PG – 882

I Semester M.Com. Examination, January 2016
(CBCS)
COMMERCE
Paper – 1.5 : Advanced Financial Management

Time : 3 Hours Max. Marks : 70

SECTION – A

1. Answer **any seven** sub questions. **Each** sub question carries **2** marks. **(7×2=14)**
   a) Define Finance.
   b) What are European Options ?
   c) What do you mean by Synergy ?
   d) What are the essentials of Sound Capital Mix ?
   e) What do you mean by Investment Timing ?
   f) What is Bailout Takeover ?
   g) What do you mean by Back to Back loan in Swaps ?
   h) What is Decision Tree Analysis ?
   i) What is hostile takeover ?
   j) What is Implicit Reinvestment Rate ?

SECTION – B

Answer **any four** questions; **each** question carries **5** marks. **(4×5=20)**

2. The investment data of A Company Limited launching a new product and with 10 percent cost of capital, is as follows :

Particulars	Amount (₹)
Investment ₹	7,00,000
Cash Flow After Tax :	₹
1	5,00,000
2	4,00,000
3	2,00,000
4	1,00,000
5	1,00,000

Assuming an inflation rate of 5 percent, determine NPV of the project by using both the nominal rate of discount and the real rate of discount.

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3. Briefly explain the participants of Derivatives Market in India.

4. 'Conglomerate firm shares tend to have a higher market value due to lower cost of capital'. Elucidate the statement.

5. What are the critical factors to be observed while making capital budgeting decisions under capital rationing ?

6. Paramount Products Ltd. wants to raise Rs. 100 lakh for diversification project. Current estimates of EBIT from the new project are Rs. 22 lakh p.a.

   Cost of debt will be 15% for amounts up to and including Rs. 40 lakh, 16% for additional amounts up to and including Rs. 50 lakh and 18% for additional amounts above Rs. 50 lakh. The equity shares (face value of Rs. 10) of the company have a current market value of Rs. 40. This is expected to fall to Rs. 32 if debts exceeding Rs. 50 lakh are raised. The following options are under consideration of the company.

Option	Debt	Equity
(i)	50%	50%
(ii)	40%	60%
(iii)	60%	40%

   Determine EPS for each option and state which option should be Company Adopt. Tax rate is 50%.

7. There are two firms 'A' and 'B' which are exactly identical except that A does not use any debt in its financing, while B has Rs. 2,50,000, 6% debentures in its financing. Both the firms have earnings before interest and tax of Rs. 75,000 and the equity capitalization rate is 10%. Assuming the corporation tax is 50%, calculate the value of the firm.

SECTION – C

Answer **any three** questions; **each** question carries **12** marks. **(3×12=36)**

8. Write a critical note on Capital Structure Theories.

9. What are Derivatives ? How Future and Options Contracts are priced ?

10. A company with a 12 percent of cost of funds and limited investment funds of Rs. 4,00,000 is evaluating the desirability of several investment proposals.

Project	Initial Investment (₹)	Life (in years)	Year-end Cash Inflow (₹)
A	3,00,000	2	1,87,600
B	2,00,000	5	66,000
C	2,00,000	3	1,00,000
D	1,00,000	9	20,000
E	3,00,000	10	66,000

i) Rank the projects according to the profitability index, and NPV methods.
ii) Determine the optimal investment package.
iii) Which projects should be selected, if the company has Rs. 5,00,000 as the size of its capital budget ?
iv) Determine the optimal investment package in the above situations, assuming that the projects are divisible.

11. Mr. Agni is considering an investment proposal of Rs. 80,000. The expected returns during the life of the investment are as under :

Year I

Event	Cash Inflow (₹)	Probability
(i)	32,000	0.3
(ii)	48,000	0.3
(iii)	40,000	0.4

Year II

Cash inflows in year 1 are :

Event	32,000		48,000		40,000	
	Cash Inflows (Rs.)	Prob.	Cash Inflows (Rs.)	Prob.	Cash Inflows (Rs.)	Prob.
(i)	60,000	0.2	80,000	0.33	10,000	0.25
(ii)	80,000	0.6	1,20,000	0.34	16,000	0.5
(iii)	1,00,000	0.2	1,60,000	0.33	24,000	0.25

Using 10% as the cost of capital, advice about the acceptability of the proposal.

12. AB Limited wishes to acquire CD Ltd. on the basis of an exchange ratio of 0.8. Other relevant financial data is as follows :

Particulars	AB Ltd.	CD Ltd.
Earnings After Tax (₹)	1,00,000	20,000
Equity Shares Outstanding	50,000	20,000
Earnings Per Share (₹)	2	1
Market Price Per Share (₹)	20	8

i) Determine the number of shares required to be issued by AB Ltd. for acquisition of CD Ltd.

ii) What would be the exchange ratio if it is based on the market prices of shares of AB Ltd. and CD Ltd. ?

iii) What are the Current Price-Earnings of the two companies ?

iv) Assuming the earnings of each firm remains the same, what is the EPS after the acquisition ?

v) What is the equivalent EPS per share of CD Ltd. ?

vi) Ascertain the gain to shareholders of both the companies (a) at 0.8 exchange ratio and (b) an exchange ratio based on market price.