Unique Paper Code : 22411502

Name of the Paper : Fundamentals of Financial Management

Name of the Course : B.Com. (H) - CBCS

Semester : V

Duration : 3 hours

Maximum Marks : 75 Marks

Instructions for Candidates

Attempt ***any four*** questions. All questions carry equal marks.

Q1. “Financial Management is concerned with solution of three major decisions- the investment decision, the financing decision and the dividend decision”. Explain the statement highlighting the inter-relationship amongst these decisions.

Also advise Mr. X that if he borrows from Bank an amount of Rs. 12,00,000 @ 10% p.a. on 1-4-2020. The repayment is to be made in 6 equal annual installment starting from three years from now. What would be the amount of each installment?

Q2. XYZ Ltd. Is considering the proposal of buying one of the two machines to manufactures a new product. Each of these machines requires an investment of Rs. 50,000 and is expected to provide benefits over a period of 4 years. After the expiry of the useful life of the machine, the seller of both the machines have guaranteed to buy back the machine at Rs. 5,000. The management of the company uses CE Approach to evaluate risky investment. The company’s risk adjusted discount rate is 16% and the risk free rate is 10%. The expected values of the net cash flow (CFAT) with their respective CE are:

	Proposal A		Proposal B	
Year	**CFAT**	**CE**	**CFAT**	**CE**
1	30,000	0.8	18,000	0.9
2	30,000	0.7	36,000	0.8
3	30,000	0.6	24,000	0.7
4	30,000	0.5	32,000	0.4

Which machine, if either, should be purchased by the company? Is Certainty Equivalent Approach theoretically superior to the Risk Adjusted Discount Rate?

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Q3. Give a critical appraisal of Modigliani and Miller Approach to the theory of capital structure.

The two companies U and L belong to the same risk class. They have everything in common except that firm L has 12% debentures of Rs. 10,00,000. The following information about the two firms is available to you:

Particulars	Firm U	Firm L
Net operating income(EBIT)	Rs. 4,00,000	Rs. 4,00,000
12% Debentures	-	Rs. 10,00,000
Equity capitalization rate(k_e)	0.15	0.16

Calculate the value of two firms and explain how under Modigliani – Miller approach an investor who owns 10% equity shares of the overvalued firm will be better off switching his holdings to the other firm. Also explain when arbitrage process will come to an end.

Q4. How is the cost of capital relevant in capital budgeting decisions? Also discuss the factors affecting cost of capital.

A company has the following capital structure :

Particulars	Book Value	Market Value
Equity Capital(30,000 shares of Rs. 10 each)	3,00,000	4,80,000
Preference capital (600 shares of Rs. 100 each carrying 12% dividend)	60,000	70,000
Reserves and Surplus	1,50,000	-
Debentures (2000 debentures of Rs. 100 each carrying 12% interest)	2,00,000	1,90,000
	7,10,000	7,40,000

The expected dividend per share is Rs. 1.50 and the dividend per share is expected to grow at a rate of 8 per cent forever. Preference shares are redeemable after 5 years at par whereas debentures are redeemable after 6 years at par. The tax rate for the company is 50 per cent.

You are required to compute the weighted average cost of capital (WACC) using market value weights.

Q5. Radiant Corporation, a market leader dealing in refrigeration products, has been paying dividend consistently over last several years The growth rate of dividend on an average has been 12%. The capitalisation rate of Radiant Corporation is 16%.
Consistent with its developmental philosophy Radiant Corporation acquired a technology for a new refrigerant that called for huge investment but offered a market potential of growth of 14% in earnings and dividends as well.

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The management decided to skip the dividend for next three years However, as a measure of good corporate governance and to reassure the investors it announced that the dividend would re-commence in 4 years from now at Rs. 12 only and would offer better growth of 14% instead of 12%. What do you think would the impact on the price of shares of Radiant Corporation in the market of the announcement of new project and resultant postponement of dividend, assuming Gordon Assumptions?

In this context, "Do you agree that dividend policy can be used to maximize the wealth position of equity holders" Explain with reference to the determinant of dividend policy.

Q6. "The efficiency of cash management depends on how efficiently the firm manages its inventory and Receivables" Comment.

Transient Ltd is currently operating at the 65% capacity utilization level with its sales pegged at Rs. 950 lakhs. As per its current credit policy the firm is offering a credit period of 20 days. The average collection period for Transient Ltd is 30 days. In view of increased competition that has started to erode its bottom-line recently, the firm's management has been contemplating relaxing its credit terms. As per management's projections such a liberalization of firm's credit policy is likely to boost its sales by 30%.However, since the proposed change is likely to increase the average credit period for the firm by 30 days, one section of company management is opposed to such a change proposed in the credit policy and is advocating a status quo. The variable costs for the firm are 75% of the sales and the fixed cost is Rs.100 lakhs. Are you in favor of such a change proposed in the firm's credit policy? Assume the opportunity cost of capital for Transient Ltd is 12%.

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