

Roll No.....

Time allowed : 3 hours

Maximum marks : 100

Total number of questions : 7

Total number of printed pages : 6

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. Comment on **any four** of the following :

- (i) Dividend policy is strictly a financing decision and payment of cash dividend is a passive residual.
- (ii) Depository system functions very much like banking system.
- (iii) Accounting profit does not take into account all costs of capital invested in business.
- (iv) The mark-to-market process is lengthy for index futures.
- (v) Financial gearing is a fair weather friend.

(5 marks each)

2. (a) Following figures relate to Twinkle Ltd. :

	<i>Rs.</i>
Sales (at 3 months' credit)	45,00,000
Materials consumed (suppliers extend 1½ months credit)	11,25,000
Wages paid (1 month in arrear)	9,00,000
Manufacturing expenses outstanding at the end of the year (cash expenses are paid one month in arrear)	1,00,000
Total administration expenses for the year (cash expenses are paid one month in arrear)	3,00,000
Sales promotion expenses for the year (paid quarterly in advance)	6,00,000

The company sells its product on gross profit margin of 25% assuming depreciation as a part of cost of production. It keeps 2 months' stock of finished goods and one month's stock of raw materials as inventory. It keeps cash balance of Rs.1,25,000. Assume a safety margin of 5%.

Work out working capital requirements of the company on cash cost basis. Ignore work-in-process.

(12 marks)

- (b) Gel Corporation presently gives credit terms of 'net 30 days'. It has Rs.600 lakh in credit sales and its average collection period is 45 days. To stimulate sales, the company may give credit terms of 'net 60 days' with sales expected to increase by 15%. After the change, the average collection period is expected to be 75 days with no difference in payment habits between old and new customers. Variable costs are Re.0.80 for every Re.1 of sales; and the company's before tax required rate of return on investment in receivables is 20%. Assume 360 days in a year. Should the company extend its credit period ?

(8 marks)

3. (a) Sushmita Ltd. produces an electronic component with a selling price of Rs.100. Fixed cost amounts to Rs.2 lakh. 5,000 Units are produced and sold each year. Annual profits amount to Rs.50,000. The company's all equity-financed assets are Rs.5 lakh.

The company proposes to change its production process, adding Rs.4,00,000 to investment and Rs.50,000 to fixed operational costs. The consequences of such a proposal are —

- (i) Reduction in variable costs per unit Rs.10;
- (ii) Increase in output by 2,000 units; and
- (iii) Reduction in selling price per unit to Rs.95.

Assuming an average cost of capital at 10%, examine the proposal and advise whether the company should make the change. Also, measure the degree of operating leverage and break-even point.

(10 marks)

- (b) You are given following information of Alpha Ltd. for the year ended 31st March, 2010 :

	<i>Rs. in Thousands</i>
Sales	1,05,000
Variable cost	76,700
Fixed cost	7,500
Interest	11,000
Income-tax @ 30%.	

On the basis of above information, you are required to calculate and interpret operating, financial and combined leverages.

(6 marks)

- (c) Security-A offers an expected rate of return of 14% with a standard deviation of 8%. Security-B offers an expected rate of return of 11% with a standard deviation of 6%. If an investor wishes to construct a portfolio with a 12.8% expected return, what percentage of the portfolio will consist of Security-A ?

(4 marks)

4. Distinguish between **any four** of the following :

- (i) 'Financial distress' and 'insolvency'.
- (ii) 'Leasing' and 'hire-purchase'.
- (iii) 'Financial viability of a project' and 'commercial viability of a project'.
- (iv) 'Clearing mechanism' and 'settlement mechanism'.
- (v) 'Return on capital employed' and 'return on net worth'.

(5 marks each)

5. India Inc.'s dependence on banks for funding appears to be showing decline. With the Reserve Bank of India blocking sub-benchmark prime lending rate route for cheap financing from banks, corporates are looking at non-bank alternatives.

Under the earlier below prime lending rate (BPLR) regime, while large corporates could borrow at low interest rates from banks, the small and medium enterprises (SMEs) and retail borrowers ended up paying high interest rates. The new lending regime is aimed at enhancing transparency in lending rates of banks.

Highly rated corporates are replacing their earlier short-term sub-BPLR loans, by taking recourse to the debt market to keep a lid on borrowing costs and have been able to raise resources around the base rate of banks. However, corporates may not be able to supplant bank finance with funds from the debt capital market. Funding could dry up from debt markets in case of a liquidity crisis in the financial system.

Although, a bit costly as compared to the debt markets, banks are a steady source of funds for corporates. A bank is unlikely to jeopardize its long-standing relationship with a corporate by choking off funds during a liquidity crisis.

Answer the following questions :

- (i) List and describe features of sources of finance other than banks and equity for corporates.

(10 marks)

- (ii) How is base rate system more expensive than prime lending rate for corporates ?

(5 marks)

- (iii) How is bank finance superior to funding from debt market for corporates ?

(5 marks)

6. (a) Sushant Ltd. has the following capital structure :

	<i>Rs.</i>
Equity shares	50,00,000
10% Preference shares	10,00,000
14% Debentures	20,00,000
	80,00,000
	80,00,000

Equity shares of the company are sold at Rs.25 per share in the market. It is expected that the company will pay next year a dividend of Rs.4 per share which will grow at 8% forever. Assume a tax-rate of 30%.

- (i) Compute weighted average cost of capital based on the existing capital structure.
- (ii) Compute the new weighted average cost of capital, if the company raises an additional Rs.20,00,000 debt by issuing 15% debentures. This would increase the expected dividend to Rs.5 per share with dividend growth rate unchanged, but the price of share will fall to Rs.20 per share.

(12 marks)

- (b) A company is considering three methods of attracting customers to expand its business by undertaking — (A) advertising campaign; (B) display of neon signs; and (C) direct delivery service. The initial outlay for each alternative is as under :

A	Rs.1,00,000
B	Rs.1,50,000
C	Rs.1,50,000

If A is carried out, but not B, it has an NPV of Rs.1,25,000. If B is done, but not A, B has an NPV of Rs.45,000. However, if both are done, then NPV is Rs.2,00,000. The NPV of the delivery system C is Rs.90,000. Its NPV is not dependent on whether A or B is adopted and the NPV of A or B does not depend on whether C is adopted.

Which of the investments should be made by the company if (i) firm has no budget constraint; and (ii) the budgeted amount is only Rs.2,50,000 ?

(8 marks)

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

- (i) Secured premium note
- (ii) Important motives to hold cash
- (iii) Domestic resource cost
- (iv) Purchasing power parity
- (v) Factoring.

(5 marks each)

TABLE - I : PRESENT VALUE OF RUPEE ONE

RATE	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 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	0.8264	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	0.3996	0.3506	0.3075	0.2697	0.2366	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	0.0693	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 RUPEE ONE

RATE	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR	YEAR
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
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	5.3893	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	7.4869	7.7862	8.0607			
10%	0.9091	1.7355	2.4869	3.1699	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	5.8892	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	5.4262	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	3.1993	3.5892	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	5.0081	5.0916			
19%	0.8403	1.5465	2.1399	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	2.9260	3.2446	3.5079	3.7256	3.9054	4.0541	4.1769	4.2784	4.3624	4.4317	4.4890			
22%	0.8197	1.4915	2.0422	2.4936	2.8636	3.1669	3.4155	3.6193	3.7863	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	2.6893	2.9514	3.1611	3.3289	3.4631	3.5705	3.6564	3.7251	3.7801	3.8241	3.8593			