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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."- Explain. [10]

[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 are the information for the same. [15]

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 of capital budgeting from the point of view of industrial concern. [10]

[B] Using the information given below, compute discounted pay back period. [05]

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 cost of capital as per traditional approach from the following information. [06]

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

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.

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