



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)
- Discuss Arbitrage process.
  - Explain value of the firm.
  - Define opportunity cost of capital.
  - Explain decision tree.
  - Define 'time value of money'.
  - Explain utility theory.
  - Discuss the significance of P/E ratio.
  - What is Leveraged buyout ?
  - Define a 'futures' contract.
  - Explain the difference between futures and options.

## SECTION – B

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

- Define strategic financial management. State three examples of strategic financial decisions.
- Discuss the use of sensitive analysis in risk evaluation.
- Critically examine NPV and IRR. Do they give identical results ?
- 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 ?

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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.
- 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 ?
  - 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%
1	2,00,000	7
2	2,30,000	8
3	2,00,000	9
4	2,00,000	23
5	1,20,000	19
6	1,50,000	17
7	90,000	16
8	3,00,000	13
9	3,60,000	12
10	5,00,000	11

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



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	Probability	NPV Estimate	Probability
Rs.		Rs.	
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 ?
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