TYBAF (V) / Financial Management / 18
Paper - II

Q.P.Code: 21764

[2Hrs 30Mins] **Total Marks: 75**

Instructions:

1. All questions are compulsory subject to internal choice.
2. Working notes form part of your answer.
3. Use of simple calculator is permitted.

Q1 A. Fill in the blanks (any 8) (08)

1. Diversification means ----------- investment in different securities.
2. The level of risk premium depends upon level of -----.
3. The net operating income approach is advocated by --------.
4. ----------- leverage is also known as trading on equity.
5. The Baumol Model assumes cash is used ------ throughout the period.
6. ------- financing is appropriate when operating leverage is low.
7. If sales volume increases the need for working capital ---------.
8. A ------- discount is a reduction in payment offered to customers to induce them to pay earlier.
9. Capital Structure is only the part of ------------ structure.
10. Excessive receivables involve ------ costs of financing, collection, delay and default.

Q1B. State whether following statements are True or False(any 7) (07)

1. Inflation rate has no impact on expected returns for an investors.
2. Default risk is the difficulty to sell the fixed income security.
3. Lenders require a lower rate of return than the ordinary shareholders.
4. Under Net Income Approach the cost of debt is less than cost of equity.
5. Walter model assumes earnings and dividend of firm never change.
6. Deposits with bank are short term investments.
7. If the firm follows lenient collection policy receivables could decrease.
8. If default rate is in excess of 10 percent the customers are classified with negligible risk of default.
9. Financial risk is associated with operating cash flows.
10. Tax and interest rate impacts operating leverage considerably.

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Q2A. Suraj Ltd. has Equity Share Capital of Rs 10,00,000 divided into shares of Rs 100 each. It wishes to raise further Rs 5,50,000 for expansion – cum- moderation scheme.

The Company plans the following financing alternatives:

(i) By issuing Equity shares only at 10% premium

(ii) By raising Term Loan only at 10% per annum.

(iii) By Issuing Equity shares and Debt finance in ratio of 6:5. The shares shall be issued at par while debentures carry interest rate of 12% p.a

(iv) By Issuing Equity shares and 8% Preference shares (FV 100) in the ratio 7:4. (At Par)

You are required to suggest the best alternative giving your comments assuming that the estimated operating profit after expansion is Rs 6,00,000 and corporate tax rate is 25%. (15)

OR

Q2B. The following data is available in case of Ganesh Ltd, Shiv Ltd and Parvathi Ltd, you are required to compute degree of financial leverage and EPS if the rate of EBIT on capital employed is 25%, 15% and 10%. Also interpret the results to ascertain which company is financially leveraged. The capital structure of companies are as below – (15)

	Ganesh Ltd	Shiv Ltd	Parvathi Ltd
Equity Capital	Rs 30,00,000	Rs 15,00,000	Rs 3,00,000
Debt Capital	-	Rs 15,00,000	Rs 27,00,000
Total Capital Employed	Rs 30,00,000	Rs 30,00,000	Rs 30,00,000

Tax rate 25%

Q3A. Prepare cash budget for the quarter ended 31st March 2018 from the following details:

(15)

Month	Sales (Rs.)	Purchases (Rs.)	Fixed Overheads (Rs.)	Variable Overheads (Rs.)
November	14,00,000	9,50,000	1,00,000	10% of sales
December	15,00,000	10,00,000	1,00,000	10% of sales

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January	18,00,000	13,00,000	1,00,000	10% of sales
February	20,00,000	16,00,000	1,00,000	10% of sales
March	20,00,000	15,00,000	1,00,000	10% of sales
April	19,00,000	15,00,000	1,00,000	10% of sales

Other details:

a. All sales are on credit basis and debtors make payment in following pattern in general:
   i. 10% advance in previous month
   ii. 50% in month of sale
   iii. Balance in month next to sale
b. 20% purchases are on cash basis and creditors are paid for credit purchases at the end of next month
c. All fixed expenses are paid in next month and all variable expenses are paid with a time lag of half month.
d. Company will be receiving interest on investment in March Rs.25000

The opening cash balance was Rs. 25000 as on 1st January, 2018.

OR

Q3 B. Mr Anagad holds the following securities you are required to ascertain the rate of return on the portfolio – (08)

Security	Cost (Rs in Lakhs)	Dividend (Rs in Lakhs)	Market Price at the end of the year (Rs in Lakhs)
BAT	45	3	65
CAT	55	3	57
MAT	42	1.5	40
RAT	100	4	98

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Q3C. From the following data, calculate the MARKET PRICE of a share of LSK Ltd., under (i) Walter's formula; and (ii) Gordon model. (07)

EPS = Rs. 1000

DPS = Rs. 550

Ke = 16%

IRR = 20%

Retention ratio = 55%

Q4 A. Guru- Krupa Ltd. is considering the revision of its credit policy with a view to increase its sales and profit. Currently all its sales are on credit and the customers are given one month's time to settle the dues. It has a contribution of 40% on sales. It can raise funds at a cost of 20% p.a. The marketing manager of the company has given the following options along with estimates for considerations:

Particulars	Existing Policy	Policy I	Policy II	Policy III
Sales (Rs. in lakhs)	200	210	220	250
Credit period (in months)	1	1 ½	2	3
Bad debts (% of sales)	2	2 ½	3	5
Cost of credit administration (Rs. in lakhs)	1.20	1.30	1.50	3.00

Tax rate 25%

Investment in Debtors is to be taken at variable cost only. You are required to advise the company for the most beneficial credit policy. (15)

OR

Q4B. A company needs Rs.40,00,000 for the construction of new plant. The company may issue Equity share capital of Rs.32,00,000 and 10% preferences share capital of Rs.8,00,000 or Equity shares capital of Rs.16,00,000 , 10 % Preference share capital of Rs.8,00,000 and 12% Debentures of Rs.16,00,000. Assume that the corporate tax rate is 25 percent and the price of the Equity share is Rs. 10 each and preference shares Rs 100 each. Calculate the level of EBIT at which the indifference point between the financing alternatives will occur. (08)

Q4C. Stock S has a beta of 1.70 and a market expectation of 12% return. For stock K, it is 1.20 and 10 % respectively. If the risk free rate is 7.5% and the market risk premium is 8%, evaluate whether these two stock are priced correctly? (07)

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Q5 A. What do you mean by business risk? Explain different types of business risk. (08)

B. Critically evaluate Modigliani Miller Theory. (07)

OR

Q5. Write Short notes on any 3: (15)

1. Security Market Line
2. Residual Dividend Policy
3. Miller – Orr Cash Management Model
4. 5 C's of Credit standards
5. Capital Asset Pricing Model

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