0.907	0.826	0.756	0.718	1.102	1.859
3	0.864	0.751	0.658	0.609	1.158	2.723
4	0.823	0.683	0.572	0.516	1.216	3.546
5	0.784	0.621	0.497	0.437	1.276	4.329
6	0.746	0.564	0.432	0.370	1.340	5.076
7	0.711	0.513	0.376	0.314	1.407	5.786
8	0.677	0.467	0.327	0.266	1.477	6.463
9	0.645	0.424	0.284	0.225	1.551	7.108
10	0.614	0.386	0.247	0.191	1.629	7.722