# WEST BENGAL STATE UNIVERSITY

BBA Honours 3rd Semester Examination, 2020, held in 2021

## BBAACOR07T-BBA (CC7)

## FINANCIAL MANAGEMENT

Time Allotted: 2 Hours | Full Marks: 50

*The figures in the margin indicate full marks.*
*Candidates should answer in their own words and adhere to the word limit as practicable.*
*All symbols are of usual significance.*

### GROUP-A

**Answer any *two* questions from the following** 10×2 = 20

1. "Decision regarding asset mix, capital mix and profit allocation are known as financial management." – Discuss. 10

2. (a) What do you mean by Working capital? 2+8
   (b) What are the factors on which duration of the working capital cycle depend?

3. (a) State the assumptions underlying the Walter's Model. 4+(5+1)
   (b) (i) From the following information, calculate market price of an equity share of ABC Ltd. using Gordon's Model.

| | |
|---|---|
| Total investment in assets: | Rs. 12,00,000 |
| Number of equity shares: | 50,000 |
| Total earnings; | Rs. 2,00,000 |
| Cost of equity capital: | 15% |
| Pay-out ratio: | 40% |

   (ii) Also state what would be the impact on the market price of the shares if the company increases the dividend pay-out ratio.

4. (a) "Retained earnings have no cost" — Explain. 4+6
   (b) Write a note on 'Net Operating Income (NOI) Approach' of the Capital Structure Theory.

5. Cost of a project is Rs. 7,50,000. From the following information, calculate: 4+4+2
   (a) Payback Period and
   (b) Discounted Payback Period.
   – Life of the project: 5 years
   – Cost of capital: 11%

– Estimated net annual cash inflows are as follows:

Year I : Rs. 6,00,000
Year II : Rs. 2,00,000
Year III : Rs. 2,00,000
Year IV : Rs. 4,00,000

Also comment on the results.

6. (a) What is financial risk? 2+(4+2+2)

(b) Given that, Units sold: 500 units

Selling price per unit: Rs. 300

Total Variable Cost = 60% of Sales.

DOL = 2 and interest expenses is Rs. 10,000.

(i) Calculate Total Contribution, Total Fixed Cost and EBIT.

(ii) What can be the level of EBIT, if sales amount increases by 8% next year?

(iii) Also state the percentage change one can expect in the EPS, if sales amount increases by 8% next year.

## GROUP-B

**Answer any *two* questions from the following** 15×2 = 30

7. (a) Explain critically the profit maximisation and the wealth maximisation goals of financial management. 8+4+3

(b) You have options either to receive Rs. 10,000 after 1 year or Rs. 14,000 after 5 years. If appropriate discounting rate is 8%, state which one would you choose and why?

(c) Mr. Lal has invested Rs. 2,00,000 with a public bank for two years. Interest of 8% p. a. is to be compounded quarterly on the investment. Compute the amount of money Mr. Lal can expect at the time of maturity of the investment.

8. (a) What do you understand by optimum capital structure? 3+12

(b) From the following Capital Structure of Itanagar Company Ltd., calculate its weighted average cost of capital (use market value as weight).

| | **Rs.** |
|---|---|
| Equity Shares of Rs. 10 each | 2,00,000 |
| Reserve and Surplus | 1,00,000 |
| 12% Debentures of Rs. 100 each | 5,00,000 |
| Total: | 8,00,000 |

(i) Market Price per share of the company is Rs. 50 and earnings per share is Rs. 16. The company pays 40% of its earnings as dividend to its equity shareholders. Expected growth rate is 5% p.a.

(ii) Debentures were issued at par, but these will be redeemed at a premium of 5% after 5 years.

(iii) Appropriate corporate tax rate is 30%.

9. From the following information of AGB Ltd., calculate the degree of operating leverage, financial leverage and combined leverage for each situation A and B under financial plans I, II and III. Also indicate which of the following plans is most risky and which one is least risky: 15

- Production and Sales: 2,000 units
- Selling Price per unit: Rs. 100
- Variable Cost per unit: Rs. 30
- **Fixed Cost (Operating):**

  Situation A: Rs. 40,000

  Situation B: Rs. 10,000

- **Financial Plan**

| | **I** | **II** | **III** |
|---|---|---|---|
| Equity | 7,00,000 | 5,00,000 | 3,00,000 |
| 10% debt | 3,00,000 | 5,00,000 | 7,00,000 |

- Tax rate is given as 30%.

10.(a) Do you think payment of dividend is relevant for valuation of firms? Explain briefly. 5+10

(b) TD Ltd. belongs to a risk-class for which the appropriate price-earnings (P/E) ratio is 12.5. It currently has 1,00,000 outstanding shares selling at Rs. 100 each. The firm is contemplating the declaration of dividend of Rs. 20 per share at the end of the current financial year. Under the Modigliani and Miller assumption, answer the following questions:

(i) What will be the price of the share at the end of the year, if dividend is declared?

(ii) How many new shares must be issued if it is assumed that company pays the dividend, has a net income of Rs. 18,00,000 and makes new investment of Rs. 27,50,000 during the period?

(iii) What will be the value of the firm if dividend is paid?

11. A factory produces 12,000 units in a year and sells them at Rs. 100 per unit. Cost structure of the product is given below: 15

Materials- 50%; Labour- 20%; Overhead- 20%; Profit- 10%.

The following additional information is available:

(i) Purchase, sales and production occur evenly throughout the year and labour and overhead accrue similarly.

(ii) Raw materials remain in store for 2 months.

(iii) The production process takes 2 months.

(iv) Finished goods stay in store for 4 months.

(v) Debtors are allowed 2 months credit.

(vi) Creditors allow 1 month credit.

(vii) Cash balance to be maintained at 10% of the Working capital.

(viii) 20% of purchases are for cash.

Forecast the working capital requirement of the factory.

12. Cisco Ltd. wants to select one of the following two projects. Assume tax rate of 30% and Straight-Line Method of depreciation. 10+2+3

| **Particulars** | **Project-A (Rs.)** | **Project-B (Rs.)** |
|---|---|---|
| Initial investment | 5,00,000 | 5,00,000 |
| **Earnings after tax:** | | |
| 1st year | 1,00,000 | 20,000 |
| 2nd year | 50,000 | 20,000 |
| 3rd year | 20,000 | 20,000 |
| 4th year | 20,000 | 50,000 |
| 5th year | 20,000 | 1,00,000 |

You are required to:

(a) Compute Net Present Value (NPV) of the projects taking cost of capital of 12%.

(b) Comment on the acceptability of the projects.

(c) Justify whether IRR of the projects would be more than 12% or not. (without any additional calculation).

**N.B. :** *Students have to complete submission of their Answer Scripts through E-mail / Whatsapp to their own respective colleges on the same day / date of examination within 1 hour after end of exam. University / College authorities will not be held responsible for wrong submission (at in proper address). Students are strongly advised not to submit multiple copies of the same answer script.*

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