PG – 755

I Semester M.Com. Examination, January 2015
(CBCS)
COMMERCE
Paper – 1.5 : Advanced Financial Management

Time : 3 Hours Max. Marks : 70

SECTION – A

Answer **any seven** sub questions. **Each** sub question carries **2** marks. **(7×2=14)**

1. a) What do you mean by Capital Budgeting ?

   b) What do you mean by Sequential Investment Decision ?

   c) What is Absorption ?

   d) Define Derivatives.

   e) Give the meaning of Utility Theory.

   f) What is MIRR ?

   g) What is Sensitivity Analysis ?

   h) What is hedging ?

   i) How are future contracts priced ?

   j) What is meant by risk-return tradeoff ?

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SECTION – B

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

2. Is the MM thesis realistic with respect to capital structure and the value of the firm ? If not, what are its main weakness ?

3. Do you agree that an option is always more risky than the associated share with it ? How does the risk of an option change when the share price changes ?

4. The Balance Sheet of Alpha Numeric company is given below :

Liabilities	**Amount**	**Assets**	**Amount**
Equity capital of Rs. 10 per share	90,000	Net Fixed Assets	2,25,000
10% Long term debt	1,20,000	Current Assets	75,000
Retained Earnings	30,000		
Current liabilities	60,000		
Total	**3,00,000**	**Total**	**3,00,000**

The company's total assets turnover ratio is 3, its fixed operating cost is Rs. 1,50,000 and its variable operating cost ratio is 50%. The income tax rate is 50%.

You are required to :

i) Calculate the different types of leverages for the company

ii) Determine the likely level of EBIT if the EPS is

a) Re. 1 b) Rs. 2 c) Rs. 0

5. XYZ expects a net operating income of Rs. 2,00,000. It has 8,00,000, 6% debentures. The overall capitalization rate is 10%. Calculate the value of the firm and the equity capitalization rate (Cost of Equity) according to the net operating income approach. If the debentures debt is increased to Rs. 10,00,000. What will be the effect on volume of the firm and the equity capitalization rate ?

6. A company has under review a project involving the outlay of Rs. 55,000 and expected to yield the following cash flows in current terms.

Year	**1**	**2**	**3**	**4**
Cash Flows in (Rs.)	10,000	20,000	30,000	6,000

The company's cost of capital, incorporating a requirement for growth in dividends to keep peace with cost inflation is 20% and this is used for the purpose of investment appraisal. On the above basis, the divisional manager involved as recommended rejection of the proposal.

Having regard to your own forecast that the rate of inflation is likely to be 15% in year 1 and 10% in each of the following years, you are required to comment on his recommendation. (Discount factors @ 20% are. 0.833, 0.694, 0.579 and 0.482 respectively.)

7. Explain the difference between operating leverage and financial leverage.

SECTION – C

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

8. Mr. Kumar in considering an investment proposal of Rs. 40,000. The expected returns during the left of the investment are as under :

Year – I

Event	**Cash Inflow**	**Probability**
i)	16,000	0.3
ii)	24,000	0.5
iii)	20,000	0.2

Year – II

Cash inflows in year 1 are :

Event	**16,000**		**24,000**		**20,000**	
	Cash Inflows (Rs.)	**Prob.**	**Cash Inflows (Rs.)**	**Prob.**	**Cash Inflows (Rs.)**	**Prob.**
(i)	30,000	0.2	40,000	0.1	5,000	0.2
(ii)	40,000	0.6	60,000	0.8	8,000	0.5
(iii)	50,000	0.2	80,000	0.1	12,000	0.3

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

9. "Changes in capitalization may be sought as a means of easing tension and giving corporation a better opportunity to pursue its purpose." In the light of this statement, discuss various reasons for changes in capitalization.

10. A company is considering which of two mutually exclusive projects is should undertake. The finance director thinks that the project which had higher NPV should be chosen; where as the MD thinks that the one with the higher IRR should be undertaken especially for both projects have the same initial outlay and length of life. The company anticipates a cost of capital of 10% and the net after tax cash flows of the projects are as follows :

Year	Project X	Project Y
1	35,000	2,18,000
2	80,000	10,000
3	90,000	10,000
4	75,000	4,000
5	20,000	3,000

a) Calculate NPV and IRR of each project.

b) State with reasons, which project you would recommend.

c) Explain the inconsistency in the ranking of the two projects.

11. Excellent Limited, acquiring company, is interested in the acquisition of Pathetic Limited, Target company. The management of Excellent Limited wants you to compute the maximum price it should be willing to pay to acquire Pathetic Limited as per adjusted present value approach. For the purpose you have been provided with the following data :

i) As a result of acquisition, it is expected that the FCFF of Excellent Limited are likely to increase as follows for 6 years

Year	Amount (Rs. in lakh)
1	120
2	150
3	200
4	220
5	140
6	100

ii) The FCFF of Pathetic Limited is expected to be contact after 6 years.

iii) Unlevered cost of equity is 15 percent.

iv) 10% Debt (to the extent of Rs. 120 lakh) will finance part of acquisition cost. Debt will be reduced to Rs. 70 lakh at the end of year 6 by repaying Rs. 10 lakh at the end of each year, commencing from year 1. Debt level is expected to remain at that level thereafter.

v) Corporate tax rate is 35 percent.

vi) Advantage from debt is to be valued at cost of debt.

viii) Bankruptcy costs are assumed to be zero.

12. Explain the following derivative instruments in brief :

    i) Forward Contract

    ii) Futures Contract

    iii) Options

    iv) Swaps.