SVKM'S NMIMS University

SCHOOL OF DISTANCE LEARNING

Programme (Semester): DFM(II)/PGDFM(II)/PGDBFM(IV)/ADBFM(II)
Subject: Capital Investment and Financing Decisions
Marks: 100
Duration: 3 Hours (3.00pm to 6.00pm) Date - 28.05.2009

NB:

1. All the questions are compulsory.
2. Answer to each new question to be started on a fresh page.

Q.1. Attempt any 2 out of 4 questions. **Max Marks: 10**

(i). Two firms A and B have the following information:

	Sales (Rs in lakh)	Variable Cost (Rs in lakh)	Fixed Cost (Rs in lakh)
Firm A	1,800	450	900
Firm B	1,500	750	375

You are required to calculate the degree of operating leverage for both firms. Comment on the positions of the firms.

(ii). Assuming that a firm pays tax at a 50 per cent rate, compute the after tax cost of capital in the following cases:

(a). A 8.5 per cent preference share sold at par.

(b). A perpetual bond sold at par, coupon rate of interest being 7 per cent.

(iii). Determine the present value of Rs 700 each paid at the end of each of the next six years. Assume an 8 per cent of interest.

(iv). A company needs Rs 500,000 for construction of a new plant. The following three financial plans are feasible: (i) The company may issue 50,000 ordinary shares at Rs 10 per share (ii) The company may issue25000 ordinary shares at Rs 10 per share and 2,500 debentures of Rs 100 denominations bearing a 7 per cent rate of interest. (iii) The company may issue 25,000 ordinary shares at Rs 10 per share and 2,500 preference shares at Rs 100 per share bearing a 9 per cent rate of dividend.

If the company's earnings before interest and taxes are Rs 10,000, what are the EPS under each of the three financial plans? Which alternative would you recommend and why?

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

(i). Briefly discuss the financial engineering process that you will follow while developing new products or solutions?

(ii). Discuss various forms of mergers. What are the driving forces for mergers and acquisitions?

(iii). What do you mean by globalization? Comment on the level of globalization of Indian capital market.

(iv). Assess utility of equity shares as source of corporate financing.

(v). What is Net Present Value? How is the NPV rule related to the wealth maximization objective of a firm?

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

(i). The historical average rate of return earned by equity shareholders of the firm C has been about 17% per year until very recently. The dividends of the firm have grown at an average rate of 13% per year over the same period. The financial Express and another financial fortnightly have issued a report indicating the problems of the firm with government's regulatory agencies and forecasted that dividends and earnings of the firm will grow at no more than the overall growth rate of the economy which is 5 per cent. The dividends are likely to be Rs.10/- per share. The price of the firm's share adversely reacted to the report dropping from Rs.100 to Rs.50. The tax rate is 40 per cent.

Calculate cost of capital of the firm.

(ii). A firm has an opportunity to invest in a machine at a cost of Rs.6,56,670. The net cash flows after taxes from the machine would be Rs.2,10,000 per year and would continue for five years. The applicable cost of capital for this project is 12 percent.

a. Calculate the net present value for the investment.
b. What is the internal rate of return for the investment ?

Should the investment be made ?

(iii). XYZ Inc., can invest in one of two mutually exclusive, one-year projects requiring equal initial outlays. The two proposals have the following discrete probability distributions of net cash inflows for the first year:

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