Seat No. : _______________

AA-160

April-2019

4th Year MBA Integrated, Sem.-VIII

Advance Financial Management

Time : 2:30 Hours] **[Max. Marks : 70**

1. Answer the following questions : (any **TWO**) **14**

(1) 'Financial Management in simple words is managerial decision making on asset mix, capital mix and profit allocation.' Explain.

(2) A finance company advertises that it will pay a lump sum of ₹ 1,00,000 at the end of 5 years to investors who deposit annually ₹ 12,000. What interest rate is implicit in this offer ? What would be your answer if the amount is to be deposited ₹ 1000 per month instead of ₹ 12,000 annually ?

(3) The following information is available:

	Stock - A	Stock - B
Expected Return	12%	26%
Standard deviation	15%	21%
Coefficient of correlation	0.30	

What is the expected return and risk of a portfolio in which A and B are weighted in the ratio of 3:7 ?

2. A project involving an outlay of ₹ 1 crore has the following cash inflows associated with it over its useful life of 3 years. **14**

[₹ in lakhs]

Year-1		Year -2		Year - 3	
Cash flow	**Probability**	**Cash flow**	**Probability**	**Cash flow**	**Probability**
40	0.4	50	0.4	30	0.3
50	0.5	60	0.4	40	0.5
60	0.1	70	0.2	50	0.2

Assume that the cash flows are independent and the risk free discount rate is 10%

Required :

(1) What is the expected NPV and its standard deviation ?

(2) If the distribution is normal, what is the probability that the NPV will be positive ?

(3) What is the probability that the profitability index will be less than 1 ?

OR

(a) Discuss advantages and limitations of NPV method of capital budgeting. **7**

(b) Explain Risk Adjusted Discount Rate and Certainty Equivalent approach of capital budgeting with example. **7**

3. (a) Two firms M and T belong to an equivalent risk class and identical in all respects except that firm M has 8% debt and firm N has no debt. The following is the relevant information available about two firms. **8**

Particulars	Firm M (₹)	Firm T (₹)
EBIT	50,00,000	50,00,000
Less: Interest on debt	8,00,000	–
Earnings to equity holders	42,00,000	50,00,000
Cost of equity	12.5%	15%

Ms. F owns 2 percent equity shares of M. Show the arbitrage process and the amount by which she could reduce her outlay using personnel leverage.

(b) Give meaning Cost of Capital and answer the following.

The dividend growth rate of a company is 12%. It is expected that the same growth rate would be maintained in future too. If dividend paid in the last year was ₹ 5.30 per share and required rate of return of equity shareholders is 16%, find the value of equity. **6**

OR

A company's present capital structure contains 15 lakhs equity shares and 5 lakhs preference shares of ₹ 10 each. The rate of dividend on preference share is 12%. The company is planning to raise ₹ 1 crore of external financing. Two financing alternatives are being considered :

(i) issuing equity shares of ₹ 10 each

(ii) issuing debentures carrying 15% interest.

Assuming tax rate of 30%, compute the EPIT - EPS indifference point and advise the company about the financing plan.

4. Answer any **two** from a, b and c below : **14**

(a) New Horizon Ltd. sells goods on a gross profit of 25%. Depreciation is considered as a cost of production. The following are the annual figures given to you:

Sales (2 months credit)	₹ 18,00,000
Materials consumed (1 month credit)	₹ 4,50,000
Wages paid (30 days lag in payment)	₹ 3,60,000
Manufacturing expenses outstanding at the end of the year (1 month lag in payment of cash manufacturing expenses)	₹ 40,000
Administrative expenses (15 days lag in payment)	₹ 1,20,000
Sales promotion expenses (paid quarterly in advance)	₹ 60,000

The company keeps one month's stock each of raw materials and finished goods. There will be no work-in-progress. It also keeps ₹ 1,00,000 in cash. You are required to estimate the working capital requirement of the company, assuming 15% safety margin.

(b) N Ltd. has annual sales of ₹ 60 lakhs at present. The variable cost to sales ratio is 2:3 and fixed cost amounted to ₹ 6 lakh p.a. The company allows one month credit to its customers at present and bad debt rate is 1% of sales. It is considering proposals to increase the credit period and has made the following estimates:

Particulars	**Proposal - 1**	**Proposal - II**
Credit period (month)	2	3
Increase in sales (%)	20	30
Bad debt (%)	2	5
Total fixed costs (₹)	7,00,000	7,50,000

Income tax rate is 25% and required rate of return is 20%. Advise the company about the credit policy.

(c) Explain Miller - Orr model of cash management.

5. (a) The following information is available in respect of a firm : **7**

Capitalization Rate (Ke) - 10%

Earnings per Share (E) - ₹ 10

Assume rate of return on investments (r) (i) 15% (ii) 8%

If Dividend pay out ratio is 50%, what is the market price of shares ? What should be the optimum pay out ratio ? (As per Walter Model)

OR

Why do companies pay dividend ? What factors are considered for deciding the Payout ratio ?

(b) Discuss various methods of business valuation. **7**

OR

Give meaning of the following in the context of foreign exchange market :

Bid rate, Ask rate, Spread, Direct quote, Cross rate, Forward rate, Forward Premium.