

BFS GEC 5: FINANCIAL MANAGEMENT**Duration: 3 Hours****Max. Marks: 60****Instructions:**

- *Figures to the right indicate maximum marks.*
- *Start each question on a fresh page*
- *Question One is compulsory*
- *Answer any Four from question 2 to question 6*

Q.1. Answer any five of the following:**(5*4=20)**

- Explain any four sources of working capital.
- Explicate the primary functions of financial management
- Forms of dividend
- Write a short note on over capitalization
- Need for adequate working capital
- Highlight the differences between wealth maximization and profit maximization

Q.2.a A company is considering an investment proposal to purchase a machine costing Rs. 250000. 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 after depreciation (CFBT) from the machine are as follows:

Year	Cash flows Before Tax After Depreciation (CFBT)
1	60000
2	70000
3	90000
4	100000
5	150000

Help the company to decide whether to accept the proposal by calculating Pay Back Period when the maximum desired payback period of the Company is 3 years. **(06)**

Q.2.b. A company issues 1000000 10% debentures at a discount of 5%. The cost of flotation amounts to Rs. 30000. The debentures are redeemable after 5 years. Calculate the cost of debt capital before and after tax liability assuming corporate tax at 30%. **(04)**

Q.3.a. Delta Ltd. is considering the purchase of a machine. two machines are available, M and N. The cost of each machine is 60000. Each machine has an expected life of 5 years. Net profit before tax (after depreciation) during the expected life of the machine are given below:

Years	Machine M	Machine N
1	15000	5000
2	20000	15000
3	25000	20000
4	15000	30000
5	10000	20000
Total	85000	90000

Following the method of average return on investment ascertain which of the alternative will be more profitable. The average rate of tax is at 50%. (06)

Q.3.b. A company issues 10,000, 10% preference shares of Rs.100 each. The cost of the issue is Rs.2 per share. Calculate the cost of preference capital before and after tax liability if these shares are issued at a premium of 10% and at a discount of 5%. Assume corporate tax at 30%. (04)

Q.4.a. The Alpha Company Ltd. is considering the purchase of the new machine. Two alternative machines (A and B) have been suggested each costing Rs. 400000. Earnings after taxation are expected to be as follows:

Years	Cash Flows	
	Machine A (Rs.)	Machine B (Rs.)
1	40000	120000
2	120000	160000
3	160000	200000
4	240000	120000
5	160000	80000

The company has a target of return on capital of 10% and on this basis, you are required to compare the profitability of the machines on the basis of net present value and state which alternative you consider financially preferable. (NOTE: The Present Value of Re. 1 of 5 years is 0.91, 0.83, 0.75, 0.68, 0.62 respectively). (06)

Q.4.b. A limited has issued 2000 equity shares of Rs. 100 each as fully paid. The company has earned a profit of Rs. 20,000 after tax. The market price of these shares is Rs. 160 per share. On these shares, dividend has been paid at the rate of Rs. 8 per share. Find out the cost of equity capital using:

- 1) Dividend yield method
- 2) Earning yield method
- 3) If the 8% p.a. growth in the dividend is expected, then cost of capital would be?

Q.5.a. Aasmann Ltd. is currently under examination of a project which will yield the following returns over the life of the project:

Year	1	2	3	4	5
Gross Yield (Rs.)	80000	80000	90000	90000	83000

The cost of a machine to be installed amounts to Rs. 200000 and the machine is to be depreciated at 20% p.a. at the written down value method. The income tax rate is 50%. The salvage value of the machine is zero. If the average cost of raising capital is 11% would you recommend accepting the project under the internal rate of return method?

Present value of money at rates of interest is as under:

Year	1	2	3	4	5
At 10%	0.91	0.83	0.75	0.68	0.62
At 14%	0.88	0.77	0.67	0.59	0.52

Show the calculations.

(06)

Q.5.b. The following information is available:

Dividend per share	Rs.120
Personal Income tax rate	30%
Brokerage on Investment of dividend	2%
Market price per share	Rs. 840

Calculate the cost of retained earnings.

(04)

Q.6.a. A firm whose cost of capital is at 10% is considering two mutually exclusive projects X and Y, the cashflows of which are given as follows:

YEAR	PV Factor at 10%	Cash Flows (Rs.)	
		Project X	Project Y
0	1.000	(100000)	(70000)
1	0.909	80000	60000
2	0.826	80000	60000

You are required to rank the projects on the basis of Profitability Index method.

(06)

Q.6.b. Following information is available with regards to the capital structure of a company

Sources of funds	Amount (Rs)	After tax cost of capital
Equity share capital	800000	12%
Retained earnings	300000	12%
Preference shares	200000	9%
Debentures	400000	7%

Assuming a corporate tax rate of 25% calculate the Weighted average cost of capital. (04)
