[This question paper contains 6 printed pages.]

Sr. No. of Question Paper : 6066 **Your Roll No................**

Unique Paper Code : 248303

Name of the Paper : Business Finance

Name of the Course : **B.A. (Hons) Business Economics, 2016**

Semester : III

Duration : 3 Hours

Maximum Marks : 75

Instructions for Candidates

1. Write your Roll No. on the top immediately on receipt of this question paper.
2. Attempt **all** questions.
3. The sub parts **'I & II'** of a question must be done together.
4. Use of only simple calculator is allowed.

1. (i) A company offers a scheme under which a deposit of Rs. 15,000 now will entitle the depositor to receive Rs. 4,000 per year at the end of each of next 5 years. Should the scheme be accepted if the market rate of interest is 9%.

OR

A company offers to refund an amount of Rs. 44,650 at the end of 5 years for a deposit of Rs. 6,000made annually. Find the implicit rate of interest offered by the company.

(ii) "Cash flows occurring at different point of time are not comparable." Explain the reason and how can they be made comparable ? (5+5=10)

2. (i) A software company is considering a proposal to replace one of its plants costing Rs. 60,000 and having a written down value of Rs. 24000. The remaining economic life of the plant is 4 years after which it will have no salvage value. However, if sold today, it has a salvage value of Rs. 20,000. The new machine costing Rs. 1,30,000 is also expected to have a life of four years with a scrap value of Rs. 18000. The new machine is expected to contribute additional annual benefit (before depreciation and tax) of Rs. 60,000.

Find out the cash flows associated with this decision given that the tax rate applicable to the firm is 40% and the capital gain or loss is not subject to tax.

(ii) Do the NPV, IRR and PI always agree with respect to accept-reject decisions ? Discuss. (10+5=15)

OR

(i) A company needs an initial investment of Rs. 40,000/-. The estimated cash flows are as follows :

Year	Net Cash flows
1	7,000
2	7,000
3	7,000
4	7,000
5	7,000
6	8,000
7	10,000
8	15,000
9	10,000
10	4,000

Using 10% as the cost of capital (rate of discount) determine the following :

(a) Payback period

(b) Net Present Value

(c) Internal Rate of Return (15)

3. (i) The following figures are taken from the current balance sheet of D & Co.

Equity Capital (Shares of Rs. 10 each)	Rs. 8,00,000
Share Premium	Rs. 2,00,000
Reserves	Rs. 6,00,000
Shareholder's funds	**Rs. 16,00,000**
12% Irredeemable Debentures	**Rs. 4,00,000**

An annual ordinary dividend of Rs. 2 per share has just been paid. In the past, ordinary dividends have grown at a rate of 10% per annum and this rate is expected to continue. The ordinary shares are quoted at Rs. 27.5 and the debentures at 80% in the market. Ignore taxation. You are required to estimate the weighted average cost of capital (WACC) based on market value weights for D &Co. (7.5)

(ii) Company X and Company Y are in the same risk class and are identical in every respect except that company X uses debt, while company Y does not. The levered firm has Rs. 9,00,000 debentures, carrying 10 percent of interest. Both the firms earn 20 percent operating profit on their total assets of Rs. 15 lakhs. Assume perfect capital markets, rational investors and so on; a tax rate of 35 percent and capitalization rate of 15 percent for an all equity company.

P.T.O.

(a) Compute the total value of firms X and Y using the Net Income (NI) Approach.

(a) Compute the total value of firms X and Y using the Net Operating Income (NOI) Approach. (7.5)

OR

(i) A Limited has the following capital structure :

Equity Share capital (2,00,000 shares)	Rs. 40,00,000
6% Debentures	Rs. 10,00,000
8% Debentures	Rs. 30,00,000
Total	Rs. 80,00,000

The market price of the company's equity share is Rs. 20. It is expected that company will pay a dividend of Rs. 2 per share at the end of current year, which will grow at 7 percent forever. The tax rate may be presumed at 50%. You are required to compute the following :

(a) A weighted cost of capital based on existing capital structure

(b) The new weighted average cost of capital if the company raises an additional Rs. 20,00,000 debt by issuing 10% debentures. This would result in increasing the expected dividend to Rs. 3 and leave the growth rate unchanged but the price of the share will fall to Rs. 15 per share. (6+4=10)

(ii) Explain briefly the two schools of thought relating to the effect of capital structure on value of the firm. (5)

4. (i) A company belongs to a risk class for which the capitalization rate is 10%. It currently has outstanding 25,000 shares selling at Rs. 100 each. The firm is likely to declare dividend of Rs. 5 per share at the end of the current financial year. The company expects to have a net income of Rs. 2.5 lakhs & a proposal of new investment of Rs. 5 lakhs. Show that under MM hypothesis, the payment of dividend does not affect the value of the firm.

(ii) Explain the various factors affecting dividend policy of a firm.

OR

(i) A Company is planning to make an investment of Rs. 10,00,000 and it expects to earn Rs. 5,00,000 by the year end. Presently, the company has 50,000 outstanding shares and the share of the company is trading at a price of Rs. 125. The company expects to pay shareholders Rs. 10 as dividends next year. The company's required rate of return is 15%. Find out the following :

(a) Value of the firm when dividends are paid

(b) Value of the firm when dividends are not paid

(ii) The earnings per share (EPS) of a company is Rs. 10. It has return on investment of 15% and an equity capitalization rate of 12.5%. If Walter model is used :

(a) What should be the optimum payout ratio of the company ?

(b) What would be the price per share at this payout ? (10+5=15)

5. (i) Explain the various types of lease agreements.

(ii) Explain the various benefits and costs involved in a merger transaction.

OR

(i) Explain the various financial considerations in executing mergers and acquisitions.

(ii) What are the various sources of finance available to a firm ? Explain briefly. (5+5=10)

6. Write short notes on : **(Any two)**

(i) Factors affecting capital structure

(ii) Traditional Approach to Capital Structure

(iii) Accounting vs. cash flow approach to capital budgeting (5+5=10)