Question Paper
Financial Management-I (MB211): July 2008

- **Answer all 72 questions.**
- **Marks are indicated against each question.**

Total Marks : 100

1. The objective of financial management is to increase the wealth of the shareholders which means to <Answer>

(a) Increase the physical assets owned by the firm
(b) Increase the market value of the shares of the firm
(c) Increase the current assets of the firm
(d) Increase the cash balance of the company
(e) Increase the total number of outstanding shares of the company. **(1 mark)**

2. Which of the following statements is/are **not true** regarding the Walter Model of dividend policy? <Answer>

I. It explains the relation between the dividends and stock price.
II. Firm has an infinite life.
III. Retained earnings and equity are the only sources of finance available to the firm.

(a) Only (I) above
(b) Only (II) above
(c) Both (I) and (III) above
(d) Both (II) and (III) above
(e) All (I), (II) and (III) above. **(1 mark)**

3. Which of the following is **not true**? <Answer>

(a) The inverse of PVIFA factor is called the capital recovery factor
(b) The present value of interest factor for annuity is equal to the product of the future value interest factor for annuity and the present value interest factor
(c) The inverse of PVIF factor is FVIF factor
(d) The sinking fund factor is used to determine the amount that must be deposited periodically to accumulate a specified sum at the end of a given period at a given rate of interest
(e) The product of PVIFA and the sinking fund factor is the PVIF factor. **(1 mark)**

4. Which of the following is **not true** regarding the partnership firm? <Answer>

(a) Easy and inexpensive to set up
(b) It is relatively free from governmental regulations
(c) Personal liabilities of the partners are limited
(d) The expertise and experience of the partners is useful to the firm's operations
(e) Its ability to raise funds is limited. **(1 mark)**

5. Which of the following regulations is **no** more relevant in today's business environment? <Answer>

(a) Foreign Exchange Regulation Act, 1973
(b) Partnership Act, 1932
(c) Companies Act, 1956
(d) Income Tax Act, 1961
(e) SEBI Act, 1992. **(1 mark)**

6. Which of following statements are **true** regarding issuance of Commercial Paper (CP)? <Answer>

I. They normally have a buyback facility.
II. Corporate need prior approval of RBI for CP issue.
III. CPs are issued in multiples of Rs.1 lakh.
IV. Underwriting of a CP issue is not mandatory.

(a) Both (I) and (II) above
(b) Both (I) and (III) above
(c) Both (I) and (IV) above
(d) (I), (II) and (III) above
(e) All (I), (II), (III) and (IV) above. **(1 mark)**

7. Which of the following is/are **true** regarding the major advantages of bought-out deals? <Answer>

I. Companies, both existing and new, which satisfy conditions laid down by SEBI for premium **(1 mark)**

issues, may issue at a premium through the BOD method.
II. The procedural complexities are more and the funds take some time to reach the firm.
III. Issue price usually reflects the company's intrinsic value.

(a) Only (I) above
(b) Only (III) above
(c) Both (I) and (II) above
(d) Both (II) and (III) above
(e) All (I), (II) and (III) above.

<Answer>

8. Which of the following may be termed as "Limited Discretionary Order"?

(a) An order limited by a fixed price as decided solely by the customer
(b) An order limited by a fixed price as decided solely by the broker
(c) An order to be executed by a broker at a price that is very near to the price set by the customer
(d) An order that is to be executed by the broker any time at the discretion of the customer
(e) An order that is to be executed by the broker any time at his discretion. **(1 mark)**

<Answer>

9. The face value of a T-Bill is Rs.100. The purchase price of Mr. A is Rs.96. On maturity if the yield earned on the bill is 8.35% p.a., the maturity period of the bill is (Assume 365 days a year)

(a) 14 days
(b) 28 days
(c) 91 days
(d) 182 days
(e) 364 days. **(2 marks)**

<Answer>

10. Which of the following companies provides risk capital to support the technocrats in setting up projects and businesses which involve high risk?

(a) Lease Finance companies
(b) Hire Purchase Finance Companies
(c) Factoring Companies
(d) Mutual Benefit Fund Companies
(e) Venture Capital Funding Companies. **(1 mark)**

<Answer>

11. Rs.1,25,000 was borrowed at an effective interest rate of 10 percent per annum. The amount has to be repaid with interest in ten equal annual installments. Each installment is payable at the end of every year. What will be amount of each installment?

(a) Rs.16,273
(b) Rs.17,225
(c) Rs.18,750
(d) Rs.19,375
(e) Rs.20,342. **(1 mark)**

<Answer>

12. Credit facilities provided by the suppliers of machinery and equipment to a project firm is referred to as

(a) Leasing
(b) Deferred credit
(c) Hire purchase
(d) Unsecured credit
(e) Secured credit. **(1 mark)**

<Answer>

13. Which of the following may be considered as the reason(s) for money having time value?

I. It is the legal tender for carrying out any type of transaction.
II. In India, it is guaranteed by the union government.
III. Its purchasing power increases with the passage of time due to inflation.
IV. Money can be productively invested to generate real returns over a period of time.

(a) Only (II) above
(b) Only (IV) above
(c) Both (II) and (III) above
(d) Both (III) and (IV) above
(e) (I), (III) and (IV) above. **(1 mark)**

<Answer>

14. Mr. Suresh deposited Rs.2,000 at the beginning of every month in a bank for five years. If the interest rate is 9% p.a. compounded monthly, the accumulated amount he will get after 5 years is **(2 marks)**

(a) Rs. 89,910
(b) Rs.1,34,400
(c) Rs.1,43,340
(d) Rs.1,51,980
(e) Rs.1,62,000.

<Answer>

15. The EBIT for a company at 6,000 level of production is Rs.7,50,000. At the financial break even point, the EBIT of the company is Rs.2,10,000. The Degree of Financial Leverage (DFL) for the company at 6,000 level of production is

(a) 1.56
(b) 1.51
(c) 1.49
(d) 1.46
(e) 1.39. **(2 marks)**

<Answer>

16. If the current stock price is Rs.185, the last dividend declared is Rs.17 and the growth rate in dividend is 12%, the required rate of return is

(a) 18.76%
(b) 19.02%
(c) 22.29%
(d) 21.00%
(e) 22.12%. **(1 mark)**

<Answer>

17. The money that is lent exceeds one day but less than fifteen days is known as

(a) Call money
(b) Notice Money
(c) Short term loan
(d) Certificate of deposits
(e) Term loan. **(1 mark)**

<Answer>

18. If the beta of a stock is 1.2 and the standard deviation of the return on the market is 11.25%, then the covariance of returns of the stock and market is

(a) $322.125\%^2$
(b) $250.026\%^2$
(c) $162.003\%^2$
(d) $151.875\%^2$
(e) $99.397\%^2$. **(1 mark)**

<Answer>

19. If the return on a security lies below the security market line, then

(a) The security is defensive
(b) The security is aggressive
(c) Expected return is less than the risk free rate of return
(d) The security is over priced
(e) The security is under priced. **(1 mark)**

<Answer>

20. Consider the following data:

Risk-free rate of return	8% p.a.
Market return	16% p.a.
Beta of stock X	1.25

If the risk free rate of return increases to 10% p.a. and the slope of the SML remains constant, the existing and the new required rate of return will be

(a) 16.3%; 17.3%
(b) 18.0%; 20.0%
(c) 15.2%; 19.5%
(d) 15.2%; 17.2%
(e) 19.2%; 22.2%. **(2 marks)**

<Answer>

21. The probability distributions of returns of Deepak Ltd., and the market returns are given below:

Probability	0.40	0.25	0.15	0.20
Deepak Ltd. (in %)	3	4	5	7
Market return (in %)	6	9	8	7

(3 marks)

The covariance of market returns and returns from Deepak Ltd. is $0.4625(\%)^2$. If the market return is zero, the expected return by Deepak Ltd. as per single index model will be

(a) 1.595%
(b) 1.900%
(c) 2.103%
(d) 5.695%
(e) 6.598%.

<Answer>

22. A portfolio consists of investment in Sahana Services, which is expected to give a handsome return of 18 percent and Supreme & Co., which is expected to return 10 percent. 75% of the funds are invested in Sahana and the rest in Supreme. The expected return on the portfolio is

(a) 12%
(b) 15%
(c) 16%
(d) 10%
(e) 8%. **(1 mark)**

<Answer>

23. Mr. Ashwin borrowed an amount of Rs.4,80,000 from M/s. Goodwill Finance Ltd. As per the loan agreement, he has to repay Rs.3 lakhs at the end of 7^{th} year, Rs.4 lakhs at the end of 8^{th} year, Rs.2 lakhs at the end of 9^{th} year and Rs.1 lakh at the end of 10^{th} year from now. In order to meet these payments, he wants to deposit money in a bank scheme that offers an interest rate of 9% p.a. The approximate amount that Mr. Ashwin should invest at the end of every year for a period of 6 years, so that he can repay the loan as per the agreement is

(a) Rs.1,02,090
(b) Rs.1,11,270
(c) Rs.1,21,293
(d) Rs.1,28,905
(e) Rs.1,89,389. **(2 marks)**

<Answer>

24. According to the CAPM, the risk premium for an individual security is equal to the

(a) Beta times the market return
(b) The security's covariance divided by the variance of the market
(c) Weighted average of the individual security betas in a portfolio
(d) Difference between the required return and the risk free rate multiplied by beta of the particular security
(e) Beta times the risk free return. **(1 mark)**

<Answer>

25. A portfolio consists of equal investments in the following common stocks:

Security	Beta
Infotech Computer	1.15
Minto Pharma	1.05
Magna Industries	1.50
Essar Steel	0.50

The beta of the portfolio is

(a) 0.95
(b) 1.00
(c) 1.05
(d) 1.10
(e) 1.15. **(1 mark)**

<Answer>

26. Which of the following is an example of diversifiable risk?

(a) Inadequate supply of raw materials
(b) Changes in the tax structure
(c) Reduction in the purchasing power of money
(d) Recession in the economy
(e) Introduction of a restrictive credit policy by RBI. **(1 mark)**

<Answer>

27. The degree of financial leverage is a measure of relationship between the

(a) EPS and EBIT
(b) EPS and sales
(c) EBIT and sales **(1 mark)**
(d) EPS and taxes

(d) EPS and taxes
(e) EBIT and dividend payment.

<Answer>

28. A Ltd. and B Ltd. are two companies that manufacture computer hardware. The most recent dividend paid by these two companies is Re.1.80 per share and the required rate of return for both the companies is 11%. The intrinsic value of the share of A Ltd. is Rs.34.12. The dividends of B Ltd. are expected to grow at a rate of 8% annually for 3 years, followed by "x%" annual growth rate from year 4 to infinity. The price of the security of A Ltd. is greater than the price of the share of company B by Rs.7.60. The value of "x" is

(a) 1%
(b) 2%
(c) 3%
(d) 4%
(e) 5%. **(3 marks)**

<Answer>

29. If degree of financial leverage is 3 and the amount of interest is Rs. 2,000 the EBIT shall be

(a) Rs.6,000
(b) Rs.2,000
(c) Rs.3,000
(d) Rs.5,000
(e) Rs.1,000. **(2 marks)**

<Answer>

30. Consider the following data:

Face value and maturity value of a deep discount bond	=	Rs.1,00,000
Time period of redemption	=	20 years
Issue price of the bond	=	Rs.10,500

Yield to maturity is (approximately)

(a) 11.90%
(b) 12.85%
(c) 10.90%
(d) 9.50%
(e) 8.95%. **(1 mark)**

<Answer>

31. Which of the following statements is **not true**?

(a) Each level of EBIT has a distinct DFL
(b) DFL is undefined at financial breakeven point
(c) DFL will be negative when the EBIT level goes below the financial breakeven point
(d) DFL will be positive for all values of EBIT that are above the financial breakeven point
(e) DFL is a measure of the business risk of a firm. **(1 mark)**

<Answer>

32. A firm has sales of Rs.75,000, operating income of Rs.27,000 and degree of operating leverage (DOL) of 1.22. If sales drop to Rs.60,000, what will be the revised EBIT?

(a) Rs. 5,400
(b) Rs. 6,588
(c) Rs.20,412
(d) Rs.21,600
(e) Rs.22,000. **(2 marks)**

<Answer>

33. According to the recent Amendments to the Companies Act, the minimum paid-up capital limit for private and public limited companies is respectively

(a) Rs.1.00 lakh and Rs.5.00 lakh
(b) Rs.1.00 lakh and Rs.3.00 lakh
(c) Rs.2.00 lakh and Rs.4.00 lakh
(d) Rs.2.00 lakh and Rs.5.00 lakh
(e) Rs.3.00 lakh and Rs.5.00 lakh. **(1 mark)**

<Answer>

34. The salient features of a bond are as follows:

Face value = Rs.700, coupon rate = 15%, maturity period = 5 years. The current yield of the bond is 14%. The market price of the bond is

(a) Rs.650 **(1 mark)**
(b) Rs.680

(b) Rs.680
(c) Rs.700
(d) Rs.720
(e) Rs.750.

<Answer>

35. Which of the following statements is/ are **true**?

I. Bond's price moves inversely proportional to its yield to maturity.
II. Whenever the required rate of return is equal to the coupon rate, the value of the bond is equal to its par value.
III. For equal sized increases and decreases in the YTM, price movements are not symmetrical.

(a) Only (II) above
(b) Both (I) and (II) above
(c) Both (I) and (III) above
(d) Both (II) and (III) above
(e) All (I), (II) and (III) above. **(1 mark)**

<Answer>

36. The current price of a share of ABC Ltd. is Rs.60. The company issues one rights share for every four shares held at Rs.50 per share. The ex-rights price of the share would be

(a) Rs.68
(b) Rs.64
(c) Rs.58
(d) Rs.48
(e) Rs.40. **(1 mark)**

<Answer>

37. Which of the following is/are **true** regarding the comparison of actual P/E with its E (P /E)?

I. If the E (P /E) is less than the actual P/E, the stock is currently under priced and it's the time to buy.
II. If the E (P /E) exceeds the actual P/E, the stock is currently over priced and it's the time to sell.
III. If the E (P /E) equals the actual P/E, the stock is correctly priced – neither buy nor sell.

(a) Only (I) above
(b) Only (II) above
(c) Only (III) above
(d) Both (I) and (II) above
(e) All (I), (II) and (III) above. **(1 mark)**

<Answer>

38. Ms. Suja purchased a debenture of face value Rs.1,100 for Rs.1,080. The coupon rate on this is 8%. After a year she sold the debenture for Rs.1,150. Then the holding period return to Suja is

(a) 14.63%
(b) 14.96%
(c) 15.22%
(d) 15.85%
(e) 15.96%. **(2 marks)**

<Answer>

39. A bond of Zenith Information Technology Ltd., has the following features:

Face value is Rs.120, coupon rate is 15%, years to maturity is 5 years and if the required rate of return is 15%, then the value of the bond is

(a) Rs.120
(b) Rs.130
(c) Rs.140
(d) Rs.150
(e) Rs.160. **(2 marks)**

<Answer>

40. Which of the following statements is/ are **true** regarding the Warrants?

I. It gives the holder the right to subscribe to the equity shares of a company.
II. Most of the warrants are detachable from the bond or preferred stock.
III. If detached, warrants cannot be traded as independent securities.

(a) Only (I) above
(b) Both (I) and (II) above
(c) Both (I) and (III) above
(d) Both (II) and (III) above **(1 mark)**
(e) All (I), (II) and (III) above.

(e) All (I), (II) and (III) above.

<Answer>

41. The Intrinsic value of the stock is justified by

I. Earning power and profitability of the management in the employment of assets.
II. Dividends paid and the ability to pay such dividends in the future.
III. Estimates of growth of earnings.
IV. Stability and predictability of these quantitative and qualitative projections.

(a) Both (I) and (II) above
(b) Both (II) and (IV) above
(c) (I), (II) and (IV) above
(d) (II), (III) and (IV) above
(e) All (I), (II), (III) and (IV) above. **(1 mark)**

<Answer>

42. SPG Ltd belongs to a risk class for which the appropriate capitalization rate is 12%. It currently has 1,50,000 shares selling at Rs.125 each. The firm is contemplating the declaration of Rs.6 as dividend at the end of the current financial year, which has just begun. On the basis of the Modigliani Miller model, what would be the price of the share at the end of the year, if a dividend is declared?

(a) Rs.132
(b) Rs.134
(c) Rs.136
(d) Rs.138
(e) Rs.140. **(2 marks)**

<Answer>

43. We have two stocks X and Y with standard deviation 0.05 and 0.10 respectively. The correlation coefficient for these two stocks is 0.8. What will be the diversification gain from forming a portfolio that has equal proportion of each stock?

(a) 3.53%
(b) 4.53%
(c) 5.53%
(d) 6.53%
(e) 7.53%. **(2 marks)**

<Answer>

44. Who is responsible for the preparation of prospectus when a company wants to go for the Public issue?

(a) Lead manager
(b) Securities Exchange Board of India
(c) Company's manager
(d) Under writer
(e) Stock Exchange. **(1 mark)**

<Answer>

45. According to Gordon's model, the optimal dividend pay-out ratio for a firm whose cost of capital and return on investment are 15% and 12% respectively is

(a) 100%
(b) 80%
(c) 60%
(d) 20%
(e) 0%. **(1 mark)**

<Answer>

46. If debentures are issued by a company, then which of the following statements is/are **true**?

I. The interest of the debenture holder is assured by SEBI.
II. The Debenture Redemption Reserve must be created if the maturity period is less than 18 months.
III. The Debenture Redemption Reserve should be at least half of the issue amount before redemption commences.
IV. The Debenture Redemption Reserve should be at least one third of the issue amount before redemption commences.

(a) Only (I) above
(b) Only (III) above
(c) Both (I) and (II) above
(d) Both (I) and (IV) above
(e) (I), (II) and (IV) above. **(1 mark)**

<Answer>

47. A firm can raise capital from the primary market by issuing securities. Which of the following is **not** one of the ways a firm can raise capital from the primary market? **(1 mark)**

(a) Public issue
(b) Rights issue
(c) Private placements
(d) Deferred credit
(e) Euro-Issues.

<Answer>

48. Consider the following information regarding Sunshine Ltd.

Face value of the share	Rs.20
Market price of the share	Rs.40
Cost of equity capital	16%
Internal rate of return	14%
Expected earnings per share	Rs.12

If the market price per share has to increase to Rs.70, according to Walter's model on dividend policy, the dividend payout ratio of the company should be approximately

(a) 0%
(b) 12%
(c) 25%
(d) 47%
(e) 80%. **(2 marks)**

<Answer>

49. Which of the following is **true** regarding the going concern value of a business?

(a) It is the amount that is required to be spent if it were to replace its existing assets in the current condition
(b) It is generally the minimum value that a company might accept if it wishes to sell its business
(c) It is the price that is prevailing in the market at which the assets are being sold or bought
(d) It is always higher than the liquidation value, the difference accounting for the usefulness of assets and value of intangibles
(e) It is similar to the book value of the assets. **(1 mark)**

<Answer>

50. According to which of the following approaches, the return required by the investors is directly based on the risk profile of the company?

(a) Dividend forecast approach
(b) Capital asset pricing approach
(c) Realized yield approach
(d) Earnings-price ratio approach
(e) Bond yield plus risk premium approach. **(1 mark)**

<Answer>

51. Which of the following is/are the imperfections of the capital market affecting the value of a firm?

I. Corporate taxes.
II. Personal taxes.
III. Bankruptcy costs.
IV. Agency costs.

(a) Only (I) above
(b) Only (III) above
(c) Both (I) and (IV) above
(d) (I), (III) and (IV) above
(e) All (I), (II), (III) and (IV) above. **(1 mark)**

<Answer>

52. An ordinary share of a company, which engages no external financing, is selling for Rs. 50. The EPS is Rs.7.50 of which 60% is paid in dividends. The dividend growth rate is estimated to be 4%. The corporate tax rate can be assumed to be 30%. The post-tax cost of funds of the company is

(a) 10.11%
(b) 11.87%
(c) 12.54%
(d) 13.36%
(e) 16.21%. **(2 marks)**

<Answer>

53. According to which of the following approaches, the cost of debt capital remains more or less constant up to a certain degree of leverage but rises thereafter at an increasing rate?

(a) Net Income approach
(b) Net Operating Income approach **(1 mark)**
(c) Traditional approach

(c) Traditional approach
(d) David Durand Approach
(e) Miller and Modigliani approach.

<Answer>

54. Spectra Ltd. issued non-convertible debentures worth Rs.18 million redeemable after 12 years at a premium of 3.0%. The face value of the debentures is Rs.100, at a coupon rate of 12.4%. If the net amount realized is Rs.93 and the applicable tax rate is 40%, then the cost of debenture capital is

(a) 0.82%
(b) 0.84%
(c) 7.60%
(d) 8.44%
(e) 8.62%. **(2 marks)**

<Answer>

55. Which of the following statements is **not true**?

(a) If the probability of bankruptcy is very high, assets are likely to be sold at a significant discount to their true economic values
(b) Bankruptcy entails high legal and administrative costs
(c) Other things remaining the same, the probability of bankruptcy is lower for a levered firm than for an unlevered firm
(d) The equity shareholders expect a higher rate of return from a firm, which is faced with the problem of bankruptcy
(e) Beyond a threshold level, the probability of bankruptcy increases at an increasing rate, as the debt-equity ratio increases. **(1 mark)**

<Answer>

56. A firm has combined leverage of 1.7 and financial leverage of 1.04. If the firm's sales amounts to be Rs.5,00,000 p.a. and its EBIT is equal to Rs.2,32,500 ,what will be the variable cost of the firm?

(a) Rs.1,21,000
(b) Rs.1,22,000
(c) Rs.1,24,000
(d) Rs.1,26,000
(e) Rs.1,28,000. **(2 marks)**

<Answer>

57. While calculating the weighted average cost of capital,

(a) Retained earnings are excluded
(b) Debenture are given more weights
(c) Cost of issues are included
(d) Weights are based on market value or on book value
(e) Equity shares are given more weights. **(1 mark)**

<Answer>

58. The management of Vibgyor Fabrics subscribes to the NOI approach and believes that its cost of debt and overall cost of capital will remain at 9% and 12% respectively. If the ratio of the market value of equity to debt is 0.8, what rate of return is earned by equity shareholders? (Assume there are no taxes.)

(a) 13.0%
(b) 13.5%
(c) 13.8%
(d) 14.0%
(e) 14.4%. **(2 marks)**

<Answer>

59. Which of the following is/are **not true** regarding capital structure theory as stated by Miller & Modigliani?

I. If the given assumptions hold, the total market value of the firm is independent of the degree of leverage.
II. In the presence of taxes, the market value of the firm is decreased by the tax shield of debt.
III. If bankruptcy costs are considered, the expected cost of bankruptcy decreases, when the debt-equity ratio increases.

(a) Only (I) above
(b) Only (II) above
(c) Only (III) above
(d) Both (II) and (III) above
(e) All (I), (II) and (III) above. **(1 mark)**

<Answer>

60. A firm has a debt of Rs.80,000. The personal tax on debt income and equity are 35% and 30% respectively and its corporate tax is 40%. The tax shield associated with debt is **(2 marks)**

respectively and its corporate tax is 40%. The tax shield associated with debt is

(a) Rs.28,308
(b) Rs.50,000
(c) Rs.64,429
(d) Rs.76,740
(e) Rs.88,503.

<Answer>

61. Consider the following information regarding Glory Ltd.:

Net operating income	Rs.75 lakh
Overall capitalization rate	15%
Interest on debt	Rs.7 lakh
Equity capitalization rate	17%

According to the net operating income approach, the debt-equity ratio of Glory Ltd. is

(a) 0.20
(b) 0.25
(c) 0.60
(d) 1.22
(e) 4.00. **(2 marks)**

<Answer>

62. Mr. Rajkumar is 70 years old and he is expecting that he will live for another ten years. His total savings are Rs.2,00,000, which he has deposited in a bank. He wants to spend his savings equally over these ten years. If the interest earned on these deposits is 10% per annum, the annual withdrawal made over the defined period such that the account balance becomes zero at the end of 10 years is

(a) Rs.77,100
(b) Rs.40,000
(c) Rs.37,100
(d) Rs.32,546
(e) Rs.12,550. **(2 marks)**

<Answer>

63. Following is the relevant information of the bond

Face value	Rs.1,000
Coupon rate	14%
Interest payment	Annually
Maturity	5 years
Current market price	Rs.1,050

Yield To Maturity (YTM) of this bond is

(a) 12.60%
(b) 12.00%
(c) 14.62%
(d) 13.62%
(e) 11.92%. **(2 marks)**

<Answer>

64. Which of the following is/are **not** the assumptions of Miller and Modigliani Model of dividend policy?

I. The market is perfect and investors are rational.
II. Some of the investors can influence the share values.
III. There is no differential tax for the dividend income.
IV. There will be change in the investment policy of the firm.

(a) Only (I) above
(b) Only (III) above
(c) Both (I) and (II) above
(d) Both (II) and (IV) above
(e) (I), (II) and (IV) above. **(1 mark)**

<Answer>

65. The following information is regarding the equity shares of M/s. Venus Ltd:

Market Price	Rs.32.00
DPS	Rs. 4.00
Multiplier	5

(2 marks)

According to the traditional approach to the dividend policy, the EPS for M/s. Venus Ltd., is

(a) Rs.4.8
(b) Rs.5.6
(c) Rs.6.9
(d) Rs.7.2
(e) Rs.8.7.

<Answer>

66. Which of the following concepts of dividend policies considers that the changes in dividend payment and the expectations of shareholders are more important than the absolute value of the dividend actually paid by a company?

(a) Traditional model
(b) Walter model
(c) Gordon model
(d) Miller and Modigliani model
(e) Rational expectations model. **(1 mark)**

<Answer>

67. A firm has financial leverage of 1.04 and EBIT equal to Rs.2,32,500. If the Earnings After Tax (EAT) of the of the firm are Rs.1,11,000 then how much amount a firm is paying as tax?

(a) Rs.1,12,558
(b) Rs.1,15,558
(c) Rs.1,17,558
(d) Rs.1,18,558
(e) Rs.1,19,558. **(2marks)**

<Answer>

68. Which of the following is **not** an instrument to raise the funds from abroad?

(a) GDRs
(b) IPOs
(c) FCCBs
(d) ECBs
(e) ADRs. **(1 mark)**

<Answer>

69. CAPM establishes a linear relationship between

(a) Required rate of return and diversifiable risk
(b) Required rate of return on security and return on market
(c) Required rate of return of a security and its systematic risk
(d) Systematic risk and unsystematic risk
(e) Business risk and Market risk. **(1 mark)**

<Answer>

70. Banks borrow in Call market to

I. Fill the temporary gaps.
II. Meet the Cash Reserve Ratio (CRR) requirements.
III. Meet sudden demand for funds.

(a) Only (I) above
(b) Only (II) above
(c) Only (III) above
(d) Both (I) and (II) above
(e) All (I), (II) and (III) above. **(1 mark)**

<Answer>

71. What would be the percentage decline in the sales which will eliminate completely the Profit Before Tax (PBT), if the degree of total leverage is 4 and Earnings per Share (EPS) of the company is expected to be Rs.3?

(a) 22%
(b) 23%
(c) 24%
(d) 25%
(e) 26%. **(2marks)**

<Answer>

72. Mr. Ajay is considering two options for investing Rs.50,000 for 5 years. In the first option, he will get an assured return of Rs.58,000 plus percentage gain on the sensex at the end of 5th year over today's closing index, which is expected to be 30% . The second option assures him an interest rate of 12% p.a. compounded annually. The amount that Mr. Ajay is entitled to receive at the end of 5th year, if he is **(2marks)**

considering the two options independently is

(a) Rs.58,000; Rs.69,250
(b) Rs.78,000; Rs.76,550
(c) Rs.73,000; Rs.88,100
(d) Rs.71,000; Rs.90,250
(e) Rs.75,000; Rs.92,250.

END OF QUESTION PAPER

Suggested Answers
Financial Management-I (MB211): July 2008

	Answer	Reason	
1.	B	According to the objective of financial management to increase the wealth of the shareholders means to increase the market value of the shares issued by the firm. Increasing the physical assets or current assets of the company may not provide adequate returns to the shareholders, if it is done through incremental borrowing. Increasing cash balance imparts more liquidity to a company but decreases the returns on investments. Increase in the total number of outstanding shares of the company will not always result in the increase in the wealth of the share holders.	< TOP
2.	C	According to Walter Model, it explains the relation between the internal rate of return and the cost of capital of the firm to give a dividend policy that maximizes the shareholders' wealth. Hence, statement I is not true. Firm has an infinite life. It is one of the assumptions of the model. He assumed that, retained earnings are the only source of finance available to the firm, with no outside debt or additional equity used. Hence, statement II is true and III is not true. So, option c is the correct answer.	< TOP
3.	B	Capital recovery factor is the inverse of PVIFA. Hence, (a) is correct. The present value of interest factor for annuity is the reciprocal of the product of the PVIFA and FVIF. Hence, (b) is not correct. The inverse of PVIF factor is the FVIF factor. Hence, (c) is correct. To determine the amount that must be deposited periodically to accumulate a specified sum at the end of a given period, sinking fund factor is used. Hence, (d) is correct. The product of PVIFA and the sinking fund factor is the PVIF factor. Hence, (e) is correct and the answer is (b)	< TOP
4.	C	Regarding the partnership firm, It is easy and inexpensive to set up It is relatively free from governmental regulations The expertise and experience of the partner is useful to the firm's operations. These are the advantages. Its ability to raise funds is limited. It becomes a disadvantage. Personal liabilities of the partners are unlimited. So options a, b, d, and e are true and c is not true. Hence, option c is the correct answer.	< TOP
5.	A	Foreign Exchange Regulation Act, 1973 has been replaced by Foreign Exchange Management Act, 2000 in order to facilitate the external trade and payments as well as to promote an orderly maintenance of the foreign exchange market in India. So, the option (a) is correct.	< TOP

	Answer	Reason
6.	C	CPs are normally issued in multiples of Rs.5 lakhs. Hence, III is not true. The issuance of CPs does not require the approval of RBI. Hence, II is not true. Underwriting of a CP issue is not mandatory and the issuers generally have a buy back facility. Hence, I and IV are true and the answer is (c). < TOP
7.	B	The major advantages of bought-out deals < TOP I. Companies, both existing and new, which do not satisfy conditions laid down by SEBI for premium issues, may issue at a premium through the BOD method. II. The procedural complexities are reduced considerably and the funds reach the firm upfront. III. An advantage accruing the investors is that the issue price usually reflects the company's intrinsic value. Hence (b) is the answer.
8.	C	In case of limited discretionary order, a broker is given the discretion to execute order at a price that is approximately equal to the price fixed by the client. Hence, the option (c) is the answer. The option (a) represents the limit orders while the option (b) is generally an impossible proposition, except in the case of a best rate order. The option (d) represents the general mode of operations of the stock market while the option (e) occurs rarely. < TOP
9.	D	The yield on a T-bill, (k) = $\frac{F-P}{P}\times\frac{365}{d}$ where d is the maturity period and F is the face value and P is the price < TOP $0.0835=\frac{100-96}{96}\times\frac{365}{d}$ Hence, d = 182.10 days. i.e. approximately 182 days.
10.	E	Venture capital funding companies generally provide risk capital to the technology oriented and highly risky businesses. < TOP
11.	E	The amount of each installment will be < TOP $= \frac{1,25,000}{\text{PVIFA}(10\%,10\text{ years})} = \frac{1,25,000}{6.145} =$ 20341.74 = 20342(approx)
12.	B	Deferred credit is the facility offered by the suppliers of machinery and equipment to a project firm. < TOP Hence, option b is the correct answer. Leasing and Hire Purchase are the sources of finance offered by financial institutions, Non-Banking finance companies, Banks and manufactures of equipment/ asset.
13.	B	Being a legal tender and having the government guarantee do not have any role in relation to the time value of money. The purchasing power of money gradually decreases due to inflation and so the individuals prefer to spend money, rather than saving the same without any suitable incentives. But money may be productively invested to generate higher returns in future. Hence the option (b) is the correct one. < TOP
14.	D	FVIFA (annuity due) = FVIFA (1 + interest rate) < TOP $\text{FVIFA}(0.75\%, 60) = \left[\frac{(1.0075)^{60}-1}{0.0075}\right](1.0075)$ $= 75.99$ $\therefore$ Amount receivable in future = 75.99 × 2000 = Rs.1,51,980 (Note that 9% compounded monthly means 0.75% interest for each month for 12 × 5 = 60 months).

	Answer	Reason	
15.	E	At the financial break even point, EBIT = $I + \frac{D_P}{(1-t)}$ i.e. $I + \frac{D_P}{(1-t)}$ = Rs.2,10,000. DFL = $\frac{EBIT}{EBIT - I - \frac{D_p}{(1-T)}} = \frac{EBIT}{EBIT - (I + \frac{D_p}{(1-T)})}$ $= \frac{7,50,000}{7,50,000 - 2,10,000} = 1.39.$ Hence, option (e) is the correct choice.	< TOP
16.	C	$P_0 = D_1 / k - g$ and $k = (D_1 / P_0) + g$ $D_1 = D_0 (1+g) = 17 (1 + 0.12) = 19.04.$ k = (19.04/185) + 0.12 = 22.29%.	< TOP
17.	B	The money that is lent for one day in the market is known as 'Call money', and if it exceeds one day but less than 15 days, it is referred to as 'Notice money'.	< TOP
18.	D	$\beta = \frac{Cov(i,m)}{\sigma_m^2}$ or $Cov(i,m) = \beta . \sigma_m^2 = 1.2 (11.25)^2 = 151.875\%^2$	< TOP
19.	D	If the return on a security lies below the security market line, the security is over priced as the expected return is less than the required rate of return. Hence, option d is correct.	< TOP
20.	B	Required rate of return = $R_f + \beta (R_m - R_f) = 8 + 1.25 \times (16\text{-}8) = 8 + 1.25 \times 8 = 18\%$ New required rate of return = $10 + 1.25 \times (16\text{-}8) = 10 + 1.25 \times 8 = 20\%$.	< TOP
21.	C	$\bar{k}_a = 0.40 \times 3 + 0.25 \times 4 + 0.15 \times 5 + 0.20 \times 7 = 4.35\%.$ $\bar{k}_m = 0.40 \times 6 + 0.25 \times 9 + 0.15 \times 8 + 0.20 \times 7 = 7.25\%.$ $\beta = \frac{COV_{sm}}{\sigma_m^2}$ $\sigma_m^2 = (6 - 7.25)^2 0.4 + (9 - 7.25)^2 0.25 + (8 - 7.25)^2 0.15 + (7 - 7.25)^2 0.2$ $= 0.625 + 0.766 + 0.084 + 0.0125 = 1.4875$ $\beta = \frac{0.4625}{1.4875} = 0.31$ The alpha factor helps us in computing the rate of return that the security will earn when market return is zero. $\alpha = \bar{k}_A - \beta_A \bar{k}_m = 4.35\% - (0.31)\ 7.25\% = 2.1025\ \%.$ Hence, the security will earn a return of 2.1025% when the market return is zero.	< TOP
22.	C	Expected return = 0.75 x 18 + 0.25 x 10 = 16%	< TOP
23.	B	At the end of 6 years, the future value of the amount that Ashish deposits each year for a period of 6 years, should be equal to the present value of the payments that he has to make under the loan agreement in the 7^{th}, 8^{th}, 9^{th} and 10^{th} years. The discounted value of the payments to be made at the end of 7^{th}, 8^{th}, 9^{th} and 10^{th} years, as at the end of the 6^{th} year	< TOP

Answer **Reason**

$$= \frac{3}{1.09} + \frac{4}{(1.09)^2} + \frac{2}{(1.09)^3} + \frac{1}{(1.09)^4} = \text{Rs.8.371 lakh}$$

Future value of the deposits made at the end of every year, for a period of 6 years = X. $FVIFA_{(9\%,\ 6\ years)}$ (where X is the amount to be invested at the end of every period till 6 years).

X. $FVIFA_{(9\%,\ 6\ years)}$ = Rs. 8.371 lakh

$$X = \frac{8.371 \text{ lakh}}{FVIFA_{(9\%,6\ years)}} = \frac{8.371 \text{ lakh}}{7.523} = \text{Rs.1.1127 lakh}$$ i.e. Rs. 1,11,270.

Hence Ashish has to deposit Rs. 1,11,270 at the end of every period for 6 years so as to be able to make the payments under the loan agreement.

24. D The risk premium for an individual security is equal to the difference between the required return and the risk free rate multiplied by beta of the particular security. < TOP

25. C $B_p = .25(1.15) + .25(1.05) + .25(1.50) + 0.25(.50) = 1.05$ < TOP

26. A Diversifiable risks are those risks that are specific to a company or industry and hence can be eliminated by diversification. When a company is not able to obtain adequate supply of raw materials, it becomes a source of diversifiable risk. Hence option (a) is the correct choice. < TOP

Changes in tax structure, recession in the economy, the credit policy introduced by RBI and reduction in the purchasing power of the economy are examples of non-diversifiable risks. These risks are related to the general economy and cannot be eliminated by the process of diversification.

27. A Degree of financial leverage is a measure of relationship between EPS and EBIT. It measures the effect of change in the EBIT on the EPS of the company. Hence, (a) is the answer. < TOP

28. C Intrinsic value (IV) of A Ltd. = Rs.34.12 < TOP

$\therefore$ Intrinsic Value of B Ltd. = 34.12 – 7.60

Price of B Ltd. = 34.12 – 7.60 = Rs.26.52

Price = PV of dividends

$$= \frac{1.8(1.08)}{1.11} + \frac{1.8(1.08)^2}{(1.11)^2} + \frac{1.8(1.08)^3}{(1.11)^3} + \frac{1.8(1.08)^3(1+x)}{(k-g)(1.11)^3} = 26.52$$

$$= 1.751 + 1.704 + 1.658 + \frac{1.658(1+x)}{0.11-x} = 26.52$$

$$\frac{1.658(1+x)}{0.11-x} = 21.407$$

$1.658 + 1.658x = 2.355 – 21.407x$

$23.065x = 0.6968$

$x = 0.03$

Hence x = 3% and answer is (c).

29. C DFL = EBIT / EBIT – Interest = 3 < TOP

EBIT = 3(EBIT- Interest)

2EBIT = Rs. 6,000. ie. EBIT = Rs.3,000.

30. A $10{,}500 = \frac{1{,}00{,}000}{(1+x)^{20}}$ or, x= 11.9% (approx.) < TOP

31. E Financial leverage measures the effect of the change in EBIT on the EPS of the company. The measure of financial leverage is the Degree of Financial Leverage (DFL). Hence, (e) is not true regarding DFL. The other alternatives are the features < TOP

	Answer	Reason	
		of DFL.	
32.	C	% Decrease in EBIT = % decrease in sales x DOL % Decrease in sales = 75,000 - 60,000/ 75,000 = 20% % Decrease in EBIT 0.20 x 1.22 = 0.244 or 24.4% Revised EBIT = Rs. 27,000 (1-0.244) = Rs. 20412.	< TOP
33.	A	According to the recent Amendments to the Companies Act, the minimum paid-up capital limit for private and public limited companies is Rs. 1.00 lakh and Rs. 5.00 lakh respectively.	< TOP
34.	E	Current yield = Coupon amount ÷ Market price Coupon Amount = 700 x 15% = Rs.105 ∴ 0.14 = 105 ÷ MP ∴MP = Rs. 750	< TOP
35.	E	Bond's price moves inversely proportional to its yield to maturity. When ever the required rate of return is equal to the coupon rate, the value of the bond is equal to its par value. For equal sized increases and decreases in the YTM, price movements are not symmetrical. Hence, all the statements are correct.	< TOP
36.	C	Ex-rights price of a share $= \frac{NP_0 + S}{N+1} = \frac{4(60)+50}{4+1} =$ Rs.58.	< TOP
37.	C	By the comparison of actual P/E with its E(P /E), the rules are If the E(P /E) exceeds the actual P/E, the stock is currently under priced and it's the time to buy. If the E(P /E) is less than the actual P/E, the stock is currently over priced and it's the time to sell. If the E(P /E) equals the actual P/E, the stock is correctly priced – neither buy nor sell. Hence, statements (I) and (II) are not true and (III) is true.	< TOP
38.	A	Holding period return, $k = \frac{I + (P_t - P_{t-1})}{P_{t-1}} = \frac{88 + (1150 - 1080)}{1080} = 14.63\%$ Hence (a) is the correct answer.	< TOP
39.	A	If the required rate of return is equal to the coupon rate, then the value of the bond is equal to its par value. So, option a is the correct answer.	< TOP
40.	B	It gives the holder the right to subscribe to the equity shares of a company. Most of the warrants are detachable from the bond or preferred stock. So, I and II are true. If detached, warrants can be traded as independent securities. Hence, b is the correct option.	< TOP
41.	E	The Intrinsic value of the stock is justified by Earning power and profitability of the management in the employment of assets. Dividends paid and the ability to pay such dividends in the future. Estimates of growth of earnings. Stability and predictability of these quantitative and qualitative projections.	< TOP
42.	B	The price of the share when dividend is declared,	< TOP

Answer **Reason**

$$P_0 = \frac{1}{1+k_e}(D_1 + P_1)$$

$$125 = \frac{1}{1.12}(6 + P_1)$$

$$140 = 6 + P_1$$

$$P_1 = 134$$

So, the price would be Rs.134.

43. B $\sigma_p^2 = w_X^2\sigma_X^2 + w_Y^2\sigma_Y^2 + 2w_X w_Y \sigma_X \sigma_Y r_{XY}$ < TOP

$$or\ \sigma_p^2 = (0.5)^2(0.05)^2 + (0.5)^2(0.1)^2 + 2(0.5)(0.5)(0.05)(0.1)(0.8)$$

$$or\ \sigma_p^2 = 0.000625 + 0.0025 + 0.002$$

$$or\ \sigma_p = \sqrt{0.005125} = 0.0716$$

$$\sigma_X + \sigma_Y = (0.5)(0.05) + (0.5)(0.1) = 0.075$$

$$\therefore gain\ from\ diversification = \frac{0.075 - 0.0716}{0.075} = 0.0453 = 4.53\%$$

44. A Lead manager will take the responsibility for the preparation of prospectus when a company wants to come to the Public issue. < TOP

Lead manager be responsible for all the pre and post-issue activities, liaison with the other intermediaries, statutory bodies like SEBI, Stock Exchanges and the Registrar of Companies (ROC) and finally ensures that the securities are listed on the stock exchange.

45. A Whenever, return on investment is less than cost of capital, the firm should follow 100% pay-out ratio, as it maximizes share price. < TOP

46. B If debentures are issued by a company, < TOP

The interest of the debenture holder is assured by a trustee and this trustee is typically a bank or an insurance company or a firm of attorneys. Hence, statement I is not true.

The Debenture Redemption Reserve must be created if the maturity period is mores than 18 months. Hence, statement II is not true.

The Debenture Redemption Reserve should be at least half of the issue amount before redemption commences. Hence, statement IV is not true and statement III is true.

So, option b is the correct answer.

47. D A firm can raise capital from the primary market by issuing securities in < TOP

Public issue

Rights issue

Private placements

Euro- Issues.

Where as, deferred credit is the facility offered by the supplier of machinery to the firm.

48. D According to Walter's model on dividend policy < TOP

Answer **Reason**

$$P = \frac{D}{k_e} + \frac{r(E-D)/k_e}{k_e}$$

$$70 = \frac{D}{0.16} + \frac{(0.14)\ (12-D)/0.16}{0.16}$$

$$\text{or } 70\ (0.16) = D + \left(\frac{0.14}{0.16}\right)\ (12-D)$$

$$\text{or } 11.2 = D + 0.875\ (12) - 0.875\ D$$

$$\text{or } 0.125\ D = 0.70$$

$$\text{or } D = \frac{0.70}{0.125} = \text{Rs.}5.60$$

$$\therefore \text{ Dividend payout ratio should be} = \frac{D}{EPS} = \frac{5.60}{12} = 0.47 \text{ i.e., } 47\%.$$

49. D Going Concern Value is the amount that a company could realize if it sold its business as an operating one. Its value would always be higher than the liquidation value, the difference accounting for the usefulness of assets and value of intangibles. < TOP

Hence, (d) is true.

Replacement Value is the amount that a company would be required to spend if it were to replace its existing assets in the current condition. Liquidation Value is the amount that a company could realize if it sold its assets after having terminated its business. It is generally a minimum value which a company might accept if it sells its business. Market Value of an asset or security is the current price at which the asset or the security is being sold or bought in the market. Book value is an accounting concept and it is not the same as the going concern value.

50. E According to Dividend forecast approach, the intrinsic value of an equity stock is equal to the sum of the present values of the dividends associated with it. < TOP

According to the Realized Yield approach, the past returns on a security are taken as a proxy for the estimation of return required in the future by the investors.

In Capital asset pricing approach, the sum of risk free rate of return and the risk premium is considered.

According to Bond yield plus risk premium approach, the return required by the investors is directly based on the risk profile of the company

Hence, e is the correct option.

51. E There are certain imperfections in the capital market affecting the capital structure, thereby the value of the firm. They are: < TOP

Corporate taxes.

Personal taxes.

Bankruptcy costs.

Agency costs.

So, option e is the correct answer.

52. D $P_0 = 50$, EPS= 7.5, DPS/EPS = 0.6, g=0.04 < TOP

$K_e = (D_1 / P_0) + g = [[7.5*0.6(1+0.04)] / 50] + 0.04 = 13.36\%$.

53. C According to Traditional approach, cost of debt capital remains more or less constant up to a certain degree of leverage but rises thereafter at an increasing rate. Hence, option c is the correct answer. < TOP

	Answer	Reason	
54.	D	$k_d = \dfrac{I(1-T)+\dfrac{F-P}{n}}{\dfrac{F+P}{2}} = \dfrac{12.4(1-0.4)+\dfrac{103-93}{12}}{\dfrac{103+93}{2}} = \dfrac{7.44+0.83}{98} = \dfrac{8.27}{98} = 8.44\%$	< TOP
55.	C	If the probability of bankruptcy is very high, the assets are likely to be sold at a significant discount to their true economic values. Bankruptcy entails substantial expenditure on legal and administrative proceedings. The equity shareholders will require a higher rate of return, if the firm faces the problem of bankruptcy. The probability of bankruptcy is higher for a levered firm than for an unlevered firm. Hence, option c is false. Beyond a threshold level, the probability of bankruptcy increases at an increasing rate, as the debt-equity ratio increases.	< TOP
56.	E	$TL = OL \times FL$ $or\ OL = \dfrac{TL}{FL} = \dfrac{1.7}{1.04} = 1.6$ $OL = \dfrac{Contribution}{EBIT}$ $or\ OL = \dfrac{(S-VC)}{EBIT}$ $or\ VC = S - (OL \times EBIT)$ $or\ VC = 500000 - (1.6 \times 232500) = Rs.1,28,000$	< TOP
57.	D	For calculating the weighted average cost of capital, present market value or the book value of the sources of finance is taken.	< TOP
58.	E	As per the NOI approach, $K_e = k_0 + (k_0 - k_d)(B/S)$ $k_0 = 12\%$ $k_d = 9\%$ B/S = 0.8 substituting these values, we get, $K_e = 12 + (12-9)(0.8) = 14.4\%$	< TOP
59.	D	As per M&M approach, assuming that all assumptions hold good, the total market value of the firm is independent of the degree of leverage. Statement (I) is true. If there are taxes, the market value of the firm is increased by the tax shield of debt. Statement (II) is false. If bankruptcy costs are considered, the expected cost of bankruptcy increases when the debt equity ratio increases. Statement (III) is false. Hence, alternative (d) is answer.	< TOP
60.	A	The tax shield associated with debt $= \left[1-\dfrac{(1-t_c)(1-t_{ps})}{(1-t_{pd})}\right] \times Rs.80,000$ $\left[1-\dfrac{(1-0.4)(1-0.30)}{(1-0.35)}\right] \times Rs.80,000$ Hence tax shield with debt $= Rs.28,308$ Hence (a) is the correct answer.	< TOP
61.	B	According to the net operating income approach – Total market value of firm $= \dfrac{\text{Net operating income}}{\text{Overall capitalization rate}} = \dfrac{75}{0.15} = Rs.\ 500$ lakh Market value of equity $= \dfrac{\text{Equity income}}{\text{Equity capitalization rate}}$	< TOP

	Answer	Reason
		$= \frac{\text{Net operating income} - \text{Interest on debt}}{\text{Equity capitalization rate}} = \frac{75-7}{0.17} = \text{Rs. } 400 \text{ lakh}$ Market value of debt=Total market value of firm – Market value of equity = 500 – 400 = Rs. 100 lakh $\therefore \text{Debt equity ratio} = \frac{100}{400} = 0.25$
62.	D	Equated annual withdrawal(EAI)× PVIFA(10,10%) = Rs.2,00,000 < TOP EAI × 6.145 = 2,00,000 EAI = 2,00,000/6.145 = Rs. 32,546
63.	A	$V_o = I\ (PVIFA_{(K,n)}) + F\ (PVIF_{(K,n)})$ < TOP $1050 = 140\ PVIFA_{(K,5)} + 1000\ PVIF_{(K,5)}$ 12% = 504.67 + 567.43 = 1072.10 13% = 492.41 + 542.76 = 1035.17 Interpolation $12 + \frac{1072.10-1050}{1072.1-1035.17}(13-12)$ = 12 + 0.598 = 12.60% approximately Hence, option (a) is the answer.
64.	D	The assumptions of Miller and Modigliani Model are: < TOP The market is perfect and investors are rational. Hence, statement I is true. No single investor can influence the share values. Hence, statement II is not true. There is no differential tax for the dividend income. Hence, statement III is true. There will be constant investment policy for the firm. Hence, statement IV is not true. So, option d is the correct answer.
65.	D	The traditional approach to dividend policy establishes a relationship between the market price and the dividends in the following manner: < TOP P = m(D + E/3) Where, m is a multiplier, D is the Dividend Per Share (DPS) and E is the Earnings Per Share (EPS). Hence, 32 = 5 (4 + E/3) So E = Rs. 7.2. Hence, option (d) is the correct answer.
66.	E	The rational expectations model states that the market price may show some adjustments, if the actual dividend declared is higher or lower than the expected one. Otherwise, there would be no impact of the dividend declaration on the market price of the share as long as it is at the expected rate. < TOP Hence option (e) is the correct answer.

	Answer	Reason
67.	A	$FL = \frac{EBIT}{EBT}$ $or\ EBT = \frac{EBIT}{FL} = \frac{232500}{1.04} = Rs.2,23,558$ $EAT = EBT - T$ $or\ T = EBT - EAT = 223558 - 111000 = Rs.1,12,558$ < TOP
68.	B	Global Depository Receipts (GDRs), American Depository Receipts (ADRs), Foreign Currency Convertible Bonds (FCCBs), Euro-Convertible Bonds (ECBs) are the instruments to raise the funds from abroad. Where as Initial Public Offer (IPO) is the fund raising instrument in Domestic market. < TOP
69.	C	CAPM establishes the relation between the required rate of return of a security and its systematic risk. < TOP
70.	E	Banks usually borrow from call money market, to fill the temporary gaps or mismatches that arise in bank, to meet the Cash Reserve Ratio (CRR) requirements which they should maintain with RBI, and to meet sudden demand for funds. < TOP
71.	D	if the decline in the sales causes the PBT equal to zero then PAT and EPS will also zero $\therefore \Delta EPS = 0 - 3 = -3$ $DTL = \frac{\frac{\Delta EPS}{EPS}}{\frac{\Delta S}{S}}$ $or\ \frac{\Delta S}{S} = \frac{\Delta EPS}{EPS} \times \frac{1}{DTL} = \frac{-3}{3} \times \frac{1}{4} = -0.25$ $\therefore there\ is\ 25\%\ decline\ in\ sales$ < TOP
72.	C	At the end of the 5th year, the amount Mr. Ajay would get according to the two options is **Option 1:** Amount = Rs.58,000 + (Rs.50,000 × 0.30) = (58,000 + 15,000) = Rs.73,000 **Option 2:** Amount = 50,000 × $FVIF_{(12\%,5)}$ = 50,000 × 1.762 = Rs.88,100. < TOP

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