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SVKM'S

Narsee Monjee Institute of Management Studies (NMIMS)

SCHOOL OF DISTANCE LEARNING

I/II Year

DFM / PGDFM / ADBFM / PGDBFM

Semester II/IV , 2009-10

Subject: Capital Investment and Financing Decisions DATE: 31.12.2009

Marks: 100 TIME: 3.00 PM to 6. PM.

Duration: 3 Hours

NB:

1. All the questions are compulsory.

2. Answer to each new question to be started on a fresh page.

Q.1. Write short notes on any 2 out of 4. **Max Marks: 10**

(a). Profit Maximization

(b). Wealth Maximization

(c). Operating Leverage

(d). Payback Period Method

Q.2. Attempt any 3 out of 5 **Max Marks: 15**

(a). Discuss various uses of the concept of Cost of Capital.

(b). Explain any two derivative products and show the value addition in them

(c). What type of information is demanded by the different type of stakeholders including the shareholders?

(d). Discuss various forms of mergers.

(e). Briefly discuss Decision Tree Analysis as tool of risk management in investment decision.

Q.3. Attempt any 3 out of 5 **Max Marks: 45**

(a). The following figures relate to two companies:

(Rs.lakhs)

Particulars	P. Ltd.	Q Ltd.
Sales	500	1,000
Variable costs	200	300
Contribution	300	700
Fixed cost	150	400
	150	300
Interest	50	100
Profit before tax (PBT)	100	200

You are required to calculate – (a) operating, financial and combined leverages of the two companies, and (b) comment on the relative position of the companies in respect of the risk.

(b). The cost of capital and the rate of return on investment of WM Ltd. is 10% and 15% respectively. The company has one million equity shares of Rs. 10 each outstanding and its earnings per share is Rs. 5. Calculate the value of the firm in the following situations using Walter's model. (i) 100% retention (ii) 50% retention, and (iii) No retention. Comment on your result.

(c). Calculate the cost of capital in the following cases:

(i) X Ltd. issues 12% debentures of face value Rs. 100 each and realizes Rs. 95 per debenture. The debentures are redeemable after 10 years at a premium of 10%.

(ii) Y Ltd. issues preference shares of face value Rs. 100 each carrying 14% dividend and it realizes Rs. 92 per share. The shares are repayable after 12 years at par.

Note: - Both companies are paying income-tax at 50%.

(d). Rank the following projects in order of their desirability according to the Pay-back Period Method .

Project	**Initial Outlay**	**Annual Cash Flow**	**Life in Years**
	Rs.	**Rs.**	
A	10,000	2,500	5
B	8,000	2,600	7
C	4,000	1,000	15
D	10,000	2,400	20

(e). The Servex Company has the following capital structure on 30 June 2004:

	(Rs '000)
Ordinary Shares (200,000 shares)	4,000
10% Preference Shares	1,000
14% Debentures	3,000
Total	8,000

The share of the company sells for Rs 20. It is expected that company will pay next year a dividend of Rs 2 per share, which will grow at 7 per cent forever. Assume a 50 per cent tax rate.

Your are required to compute a weighted average cost of capital based on the existing capital structure.

Q.4. **30 Marks**

National Electronics Ltd. an electronic goods manufacturing company, is producing a large range of electronic goods. It has under consideration two projects 'X' and 'Y', each costing Rs. 120 lakhs.

The projects are mutually exclusive and the company is considering the question of selecting one of the two. Cash flows have been worked out for both the projects and the details are given below. 'X' has a life of 8 years and 'Y' has a life of 6 years. Both will have zero salvage value at the end of their operational lives. The company is already making profits and its tax rate is 50%. The cost of capital of the company is 15%.

Net Cash Inflow

(Rs. lakhs)

Year	Project X	Project Y	P.V. F. @ 15%
1	25	40	0.870
2	35	60	0.756
3	45	80	0.685
4	65	50	0.572
5	65	30	0.497
6	55	20	0.432
7	35	-	0.376
8	15	-	0.327

The company follows straight line method of depreciating assets. Advise the company regarding the selection of the project.

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