This question paper contains 8+3 printed pages]

Your Roll No. ....

4092

M.Com. : Semester – II (NC) **G**

Paper No. – 4202

(Financial Management and Policy)

Time : 3 Hours *Maximum Marks : 100*

(Write your Roll No. on the top immediately on receipt of this question paper.)

Attempt *All* questions.

All questions carry equal marks.

Answers should be specific and precise.

1. (*a*) Write a detailed note on the nature and scope of financial management as it has evolved over the years. 10

(*b*) "The Time Value of Money does not exist in case the interest rates are negligible." Do you agree ? Justify your answer. 5

P.T.O.

(*c*) Why is Modified Internal Rate of Return (MIRR) considered superior to Internal Rate of Return ? When can a project be accepted using MIRR ? 5

Or

(*d*) "The Finance function in an organization is concerned only with financing aspects of the business." Do you agree ? Explain. 10

(*e*) Explain wealth maximization as the operationally feasible criterion for financial decisions. Is maximization of sales same as maximization of shareholders' wealth ? Why ? 10

2. (*a*) What is Fisher's Rate of Intersection ? Explain its significance in capital budgeting. 5

(*b*) Worldwide Tour Ltd. is evaluating a project which requires an investment outlay of Rs. 1,00,000 and is expected to produce cash inflows for two years as given below :

Year 1		Year 2	
CFAT (Rs.)	Prob.	CFAT (Rs.)	Prob.
75,000	0.30	75,000	0.20
65,000	0.40	70,000	0.60
40,000	0.30	90,000	0.20

Assume that the cash flows are independent and follow normal distribution. The risk free rate is 10% and cost of capital is 14%. Calculate :

(*i*) NPV and risk i.e. σ(NPV) as well as Coefficient of variation of the project.

(*ii*) The probability that NPV will be more than 0.

(*iii*) Based on your calculations, should the project be accepted ? 15

Or

(*c*) What is capital rationing ? Which method is used to evaluate the capital budgeting proposals in such a situation ? 5

(*d*) How does inflation affect evaluation of capital projects ? Pepper Clock Ltd. is considering purchase of a new machine which will cost Rs. 8,00,000 and have an economic life of 8 years with no salvage value. The expected Earnings before depreciation and Taxes (EBDT) is Rs. 1,60,000 p.a. which is subject to inflation of 10% p.a. Assume the tax rate is 30% and depreciation is charged on Straight line Basis. Calculate :

(*i*) nominal CFATs of the machine

(*ii*) real CFATs of the machine

(*iii*) If real cost of capital is 15%, should the machine be purchased ? 15

3. (*a*) Explain the following :

(*i*) Net Operating Income (NOI) Approach *Vs.* Traditional approach of capital structure.

(*ii*) MM Hypothesis with Corporate Taxes. 10

(*b*) MCPizza Ltd. presently has Rs. 10,00,000 10% debentures and 3,00,000 equity shares outstanding of Rs. 10 per share, selling at Rs. 15 per share. In order to finance a new project, the company needs Rs. 30 lakh of additional funds which can be raised either by the issue of 2 lakh equity shares at Rs. 15 per share OR issue of 10% debentures for Rs. 30 lakh at par.

After undertaking new project, the expected EBIT of the company will be Rs. 8 Lakh p.a. normally distributed with a standard deviation of Rs. 5 Lakh. Assume that the corporate tax rate is 35%. Calculate :

(*i*) The expected EPS under each financial plan.

(*ii*) Indifferenec level of EBIT between the two options of fund raising.

(*iii*) Which financial plan would you advise ? Why ? 10

Or

(*c*) What is the effect of corporate taxes and personal taxes on leverage benefits ? Explain using Merton Miller argument on Capital structure. 5

(*d*) The capital structure of Everdrive Ltd. comprises 1 Lakh equity shares of Rs. 10 each selling at a price of Rs. 12 each and Rs. 10 Lakh 12% debentures. What is the present value of Interest tax shield for the company under the following cases :

(*i*) When there is no corporate tax or personal tax rates.

(*ii*) When corporate tax rate is 25% but personal tax rates are Nil.

(*iii*) When corporate tax rate is 25%, personal tax rate rate on interest income is 20% and personal tax rate on dividend income 10%.

(*iv*) When corporate tax rate is 25%, personal tax rate on interest income is 25% and personal tax rate on dividend income Nil. 5

(*e*) Unidell Ltd. is an all equity company having 1,00,000 shares outstanding. Its cost of equity is 10%. Lovadell Ltd. is similar to Unidell Ltd. and belongs to the same risk class except that it also has 10% debentures amounting Rs. 10,00,000 in its capital structure. The EBIT of both the companies is Rs. 1,40,000. Assume that the corporate tax rate is 40%.

(*i*) Calculate the value of both the companies as per MM hypothesis with corporate taxes.

(*ii*) If the actual market value of Lovadell Ltd. is Rs. 13,00,000, specify whether the company is overvalued or undervalued in the market. Also explain the process through which the equilibrium will be set ? 10

4. (*a*) Explain Miller-Orr Model of Cash Management. How is it different from Baumol's Model ? What is the significance of Return Point in that Model ? Explain with the help of an example. 10

(*b*) Xylo Ltd. has 8 lakh shares outstanding at the beginning of the year. The current market price of the share is Rs. 120. The Board of Directors of the company is contemplating Rs. 6 per share dividend. The rate of capitalization appropriate to the risk class to which the company belongs is 9%. Based on MM approach calculate the market price of the company when :

(*i*) Dividend is declared.

(*ii*) Dividend is not declared.

(*iii*) How many new shares are to be issued by the company if the company desires to fund an investment budget of Rs. 3 Crores by the end of the year assuming that the net income for the year will be Rs. 1.6 Crores. 10

Or

(*c*) Why is MM hypothesis on irrelevance of dividend criticized ? Explain in brief Signaling theory on dividend. 10

(*d*) The present cash discount terms of Giani Ltd. is "1/10 net 20 days". The company has present sales of Rs. 60 lakhs. Its average collection period is 15 days. The proportion of sales on which customers currently avail cash discount is 0.70. To stimulate demand, the company is planning to give credit terms of "2/10 net 30 days". In such a case, sales are expected to increase by 25%. After the change, the average collection period is expected to be 35 days. However the proportion of sales on which customers avail cash discount goes up to 0.80. The variable cost to sales ratio is 0.80 and the company's before tax required rate of return on investment in receivables is 20%. Corporate tax rate is 30%.

Should the company change its credit terms ? Show all necessary calculations. Assume a 360-days year. 10

P.T.O.

5. (*a*) What are the approaches of current assets financing ? Explain in detail. Which approach is more suitable in highly uncertain financial environment ? Explain. 10

(*b*) Target Ltd. is being acquired by Acquirer Ltd. on a share exchange basis. The relevant financial data for the two companies is given below :

Particulars	**Acquirer Ltd.**	**Target Ltd.**
Earning after Tax (Rs. Lakh)	150	40
No. of Shares (Lakh)	15	5
P/E Ratio	8	6

Determine :

(*i*) Pre merger market price per share for both the companies.

(*ii*) The exchange ratio Acquirer Ltd. should offer without the dilution of its EPS

(*iii*) The exchange ratio Acquirer Ltd. should offer if it does not want the dilution of its market price per share. 10

Or

Write short notes on the following :

(*i*) Demerger

(*ii*) Leveraged Buyout

(*iii*) Operating Cycle

(*iv*) Collection Matrix. 20