2019

(April)

COMMERCE

(Honours)

(Financial Management)

(BC–402)

Marks : 75

Time : 3 hours

The figures in the margin indicate full marks for the questions

1. Why is it inappropriate to seek profit maximization as the goal of financial decision making? How do you justify the adoption of wealth maximization as an appropriate substitute for it? 7+8=15

Or

(a) Explain the relevance of Time Value of money in financial decisions. 6

(b) *(i)* Miss Subu wants to buy a 50 inch FULL HD LED television set valued at ₹ 59,000. If the down payment is ₹ 9,000 and the balance is repaid in 10 equal annual instalments, how much should she pay annually @ 4% p.a. CI? 3

(ii) Mr. Manohar makes a deposit of ₹ 5,00,000 in a bank for 6 years at 6·50% interest and the number of compounding is 4 times in a year.

Find out the Future Value of deposit at the end of the 6th year. 3

(c) In 2010, Mr. Raju's annual earnings was ₹ 90,000. By 2017, his annual earnings has increased to ₹ 1,35,000.

Compute the compound annual rate of growth of his earnings. 3

2. *(a)* *(i)* Distinguish between NPV and Profitability Index. 3

(ii) What do you mean by 'capital rationing' in the context of capital budgeting decisions? 3

(b) Machine *A* costs ₹ 1,00,000 payable immediately. Machine *B* costs ₹ 1,20,000 half payable immediately and half payable in one year's time. The cash receipts expected are as follows :

Year (at the end) :	1	2	3	4	5
Machine A (in ₹) :	20,000	60,000	40,000	30,000	20,000
Machine B (in ₹) :	—	60,000	60,000	80,000	—

The cost of capital is 7%. Compute the NPV of each project and state which one should be accepted. 9

Or

(a) What are the steps in the capital budgeting process? 3

(b) Co. Sonakshi Ltd. desires to invest in a project which requires an initial investment of ₹ 50,00,000. The useful life of the project is 10 years with a salvage value of ₹ 5,00,000 and will be depreciated on straight-line method. The profit before charging depreciation is ₹ 10,00,000 p.a. The income tax rate is 35%.

Compute the—

(i) payback period (PBP);

(ii) NPV at 10% cost of capital;

(iii) IRR of the project. 3+3+6=12

3. *(a)* A company issues 12% redeemable preference shares of ₹ 100 each at 5% premium redeemable after 15 years at 10% premium. If the floatation cost of each share is ₹ 2, what is the value of cost of preference share? 6

(b) The following is an extract from the financial statements of Kanchan Ltd. :

	₹ (in '00,000)
Operating Profit	105
Less : Interest on Debentures	33
	72
Less : Income tax	36
Net Profit	36
Equity Share Capital (shares of ₹ 10 each)	200
Reserve and Surplus	100
15% Non-Convertible Debentures (₹ 100 each)	220
	520

The market price per equity share is ₹ 12 and per debenture is ₹ 93·75. The rate of tax for the company is 30%.

Compute—

(i) earnings per share;

(ii) cost of equity capital;

(iii) cost of debenture. 3×3=9

Or

(a) State the assumptions of Net Operating Income Approach theory of Capital Structure. 3

(b) Aruna Engineering Co. and Mira Engineering Co. are in the same risk class and are identical in all respect except that Aruna Engineering uses debt while Mira Engineering does not resort to debt financing.

Aruna Engineering has ₹ 18,00,000 debentures, carrying coupon rate of 10%. Both the firms earn 20% before interest and taxes on their total assets of ₹ 30 lakhs. Corporation tax rate is 30% and capitalization rate is 15% for an all equity company.

Compute the value of both the companies using the NI and NOI approaches. 12

4. *(a)* State the various types of dividend. 3

(b) Co. Dipu Ltd. has the following data :

Earnings of the company—₹ 10,00,000

Dividend paid—₹ 7,50,000

Number of equity shares outstanding—100000 of ₹ 100 each

Price-earning ratio—12·50

(i) Compute the current market price per share (MPS) as per Walter's model.

(ii) What should be the price-earnings ratio for which the D/P ratio will have no effect on the value of the firm or MPS? 8+4=12

Or

Raaj Co. belongs to a risk class for which the appropriate capitalization rate is 12%. It currently has outstanding 30000 shares selling at ₹ 100 each. The firm is contemplating the declaration of dividend of ₹ 6 per share at the end of the current financial year. The company expects to have a net income of ₹ 3,00,000 and a proposal for making new investments of ₹ 6,00,000. Show that under the *MM* assumptions, the payment of dividend does not affect the value of the firm. How many new shares issued and what is the market value at the end of the year? 15

5. *(a)* State the factors to be considered in determining the requirement of working capital. 5

(b) Calculate the operating cycle and the working capital requirements from the following figures : 10

	Balance as at 1st January ₹	*Balance as at 31st December* ₹
Raw Materials	80,000	1,20,000
Work-in-Progress	20,000	60,000
Finished Goods	60,000	20,000
Sundry Debtors	40,000	40,000
Wages and Manufacturing Expenses		2,00,000
Distribution and other Expenses		40,000
Purchase of Materials		4,00,000
Total Sales		10,00,000

(i) The company obtains a credit for 60 days from its suppliers

(ii) All goods are sold for credit

Or

Sudhina Co. is considering the following credit policy alternatives :

Particulars	*Existing policy*	*Option—A*	*Option—B*
Credit period (in days)	30	41	60
Sales (₹ in lakhs)	10	9·60	12
Bad Debts (% of sales)	5	3·33	6
Cost of credit administration (₹ in lakhs)	0·20	0·12	0·25
Average effective collection period (in days)	45	51	72

The average effective collection period differs from the credit period as all debtors do not strictly adhere to the condition stipulated. The company achieves a contribution of 40% on sales and the firm requires a 20% p.a. return on investment. Evaluate and suggest the best alternative to the company to be followed in future.

(Assume 360 working days in a year) 15

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