11205

First Semester M.Com. Degree Examination, August/September 2021

(CBCS – Semester Scheme)

Commerce

Paper 1.5 – ADVANCED FINANCIAL MANAGEMENT

Time : 3 Hours] *[Max. Marks : 70*

SECTION A

1. Answer any **SEVEN** sub-questions. Each question carries **2** marks : **(7 × 2 = 14)**

(a) Define Derivatives.

(b) What is MIRR?

(c) What is EBIT-EPS analysis?

(d) Define Opportunity Cost of Capital.

(e) What is Arbitrage process?

(f) What is Capital Rationing?

(g) What is an option contract?

(h) What are the methods of corporate valuation?

(i) What is Scenario analysis?

(j) What is difference between takeover and acquisition?

SECTION – B

Answer any **FOUR** questions. Each question carries **5** marks : **(4 × 5 = 20)**

2. "Net Income approach is relevant to the capital structure and value of the firm." Discuss.

3. A company is considering expanding its production. It can go in for an automatic machine costing Rs.5,00,000 with an estimated life of 5 years or an ordinary machine costing Rs.1,00,000 having an estimated life of 8 years. The annual sales and costs are estimated as follows :

Particulars	Automatic machine	Ordinary machine
Sales	3,00,000	3,00,000
Material cost	1,50,000	1,50,000
Labour	20,000	75,000
Variable overheads	25,000	20,000

Calculate NPV at 12% cost of capital and suggest to the Management as to which machine to be accepted. (Tax rate : 40%)

4. How is merger different from the acquisition? Explain the various types of mergers.

5. Differentiate between a Futures and a Forward contract.

6. A company is considering an investment proposal whose cost is Rs.15,000, and its economic life is 4 years. The following are the expected cash flows and the certainty equivalent coefficient :

Year :	1	2	3	4
CFAT (Rs.) :	5000	6000	8000	12000
CE :	0.90	0.80	0.50	0.40

Determine the NPV of the project if the risk-free rate of interest is 12%. Suggest whether the project is feasible or not.

7. What is Corporate Restructuring? What is the need for Corporate Restructuring?

SECTION – C

Answer any **THREE** questions. Each question carries **12** marks : **(3 × 12 = 36)**

8. The following information is available for two companies A and B. These two companies belong to the same risk class and are identical in all respects except for leverage. Firm A uses Rs.30,00,000 debt in the capital structure (Levered Company) at 5 percent interest and Firm B does not have debt (Unlevered Company). Both the firms have the same EBIT of Rs.5,00,000. The equity capitalization rate is 12 percent for A and 10 percent for B. You are required to calculate the value of each of the firm.

An investor owns 10 percent of outstanding equity shares in the levered company A.

(a) Show the Arbitrage process as described by MM.

(b) Critically evaluate MM Hypothesis

9. Supreme Engineering Limited has developed a new product. A market study conducted by the company has revealed that the domestic as well as export market exists for that product. The company has decided to launch the new product into the market. The initial outlay required for this project is Rs.25,00,000. In the year one there is 0.6 probability that cash flow after tax will be Rs.20,00,000 and 0.4 probability that cash flow after tax is Rs.25,00,000. The cash flows of second year are dependent on the cash flows of first year. The cash flows and the probabilities assigned for the second year are as follows :

Year 1 cash inflows Rs.20,00,000		Year 1 cash inflows Rs.25,00,000	
10,00,000	0.2	11,00,000	0.2
18,00,000	0.3	20,00,000	0.3
20,00,000	0.5	25,00,000	0.5

The firm uses 10% discount rate for this type of investment.

Required :

(a) Construct Decision Tree for the proposed investment project.

(b) Should the project be accepted? Suggest to the management.

10. XYZ Ltd. wants to acquire ABC Ltd. exchanging its 1.6 shares for every share of ABC Ltd. It anticipates to maintain the existing P/E ratio subsequent to the merger also. The relevant financial data are furnished below :

	XYZ Ltd.	ABC Ltd.
Earnings after taxes (EAT) (Rs.) :	15,00,000	4,50,000
Number of equity shares outstanding (N) :	3,00,000	75,000
Market price per share (MPS) (Rs.) :	35	40

(a) What is the exchange ratio based on market prices?

(b) What is pre-merger EPS and P/E ratio for each company?

(c) What was the P/E ratio used in acquiring ABC Ltd.?

(d) What is the expected market price per share of the merged company?

11. ABC Ltd. is considering a project having a life of 3 years and involving an outlay of Rs.10,00,000 has the following benefits associated with it. The cash flows are independent.

Year 1		Year 2		Year 3	
Probability	NCF (Rs.)	Probability	NCF (Rs.)	Probability	NCF (Rs.)
0.3	30,000	0.2	20,000	0.3	30,000
0.4	50,000	0.6	40,000	0.4	50,000
0.3	70,000	0.2	60,000	0.3	70,000

(a) What is the expected NPV of this project? (Assume that the probability distribution is independent and the risk free rate of interest in the market is 0.06)

(b) Calculate the standard deviation about the expected value. Advice about acceptability and risk involved.

12. Critically examine the various derivatives instruments available to a Hedger.