[This question paper contains 4 printed pages.]

Your Roll No............................

Sr. No. of Question Paper	:	**8009**
Unique Paper Code	:	61011406
Name of the Paper	:	Financial Management
Name of the Course	:	**Bachelor of Management Studies (BMS), 2024 LOCF**
Semester	:	IV
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. Answer **any five** questions in all.

1. (i) A plastic manufacturer has under consideration the proposal for the production of high-quality plastic glasses. The necessary equipment to manufacture the glasses would cost Rs 1 lakh and would last 5 years. The relevant rate of depreciation is 20% of the written-down value. There is no other asset in this block. The glasses can be sold at Rs 4 each. The company will incur a cash cost of Rs 25000 each year if the project is undertaken. The variable cost is estimated at Rs 2 per glass. The manufacturer estimates that it would sell about 75000 glasses per year. The tax rate is 35%. The additional working capital would be required to be equal to Rs 50,000. The cost of capital is 20%. Should the company accept this project if the machine will have a Rs 10,000 salvage value and (10)

   (ii) Explain the systematic and unsystematic risk sources of risk. (5)

2. (i) XYZ Ltd has the following book value capital structure (Rs Crore)

Equity capital (Rs 10 each)	Rs 15
12% preference capital (Rs 100 each)	1
Retained earnings	20
11.5% Debenture (Rs 100 each)	10
11% Term loan	12.5

The next expected dividend on equity shares per share is Rs 3.60; the dividend per share is expected to grow at the rate of 7 per cent. The market price per share is Rs 40. Preference stock, redeemable after 10 years, is currently selling at Rs 75 per share. Debentures redeemable after 6 years are selling at Rs 80 per debenture.

The income tax rate for the company is 40 per cent.

Calculate the weighted average cost of capital by using the(1) book value weights and (II) market value weights. (10)

(ii) Explain the Internal Rate of Return method of capital budgeting. (5)

3. (i) Suppose a firm is contemplating an increase in the credit period from 30 days to 60 days. The average collection period which is at present 45 days is expected to increase to 75 days. It is also likely that the bad debt expenses will increase from the current level of 1 per cent to 3 per cent of sales. Total credit sales are expected to increase from 30,000 units to 34,500 units. The present average cost per unit is Rs 8, and the variable cost and sales per unit are Rs 6 and Rs 10 respectively. Assume the firm expects a rate of return of 15 per cent. Should the firm extend the credit period? (10)

(ii) Explain the Net Operating Income approach of capital structure. (5)

4. (i) Two companies belong to the same risk class. They have everything in common except that firm Y has 10 per cent debentures of Rs 5,00,000.

	Firm X	Firm Y
Net Operating Income	7,50,000	7,50,000
Equity capitalisation rate	12.5%	14%
Implied overall capitalisation rate	12.5%	13.63%

An investor owns 10 per cent of the equity shares of the overvalued firm. Determine his investment cost of earning the same income so that he is at the breakeven point. Will he gain by investing in the undervalued firm? (10)

(ii) Discuss the cash management techniques. (5)

5. (i) Estimate net working capital required to maintain a level of activity of 78,000 units per annum based on the information given below.

The selling price is Rs.200 per unit.

The estimated cost of production (as a per cent of selling price):

Raw Material	35%
Direct Labour	15%
Overheads (exclusive of depreciation)	20%
Selling & Distribution	10%

The following information is also available:

Raw materials are expected to remain in stores for an average period of 3 weeks.

- Work-in-progress (assume 75%completion stage) are expected to remain in stores for an average period of 2 weeks. Assume raw material is completely fed into the production process at the beginning of the period.
- Finished goods are required to be in stock for an average period of 3 weeks.
- All sales are credit sales.

- Average credit allowed to debtors is 2 weeks.
- Average credit allowed by suppliers is 4 weeks.
- Lag in payment of wages average 1½ weeks.
- Lag in payment of overheads average 2 weeks.
- The company wishes to have a desired cash balance of Rs. 80,000.
- 10 per cent of net working capital is required to be maintained for contingencies.

You may assume that production is carried on evenly throughout the year (52 weeks) and wages and overheads accrue similarly. (10)

(ii) Explain the operating and financial leverage. (5)

6. (i) A firm has a capital structure of ordinary shares amounting to Rs 10,00,000. The firm wishes to raise additional Rs 10,00,000 for expansion. The firm has four alternative financial plans.

(a) It can raise the entire amount in the form of equity capital.

(b) It can raise 50% as equity capital and 50% as debenture at 5% coupon rate.

(c) It can raise 50% as equity capital and 50% as preference at 5% dividend rate.

Further assuming that the existing EBIT are Rs 1,20,000, the tax rate is 35%, the outstanding ordinary share is 10,000 and the market price per share is Rs 100 under the three alternatives.

Which financial plan should the firm select? (10)

(ii) What drawbacks of the Internal rate of return technique are being overcome by using Modified Internal Rate Return? Explain. (5)