

**NATIONAL LAW UNIVERSITY, JODHPUR**

End Term Examination – 2024

UG VI Semester

Subject: Finance III (Financial Management)

**Marks: 100**

**Time: Three Hours**

**Instructions:**

1. *Simple calculators are permitted.*
2. *Attempt any five questions.*

Q.1). How is the cost of equity capital calculated using the Capital Asset Pricing Model (CAPM)? What is the logic of using CAPM for calculating the cost of equity?

(Marks 20)

Q.2). A. Calculate the operating leverage for each of the four firms A, B, C and D from the following price and cost data:

	Firms			
	A	B	C	D
Sale price per unit (Rs)	20	32	50	70
Variable cost per unit (Rs)	6	16	20	50
Fixed operating cost (Rs)	80000	40000	200000	Nil

What calculations can you draw with respect to levels of fixed cost and the degree of operating leverage result? Explain. Assume number of units sold is 5000.

B. Explain the Pecking Order Theory.

(Marks 10+10=20)

Q.3). ABC company earns 20 percent rate of return on its investments. Its required rate of return is 12 percent. The company follows a conservative dividend policy; it pays out only 25 percent of profits as dividend. Some directors of the company feel that shareholders deserve more dividend and hence, the company should increase its payout to 50 percent. Do you agree? Give reasons.

(Marks 20)

Q.4). What is meant by profit maximization? What are its limitations as a financial goal? What is shareholders' wealth maximization? How is it superior to profit maximization?

(Marks 20)

Q.5). A. Azure Renewable Energy Ltd. Co. is thinking of investing in a wind mill project costing Rs 20 lakhs. The life of the project is five years and the estimated salvage value of the project is zero. Straight line method of charging depreciation is followed. The tax rate is 30%. The expected cash flows before tax are as follows:

Year	1	2	3	4	5
Estimated cash flow before depreciation and tax (Rs in Lakhs)	4	6	8	8	10

Determine and give decision according to the following capital budgeting methods: (i) Payback period for the investment, (ii) Average rate of return on the investment, (iii) Net present value at 10% cost of capital (iv) Profitability Index at 10% cost of capital.

B. Explain the various capital budgeting decisions.

(Marks 15+5=20)

Q.6). What are the motives behind holding cash when it does not earn any return? Expound the factors determining the cash needs and the cash management strategies.

(Marks 20)