Annual Fixed Costs			
(Rs.)	10,000	10,000	10,000
(Excluding Depreciation)			
Allocated fixed overhead			
expenses	5,000	5,000	5,000

Depreciation is charged on straight line basis and there is no salvage value of the assets after useful economic life of the project. Tax rate is 40%. 10+10=20

This question paper contains **16+4** printed pages]

Your Roll No ....

7731

M.Com./II (NC) E-I

Paper 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.

1. Attempt any *Five* out of the following :

(*a*) "Time value of money does not exist in the absence of inflation." Do you agree ? Why ? What are the important reasons for time value of money ?

(*b*) Enumerate important financial decisions. How do they involve risk return trade off ?

(*c*) "NPV (Net Present Value) and MIRR (Modified Internal Rate of Return) always give same result regarding the acceptability or otherwise of a project." Do you agree ? Why ?

The appropriate discount rate is 10%. Calculate :

(*i*) NPV and risk i.e. σ(NPV) of the project.

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

(*iii*) The probability that NPV will be between Rs. 10,000 and Rs. 15,000.

(*iv*) The probability that the NPV will be more than Rs. 30,000.

(*v*) Should the project be accepted ? Why ? 20

Or

(*a*) Explain with examples various methods of evaluating capital projects under risk and uncertainty.

(*i*) Projects A, B and F are mutually exclusive.

(*ii*) Project E can be delayed by one year. Such a delay will reduce NPV to Rs. 15 lakh without affecting cash outlay.

(*iii*) Project D cannot be selected unless both projects C and F are selected.

(*iv*) Surplus funds of first year, if any, can be invested to earn interest @ 12% p.a.

Formulate the above capital budgeting problem as Integer Programming Problem (IPP) for optimal mix of projects.

(c) Explain the following :

(i) Methods of calculating exchange ratio in M & As

(ii) Spin off

(iii) Leverage Buyout

(iv) Hostile Takeover. 10+10=20

5. Read the following case and answer the questions given below :

Prabhu Pharma Ltd. is evaluating a project for manufacturing a herbal cosmetic product. Its marketing department has long been suggesting for the launch of such a product due to the growing demand for herbal products. The project requires an investment outlay of Rs. 40,000 and has a life of three

(ii) Corporate Tax Rate is 30%, Personal tax rate on interest income is 20% and dividends are exempt from personal taxes.

(iii) Corporate Tax Rate is 30%, Personal tax rate on interest income is 20% and on dividends 10%.

(iv) Corporate Tax Rate is 30%, Personal tax rate on interest income is 30% and dividends are exempt from tax. 5×4=20

2. (a) Differentiate between the following :

(i) Financial leverage and operating leverage

(ii) Modigliani Miller (MM) Hypothesis and Trade off Theory on capital structure.

(*b*) PP Ltd. wants to acquire QQ Ltd. by exchanging 0.5 of its shares for each share of QQ Ltd. The relevant financial data are as follows :

Particulars	**PP Ltd.**	**QQ Ltd.**
EAT (Rs.)	36,00,000	7,20,000
Equity shares	12,00,000	3,60,000
EPS (Rs.)	3	2
P/E ratio	11	8

You are required to calculate the following :

(*i*) What is the number of equity shares required to be issued by PP Ltd. for acquisition of QQ Ltd. ?

Determine :

(*i*) Indifference level of EBIT between Plan A and B, Plan A and C as well as between Plan B and C.

(*ii*) EPS for each plan at the expected EBIT of Rs. 1,50,000.

(*iii*) Which plan should be adopted by the company and why ? 10+10=20

Or

(*c*) Kailash Ltd. has provided the following information :

Net Operating Income (NOI)	Rs. 55,00,000
Interest on debentures	Rs. 30,00,000
Cost of Equity	0.25
Cost of Debt	0.15

manager is not satisfied with the credit policy of the company and suggests that the company classifies its customers into four risk categories, 1, 2, 3 and 4. Then he suggests that the company should extend unlimited credit to category 1 and 2 customers, limited credit to category 3 and no credit to category 4 customers. Due to this change in credit policy the company is going to lose some sales but will save on bad debt expenses. Such a change in the policy would decrease sales by Rs. 20,00,000 and the bad debt percentage would decline to 6% of sales. The variable cost ratio is 80%, average collection period is 45 days and cost of capital is 12%. The tax rate is 40%.

thinks that debt is a cheaper source of finance and is confident of raising entire Rs. 10 crore at an interest rate of 10%. However there is some apprehension about the firm's ability to pay interest during a recessionary period. The management feels that during a recessionary year the net cash flows of the company, not taking into account the interest burden of the new debt, would have an expected value of Rs. 1.50 crore with a standard deviation of Rs. 60 lakhs.

(*i*) What is the probability of cash inadequacy during a recessionary year if the entire Rs. 10 crore is raised as debt finance ?

(*d*) IT Techno Park Ltd. is considering the following investment proposals for the forthcoming year :

Project	Year 1 Outlay	Year 2 Outlay	NPV (Rs. in lakhs)
A	13	16	18
B	10	15	28
C	45	10	18
D	20	30	25
E	15	0	20
F	25	20	10

Budget constraints for the two years are Rs. 100 lakh and Rs. 60 lakh respectively. Moreover

(*b*) From the following data calculate NPV of the project under different scenarios and comment on the results :

Particulars	Normal	Pessimistic	Optimistic
Investment (Rs.)	2,00,000	2,50,000	1,80,000
Discount rate	12%	14%	10%
Life of the project (Years)	10	10	10
Annual Sales (Units)	10,000	8,000	11,000
Selling Price (Rs. per Unit)	25	23	28
Variable cost (Rs. per Unit)	15	18	12

(*e*) What is the difference between operating cycle and cash cycle ? From the following information calculate cash cycle :

Average inventory = Rs. 5,00,000

Cost of Goods Sold = Rs. 36,00,000

Average Accounts Receivables = Rs. 6,00,000

Credit Sales = Rs. 60,00,000

Average Creditors = Rs. 2,00,000

Credit Purchases = Rs. 18,00,000.

(*f*) PPK Ltd. has Rs. 10,00,000 debt capital in its capital structure. Calculate Present Value of Interest Tax Shield as per Merton Miller Model, if :

(*i*) Corporate Tax Rate is 30% and there are no personal taxes.

years. The financial analyst of the company has been given the task of assessing the profitability of the project. After careful analysis the financial analyst came to the conclusion that uncertainty is very high and at best the following estimation is made regarding cash inflows after tax for three years :

Year 1		Year 2		Year 3	
CF	Prob.	CF	Prob.	CF	Prob.
25,000	·5	15,000	·3	10,000	0·5
30,000	·2	40,000	·6	5,000	0·4
40,000	·3	75,000	·1	2,000	0·1

(*b*) Panda Limited is considering three financing plans. The key information is as follows :

Total funds to be raised = Rs. 8,00,000.

Financing plans

Plans	A	B	C
Equity Capital (%)	100	40	60
10% Debt (%)	—	60	—
10% Preference cap. (%)	—	—	40

Tax rate 40%.

Equity shares of the face value of Rs. 10 each will be issued at a premium of Rs. 10 per share. Expected EBIT is Rs. 1,50,000.

(*ii*) What is the EPS of PP Ltd. after acquisition ?

(*iii*) What is the expected market price per share of PP Ltd. after the acquisition assuming its P/E ratio remains unchanged ?

(*iv*) Determine the market value of merged firm.

(*v*) What would have been exchange ratio based on EPS ? How many shares would have been issued by PP Ltd. in that case ?

(*vi*) What is the maximum exchange ratio acceptable to PP Ltd. if P/E ratio of the merged entity is 12 ?

Calculate :

(*i*) Weighted average cost of capital.

(*ii*) What is the cost of equity if the company uses Rs. 60,00,000 debt carrying 15% interest rate to buy back its equity and hence increases its debt equity ratio. Assume that NOI approach applies and there are no taxes.

(*d*) Explain in brief Pecking Order Theory of Capital structure.

(*e*) Rights Management Ltd. is considering investment in a new plant in one of the specified backward areas. The plant will cost Rs. 10 crore. The management

What will be the effect of the proposed change in credit policy on net income ? Show all relevant calculations. Should the company change its credit terms and make them more stringent as suggested by the new finance manager ? Why ? 10+10=20

4. Attempt any *two* out of the following :

(*a*) What are the three approaches for current assets financing ? Explain in detail. Do you recommend that a firm should finance its current assets entirely with long term financing ? Give reasons in support of your answer.

(*ii*) If the management is prepared to accept only 15% chance of cash inadequacy, what proportion of Rs. 10 crore can be raised as debt finance ?

5+5+10=20

3. Attempt any *two* out of the following :

(*a*) (*i*) Explain Modigliani Miller (MM) Hypothesis on the irrelevance of dividends. Do you agree with MM Hypothesis ? Why ?

(*ii*) Explain Lintner's model regarding corporate dividend behaviour in practice. You are given that Kinsi Ltd. is expecting an EPS of Rs. 6 for the year 2015-16. Its dividend per share last year was Rs. 2.80. The target payout ratio and adjustment

rate for the company are 0.60 and 0.70 respectively. What would be company's dividend per share as per Lintner's Model ?

(*b*) Explain the following :

(*i*) Pure residual policy of dividend *Vs.* Constant dividend payout policy

(*ii*) Dividend Signaling Theory.

(*c*) Nai Gazette Ltd. is following a very liberal credit policy. It extends credit to all its customers and is facing the problem of huge bad debts. At present the sales are Rs. 1,00,00,000 and bad debt is 10% of sales i.e. 10,00,000. Mr. Mehra, the newly inducted finance