[This question paper contains 6 printed pages.]

Sr. No. of Question Paper : 1489 **F-7** **Your Roll No...............**

Unique Paper Code : 1091304

Name of the Paper : Corporate Finance

Name of the Course : **BMS**

Semester : III

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** questions.

1. XYZ Ltd is considering the replacement of one of its moulding machine. The existing machine is in good operating condition, but is smaller than required if the firm is to expand its operations. It is 4 years old, has a current salvage value of Rs. 2,00,000 and a remaining life of 6 years. The machine was initially purchased for Rs. 10 lakh and is being depreciated at 25% on the WDV basis.

   The new machine will cost Rs. 20 lakh and will be subject to the same method as well as the same rate of depreciation. It is expected to have the useful life of 6 years. The management anticipates that with the expanded operation there will be need of an additional net working capital of Rs. 1,00,000. The new machine will allow the firm to expand the current operation and thereby increase annual revenue by Rs. 5,00,000, variable cost to volume is 30 percent. Fixed cost are likely to remain same. The corporate tax rate is 35%. Its cost of capital is 10%. The company has several machines in the block of 25% depreciation.

Should the company replace the existing machine ? What course of action will you suggest if the salvage value of the new machine has (I) zero salvage value at the sixth year end (II) Rs. 1,50,000 salvage value at the sixth year end ? (7.5+7.5=15)

2. Calculate the weighted average cost of capital of the company using the (A) market value weights (B) Book value weights. The following information is given to you :

Debentures (Rs. 100 per debenture)	Rs. 10,00,000
Preference shares (Rs. 100 per share)	12,00,000
Equity shares (Rs. 10 per share)	8,00,000

All the securities are traded in the capital markets, The latest market prices are: Debentures Rs. 110 per debenture, preference share Rs. 120 per share, and Equity share Rs. 22 per share.

Anticipated external financing opportunities are :

(1) Rs. 100 per debenture redeemable at par; 10 year maturity, 11% coupon rate, 4% flotation cost, sale price Rs. 100.

(2) Rs 100 preference share redeemable at par, 10 year maturity, 12% dividend rate, 5% flotation costs, sale price Rs. 100.

(3) Equity share: Rs. 2 per share flotation costs, sale price is Rs. 22.

The dividend expected on the equity share at the end of the year is Rs. 2 per share; the anticipated growth rate in dividends is Rs. 10% and firm has the practice of paying all its earnings in the form of dividends. The corporate tax rate is 35%. (15)

3. (i) Explain Business Risk and Financial risk.

(ii) Skyline ltd has appointed you as its finance manager. Its current capital structure consists of ordinary shares of face value Rs. 100 each amounting to Rs. 25 lacs and 10% debentures of face value Rs. 100 amounting to Rs. 10 lacs. The company lies in 50% tax bracket. The company wants to implement a project for which Rs. 20 lacs is required to be raised from the market. The following financial plans are available :

PLAN A: 100% of the amount to be raised through equity shares of Rs. 100 each.

PLAN B : 50% of the amount to be raised through equity shares of Rs. 100 each, 50% of the amount to be raised through 8% debentures of Rs. 100 each

PLAN C : 50% of the amount to be raised through equity shares of Rs. 100 each, 50% of the amount to be raised through 5% preference shares of Rs. 100 each.

(a) Which plan do you recommend if expected EBIT is Rs. 8,00,000 ?

(b) When will the firm be indifferent between Plan A and Plan B ?

(c) Calculate the point for each plan when its EPS will be Zero. (3+12)

4. (i) What are the different motives for holding cash ?

(ii) The board of directors of Ruby Ltd. requests you to prepare a statement showing working capital required for a level of activity of 1,56,000 units of production per year.

The following information is available to you.

Raw material cost per unit	Rs. 90
Direct Labour cost per unit	Rs. 40
Overheads cost per unit	Rs. 75
Total cost per unit	Rs. 205
Profit per unit	Rs. 60
Selling price per unit	Rs. 265
Raw material is in stock for average	1 month
Raw material is in process for average	2 weeks
Finished goods are in stock for average	1 month
Credit allowed by supplier	1 month
Credit allowed to customers	2 months
Time lag in payment of wages	1.5 weeks
Time lag in payment of overheads	1 month

20% of the output is sold in cash. Cash in hand is expected to be Rs. 60,000. Make a provision of 10% for contingency (except cash). Assume production is carried out evenly throughout the year and expenses accrue similarly.

(3+12)

5. (i) Explain determinants of dividend policy.

(ii) A company has total investment of Rs. 20,00,000 in assets with 20,000 outstanding equity shares of Rs. 100 each. It earns at the rate of 10% on its investment and is expected to maintain this rate of earning on investment. It has a policy of paying 75% of its earning as dividend. Using Walters Model suggest whether present payout ratio is optimum, if

the price earning ratio is 12.5. Will your decision change if the price earning ratio is 8 ? At what price earning ratio will payout ratio have no effect on price of the share ?

(iii) Global company belongs to a risk class for which appropriate capitalization rate is 15%. It has currently 50,000 shares of Rs. 10 each. It is contemplating paying a dividend of Rs. 2 per share. Using MM model and assuming no taxes, calculate the price of its share at the end of the year both when dividend is paid and when dividend is not paid. (3+6+6)

6. Write short note on any **three** : (5+5+5)

(i) Scope of financial management.

(ii) Operating and financial leverage

(iii) Explicit and implicit cost of capital

(iv) Accounting rate of return

(v) Delinquency cost

7. (i) The two companies U and L, belong to the equivalent risk class. These two firms are identical in every respect except than U company is unlevered while company L has 10 percent debentures of Rs. 30 lakh. The other information is as follow :

Particulars	**Firm U**	**Firm L**
Net operating Income (EBIT)	7,50,000	7,50,000
Equity capitalisation rate (Ke)	15%	20%
Implied overall capitalisation rate	15%	14.3%

An investor owns 10% equity shares of company L. Show the arbitrage process and the amount by which he could reduce his outlay through the use of leverage.

(ii) Explain the profitability index method of capital budgeting. (12,3)