[This question paper contains 6 printed pages.]

Sr. No. of Question Paper : 6082 **Your Roll No................**

Unique Paper Code : 12481303

Name of the Paper : Corporate Finance

Name of the Course : **B.A. (Hons) Business Economics, 2016 (CBCS)**

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 **all** questions.
3. Use of only simple calculators is allowed.
4. Marks for each question are mentioned against that question only.
5. The sub parts ('a & b') of a question must be done together.

1. (a) Briefly describe the reasons why profit maximization fails to be consistent with wealth maximization.

OR

The function of the financial manager is no longer confined to the procurement of funds. Discuss. (5)

(b) A 10 year savings annuity of Rs. 2000 per year is beginning at the end of current year. The payment of retirement annuity is to begin 16 years from now (the first payment is to be received at the end of year 16) and will continue to provide a 20 year payment annuity. If this plan is arranged through a saving bank account that pays interest @ 7% per year on the deposited funds, what will be the resultant size of the yearly retirement annuity ? (5)

P.T.O.

2. (a) Modern Enterprises Ltd. is considering the purchase of a new computer system for its Research and Development Division which would cost Rs. 35 lakhs. The operation and maintenance costs (excluding depreciation) are expected to be Rs. 7 lakhs per annum. It is estimated that the useful life of the system would be 6 years, at the end of which the disposal value is expected to be Rs. 1 lakh.

The tangible benefits expected from the system in the form of reduction in design and draughtsmanship costs would be Rs. 12 lakhs per annum. Besides, the disposal of used office equipment and furniture, initially, is anticipated to net Rs. 9 lakhs.

Capital expenditure in research and development would attract 100% write-off for tax purposes. The gains arising from disposal of used assets may be considered tax-free. The company's effective tax rate is 50%. The average cost of capital of the company is 12%. After appropriate analysis of cash flows, advise the company of the financial viability of the proposal. (12)

OR

An existing company has a machine which has been in operation for 2 years. Its estimated remaining 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 of the machine which gives increased output. The relevant particulars are as follows :

Particulars	Existing Machine	New Machine
Purchase price (Rs)	60,000	1,07,500
Estimated Life (years)	6	4
Salvage value	0	0
Annual operating hours	1000	1000
Selling price per unit (Rs)	3	3
Material per unit (Rs)	0.40	0.40
Output per hour (units)	15	30
Labour cost per hour (Rs)	11	16
Consumable stores per year (Rs)	2,000	1,000
Repairs & maintenance per year (Rs)	3,000	2,000
Working capital (Rs)	10,000	20,000
Income tax rate	35	35

Should the existing machine be replaced ? Assume that required rate of return is 10 percent and company uses the written down value method of depreciation @ 25 percent. (12)

(b) "Despite being conceptually unsound, payback period is very popular in business as a criteria for assigning priority to investment proposals". Explain the method in light of the given statement. (8)

3. (a) The beta coefficient of Target Ltd is 1.4. The company has been maintaining 8 percent rate of growth in dividends and earnings. The last dividend paid was Rs. 4 per share. The return on government securities is 10 percent while the return on market portfolio is 15 percent. The current market price of one share of Target Ltd is Rs. 36.

(i) What will be the equilibrium price per share of Target Ltd ?

(ii) Would you advise purchasing the share ? (6)

(b) "As there is no explicit cost of Retained Earnings, these funds are free of cost". Critically examine this statement. (4)

4. (a) Excel Limited is considering three financing plans. The key information is as follows :

(i) Total funds to be raised, Rs. 2,00,000

(ii) Financing plans

Plans	Equity (%)	Debt (%)	Preference (%)
A	100	----	----
B	50	50	----
C	50	----	50

P.T.O.

(iii) Cost of debt 8 percent; cost of preference shares 8 percent.

(iv) Tax rate, 35 percent.

(v) Equity shares of the face value of Rs. 10 each will be issued at a premium of Rs. 10 per share.

(vi) Expected EBIT, Rs. 80,000.

Determine for each plan :

(a) Earning per share (EPS)

(b) EBIT range among the plans for indifference. (10)

(b) Company X and Company Y are in the same risk class and are identical in every respect except that company X uses debt, while company Y does not. The levered firm has Rs. 9,00,000 debentures, carrying 10 percent of interest. Both the firms earn 20 percent operating profit on their total assets of Rs. 15 lakhs. Assume perfect capital markets, rational investors and so on; a tax rate of 35 percent and capitalization rate of 15 percent for an all equity company.

(i) Compute the total value of firms X and Y using the Net Income (NI) Approach.

(ii) Compute the value of each firm using the net Operating (NOI) Approach.

(iii) Using NOI Approach, Calculate the overall cost of capital for firms X and Y.

(iv) Which of these two firms has an optimal capital structure according to the NOI Approach ? Why ? (10)

OR

(b) (i) The Asbestos Company belongs to a risk class for which the appropriate capitalization rate is 10 percent. It currently has 1,00,000 shares selling at Rs 100 each. The firm is contemplating the declaration of Rs 6 dividend at the end of the current fiscal year, which has just begun. Answer the following questions based on Modigliani and Miller model and the assumptions of no taxes.

(a) What will be the price of the shares at the end of the year, if a dividend is not declared ? What will it be if it is declared ?

(b) Assuming that the firm has pays dividend, has a net income of Rs. 10,00,000 and makes new investments of Rs. 20,00,000 during the period, how many new shares must be issued ? (6)

(ii) Explain the arbitrage process used by the Modigliani and Miller hypothesis is support of the argument for irrelevance of dividend. (4)

5. Answer the following : (3×5=15)

(a) Length of operating cycle is a major determinant of working capital needs of a business firm. Explain.

(b) Golden syntax has annual sales of Rs. 24,00,000. The selling price per unit is Rs. 10 and the variable cost is 70 percent of the selling price. The required rate of return on investment is 20 percent; average cost, Rs. 9 per unit; annual collection expenditure, Rs. 50,000 and percentage of default, 3 percent; credit terms, 2 months. Golden syntax is considering the change in credit policy by following Programme A or Programme B.

	Prog. A	Prog. B
Average collection period (months)	1.5	1
Annual collection expenditure (Rs)	75,000	1,50,000
Percentage of default (%)	2	1

Determine which collection programme should Golden Syntex follow ?

(c) Following Information is provided by ABC Ltd :

Raw Material Storage Period	50 days
Work in progress Storage Period	18 days
Finished Goods storage Period	22 days
Debt Collection Period	45 days
Creditors Payment Period	55 days
Annual Operating cost (including depreciation of Rs. 2,10,000)	Rs. 21 lacs
Days in a year	360

Find out : (i) Operating Cycle Period, (ii) No. of Operating Cycles in a year and (iii) Working Capital Requirement on cash cost basis.