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SARDAR PATEL UNIVERSITY
BBA (ITM) SEM: V EXAMINATION

2016

Thursday, 24th November

2:00 P.M. to 4.00 P.M.

UM05EBBI03

PRINCIPLES OF FINANCIAL MANAGEMENT

Total Marks: 60

Note: Figures to the right indicate marks of question.
All working notes are part of the answer.

Q:1[A] "Sound financial management is a key to the prosperity of corporation."- [10]
Explain.

[B] Write a note on: E-finance. [05]

OR

Q:1[A] Explain wealth maximization as an objective of a firm. [08]

[B] "Financial management is nothing but managerial decision making in assets-mix, capital-mix and profit allocation" Explain in context of this statement, the important financial decisions in a firm. [07]

Q:2[A] Following is the balance sheet of Sita Ltd: [08]

Liabilities	Rs	Assets	Rs.
Equity share capital (Rs.10 per share)	1,20,000	Net Fixed Assts	3,00,000
10% Long term debt	1,60,000	Current Assets	1,00,000
Retained earnings	40,000		
Current Liabilities	80,000		
	4,00,000		4,00,000

The company's total assets turnover ratio is 3. Its fixed operating cost is Rs.2,00,000 and variable cost ratio is 40%. The tax rate is 50%. Calculate

1) All the three type of leverages.

2) Determine the likely levels of EBIT if EPS is Rs.2, Rs.6 and Rs.0.

[B] What do you understand by capitalization? Explain theories of capitalization. [07]

OR

Q:2[A] Explain meaning and causes of over capitalization. Suggest remedies to correct it. [08]

[B] Krishna Ltd. has an EBIT of Rs.1,60,000. Its capital structure consists of the following securities: [07]

10% Debenture	Rs. 5,00,000
12% Preference Shares	Rs. 1,00,000
Equity Shares of Rs.100 each	Rs. 4,00,000

The company is in 50% tax bracket. You are required to calculate:

1) The company's EPS.

2) The % change in EPS associated with 30% decrease in EBIT.

3) The degree of financial leverage

- Q:3 Kiaan Ltd. is considering two mutual exclusive projects. The following [15]
are the information for the same.

Initial Investment	Rs.20,000
Life of the project	5 years
Required rate of return	10%
Tax rate	50%

The project will be depreciated on straight line method. The estimated cash flow before depreciation and tax are as follows:

Year	1	2	3	4	5
Project A	8,000	8,000	8,000	8,000	8,000
Project B	10,000	8,000	4,000	10,000	10,000

Compute the following:

- 1) Pay back period
- 2) Average rate of return
- 3) Net present value
- 4) Profitability index

P.V. of Re.1 at 10% is given below:

Year	1	2	3	4	5
P.V. Factor	0.909	0.826	0.751	0.683	0.621

OR

- Q:3[A] What do you understand by capital budgeting? Explain the significance [10]
of capital budgeting from the point of view of industrial concern.
- [B] Using the information given below, compute discounted pay back [05]
period.

Initial Investment	Rs.80,000				
Estimated life	5 years				
Year	1	2	3	4	5
Profit after tax (Rs.)	6,000	14,000	24,000	16,000	Nil

Depreciation has been calculated under straight line method. The cost of capital may be taken at 20% and P.V. of Re.1 at 20% is given below:

Year	1	2	3	4	5
P.V. Factor	0.833	0.694	0.579	0.482	0.402

- Q:4[A] What is capital structure? Discuss factors affecting capital structure. [09]
- [B] Compute the total value of the firm, value of equity shares and overall [06]
cost of capital as per traditional approach from the following information.

Net operating income	Rs.2,00,000
Total Investment	Rs.10,00,000
Equity capitalization rate:	
(a) If firm uses no debt	10%
(b) If the firm uses Rs. 4,00,000 debentures	11%
(c) If the firm uses Rs. 6,00,000 debentures	13%

Assume that Rs. 4,00,000 debentures can be raised at 5% rate of interest whereas Rs. 6,00,000 debentures can be raised at 6% rate of interest.

OR

(2)

- Q:4[A] Two companies X and Y are identical in every respect except that X is a unlevered firm while Y is levered. The values of two firms are given below: [08]

Particulars	X	Y
NOI	1,50,000	1,50,000
- Interest	-	60,000
Net Income (NI)	1,50,000	90,000
+ Equity Capitalization Rate (Ke)	0.15	0.20
Value of equity (S)	10,00,000	4,50,000
+ Value of Debt (B)	-	6,00,000
Value of firm (V)	10,00,000	10,50,000
Ko	0.15	0.143

An investor owns 10% shares of firm Y. Show the amount of gain to be received by investor through arbitrage.

- [B] In considering the most desirable capital structure for a company, the following estimates of the cost of debt and equity have been made at various levels of debt equity mix: [07]

Debt as % of total capital employed	Cost of Debt (%)	Cost of Equity (%)
0	5	12
10	5	12
20	5	12.5
30	5.5	13
40	6	14
50	6.5	16
60	7	20

You are required to determine the optimal debt equity mix for the company by calculating overall cost of capital.
