

QUESTION 2016

GROUP – A

(Multiple Choice Type Questions)

1. Choose the correct alternatives for and any ten of the following:

i) The act of buying an asset or security in one market having lower price and selling the same in another market having higher price is known as

- a) levered pay-off
- b) asset stripping
- ✓c) arbitrage
- d) put followed by a call

ii) At the point of optimum capital structure, the weighted average cost of capital is

- a) maximum
- ✓b) minimum
- c) equal
- d) constant

iii) The rate of return or discount factor that equates the total present value cash inflows to the total present values of cash outflows is known as

- a) Net present value
- b) Payback period
- c) Average rate of return
- ✓d) Internal rate of return

iv) Modigliani and Miller's model of dividend policies is based on the assumptions

- a) the firm has a perpetual life
- ✓b) the firm operates in a perfect capital market
- c) the firm has an infinite life
- d) the firm is an all-equity firm.

v) The doubling period n given a rate of return r can be calculated by

- a) $(1+r)^n = 2$
- b) $\frac{72}{r}$
- c) $0.35 + \frac{69}{r}$
- ✓d) all of these

vi) If a 2 year-redeemable bond is purchased and held till maturity, the rate of return earned is called

- a) Coupon rate
- b) Required rate of return
- ✓c) Yield to maturity
- d) Current yield.

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viii) If current year's dividend is Rs. 2.40, growth rate for the company is 10% and the required return on the stock is 16%, then the intrinsic value of the stock will be

- ✓a) Rs. 44 b) Rs. 40 c) Rs. 24 d) Rs. 16.50

viii) The constant growth model of equity valuation assumes that

- a) the dividends paid by the company remain constant
✓b) the dividends paid by the company grow at a constant rate of growth
c) the cost of equity may be less than or equal to the growth rate
d) none of these.

ix) With continuous compounding at 8 per cent for 20 years, what is the approximate future value of a \$20,000 initial investment?

- a) \$52,000 ✓b) \$93,219 c) \$99,061 d) None of these

x) A probability index (PI) of 0.92 for a project means that

- a) the project's cost (cash outlay) is/are less than the present value of the project's benefits
b) the project's NPV is greater than zero
c) the project's NPV is greater than 1
✓d) the project returns 92 cents is present value for each current dollar invested (cost).

xi) The LMN Corporation is considering an investment that will cost \$80,000 and have a useful life of 4 years. During the first 2 years, the net incremental after-tax cash flows are \$25,000 per year and for the last two years that are \$20,000 per year. What is the payback period for this investment?

- a) 3.2 years ✓b) 3.5 years c) 4 years d) None of these

Group – B

(Short Answer Type Questions)

2. Distinguish between profit maximization and wealth maximization.

See Topic: FINANCIAL MANGEMENT, Short Answer Type Question No. 1.

3. From the following particulars compute earnings per share of XYZ Ltd.:

Capital structure:

20000 Equity shares of Rs. 10 each fully paid

10% 1600 Debentures of Rs. 100 each

EBIT Rs. 1,00,000

Tax rate @ 50%

See Topic: COST OF CAPITAL, Short Answer Type Question No. 12.

4. What is working capital cycle?

See Topic: MANAGEMENT OF WORKING CAPITAL, Short Answer Type Question No. 4.

5. From the following information, calculate the market price of each share of ABC Ltd. Under

Walter's model:

Earnings per share	Rs. 5
Dividend per share	Rs. 3
Cost of capital	16%
Internal rate of return on investment	20%
Retention ratio	50%

See Topic: DIVIDEND POLICY, Short Answer Type Question No. 3.

6. Discuss the importance of capital budgeting.

See Topic: CAPITAL BUDGETING, Short Answer Type Question No. 4.

Group - C

(Long Answer Type Questions)

7. A company is considering an investment proposal to purchase a machine costing Rs. 2,50,000. The machine has a life expectancy of 5 years and no salvage value. The company's tax rate is 40%. The firm uses straight line method for providing depreciation. The estimated cash flows before tax rate after depreciation (CFBT) from the machine as follows:

Year	CFBT (Rs.)
1	60,000
2	70,000
3	90,000
4	1,00,000
5	1,50,000

Calculate: (a) Pay-back period; (b) Average rate of return; (c) Net Present Value and Profitability Index at 10% discount rate. You may use the following table:

Year	1	2	3	4	5
P.V. Factor at 10%	0.909	0.826	0.751	0.683	0.621

See Topic: CAPITAL BUDGETING, Long Answer Type Question No. 9.

8. XYZ Company has currently an equity share capital of Rs. 40 lakhs consisting of 40,000 equity shares of Rs. 100 each. The management is planning to raise another Rs. 30 lakhs to finance a major programme of expansion through one of the four possible financing plans. The options are

- Entirely through equity shares
- Rs. 15 lakhs in equity shares of Rs. 100 each and the balance in 8% debentures.
- Rs. 10 lakhs in equity shares of Rs. 100 each and the balance through long term borrowing at 9% interest p.a.
- Rs. 15 lakhs in equity shares of Rs. 100 each and the balance through preference shares with 8% dividend.

The company's EBIT will be Rs. 15 lakhs. Assuming corporate tax rate of 50%, you are required to determine the EPS and comment on the Financial leverage that will be authorized under each of the above schemes of financing.

See Topic: OPERATING & FINANCIAL LEVERAGE, Long Answer Type Question No. 5.

FINANCIAL MANAGEMENT-I

g. From the following information prepare a Working Capital statement showing the working capital required to finance a level of activity of 10400 units per annum.

a) Selling price is Rs. 5 per unit

b) The expected ratios of cost to selling price are:

- i) Raw materials 40%
- ii) Direct Wages 10%
- iii) Overheads 30%
- iv) Profit 20%

c) Raw materials are expected to remain in store for an average period of 2 months before being issued for production and materials are in process on an average period of 6 weeks.

d) Finished goods will stay in store approximately for 6 weeks before dispatch to customers.

e) Credit allowed to debtors is for a period of 2 months.

f) Credit allowed by creditors is for a period of 2 months.

g) Lag in payment of wages and overheads are for a period of 2 weeks.

h) Cash in hand and at Bank is expected to be Rs. 10,000.

i) It may be noted that production is carried on evenly during the year and wages and overheads accrue similarly. Assume 4 weeks in a month.

See Topic: **MANAGEMENT OF WORKING CAPITAL**, Long Answer Type Question No. 13.

10. a) Why is M-M model of dividend policy called dividend irrelevance theory?

See Topic: **DIVIDEND POLICY**, Long Answer Type Question No. 5.a).

b) An engineering company has a cost of equity capital of 15 per cent. The current market value of the firm is Rs. 30,00,000 @ Rs. 30 per share). The firm also plan to new investment for Rs. 9,00,000 in a project. The company is expecting a new earnings of Rs. 5,00,000 and total dividend of Rs. 3,00,000 towards end of the year. Show that under the MM assumption the payment of dividend does not affect the value of the firm.

See Topic: **DIVIDEND POLICY**, Long Answer Type Question No. 5.b).

11. Susheel Ltd. has the following capital structure:

Type of Capital	Amount
Equity capital (1 lakh shares @Rs. 10 each)	Rs. 10 lakhs
11% preference capital (1000 shares @ Rs. 100 each)	1 lakh
Retained earning	Rs. 12 lakhs
13.5% debentures (5000 debentures @ Rs. 100 each)	Rs. 5 lakhs
12% term loan	Rs. 8 lakhs
Total	Rs. 36 lakhs

- The expected dividend on equity share is Rs. 1.50 which is expected to grow @7%. The market price of the share is Rs. 20.
- The preference share, redeemable after 10 years is currently selling at Rs. 75 per share.
- The debentures redeemable after 6 years are selling at Rs. 80 per debenture.
- The tax rate applicable for the company is 50%.

Compute the WACC of the company.

See Topic: **CAPITAL STRUCTURE**, Long Answer type Question No. 7.

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12. Write short notes on any three of the following:

- a) EOQ
- b) Optimum cash balance
- c) Optimal capital structure
- d) NOI approach
- e) Determinants of capital structure
- f) Goals of credit management.
- a) See Topic: MANAGEMENT OF WORKING CAPITAL, Long Answer Type Question No. 14(e).
- b) See Topic: MANAGEMENT OF WORKING CAPITAL, Long Answer Type Question No. 14(f).
- c) See Topic: CAPITAL STRUCTURE, Long Answer Type Question No. 8(e).
- d) See Topic: CAPITAL STRUCTURE, Long Answer Type Question No. 8(f).
- e) See Topic: CAPITAL STRUCTURE, Short Answer Type Question No. 1.
- f) See Topic: MANAGEMENT OF WORKING CAPITAL, Long Answer Type Question No. 14(g).