

END TERM EXAMINATION

FOURTH SEMESTER [BBA] MAY - JUNE 2019

Paper Code: BBA-204

Subject: Financial Management

(Batch 2017)

Time: 3 Hours

Maximum Marks: 75

Note: Attempt any five questions.

- Q1 Which of the following statements are correct and which are incorrect? Give reasons, to justify your answer: (3x5=15)
- Money has no time value.
 - Capital investment decisions are irreversible in character.
 - Under Net Operating Income Approach the overall capitalisation rate and the cost of debt does not remain constant.
 - Under Walter's Model, the payment ratio for a normal firm ($r=k$) is irrelevant.
 - The objective of financial management is wealth maximisation and not profit maximisation.
- Q2
- A company is expected to pay a dividend of Rs. 4 per share after a year. Its dividends are then expected to grow at 15% for next five years and then at the rate of 8% indefinitely. Find out the present value of its shares, if the capitalisation rate is 12%. (3)
 - Exactly ten year from now Shyam will start receiving a pension of Rs. 3,000 a year. The payment will continue for sixteen years. How much is the pension worth now, if Shyam's time preference rate is 10 per cent? (3)
 - A Ltd. has issued bonds of the par value of Rs. 1000. The present value of the bond is Rs. 900. The bond carries an interest rate is 14%. The maturity period is 5 years. You are required to calculate the yield to maturity. (3)
 - Between equity share and debentures which is preferable for raising additional long-term capital for a manufacturing company and why? (6)
- Q3
- The certainty equivalent approach is theoretically superior to the risk adjusted discount rate. Do you agree? Give reasons. (5)
 - A company is considering to purchase a machine. Two machines A and B are available each costing Rs. 5,00,000. In comparing the profitability of machine, a discount rate of 10% is to be used. Cash Flows after taxation are expected to be as follows: (10)

year	Cash Flow (Rupees)	
	Machine A	Machine B
1	1,50,000	50,000
2	2,00,000	1,50,000
3	2,50,000	2,00,000
4	1,50,000	3,00,000
5	1,00,000	2,00,000

Discount Factor at 10% is:

Year	1	2	3	4	5
PV Re. 1	.9091	.8264	.7513	.6830	.6209

You are required to indicated which of the machines would be profitable using the following methods of ranking investment proposals:

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- (i) Pay-back Method
 (ii) Net Present Value Method
 (iii) Return on Investment Method

- Q4 (a) "While evaluating single project with conventional cash flows, both NPV and IRR methods give identical decisions." Explain. (5)
 (b) X Ltd. is considering the purchase of a new plant requiring a cash outlay of Rs. 20,000. The plant is expected to have a useful life of 2 years without any salvage value. The cash flows and their associated probabilities for the two years are as follows: (10)

1 st Year	Cash Flow	Probability
(i)	8,000	0.3
(ii)	11,000	0.4
(iii)	15,000	0.3

2nd Year. If cash flows in 1st year are:

	Rs. 8,000		Rs. 11,000		Rs. 15,000	
	Cash flows	Probability	Cash flows	Probability	Cash flows	Probability
(i)	4,000	0.2	13,000	0.3	16,000	0.1
(ii)	10,000	0.6	15,000	0.4	20,000	0.8
(iii)	15,000	0.2	16,000	0.3	24,000	0.1

Presuming that 10% is the cost of capital, plot the above data in the form of a decision tree and suggest whether the project should be taken up or not.

- Q5 Following are the details regarding the capital structure of a company: (15)

Type of Capital	Book Value	Market Value	Specific Cost
Debentures	40,000	38,000	5%
Preference Capital	10,000	11,000	8%
Equity Capital	60,000	1,20,000	13%
Retained Earnings	20,000	-	9%
	1,30,000	1,69,000	

You are required to determine the weighted average cost of capital using:
 (i) Book value as weights, (ii) Market value as weights. Do you think, there can be situation where weighted average cost of capital would be the same irrespective of the weights used? <https://www.ggsipuonline.com>

- Q6 The following is the balance sheet of a company (15)

BALANCE SHEET

Liabilities	Amount	Assets	Amount
Equity Capital (Rs. 10 per share)	Rs. 60,000	Net Fixed Assets	Rs. 1,50,000
10% Long-term Debt	80,000	Current Assets	50,000
Retained Earnings	20,000		
Current Liabilities	40,000		
	2,00,000		2,00,000

The company's total assets turnover ratio is 3.0, its fixed operating costs are Rs. 1,00,000 and its variable operating costs ratio is 40%. The income tax rate is 50%.

- (a) Calculate for the company all the three types of leverages.
 (b) Determine the likely level of EBIT if EPS is (i) Re. 1 (ii) Rs. 3 (iii) Zero

P.T.O.

- Q7 (a) "In a world of no taxes and no transaction costs, a firm cannot be made more valuable by manipulating the dividend payout ratio." Examine the validity of the statement. (5)
- (b) The earnings per share of a company are Rs. 10. It has rate of return of 15% and the capitalisation rate of risk class is 12.5%. If Walter's model is used: (10)
- (i) What should be the optimum payout ratio of the firm?
- (ii) What would be the price of the share at this payout ratio?
- (iii) How shall the price of the share be affected if a different payout ratio was employed?

- Q8 The Board of Directors of Nanak Engineering Company Private Ltd., requests you to prepare a statement showing the Working capital Requirements Forecast for a level of activity of 1,44,000 units of production per annum. (15)

The following information is available for your calculation:

	Per Unit
(a) Raw Material	Rs. 90
Direct Labour	40
Overheads	<u>75</u>
	205
Profit	<u>60</u>
Selling price per unit	265

- (b) (i) Raw materials are in stock on average one month.
(ii) Finished goods are in stock, on average one month.
(iii) Credit allowed by suppliers one month.
(iv) Time lag in payment by debtors 2 months.
(v) Lag in payment of wage 1 ½ weeks.
(vi) Lag in payment of overheads one month.

20% of the output is sold against cash. Cash in hand and Bank is expected to be Rs. 60,000. It is to be assumed that production is carried on evenly throughout the year, and a time period of 4 weeks is equivalent to a month.
