PG – 569

I Semester M.Com. Examination, January 2017
(CBCS)
COMMERCE
Paper – 1.5 : Advanced Financial Management

Time : 3 Hours Max. Marks : 70

SECTION – A

1. Answer **any seven** questions out of **ten**. **Each** question carries **two** marks. **(7×2=14)**
   a) Discuss Arbitrage process.
   b) Explain value of the firm.
   c) Define opportunity cost of capital.
   d) Explain decision tree.
   e) Define 'time value of money'.
   f) Explain utility theory.
   g) Discuss the significance of P/E ratio.
   h) What is Leveraged buyout ?
   i) Define a 'futures' contract.
   j) Explain the difference between futures and options.

SECTION – B

Answer **any four** questions out of six. **Each** question carries **five** marks. **(4×5=20)**

2. Define strategic financial management. State three examples of strategic financial decisions.

3. Discuss the use of sensitive analysis in risk evaluation.

4. Critically examine NPV and IRR. Do they give identical results ?

5. Companies U and L are identical in every respect except that the former does not use debt in its capital structure, while the latter employs Rs. 6 lakh 10% debt. Assuming that (i) all the M-M assumptions are met, (ii) the corporate tax rate is 35%, (iii) the EBIT is Rs. 1,20,000, and (iv) the equity capitalization of the unleveled company is 0.20. What will be the value of the firms U and L ?

6. A company is faced with the problem of choosing between two mutually exclusive projects. Project X requires a cash outlay of Rs. 1,00,000 and cash running expenses of Rs. 30,000 per year. On the other hand project Y requires a cash outlay of Rs. 1,50,000 and running expenses of Rs. 20,000 per year. Both the projects have a eight year life. Project X has a salvage value of Rs. 4,000 and project Y has Rs. 14,000. The company's required rate of return is 10%. Assume the corporate tax rate is 50% and the depreciation of the project is on straight line basis. On a differential basis which project should be accepted ?

7. A particular put is the option to sell stock at Rs. 40. It expires after 3 months and currently sells for Rs. 2 when the price of the stock is Rs. 42.
   i) If an investor buys this put, what will the profit be after three months if the price of the stock is Rs. 45, Rs. 40 and Rs. 35 ?
   ii) What will the profit be from selling this put after three months if the price of the stock is Rs. 45, Rs. 40 and Rs. 35 ?

SECTION – C

Answer **any three** out of **five. Each** question carries **twelve** marks. **(3×12=36)**

8. Explain the different Hedging instruments and their features.

9. What is optimal capital structure and discuss the cost of capital behavior in Traditional approach ?

10. A firm has Rs. 6,00,000 available for investment. The investment opportunities available are as follows :

Proposal	Cost of the Project	IRR%	NPV
1	2,00,000	7	−14000
2	2,30,000	8	−27000
3	2,00,000	9	−7000 ?
4	2,00,000	23	1,20,000
5	1,20,000	19	54000 (given)
6	1,50,000	17	57000
7	90,000	16	22,500
8	3,00,000	13	64800
9	3,60,000	12	42000
10	5,00,000	11	45,000

Missing in question

The firms cost of capital is 10%. Select the best proposals among 10 proposals based on Internal Rate of Return.

options problem Page no 363

11. A company is considering two mutually exclusive projects X and Y. Project X cost Rs. 30,000 and Project Y Rs. 36,000. You have been given below the net present value and probability distribution for each project :

Project X		Project Y	
NPV Estimate Rs.	Probability	NPV Estimate Rs.	Probability
3,000	0.1	3,000	0.2
6,000	0.4	6,000	0.3
12,000	0.4	12,000	0.3
15,000	0.1	15,000	0.2

a) Compute the expected net present value of projects X and Y.

b) Compute the risk attached to each project that is, standard deviation of each probability distribution.

c) Which project do you consider more risky and why ?

12. Reliance Ltd. wishes to acquire Raja Ltd., a small company with food growth prospects. The relevant information both the companies is as follows :

Company	Equity shares outstanding	Share price (Rs.)	Earnings after taxes	EPS (Rs.)
Reliance Ltd.	10,00,000	25	20,00,000	2
Raja Ltd.	1,00,000	10	2,00,000	2

Reliance Ltd. is considering 3 different acquisition plans :

a) Pay Rs. 12.5 per share for each target share.

b) Exchange Rs. 25 cash and one share of Reliance Ltd. for every four shares of Raja Ltd.

c) Exchange 1 share for every two shares of Raja Ltd.

i) What will Reliance EPS be under each of the three plans ?

ii) What will the share prices of Reliance be under each of the three plans, if its current P/E ratio remains unchanged ?