Total No. of printed pages = 4

25(2) FIMN 204

2010

FINANCIAL MANAGEMENT

Paper : 204

Full Marks - 70

Time - Three hours

The questions are of equal value.

All questions are compulsory.

1. Explain the concept of financial leverage. Show the impact of financial leverage on the earnings per share. Illustrate your answer.

Or

Calculate the level of EBIT at which the indifference point between the following financing alternatives will occur :

(a) Common share capital of Rs. 10,00,000 or 8% debentures of Rs. 5,00,000 and common share capital of Rs. 5,00,000.

[Turn over

(b) Common share capital of Rs. 10,00,000 or 8% preference share capital of Rs. 5,00,000 and common share capital of Rs. 5,00,000.

(c) Common share capital of Rs. 10,00,000 or common share capital of Rs. 5,00,000, 8% preference share capital of Rs. 2,00,000 and 8% debentures of Rs. 3,00,000.

Assume that the price of a common share is Rs.10 in each case and tax rate is 50%.

2. "The existence of an optimum capital structure is not accepted by all. There exist two extreme views and a middle position." Discuss elaborately.

Or

X Co. has net operating income of Rs. 2,00,000 when it invests Rs. 10,00,000 in assets. It can raise debt at a 6% rate of interest. Assume that taxes do not exist. Using the NOI approach and an overall capitalisation rate of 10%, compute the total value of the firm, value of shares and the cost of equity if the firm has (i) no debt, (ii) Rs. 3,00,000 debt, (iii) Rs.6,00,000 debt.

3. A company is faced with the problem of choosing between two mutually exclusive projects. Project A requires a cash outlay of Rs. 1,00,000 and cash

running expenses of Rs. 35,000 per year. On the other hand, Project B will cost Rs. 1,50,000 and require cash running expenses of Rs. 20,000 per year.

Both the machines have a eight year life. Project A has Rs. 4000 salvage value and Project B has Rs. 14,000 salvage value. The company's tax rate is 50% and has a 10% required rate of return. Assume depreciation on straight line basis.

Which project should be accepted ?

Or

(a) The reciprocal of payback period is a good approximation of the rate of return under certain conditions. Explain. 4

(b) Compare between NPV and IRR techniques of investment appraisal. Explain the situations when the two would give similar and conflicting findings. 10

4. Paul's Products currently makes all sales on credit and offers no cash discount. The firm is considering a 2% cash discount for payment within 15 days. The firm's current average collection period is 60 days, sales are 40,000 units, sale price is Rs. 45 per unit, variable cost is Rs. 36 per unit and average cost per unit is

Rs. 40 at current sales volume. The firm expects the policy changes to result in an increase in sales to 42,000 units, 70% of sales will take the discount, the average collection period will fall to 30 days. If the firm requires rate of ROI of 25%, should the proposed discount be offered ?

Or

Write a comprehensive note on management of working capital.

5. Prepare a projected Balance Sheet on the basis of the following information :

Estimated sales	Rs. 4,50,000
Sales to net worth	2·5 times
Total debt to net worth	65%
Current liabilities to net worth	25%
Current ratio	3·6
Sales to Inventory	5 times
Average collection period	36 days
Fixed assets to net worth	75%.