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I Semester M.Com. Degree Examination, August - 2021
COMMERCE
Advanced Financial Management
(CBCS Scheme 2018-19)
Paper : 1.5

Time : 3 Hours **Maximum Marks : 70**

Instructions to Candidates:

Answer **All** sections.

SECTION - A

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

1. a) What is Utility Theory?

b) Discuss Arbitrage process.

c) What do you mean by Simulation?

d) Give the meaning of De-merger?

e) Define leveraged buyout.

f) Discuss the significance of P/E Ratio.

g) What do you mean by Synergy?

h) Differentiate levered and unlevered firm.

i) What are Margins?

j) What do you mean by sequential investment decisions?

SECTION - B

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

2. Mr. X is considering two mutually exclusive projects A and B. You are required to advise him regarding the acceptability of project.

Particulars	Project A	Project B
Cost	5,00,000	5,00,000
Forecast of cash flows PA for 5 years		
Optimistic	3,00,000	4,00,000
Most Likely	2,00,000	2,00,000
Pessimistic	1,50,000	50,000
Cutoff rate is 15%		

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3. Companies U and L are identical in every respect except that the firm 'U' does not use any debt in its financing, while firm 'L' has 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 corporate tax is 50% calculate value of firms.

4. Explain in brief the various types of Hedging instruments in derivatives market.

5. AMIGO products Ltd. wants to raise Rs. 50. Lakhs for a diversification of project. Current estimates of EBIT from the new project are Rs. 11 Lakhs PA.

   Cost of debt will be 15% for amounts up to and including Rs. 25 Lakhs and 18% for additional amounts above 25 lakhs. 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. 25 lakhs are raised. The following options are under consideration of the company

Option	Debt	Equity
1	50%	50%
2	40%	60%
3	60%	40%

   Determine EPS for each option and state which option should be adopted by the company. Tax rate is 50%.

6. What is finance? Write a note on importance of finance in an organization.

7. What are the factors influencing investment decisions under Capital Rationing?

SECTION - C

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

8. ABC company with a 12% 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 (years)	Year-end Cash Inflow
A	3,00,000	2	1,87,000
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

   a. Rank the projects according to profitability index and NPV methods.

   b. Determine the optimal investment package.

   c. Which projects should be selected, if the company has Rs. 5,00,000 as the size of its capital budget?

9. A Corporation plans to acquire **B** Corporation. The following information is available

Particulars	**A Corporation**	**B Corporation**
Total Current Earnings	Rs. 50 Million	Rs. 20 Million
Number of outstanding shares	20 million	10 million
Market price per share	Rs. 30	Rs. 20

a. What is the maximum exchange ratio acceptable to the shareholders of A Corporation if the PE ratio of the combined entity is 12 and there is no synergy gain?

b. What is the minimum exchange ratio acceptable to the shareholders of B Corporation if the PE ratio of the combined entity is 11 and there is a synergy benefit of 5 percent?

c. Assuming that there is no synergy gain, at what level of PE multiple will the lines ER1 and ER2 intersect?

10. The following is the capital structure of a company.

Sources	**Book Value (Rs.)**	**Market Value (Rs.)**
Equity Share Capital of Rs. 100 each	8,00,000	16,00,000
9% Cumulative Preference Share of Rs. 100 Each	2,00,000	2,40,000
11% Debentures	6,00,000	6,60,000
Retained Earnings	4,00,000	----------
Total	**20,00,000**	**25,00,000**

The current market price of company's equity share is Rs. 200. During the last year the company has paid the equity dividend @ 25%. It is observed that the dividend is likely to grow 5% per annum. The corporate tax rate is 30% and shareholders personal Income tax rate is 20%. You are required to compute.

a. Cost of capital of each source of income.

b. Weighted average cost of capital on the basis of book value weights

c. Weighted average cost of capital on the basis of market value weights.

11. A company is considering which of the two mutually exclusive projects should be undertaken. The finance director thinks that the project which had higher NPV should be chosen; whereas 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 (Rs.)	Project Y (Rs.)
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 IRR and NPV of each project.

b. State the reasons which projects should be recommended.

12. Briefly explain Modigliani Millers approach theory of Capital Structure with a diagram.