Question Paper Code : 3772

M.B.A. (Semester-IV) Examination, 2018

FINANCIAL DECISIONS & ANALYSIS

[SC-422]

Time : Three Hours] **[Maximum Marks : 70**

Note : Answer **five** questions in all. Question **No.1** is **compulsory**. In addition, attempt one question from each unit. Use of Financial/Scientific calculator is permitted.

1. Answer the questions pertaining to each of the following cases :

(a) Foodies Company enjoys market leadership in food brands segment. To capitalize on the growing demand for packaged food, the company is planning to introduce Ready-to-Eat products. The expansion would entail investment of Rs.250 Crores for the new line of business. As per current financial report, the Interest coverage ratio as well as Return on investment is higher than industry averages. The existing debt to equity ratio is 1.5:1. The company's tax rate is 35%.

(i) As a Finance Manager, what would be the break-up of the debt and equity financing you would opt to finance the venture if the company prefers to maintain its existing Debt to Equity ratio after the financing ?[5]

(ii) Give conditions under which the shareholders are likely to gain from the issue of debt. [5]

(b) Computech Ltd. is a leading I.T outsourcing company providing consultancy and outsourcing services to its clients. The company has an impressive track record of high earnings and dividend payments to its shareholders during each of the last five years. It has experience of assessing capital markets successfully to raise funds. The current year's earnings have surpassed previous levels but liquidity condition of the company is unsatisfactory. The company has identified new profitable projects and is willing to invest in order to grow further.

(i) What might have been the key factors which enabled the company to pay

(ii) What other consideration besides financial, do you think should be taken into account while deciding on the acquisition or merger. [5]

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(ii) Describe the dividend policy which each of the companies shown above appears to be following. [3]

(iii) How would you justify each of these policies to the shareholders of each of the companies concerned ? [4]

9. (a) Differentiate the pooling and purchase method for accounting for merger. [5]

(b) ABC Corporation is considering acquiring LML Co. The following details are available :

	ABC.Corp.	LML Co.
Sales (Rs.Lakhs)	6000	750
Net Income (Rs. Lakhs)	300	100
No of common shares (lakhs)	75	50
EPS	Rs.4.00	Rs.2.00
Price to Earnings ratio	10.00	8.00
MPS	Rs.40.0	Rs.16.0

(i) Suggest an appropriate Exchange ratio which ABC Company would be willing to give to the shareholders of LML company.

dividends during last 5 years ? List indicators normally used to assess capacity to pay dividents. [5]

(ii) Comment on likely dividend policy for the current year giving reasons in support of your answer. [5]

(c) Ika is a top furniture firm based in Noida.It deals in wide product range of home and office furniture through six exclusive showrooms in NCR region. The company is planning to open two showrooms each in Lucknow and Kanpur. In Kanpur it has collaborated with 'Impressions', a popular furnishing brand and will share the expenses while in Lucknow it intends to take space for showroom on lease.

(i) List the costs to be considered as cost of the project or as operating expense in the above decision. [5]

(ii) How is cash flow from the new stores likely to be affected by lease option as well as working capital financing option ? [5]

UNIT-I

2. Attempt any two of the following : [5x2=10]

(a) Explain how investment, financing and dividend decisions are inter-related ?

(b) Why is EPS not consistently a good measure of firm's performance ?

(c) What is meant by agency relationship and agency costs ?

(d) Describe the relationship between coupon rate of bond and required rate of return that will result in bond selling at a premium or at a discount.

3. (a) How each of the following factors would affect the valuation of a firm's common stock, assuming all other factors remain constant : [2]

(i) General level of interest rate shift upwards.

(ii) Increase foreign competition reduces the prospects of future earnings and future dividend payments.

		2012	2013	2014	2015	2016	2017
Company A							
	Shares issued 1,200 million						
	Profit after tax (Rs. in	600	630	580	600	640	660
	Dividends declared	240	252	232	240	256	264

		2012	2013	2014	2015	2016	2017
Company B							
	Shares issued 2,000 million						
	Profit after tax (Rs. in millions)	1,200	1,300	1,580	1,800	1,240	1,460
	Dividends declared (Rs.in millions)	120	132	145	160	176	194

		2012	2013	2014	2015	2016	2017
Company C							
	Shares issued 3,500 million						
	Profit after tax (Rs. in millions)	2,200	1,400	2,100	1,950	2,200	2,560
	Dividends declared (Rs.in millions)	200	0	100	0	200	560

Required :

(i) Calculate EPS and DPS for the three companies for each of the six years. [3]

(i) Calculate the Debt Service Coverage ratio and EBIT needed to service debt.

(ii) How much could EBIT decline before it is insufficient to service debt ?

(b) The Evergreen Light Company's capital structure consists of 10 lakh ordinary shares. It has the choice of raising an additional sum of Rs.50 lakhs by the issue of 10% debentures or by issue of additional equity shares at Rs.50 per share . The applicable tax rate for the company is 35%. At what level of earnings before tax (EBIT) would EPS be the same under both the financing options ? [5]

7. Enumerate the practical checklist that should be considered in arriving at capital structure decision. [10]

UNIT-IV

8. The data given below relates to three firm's dividend payouts over the last six years. None of the companies has issued, or cancelled, any shares over the period . All three firms are listed on a Stock Exchange.

(b) Differentiate between Systematic and unsystematic risk enumerating their respective causal factors. [3]

(c) Two securities have the following characteristaics: [5]

	Security A	Security B
Expected return	0.15	0.12
Standard deviation	0.04	0.06
Beta	0.90	-0.25

Furthermore, the correlation of returns between the securities is -1.0. Determine the risk(standard deviation) of a portfolio consisting of equal proportions of Securities A and B.

UNIT-II

4. (a) Ganga Company has the following projects available for the next year : [5]

Investment	Investment outlay	PV of cash flow
A	Rs.400,000	Rs.570,000
B	Rs.250,000	Rs.500,000
C	Rs.500,000	Rs.650,000
D	Rs.250,000	Rs.440,000

The projects are not mutually exclusive, but they are entirely independent of one another. The company has Rs.10,00,000 available for investment.

Suggest the optimum choice of investments.

(b) A toy manufacturer has the following estimates of project cash flow for the next two years : [5]

Year 1		Year 2	
Probability	cash flow	Probability	cash flow
0.25	Rs.4,000	0.40	Rs.4,000
0.50	Rs.5,000	0.30	Rs.7,000
0.25	Rs.6,000	0.30	Rs.10,000

Determine the NPV and the standard deviation of the project considering that cash flows in each of the years are independent . Assume required rate of return to be 8% and the risk free rate to be 5%.

5. ZZZ Corporation is a high technology company listed on BSE. The Company's estimated Beta is 1.50. ZZZ Corp. is considering investment of Rs. 10 Crores in a telecom

project. There is 50% chance that the project will return Rs.1.5 Crore per year forever or Rs. 3 Crores per year forever. Firms investing solely in this type of project have a beta averaging 2.0. The average rate of return on the market portfolio is 15% and that the risk free rate of return is 9%.

(a) If ZZZ is all equity firm, what is its required rate of return (R_{zzz} ? (Hint: use CAPM)

(b) What is the expected cash flow of the project ?

(c) What is the expected rate of return on the project i.e. Expected $R_{(project)}$?

(d) What is the required rate of return on the project i.e.Required $R_{(project)}$?

(e) Should ZZZ accept the project ? [2x5=10]

UNIT-III

6. (a) Ola service Company has EBIT of Rs.900,000, annual interest payments of Rs.150,000 and annual principal payments of Rs.100,000. Its tax rate is 40%. [5]