6. (a) X Ltd is considering relaxing its present credit policy and is in the process of evaluating two alternative policies. The firm is required to give a return of 25% on the investment in new accounts receivable. The company's variable cost is 40% of the sale. The other relevant information is given below. Which policy option is best for the company?

Particulars	Present Policy	Policy option-1	Policy option-2
Sales	Rs. 1,10,00,000	Rs. 1,25,00,000	Rs. 1,65,00,000
Accounts receivable turnover ratio	4	3	2.4
Bad debt losses	1%	2%	3.%

(12)

(b) A project requiring a Rs.5 Crore investment has a profitability index of 0.94. What is its net present value? (6)

[This question paper contains 8 printed pages.]

Your Roll No..............

Sr. No. of Question Paper : 1655 **I**

Unique Paper Code : 2922072301

Name of the Paper : Corporate Finance

Name of the Course : **BBA (FIA)**

Semester : III

Duration : 3 Hours Maximum Marks : 90

Instructions for Candidates

1. Write your Roll No. on the top immediately on receipt of this question paper.
2. Attempt **five** questions including question no. **1** which is compulsory.
3. Attempt **all** parts of a question together.
4. Marks are indicated against each question.
5. Show your working clearly on the answer sheet.
6. Use of a scientific non-programmable calculator is allowed.

P.T.O.

1. (a) XYZ Ltd. is considering the replacement of one of its moulding machines. The existing machine is in a good operating condition, but is smaller than required if the company is to expand its operation. It is 4 years old, has a current salvage value of Rs. 4,00,000 and a remaining life is 6 years. The machine was initially purchased for Rs. 20,00,000 and is being depreciated at 25% on the WDV basis.

The new Machine will cost Rs. 30,00,000 and will be subject to the same method as well as the same rate of depreciation. it is expected to have the useful life of 6 years. The management anticipates that with the expanded operations there will be a need of an additional net working capital of Rs. 2,00,000. The new machine will allow the company to expand the current operations and thereby increase annual revenue by Rs. 10,00,000. Variable cost will be 30% of sale. Fixed cost is likely to remain same. The corporate tax rate is 35%. Its cost of capital is 10%. The company has several machines in the block of 25% depreciation. Should the company replace the existing machine? What course of action will you suggest if the new machine has zero salvage value at the sixth year end. (12)

(v)	Credit allowed by suppliers	3.5 weeks
(vi)	Time lag in payments of labour	2 weeks
(vii)	Time lag in payments of factory overheads	1.5 weeks
(viii)	Company sells, 25% of the output against cash	
(ix)	Cash in hand and bank is desired to be maintained	Rs. 2,25,000
(x)	Safety margin of 15% is required to be maintained	

You may assume that production is carried on evenly throughout the year and labour and factory overheads accrue similarly.

You are required to prepare a statement showing estimate of working capital needed to finance a budgeted activity level of Rs. 1,04,000 units production. Finished stock, receivables and overhead are taken at cash cost. (12)

(b) Investment, Financing and Dividend decisions are all interrelated. Comment. (6)

5. (a) XYZ Ltd. has furnished the following cost sheet :

	Rs. Per unit
Raw material	98
Direct Labour	53
Factory overhead (includes depreciation of Rs. 15 per unit at budgeted level of activity)	88
Total cost	239
Profit	43
Selling price	282

Additional information :

(i) Average raw material in stock 3 weeks

(ii) Average work in progress (% of completion with respect to material-75% Labour & overhead-70%) 2 weeks

(iii) Finished goods in stock 4 weeks

(iv) Credit allowed to receivables 2.5 weeks

(b) What is sensitivity Analysis? How is it different from Scenario analysis? (6)

2. (a) A company needs Rs. 50,00,000 for the construction of a new plant. The following three plans are feasible :

I. The company may issue 5,00,000 equity shares at Rs. 10 per share.

II. The company may issue 2,50,000 equity shares at Rs. 10 per share and 25,000 debentures of Rs. 100 denominations bearing a 9% rate of interest.

III. The company may issue 2,50,000 equity shares at Rs. 10 per share and 2,50,000 cumulative preference shares at Rs. 100 per share bearing a 9% rate of dividend.

You are required to calculate :–

(i) If the company's earnings before interest and tax is Rs. 2,25,000, what are the earnings per share under each of the three plans? Assume a corporate tax rate of 30%.

(ii) Which alternative would you recommend and why?

(iii) Determine the EBIT-EPS indifference points by formulae between Financing Plan I and Plan II, Plan I and Plan III. (12)

(b) Under the Traditional approach to capital structure, what happens to the cost of debt and cost of equity when leverage increases? Describe the behaviour of overall cost of capital. (6)

3. (a) Calculate the explicit cost of debt for each of the following situations : (a) Debentures are sold at par and flotation costs are 3 per cent. (b) Debentures are sold at premium of 10 per cent and flotation costs are 6 per cent of issue price. (c) Debentures are sold at discount of 10 per cent and flotation costs are 4 per cent of issue price. Assume: (i) coupon rate of interest on debentures is 8 per cent; (ii) face value of debentures is Rs 1000; (iii) maturity period is 20 years; and (iv) tax rate is 25 per cent. (12)

(b) Briefly discuss ABC analysis of inventory management. (6)

4. (a) Tata Motors Ltd. has outstanding 1,20,000 shares selling at Rs. 20 per share. The company hopes to make a net income of Rs. 3,50,000 during the year ended 31st march 2024. The company is, considering to pay a dividend of Rs. 2 per share at the end of the current year. The capitalization rate for risk class of this company has been estimated to be 15%. Assuming no taxes, answer the questions listed below on the basis of the Modigliani Miller Dividend valuation Model :

(i) What will be the price of a share at the end of the 31st march, 2024, if

(a) The dividend is paid; and

(b) If the dividend is not paid?

(ii) How many new shares must the company issue if the dividend is paid and company needs Rs. 7,40,000 for an approved investment expenditure during the year. (12)

(b) Briefly discuss Baumol's model of cash management. (6)