4/H–76 (x) (Syllabus–2015)

2018

(April)

COMMERCE

(Honours)

(Financial Management)

(BC–402)

Marks : 75

Time : 3 hours

The figures in the margin indicate full marks for the questions

1. What is financial management? Discuss the interrelationship between the functions of financial management. 3+12=15

Or

(a) Distinguish between discounting and compounding. 3

(b) *(i)* Miss Payal invested ₹ 50,000 in a one-year fixed deposit and rolled over annually for the next two years. The interest rate for the first year is 5% annually and the expected interest rate for the next two years are 6% and 6·5% respectively. Calculate the future value of the investment after 3 years. 3

(ii) Miss Srishti deposits ₹2,00,000 in a bank account which pays 10% interest. How much can she withdraw annually for a period of 15 years? 3

(c) Discuss briefly the scope of financial management. 6

2. (a) What is capital budgeting? What are the various methods for evaluation of capital expenditure projects? 3+3=6

(b) A company is considering a capital investment proposal where two alternatives involving differing degrees of mechanisation are being considered. Both investments would have a five-year life.

In option 1, new machinery would cost ₹2,78,000 and in option 2, ₹8,05,000. Anticipated scrap values after 5 years are ₹28,000 and ₹1,50,000 respectively. Depreciation is provided on a straight-line basis. Option 1 would generate annual inflows (including depreciation) of ₹1,00,000 and option 2, ₹2,50,000. The cost of capital is 15%.

Calculate for each option—

(i) the accounting rate of return, based on average book value;

(Continued)

(ii) the net present value;

(iii) the internal rate of return. 3+3+3=9

Or

(a) Compute the payback period under both the traditional and discounted payback period method and comment on the results : 10

Initial outlay : ₹80,000

Estimated life : 5 years

End of year	:	1	2	3	4	5
Profit after tax (₹)	:	6,000	14,000	24,000	16,000	Nil

Depreciation has been calculated under the straight-line method. The cost of capital may be taken at 10% p.a. Tax rate is 25%.

(b) Under what circumstances, IRR and NPV methods provide contradictory results regarding acceptance or rejection of investment proposal? 5

3. (a) A company raised loan by selling 250 debentures with 10% rate of interest at premium of ₹5 per debenture (par value = ₹100), redeemable at the end of 10th year. Underwriting and other issuance costs amounted to 3% of the proceeds. The tax rate is 30%. Calculate the cost of debt capital. 6

(b) KANU manufacturing company has current earnings of ₹ 2,00,000. The total number of equity shares is 20000. The current market price of equity share is ₹ 100. Shareholders of the company expect 10% return on their investments.

The company decides to finance a project costing ₹ 24,00,000 by selling new equity shares of ₹ 100 per share which can be sold to net ₹ 90 per share. Underwriting and other issue costs are expected to be 10% of the capital to be raised. The project to be financed with the proceeds of the new issue is expected to earn ₹ 10 per share.

Compute the cost of new equity stock. 9

Or

(a) What is weighted average cost of capital? State the importance of cost of capital in capital budgeting decision. 3+4=7

(b) Compute the overall cost of capital from the following information and find out the optimum combination of debt and equity. Assume tax rate to be 30% : 8

Situation	*Debt as a % of capital*	*Interest on debt capital*	*Cost of equity*
1	0%	7·2%	8·2%
2	30%	8·0%	8·5%
3	50%	9·0%	9·5%
4	80%	11·5%	11·8%

(Continued)

4. (a) Describe the 'birds-in-hand' argument of dividend. 5

(b) The following data are available for Jhuma Ltd. :

Earning per share—₹ 8·00

Rate of return on investment—16%

Rate of return required by share-holders—12%

If Gordon's basic valuation formula holds, what will be the price per share when the dividend pay-out ratio is *(i)* 25% and *(ii)* 60%? 10

Or

(a) State the assumptions of MM-Model of dividend policy. 3

(b) The cost of capital and rate of return on investment of Co. Sona Ltd. is 10% and 15% respectively. The company has 1000000 equity shares of ₹ 10 each and its EPS is ₹ 5. Calculate the value of the firm using Walter's model in the following situations : 12

(i) No retention

(ii) 100% retention

(iii) 70% retention

(iv) 30% retention

(Turn Over)

5. *(a)* Explain the concept of 'operating cycle' and its usefulness.

(b) Co. Subu, a large-scale consumer retailer is requesting you to forecast their working capital requirement from the following information : 1(

(i) Projected annual sales—
₹1,30,00,000

(ii) Percentage of net profit 25% (on cost of sales)

(iii) Average credit period allowed to debtors—10 weeks

(iv) Average credit period allowed by creditors—4 weeks

(v) Average stock carrying (in terms of sales requirement)—8 weeks

(vi) Add 10% for contingencies

Or

(a) What are the types of cost associated with receivable management? 3

(Continued)

(b) A company uses annually 50000 units of an item each costing ₹1·20. Each order costs ₹45 and inventory carrying costs 15% of the annual average inventory value.

(i) Find EOQ.

(ii) If the company operates 250 days a year, the procurement time is 10 days and safety stock is 500 units, find re-order level, maximum, minimum and average inventory.

2+10=12

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