

Roll No.....

Time allowed : 3 hours

Maximum marks : 100

Total number of questions : 7
Total number of printed pages : 8

- 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) 'Wealth maximisation' objective of the financial management is redefined as 'value maximisation'.
 - (ii) Project planning aims at choosing the minimum quantum of investment which may yield the highest return or maximise investments for obtaining the highest growth of the project.
 - (iii) Corporate financing decision without consideration of corporate taxation is meaningless.
 - (iv) Zero based budgeting plays a vital role in treasury management.
 - (v) Operations in forex market are exposed to a number of risks.
 - (vi) Large shareholders are not interested in dividends.

(5 marks each)
2. (a) Ritesh holds a well diversified portfolio of stock in XYZ Group. During the last 5 years, returns on these stock have averaged 20% per year and had a standard deviation of 15%. He is satisfied with the yearly availability of his portfolio and likes to reduce its risk without affecting overall returns. He approaches you for help in finding an appropriate diversification medium. After a lengthy review of alternatives, you conclude — (i) future average returns and volatility of returns on his current portfolio will be the same as he has historically expected; and

(ii) to provide a quarter degree of diversification in his portfolio, investment could be made in stocks of the following groups :

Groups	Expected Returns	Co-relation of Returns with XYZ Group	Standard Deviation
Rekha Ltd.	20%	+1.0	15%
Tina Ltd.	20%	-1.0	15%
Bipasha Ltd.	20%	+0.0	15%

- (i) If Ritesh invests 50% of his funds in Rekha Ltd. and leaves the remainder in XYZ Group, would this affect both his expected returns and his risk? Why ?
- (ii) If Ritesh invests 50% of his funds in Tina Ltd. and leaves the remainder in XYZ Group, how would this affect both his expected return and his risk ? Why ?
- (iii) What should Ritesh do ? Indicate precise portfolio weightage.

(6 marks)

- (b) Blue Berry Ltd. estimates its carrying cost at 12% and its ordering cost at Rs.12 per order. The estimated annual requirement is 40,000 units at a price of Rs.5 per unit. What is the most economical number of units to order and how often will an order need to be placed ?

(6 marks)

- (c) An equity share of Rs.100 is expected to earn an annual dividend of Rs.10 and this share can be sold at price of Rs.180 at the end of year. If the required rate of return is 12%, calculate the value of equity share.

(4 marks)

- (d) A simplified income statement of Abhiash Ltd. is given below. Calculate and interpret its degree of operating leverage, degree of financial leverage and degree of combined leverage.

Particulars of income of Abhiash Ltd. for the year ended on 31st March, 2006 are as follows :

	<i>Rs.</i>
Sales	1,05,00,000
Variable cost	76,70,000
Fixed cost	7,50,000
EBIT	20,80,000
Interest	11,00,000
Taxes (30%)	2,94,000
Net income	6,86,000

(4 marks)

3. Prithvi Ltd. is a manufacturer of variety of electrical equipments. The existing machine is based on old technology. In order to improve the quality of the product and bring down operating cost, the management is planning to replace the existing machine with a new one based on latest technology. Following are the relevant information :

Existing machine :

Purchased	–	5 years ago
Remaining life	–	5 years
Salvage value	–	Rs.20,000
Depreciation	–	Straight line basis
Current book value	–	Rs.3,00,000
Realisable market value	–	Rs.3,50,000
Annual depreciation	–	Rs.28,000

New replacement machine :

Capital cost	–	Rs.10,00,000
Estimated useful life	–	5 years
Estimated salvage value	–	Rs.1,00,000

The replacement machine would permit an output

expansion. As a result, sales is expected to increase by Rs.1,00,000 per year, operating expenses would decline by Rs.2,00,000 per year. It would require an additional inventory of Rs.2,00,000 and would cause an increase in accounts payable by Rs.50,000.

Assuming a corporate tax rate of 30% and cost of capital of 12%, advise the company about replacement of the existing machine.

(20 marks)

4. (a) "Internal funds are the important sources of finance." Discuss.
(5 marks)
- (b) "No major economic benefit results from bonus shares and share splits." Explain.
(5 marks)
- (c) "Future contracts have linear pay-offs. It means that the losses as well as profits for the buyer and seller are unlimited." Explain.
(5 marks)
- (d) "There is usually a difference between the social and monetary cost/benefits of a project." Discuss.
(5 marks)
5. (a) "In an uncertain world in which verbal statements can be ignored or misinterpreted, dividend action does provide a clear-cut means of 'making a statement' that speaks louder than thousand words." Explain.
(6 marks)
- (b) Identify the profit or loss (ignoring dealing cost and interest) in each of the following cases :
- (i) A call option with an exercise price of Rs.200 is bought for a premium of Rs.89. The price of underlying share is Rs.276 at the expiry date.
(3 marks)
- (ii) A put option with exercise price of Rs.250 is bought for a premium of Rs.42. The

price of underlying share is Rs.189 at the expiry date.

(3 marks)

(iii) A put option with an exercise price of Rs.300 is written for a premium of Rs.57. The price of the underlying share is Rs.314 at the expiry date.

(3 marks)

(c) The present credit terms of Creation Ltd. are 1/10, net 30. Its annual sales are Rs.80 lakh, its average collection period is 20 days. Its variable costs and average total costs to sales are 0.85 and 0.95 respectively and its cost of capital is 10%. The proportion of sales on which customers currently take discount is 0.5. Creation Ltd. is considering relaxing its discount terms to 2/10, net 30. Such relaxation is expected to increase sales by Rs.5 lakh, reduce the average collection period to 14 days and increase the proportion of discount sales to 0.8. What will be the effect of relaxing the discount policy on company's profit? Take an year as of 360 days.

(5 marks)

6. (a) Astro Ltd. is planning to import a machine from Japan at a cost of 7,640 Yen. The company can avail loan at 12% interest per annum with quarterly rests with which it can import the machine. However, there is an offer from Tokyo branch of an India-based bank extending credit of 180 days at 1.5% per annum against opening of an irrevocable letter of credit.

Other information :

Present exchange rate Rs.100 = 382 Yen

180-Day forward rate Rs.100 = 388 Yen

Commission charges for letter of credit at 2% per 12 months. Advise whether the offer from the foreign branch should be accepted.

(10 marks)

- (b) Kastro Ltd. issued commercial paper as per following details :

Date of issue	19 th October,
	2006
Date of maturity	17 th January,
	2007
Interest rate	7.25% per annum

Face value of commercial paper Rs.10 crore

What was the net amount received by the company on issue of commercial paper ?

(5 marks)

- (c) Following information has been extracted from the books of Unique Fashioners Ltd. :

<i>Particulars</i>	<i>Rs.</i>
Equity capital	4,00,00,000
12% Debentures	4,00,00,000
18% Term loan	12,00,00,000
	20,00,00,000

The company has been paying 20% dividend per annum constantly. Compute average cost of capital if the current market price of a share of Rs.100 is Rs.160.

(5 marks)

7. Write notes on *any four* of the following :
- Determinants of working capital requirements
 - Capital rationing
 - Mechanics of factoring
 - Loan syndication
 - Economic rate of return
 - Financial distress.

(5 marks each)

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TABLE - I : PRESENT VALUE OF RUPEE ONE

RATE	YEAR	YEAR	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					
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					

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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			
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			∞