[This question paper contains 4 printed pages.]

Sr. No. of Question Paper : 150 **Roll No............**

Unique Paper Code	: 101204
Name of the Course	: **BFIA**
Name of the Paper	: Financial Management
Semester	: II (2014)
Duration	: 3 Hours
Maximum Marks	: 75

Instructions for Candidates

1. Write your Roll No. on the top immediately on receipt of this question paper.
2. Attempt any **five** out of seven questions.
3. Each question carries equal marks.

1. (a) "The profit maximisation is not an operationally feasible criterion". Do you agree ? (7)

   (b) Assume that a 10-year savings annuity of Rs. 2,000 per year is beginning at year zero. The retirement annuity is to begin 15 years from now (the first payment is to be received in year 15) and has to provide a 20-year annuity. If this plan is arranged through a savings bank that pays interest @ 7% per year on the deposited funds, what is the size of the yearly retirement annuity that will result ? (8)

2. An existing company has a machine which has been in operation for 2 years and its remaining estimated useful life is 4 years with no salvage value in the end. Its current market value is Rs. 25,000. The management is considering a proposal to purchase an improved model to similar machine, which gives increased output. The relevant particulars are as follows :

Particulars	Existing	New
Purchase price (Rs.)	60,000	1,07,500
Estimated life (years)	6	4
Salvage value	Nil	Nil
Annual operating hours	1000	1000
Selling price per unit (Rs.)	3	3
Material cost per unit (Rs.)	0.40	0.40
Output per hours (units)	15	30
Labour cost per hour (Rs.)	11	16
Consumable stores per year (Rs.)	2000	1000
Repairs and maintenance per year (Rs.)	3000	2000
Working capital (Rs.)	10000	20000
Income tax rate	35	35

(i) The company follows the written down value method of depreciation @ 20% and it has several machines in the 20% block and (ii) the required rate of return is 10%. Should the existing machine be replaced ? (15)

3. The well-established company's most recent balance sheet as follows :

Liabilities	Amount	Assets	Amount
Equity capital (Rs. 10 per share)	60,000	Net Fixed Assets	1,50,000
10% long-term debt	80,000	Assets Current	50,000
Retained Earnings	20,000		
Current Liabilities	40,000		
	2,00,000		2,00,000

The company's total asset turnover ratio is 3, its fixed operating costs are 1,00,000 and the variable operating costs ratio is 40%. The income tax rate is 35%.

(a) Calculate financial leverage, operating leverage and combined leverage. (7)

(b) Determine the likely level of EBIT if EPS is (i) Rs. 1 (ii) Rs. 3 and (iii) zero. (8)

4. As a financial analyst of a company you are required to determine the WACC of the company using i) book value weights and ii) market value weights. The following information is available for your perusal :

The company's present book value capital structure is as follows :

Debentures (Rs. 100 per debenture)	8,00,000
Preference shares (Rs. 100 per share)	2,00,000
Equity shares (Rs. 10 each)	10, 00,000

All these securities are traded in the capital market and their recent prices are: debentures Rs. 110, Preference shares Rs. 120 per share, Equity share Rs. 22 per share.

Anticipated external financing opportunities are :

(a) Rs. 100, redeemable debenture at face value after 10 years, 11% interest rate, 4% floatation cost, sale price, Rs. 100.

(b) 12% redeemable preference shares (10 years). It involves floatation cost of 5% and sales price Rs. 100.

(c) Equity share : Rs. 2 per share floatation costs, sales price is Rs. 22.

In addition, the dividend expected on the equity share at the end of the year is Rs. 2 per share. The anticipated growth rates in dividends are 7% and the firm has the practice of paying all its earnings in the form of dividends. Tax rate is 35%. (8+7)

5. Easy Limited specialises in the manufacture of a computer component. The component is currently sold for Rs. 1,000 and its variable cost is Rs. 800. For the current year ended December 31, the company sold on an average 400 components per month.

At present, the company grants one month credit to its customers. It is thinking of extending the same to two months on account of which the following are expected :

Increase in sales, 25%

Increase In stock, Rs. 2,00,000

Increase in creditors, Rs. 1,00,000

You are required to advise the company on whether or not to extend credit terms if (a) all customers avail of the extended credit period of two months and (b) existing customers do not avail of the credit terms but only the new customers avail of the same. Assume the entire increase in sales is attributable to the new customers.

The company expects a minimum return of 40% on the investments. (15)

6. (a) What is the conservative approach to financing funds requirements ? What kind of profitability-risk trade-off is involved ? (8)

   (b) Since the right issue allows the ordinary existing shareholders to purchase the shares at a price much lower than the current market price, why does shareholders' wealth not increase ? Illustrate your answer. (7)

7. Write short notes on the following :

   (a) Lock box system

   (b) Miller-Orr Model

   (c) EOQ

   (d) NOI approach

   (e) Quasi Equity (3×5=15)

(100)