

Roll No.....

Time allowed : 3 hours

Maximum marks : 100

Total number of questions : 7    Total number of printed pages : 10

**NOTE :** 1. Answer FIVE questions including Question No.1 which is compulsory. All working notes should be shown distinctly.

2. Tables showing the present value of Re.1 and the present value of an annuity of Re.1 for 15 years are annexed.

1. (a) "The choice of an appropriate debt policy involves a trade-off between tax benefits and the cost of financial distress." Comment.
- (b) "In the emerging economic and financial environment, the role and responsibility of treasury manager has become more demanding, complex and important." Elaborate.
- (c) "Cost of retained earnings is the opportunity cost of returns obtained in a similar investment elsewhere." Discuss.
- (d) "Internal treasury control is a process of self-improvement." Comment.

(5 marks each)

2. (a) Joel Ltd. is commencing a new project for manufacture of a plastic component. The following cost information has been ascertained for annual production of 12,000 units at full capacity :

	<i>Cost Per Unit</i> (Rs.)
Materials	40
Direct labour and variable expenses	20
Fixed manufacturing expenses	6
Depreciation	10
Fixed administrative expenses	4
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	80
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Selling price per unit is expected to be Rs.96 and selling expenses Rs.5 per unit, 80% of which is variable.

In the first two years of operations, production and sales are expected to be as follows :

<i>Year</i>	<i>Production</i> (No. of Units)	<i>Sales</i> (No. of Units)
1	6,000	5,000
2	9,000	8,500

Following additional information is available :

- (i) Stock of materials : 2.25 months' average consumption.
- (ii) Work-in-process : Nil.
- (iii) Debtors : 1 month's average sales.
- (iv) Cash balance : Rs.10,000.
- (v) Creditors for supply of materials : 1 month's average purchase during the year.

(vi) Creditors for expenses : 1 month's average of all expenses during the year.

Prepare projected statement of working capital requirements for the two years.

(15 marks)

- (b) Ankit Ltd. is considering to take up Project-X or Project-Y. Both the projects have same life, require equal investment of Rs.80 lakh and have almost same yield. An attempt is made to use Probability Theory to analyse the pattern of cash flow from either project during first year of operation. This pattern is likely to continue during life of these projects. The results of analysis are as follows :

<i>Project-X</i>		<i>Project-Y</i>	
<i>Cash Flow</i>	<i>Probability</i>	<i>Cash Flow</i>	<i>Probability</i>
<i>(Rs.)</i>		<i>(Rs.)</i>	
12,00,000	0.10	8,00,000	0.10
14,00,000	0.20	12,00,000	0.25
16,00,000	0.40	16,00,000	0.30
18,00,000	0.20	20,00,000	0.25
20,00,000	0.10	24,00,000	0.10
<u>80,00,000</u>	<u>1.00</u>	<u>80,00,000</u>	<u>1.00</u>

You are required to decide as to which project is riskier to be dropped by the company.

(5 marks)

3. (a) Following information is available regarding Faxfit Ltd. :

	<i>Rs.</i>
Earnings before interest and tax (EBIT)	... 100 lakh
Interest on debentures @ 10%	... 4.00 lakh
Interest on term loan @ 12%	... 4.80 lakh
Income-tax	... 27.36 lakh
Market price per share	... 20.00
Number of equity shares (Face value Rs.10)	... 20 lakh (equity shares)

The company has undistributed reserves and surplus of Rs.70 lakh. It is in need of Rs.130 lakh to pay off debentures and modernise plants.

The company is considering following alternatives of financing :

- Raising entire amount as term loans @ 14% per annum.
- Issuing 4 lakh shares @ Rs.18 per share and rest of the amount as loan @ 14% per annum.

As a result of modernisation, the return on capital employed is likely to improve by 2.5%. In case the total amount is raised in the form of term loans, the P/E ratio of the company is likely to decline by 10%.

You are required to --

- (i) advise the company on financial plan to be selected; and
- (ii) find out the indifference level of EBIT.

*(12 marks)*

- (b) From the following information, ascertain whether the firm is following an optimal dividend policy as per Walter's Model :

Total earnings (Rs.)	..	6,00,000
Number of equity shares of Rs.100 each	..	40,000
Dividend paid (Rs.)	..	1,60,000
Prices-Earnings (P/E) ratio	..	10

The firm is expected to maintain its rate of return on fresh investment. What should be the P/E ratio at which dividend policy will have no effect on the value of the share ? Will your decision change if the P/E ratio is 5 instead of 10 ?

(8 marks)

4. Distinguish between the following :

- (i) 'Sensex' and 'nifty'.
- (ii) 'Caps' and 'collars'.
- (iii) 'Financial structure' and 'capital structure'.
- (iv) 'Forward contract' and 'options'.

(5 marks each)

5. Karishma Ltd. is considering to manufacture a new product which will involve use of a new machine costing Rs.1,50,000 and an existing machine, which was purchased two year ago at a cost of Rs.80,000, having current book value of Rs.60,000. There is sufficient under-utilised capacity on

this machine. It is also estimated that annual sales of the product will be 5,000 units at Rs.32 per unit with following cost composition :

	<i>Rs.</i>
Direct material	7
Direct labour (4 Hours per unit @ Rs.2 per unit)	8
Fixed cost (including depreciation)	9
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	24
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The project would have a five year life, with residual value of Rs.10,000 for new machine. Direct labour being continuously in short supply, the labour resources would have to be diverted from other work, currently earning a profit of Rs.1.50 per direct labour hour. Fixed overheads absorption rate would be Rs.2.25 per hour and actual expenditure on fixed overheads will not change. The requirement of working capital would be Rs.10,000 in the first year, Rs.15,000 in the second and subsequent years till the end of the project when it will be recovered. The company's cost of capital is 20%. Ignoring tax implications, decide if the project is worth accepting.

*(20 marks)*

6. (a) From the following data of Abhishek Ltd. as on 30<sup>th</sup> September, 2006, compute the operating leverage, financial leverage, combined leverage and percentage change in earnings per share (EPS), if sales are expected to increase by 5% :

	<i>Rs.</i>
Earnings before interest and tax (EBIT)	10 lakh
Profit before tax (PBT)	4 lakh
Fixed cost	6 lakh

*(5 marks)*

- (b) Management of an Indian company is contemplating to import a machine from USA at a cost of US\$15,000 at today's spot rate of \$0.0227272 per Rupee. Finance manager opines that in the present foreign exchange market scenario, the exchange rate may shoot up by 10% after two months and accordingly he proposes to defer import of machine. Management thinks that deferring import of machine will cause a loss of Rs.50,000 to the company in the coming two months. As the Company Secretary, you are asked to express your views, giving reasons, as to whether the company should go in for purchase of machine right now or defer purchase for two months.

(5 marks)

- (c) Sales manager of a company proposes to sell goods to a group of new customers with 10% risk of non-payment. This group would require one and a half month's credit and is likely to increase sales by Rs.1,00,000 per annum. Production and selling expenses amount to 80% of sales and income-tax rate is 30%. The company's minimum required rate of return after tax is 25%.

Should the sales manager's proposal be accepted ?

Find the degree of risk of non-payment that the company should be willing to assume, if required rate of return (after tax) is (i) 30%; (ii) 40%; or (iii) 60%.

(10 marks)

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7. Write notes on *any four* of the following :

- (i) Relationship between spot rate and forward rate
- (ii) Sources of real estate funding
- (iii) Stock lending scheme
- (iv) Technical charts
- (v) Economic value added (EVA) and wealth-maximisation.

*(5 marks each)*

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TABLE - 1 : PMSNT VALUE OF MUPE ONE

RATE	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
5 %	0.9524	0.9070	0.8638	0.8227	0.7835	0.7462	0.7107	0.6768	0.6446	0.6139	0.5847	0.5568	0.5303	0.5051	0.4810
6 %	0.9434	0.8900	0.8396	0.7921	0.7473	0.7050	0.6651	0.6274	0.5919	0.5584	0.5268	0.4970	0.4688	0.4423	0.4173
7 %	0.9346	0.8734	0.8163	0.7629	0.7130	0.6663	0.6227	0.5820	0.5439	0.5083	0.4751	0.4440	0.4150	0.3878	0.3624
8 %	0.9259	0.8573	0.7938	0.7350	0.6806	0.6302	0.5835	0.5403	0.5002	0.4632	0.4289	0.3971	0.3677	0.3405	0.3152
9 %	0.9174	0.8417	0.7722	0.7084	0.6499	0.5963	0.5470	0.5019	0.4604	0.4224	0.3875	0.3555	0.3262	0.2992	0.2745
10 %	0.9091	0.8284	0.7513	0.6830	0.6209	0.5645	0.5132	0.4665	0.4241	0.3855	0.3505	0.3186	0.2897	0.2633	0.2394
11 %	0.9009	0.8116	0.7312	0.6587	0.5935	0.5346	0.4817	0.4339	0.3909	0.3522	0.3173	0.2858	0.2575	0.2320	0.2090
12 %	0.8929	0.7972	0.7118	0.6355	0.5674	0.5066	0.4523	0.4039	0.3606	0.3220	0.2875	0.2567	0.2292	0.2046	0.1827
13 %	0.8850	0.7831	0.6931	0.6133	0.5428	0.4803	0.4251	0.3762	0.3329	0.2946	0.2607	0.2307	0.2042	0.1807	0.1599
14 %	0.8772	0.7695	0.6750	0.5921	0.5194	0.4556	0.3986	0.3506	0.3075	0.2687	0.2336	0.2076	0.1821	0.1597	0.1401
15 %	0.8696	0.7561	0.6575	0.5718	0.4972	0.4323	0.3759	0.3269	0.2843	0.2472	0.2149	0.1869	0.1625	0.1413	0.1229
16 %	0.8621	0.7432	0.6407	0.5523	0.4761	0.4104	0.3538	0.3050	0.2630	0.2267	0.1954	0.1685	0.1452	0.1252	0.1079
17 %	0.8547	0.7305	0.6244	0.5337	0.4561	0.3898	0.3332	0.2848	0.2434	0.2080	0.1778	0.1520	0.1299	0.1110	0.0949
18 %	0.8475	0.7182	0.6086	0.5158	0.4371	0.3704	0.3139	0.2660	0.2255	0.1911	0.1619	0.1372	0.1163	0.0985	0.0835
19 %	0.8403	0.7062	0.5934	0.4987	0.4190	0.3521	0.2959	0.2487	0.2090	0.1756	0.1476	0.1240	0.1042	0.0876	0.0736
20 %	0.8333	0.6944	0.5787	0.4823	0.4019	0.3349	0.2791	0.2326	0.1938	0.1615	0.1346	0.1122	0.0935	0.0779	0.0649
21 %	0.8264	0.6830	0.5645	0.4665	0.3855	0.3186	0.2633	0.2176	0.1799	0.1486	0.1228	0.1015	0.0839	0.0683	0.0573
22 %	0.8197	0.6719	0.5507	0.4514	0.3700	0.3033	0.2486	0.2038	0.1670	0.1369	0.1122	0.0920	0.0754	0.0618	0.0507
23 %	0.8130	0.6610	0.5374	0.4369	0.3552	0.2888	0.2348	0.1909	0.1552	0.1262	0.1026	0.0834	0.0678	0.0551	0.0448
24 %	0.8065	0.6504	0.5245	0.4230	0.3411	0.2751	0.2218	0.1789	0.1443	0.1164	0.0938	0.0757	0.0610	0.0492	0.0397
25 %	0.8000	0.6400	0.5120	0.4096	0.3277	0.2621	0.2097	0.1678	0.1342	0.1074	0.0859	0.0687	0.0550	0.0440	0.0352

**TABLE - 2 : PRESENT VALUE OF AN ANNUITY OF RUPE ONE**

RATE	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
5 %	0.9524	1.8594	2.7232	3.5460	4.3295	5.0757	5.7864	6.4632	7.1078	7.7217	8.3064	8.8633	9.3936	9.8986	10.3797
6 %	0.9434	1.8334	2.6730	3.4651	4.2124	4.9173	5.5824	6.2098	6.8017	7.3601	7.8869	8.3838	8.8527	9.2950	9.7122
7 %	0.9346	1.8080	2.6243	3.3872	4.1002	4.7665	5.3883	5.9713	6.5152	7.0236	7.4987	7.9427	8.3577	8.7455	9.1079
8 %	0.9259	1.7833	2.5771	3.3121	3.9927	4.6229	5.2064	5.7466	6.2469	6.7101	7.1390	7.5361	7.9038	8.2442	8.5595
9 %	0.9174	1.7591	2.5313	3.2397	3.8897	4.4859	5.0330	5.5348	5.9952	6.4177	6.8052	7.1607	7.4889	7.7882	8.0607
10 %	0.9091	1.7355	2.4869	3.1639	3.7908	4.3553	4.8684	5.3349	5.7590	6.1446	6.4951	6.8137	7.1034	7.3667	7.6061
11 %	0.9009	1.7125	2.4437	3.1024	3.6959	4.2305	4.7122	5.1461	5.5370	5.8882	6.2065	6.4924	6.7499	6.9819	7.1909
12 %	0.8929	1.6901	2.4018	3.0373	3.6048	4.1114	4.5638	4.9676	5.3282	5.6502	5.9377	6.1944	6.4235	6.6282	6.8109
13 %	0.8850	1.6681	2.3612	2.9745	3.5172	3.9975	4.4226	4.7988	5.1317	5.4282	5.6869	5.9176	6.1218	6.3025	6.4624
14 %	0.8772	1.6467	2.3216	2.9137	3.4331	3.8887	4.2883	4.6389	4.9464	5.2161	5.4527	5.6603	5.8424	6.0021	6.1422
15 %	0.8696	1.6257	2.2832	2.8550	3.3522	3.7845	4.1604	4.4873	4.7716	5.0188	5.2337	5.4206	5.5831	5.7245	5.8474
16 %	0.8621	1.6052	2.2459	2.7982	3.2743	3.6847	4.0386	4.3436	4.6065	4.8332	5.0286	5.1971	5.3423	5.4675	5.5755
17 %	0.8547	1.5852	2.2096	2.7432	3.1933	3.5882	3.9224	4.2072	4.4506	4.6586	4.8364	4.9884	5.1183	5.2293	5.3242
18 %	0.8475	1.5656	2.1743	2.6901	3.1272	3.4976	3.8115	4.0776	4.3030	4.4941	4.6560	4.7932	4.9095	5.0061	5.0916
19 %	0.8403	1.5465	2.1389	2.6386	3.0576	3.4098	3.7057	3.9544	4.1633	4.3389	4.4865	4.6105	4.7147	4.8023	4.8759
20 %	0.8333	1.5278	2.1065	2.5887	2.9906	3.3255	3.6046	3.8372	4.0310	4.1925	4.3271	4.4392	4.5327	4.6106	4.6755
21 %	0.8264	1.5095	2.0739	2.5404	2.9280	3.2446	3.5079	3.7256	3.9054	4.0541	4.1789	4.2784	4.3624	4.4317	4.4880
22 %	0.8197	1.4915	2.0422	2.4936	2.8636	3.1689	3.4155	3.6193	3.7883	3.9232	4.0354	4.1274	4.2028	4.2646	4.3152
23 %	0.8130	1.4740	2.0114	2.4483	2.8035	3.0923	3.3270	3.5179	3.6731	3.7993	3.9018	3.9852	4.0530	4.1082	4.1530
24 %	0.8065	1.4568	1.9813	2.4043	2.7454	3.0205	3.2423	3.4212	3.5655	3.6819	3.7757	3.8514	3.9124	3.9616	4.0013
25 %	0.8000	1.4400	1.9520	2.3616	2.6883	2.9514	3.1611	3.3289	3.4631	3.5705	3.6564	3.7251	3.7801	3.8241	3.8593