2017

(April)

BUSINESS ADMINISTRATION

(Honours)

(Financial Management)

(BBAH–402)

Marks : 75

Time : 3 hours

The figures in the margin indicate full marks for the questions

PART—A

(*Marks* : 15)

UNIT—I

1. Outline any three key activities of a financial manager. 3

Or

A sum deposited at a bank fetches ₹ 14,898 after 4 years at 14% simple interest. Find out the principal amount.

UNIT—II

2. Mention three uses of capital budgeting for a firm. 3

Or

What is sensitivity analysis?

UNIT—III

3. Define cost of capital. 3

Or

H Ltd. issues 12% perpetual preference shares with face value of ₹200 each. Compute cost of preference shares (assume without tax).

UNIT—IV

4. What is meant by Financial leverage? 3

Or

State the assumptions under Net Operating Income approach.

UNIT—V

5. What do you mean by 'playing the float'? 3

Or

What are the motives for holding cash?

(Continued)

PART—B

(*Marks* : 50)

UNIT—I

6. What is Capital Asset Pricing Model (CAPM)? Explain its assumptions and limitations. 3+4+3=10

Or

(a) Mr. *X* is planning on getting married in 10 years from now. He estimates the wedding would cost him ₹5,00,000. How much should Mr. *X* save annually so as to have the required amount at the end of 10 years? Assume an interest rate of 12% p.a.

(b) You are valuing an investment that will pay you ₹12,000; ₹14,000; ₹17,000; ₹19,000 and ₹23,000 in the first year through the fifth year respectively. All payments are made at the end of each year. What is the present value of the investment if the appropriate discount rate is 10%? 5+5=10

(Turn Over)

UNIT—II

7. Shillong Bright Ltd. is considering two different investment proposals, *A* and *B*, and the cash flow are as under :

	Proposal—A	*Proposal—B*
	₹	₹
Investment cost	9,500	20,000
Estimated income :		
Year 1	4,000	8,000
2	4,000	8,000
3	4,500	12,000

Suggest the most attractive proposal on the basis of the Net Present Value (NPV) method considering that the future incomes are discounted at 12%. Also find out internal rate of return (IRR) of the two proposals. 5+5=10

Or

From the following details, relating to two companies, calculate the expected return of company *P* and *Q* and standard deviation as a risk measure of the two companies. Comment on the return and risk estimates of the two companies : 10

Outcome	*Company P*		*Company Q*	
	Expected Return	*Probability*	*Expected Return*	*Probability*
1	6	0·3	8	0·5
2	8	0·5	12	0·3
3	10	0·2	18	0·2

(Continued)

UNIT—III

8. Equity share of a paper manufacturing company is currently selling at ₹ 100. It wants to finance its capital expenditure of ₹ 1,00,000 either by retaining earnings or selling new shares. If company seeks to sell shares, the issue price will be ₹ 95. The expected dividend for next year is ₹ 4·75 per share and is expected to grow at 6% perpetually.

Calculate cost of internal and external equity capital. 5+5=10

Or

K. G. Ltd. has provided the following information and requested you to calculate—

(a) Weighted Average Cost of Capital (WACC) using book-value weights;

(b) Weighted Marginal Cost of Capital (WMCC) assuming that specific cost do not change.

Source of Finance	*Amount* ₹	*Weights* (%)	*After tax cost* (%)
Equity Capital	14,00,000	0·452	9
Preference Capital	8,00,000	0·258	12
Debenture	9,00,000	0·290	16

K. G. Ltd. wishes to raise an additional capital of ₹ 12,00,000 for an expansion programme. The details of funds sources are as follows :

	₹
Equity Capital	6,00,000
Preference Capital	3,00,000
Debentures	3,00,000

5+5=10

UNIT—IV

9. *X* Ltd. and *Y* Ltd. are in the same risk class and are identical in all respects except that company *X* Ltd. uses debt while company *Y* Ltd. does not use debt. The levered firm has ₹ 9,00,000 debentures carrying 10% rate of interest. Both the firms earn 20% operating profit on their total assets of ₹ 15,00,000. The company is in the tax bracket of 35% and capitalization rate of 15% on all equity shares.

Compute the value of *X* Ltd. and *Y* Ltd. using Net Income (NI) approach. 10

Or

The earnings per share of a company is ₹ 8 and the rate of capitalization is 10%. The company has before it an option of adopting *(a)* 50%, *(b)* 75% and *(c)* 100% dividend payout ratio.

(Continued)

Compute the market price of the company's quoted shares as per Walter's model, if it can earn a return of *(a)* 15%, *(b)* 10%, *(c)* 5% on its retain earnings. 10

UNIT—V

10. What is working capital management? Explain the various factors influencing working capital requirements. 2+8=10

Or

(a) *X* Ltd. feels a Lock Box System (LBS) would reduce its debtors' collection period by 2 days. The average number of daily payments is 50. Credit sales are ₹ 8,000 billed on a continuous basis. However, the cost of renting the Lock Box is ₹ 3,000 per annum. The bank charges for operating the LBS are ₹ 72,000. The interest is 15%. Should the system be introduced?

(b) Discuss Miller and Orr model of cash management. 5+5=10

(Turn Over)

PART—C

(Case Study)

(*Marks* : 10)

Consider the following particulars :

	Firm A	*Firm B*
	₹	₹
Equity Share Capital	5,00,000	3,00,000
Debt Capital	0	2,00,000
Total Capital Employed	5,00,000	5,00,000
EBIT (Net Operating Income) (in ₹)	50,000	50,000
Interest on debt (in ₹)	0	10,000
Market value of debt (Debt capitalization rate is 5%) (in ₹)	—	2,00,000
Equity earnings (in ₹)	50,000	40,000
Equity capitalization rate	10%	12%
Market value of equity (in ₹)	5,00,000	3,33,333
Total value of the firm (in ₹)	5,00,000	5,33,333
Weighted average cost of capital	10%	9·33%

Sam, an investor, was 1% equity of firm *B*. He feels that by selling off his shareholding in firm *B* and investing in firm *A*, his income would increase. Do you agree? Yes or No? Justify.

(The assumptions of Modigliani-Miller hold good in this case) 10