(c) Explain the following with the help of suitable examples :

(i) Miller-Orr model of cash management

(ii) Demerger

(iii) Tender offer

(iv) Motives for M&A

[This question paper contains 10 printed pages.]

2889 Your Roll No. ....

M.COM. : SEMESTER – II (NC) F

Paper No. – 4202

Financial Management & Policy

Time : 3 Hours *Maximum Marks : 100*

(Write your Roll No. on the top immediately on receipt of this question paper.)

Attempt **all** *questions.*
All *questions carry equal marks.*

1. Attempt any **Five** out of the following : (4×5=20)

(a) What is the justification for the goal of maximizing shareholders' wealth ? What do the critics of the goal of maximizing shareholders' wealth say ?

(b) Discuss the risk return trade off in financial decisions.

(c) How is Modified internal rate of return (MIRR) different from Internal Rate of Return (IRR) ? Explain using example.

(d) What is Cash cycle ? Can it be negative ? How is it different from Operating Cycle ?

(e) What is Financial leverage ? How can degree of financial leverage be measured ? When is financial leverage favourable to the company ?

(f) What do you mean by corporate restructuring ? What are its various forms ?

2. (a) A company is considering two mutually exclusive projects L and M. the company uses Certainty equivalent method for the evaluation of its capital projects. Project L and M have initial costs of Rs 30000 and Rs 40000 respectively. The estimated cash inflows and certainty coefficients of both the projects are given below :

	Project L		Project M	
Year	Cash inflows	Certainty Coefficient	Cash inflows	Certainty Coefficient
1	25000	1	35000	0.95
2	15000	0.95	20000	0.8
3	10000	0.85	15000	0.6
4	5000	0.7	10000	0.5

The risk free rate is 5% while the cost of capital is 14%.

(i) Calculate Discounted payback period and NPV of each project.

(ii) Which project should be accepted ? Why ?

(iii) If the projects are not mutually exclusive, rank them using profitability index method.

(b) Explain the following with suitable examples

(i) Risk adjusted discount rate method

(ii) Sensitivity analysis

(iii) Impact of inflation on capital budgeting

(iv) Fisher's rate of intersection

OR

(c) "NPV and IRR methods can never give contradictory results". Do you agree ? Explain. (5)

(d) TTZ Ltd is evaluating a new project requiring investment of Rs. 45 lakhs. The expected useful life of the project is 15 years. Since the initial cost is very high, the management of the company wants to take extra care in its evaluation. The expected sales revenue from the project is Rs. 3000000 p.a. The variable cost ratio is 60% of sales. Fixed costs of the project excluding depreciation is Rs. 100000 p.a. and depreciation is charged on straight line basis. There is no salvage value at the end of the project's life. Tax rate is 40% and cost of capital is 12%.

Calculate the discounted cash flow break even sales (in Rs.) which justifies investment in the project. (5)

(e) A firm has an investment proposal requiring an outlay of Rs. 30,000. The investment proposal is expected to have 2 years' economic life with no salvage value. The probabilities assigned to CFAT for year 1 and 2 are as follows :

Year 1		Year 2	
CF	P	CF	P
Rs. 27000	0.4	Rs. 13000	0.3
		Rs. 15000	0.3
		Rs. 20.000	0.4
Rs. 35000	0.6	Rs. 15000	0.4
		Rs. 30000	0.5
		Rs. 35000	0.1

The firm uses a 12% discount rate for this type of project. Should the project be accepted ? (10)

3. Attempt any **TWO** out of the following : (10+10)

(a) Explain the following :

(i) Trade off Theory

(ii) Merton Millers argument on capital structure (with corporate and personal taxes)

(b) The following information is available for two companies P Ltd and Q Ltd.

Particulars	P Ltd (Rs)	Q Ltd. (Rs)
Total value of the company	50000	60000
Market value of Debt	–	30000
Market value of equity	50000	30000
Net operating income	5000	5000
Interest Cost of debt	0	1800
Cost of equity	10%	10.70%

Assume that there are no taxes.

Calculate –

(i) Average cost of capital of both the companies as per Traditional approach.

(ii) Equilibrium value of both the companies as per MM hypothesis if it is given that equilibrium average cost of capital is 9.09%.

(iii) Cost of equity and market value of equity of both the companies as per MM Hypothesis.

(c) A company needs Rs. 500000 for construction of a new plant. The following three financial plans are available.

Plan A – issue 50000 equity shares @ 10 per share

Plan B – issue 25000 equity shares @ Rs. 10 per share and raise Rs 250000 through 8% debentures.

Plan C – issue 30000 equity shares @ Rs. 10 per share and 20000 preference shares of Rs. 10 each bearing a fixed dividend rate of 8%.

If the company's expected EBITs is 70000 and corporate tax rate is 40%, calculate

(i) Expected EPS under each plan

(ii) Indifference level EBIT between plan A&B and between Plan A&C. Interpret the results.

(iii) Which plan would you recommend and why ?

4. Attempt any **Two** out of the following : (10+10)

(a) (i) Explain Bird in Hand argument regarding dividend relevance. How is it related with information asymmetry prevailing in the market ?

(ii) Gaurav Ltd has 20000 equity shares outstanding currently selling at a price of Rs. 20 each. The company has net profit of Rs. 200000 and wants to invest Rs. 500000 during the period. The company is also planning to declare a dividend of Rs. 5 per share at the end of the year. The cost of equity capital is 10%. What will be the price of the share of the company as per MM hypothesis on dividend if the dividend is not declared ? What will be the price of the company's share if dividend of Rs. 5 per share is declared ? How many new shares must be issued ?

(b) What do you mean by Dividend policy ? What the various types of dividend policies a company may adopt ? Explain the pros and cons of each of the dividend policy.

(c) The present cash discount terms of Rock Ltd are 3/15 net 40. Its present sales are Rs. 200 lakh and average collection period is 30 days. Variable cost per unit is Rs. 6, Average cost per unit is Rs 8 and selling price per unit is Rs. 10. The cost of capital is 13% and corporate tax rate is 30%. The proportion of sales on which customers currently take cash discount is 0.60. The company is planning to change its discount terms to 4/15 net 40. Such a change is expected to increase sales by 10 lakh, decrease average collection period to 25 days and increase the proportion of discount sales to 0.75. What is the effect of change in discount terms on earnings of the company ? Should the company change its discount terms ? Show all necessary calculations.

5. Attempt any **Two** out of the following : (10+10)

(a) What is the importance of working capital for a manufacturing firm ? Explain permanent and temporary working capitals. How can they be financed ? Explain risk- return trade off involved in working capital financing ?

(b) H Ltd. is considering the acquisition of K Ltd with exchange of its shares. The following information is available for the two companies.

Particulars	H Ltd (Rs)	K Ltd (Rs)
Equity share capital (Rs. 10 each)	400000	200000
10% preference share capital	300000	–
6% debentures	–	100000
Total fixed assets	800000	500000
Current assets	200000	100000
Current liabilities	100000	50000
Profit after tax and preference dividend	200000	250000
P/E ratio	5	3

You are required to calculate the following :–

(i) What is the number of equity shares required to be issued by H Ltd. for acquisition of K Ltd. if the exchange ratio is based on market price ?

(ii) Whatis the number of equity shares required to be issued by H Ltd. for acquisition of K Ltd. if the exchange ratio is based on book value per share ?

(iii) What is the exchange ratio based on EPS ?

(iv) What is the maximum exchange ratio acceptable to H Ltd. if P/E ratio of the merged entity is 4 and there is a synergy gain of 5% in earnings ?

(c) Explain the following with the help of suitable examples :

(i) Miller-Orr model of cash management

(ii) Demerger

(iii) Tender offer

(iv) Motives for M&A