Seat No. : _______________

# XE-101

## T.Y. B.B.A.

**March-2013**

## Advance Financial Management

**Time : 3 Hours]** **[Max. Marks : 70**

1. (a) Attempt the following : **8**

Calculate the explicit cost of debt for each of the following situations :

(i) Debentures are sold at par and flotation costs are 5%.

(ii) Debentures are sold at premium of 10% and flotation costs are 5% of issue price.

(iii) Debentures are sold at discount of 5% and flotation costs are 5% of issue price.

(iv) Debentures are sold at premium of 10% and flotation costs are 5%.

Assume for all the above situations :

(i) Coupon rate of interest on debentures is 15%.

(ii) Face value of debenture is ₹ 1,000.

(iii) Maturity period is 10 years

(iv) Tax rate is 35%.

(b) From the following information, determine WACC using (a) book value weights and (b) market value weights : **6**

| Source of Finance | Book value | Market value | (after tax) cost % |
|---|---|---|---|
| Equity Capital | 6,00,000 | 12,00,000 | 15% |
| Retained Earnings | 2,00,000 | | 13% |
| Preference Capital | 1,00,000 | 1,20,000 | 8% |
| Debt Capital | 4,00,000 | 3,80,000 | 6% |
| | **13,00,000** | **17,00,000** | |

**OR**

(a) Assuming the corporate tax rate of 35%, compute the after tax cost of capital in the following situations : **8**

(i) Perpetual 15% debentures of ₹ 1,000, sold at a premium of 10% with no flotation costs.

(ii) 10 years 14% debenture of ₹ 100, redeemable at premium of 5% with 5% flotation costs.

(iii) 20 years, 8% bond of ₹ 2,500 face value, redeemable at 5% premium, 2% flotation costs.

(iv) An equity share selling at ₹ 50 and paying a dividend of ₹ 6 per share, which is expected to continue indefinitely.

(b) From the following information supplied to you, determine the appropriate weighted average cost of capital, relevant for evaluating long term investment projects of the company. **6**

| | |
|---|---|
| Cost of equity | 12% |
| After tax cost of long term debt | 7% |
| After tax cost of short term loans | 4% |

| **Source of capital** | **Book value** | **Market value** |
|---|---|---|
| Equity | 5,00,000 | 7,50,000 |
| Long term debt | 4,00,000 | 3,75,000 |
| Short term | 1,00,000 | 1,00,000 |
| | **10,00,000** | **12,25,000** |

2. Determine the working capital required to finance an activity level of 3,60,000 units of output for a year. The cost structure is as under : **8**

| | **Cost per unit (₹)** |
|---|---|
| Raw Materials | 10 |
| Direct Labour | 10 |
| Overheads | 20 |
| Total cost | 40 |
| Profit | 10 |
| Sale price | 50 |

**Additional Information :**

(a) Minimum desired cash balance is ₹ 40,000.

(b) Finished goods remain in stock on an average for a month.

(c) Materials are introduced in the beginning and taken 100% whereas other conversion cost is taken at 40%. For the calculation of work-in-progress inventory the WIP stock is maintained for a month.

(d) Raw materials are held in stock on an average for two months.

(e) Suppliers of materials extend a month's credit and debtors are provided two months credit. Cash sales are 25% of total sales.

(f) Time lag in payment of wages is 2 months and in case of overheads it is $\frac{1}{2}$ a month.

(g) The company provides 10% for contingency reserves to be added to the requirement of Working Capital.

**OR**

(a) Define Factoring. Discuss the various types of factoring. **8**

(b) Determine the indifference points by formulae of the financial plans (A & B), A and C, and B and C formulated by the finance department of Diya Ltd. to finance its Capital Budget, assuming 50% tax. **6**

(i) Issue 1,00,000 equity shares of ₹ 20 per share.

(ii) Issue 50,000 equity shares of ₹ 20 per share and 10% debentures of ₹ 10,00,000.

(iii) Issue 50,000 equity shares of ₹ 20 per share and 12% preference shares of ₹ 10,00,000.

**OR**

Determine the indifference points between option (i) and (ii) and option (i) and (iii), (ii & iii) from the following data, assume tax rate at 40%. **6**

(i) Issue of 50,000 equity shares of ₹ 10 per share.

(ii) Issue of 25,000 equity shares of ₹ 10 per share and balance 10% debentures.

(iii) Issue of 20,000 equity shares of ₹ 10 per share and balance 10% preference shares.

3. A toy manufacturing company has under consideration the proposal of production of high quality plastic toys. The necessary equipment to manufacture the toys would cost ₹ 1 lakh and would last for 5 years. The tax relevant rate of depreciation is 25% on written down value. There is no other asset in this block. The expected salvage value is ₹ 10,000. The toys can be sold at ₹ 4 each. The manufacturer will incur cash expenses of ₹ 25,000 each year. The variable costs are estimated at ₹ 2 per toy. The manufacturer estimates it will sell about 75,000 toys per year. The tax rate is 35% should the proposed equipment be purchased. Assume 20% cost of capital and additional working capital requirement ₹ 50,000. **14**

**OR**

(a) Rajesh Ltd. is considering two mutually exclusive proposals, X and Y. Proposal X will require the initial cost of ₹ 1,40,000 with no salvage value, and will also require an increase in the level of inventories and receivables of ₹ 60,000 over its life. The project will generate additional sales of ₹ 1,30,000 and will require cash expenses of ₹ 40,000 in each of its 5 years life. It will be depreciated on SLM and the same is accepted for tax purposes. **9**

Proposal Y will require an initial capital of ₹ 2,50,000 with no salvage value, and will be depreciated on SLM. The earnings before depreciation and taxes during its 5 years life are :

| **Year 1** | **Year 2** | **Year 3** | **Year 4** | **Year 5** |
|---|---|---|---|---|
| ₹ 80,000 | ₹ 86,000 | ₹ 90,000 | ₹ 1,00,000 | ₹ 1,02,000 |

The company has to pay corporate income tax at the rate of 35% and is evaluating projects with 10% as the cost of capital. Which project is acceptable under NPV method ?

(b) Write a short note on RADR approach. **5**

4. (a) Write a note on process of venture financing. **7**

**OR**

Explain the factors affecting dividend policy in brief.

(b) Explain any **seven** terms : **7**

(i) Debit Card

(ii) Circuit Breaker

(iii) Floor Price

(iv) Z group

(v) Forward Contract

(vi) Option Premium

(vii) FDI

(viii) HNIs

(ix) Dematerialisation

5. (a) Explain the portfolio and geographical classification of Mutual Funds. **7**

(b) Discuss the principles underlying Insurance Contracts. **7**

**OR**

(a) Explain the following in context of Mutual Funds : **7**

(i) Sponsor

(ii) Net Asset Value

(iii) Asset Management Company

(b) What is General Insurance ? Discuss the various general insurance products. **7**