

SVKM's NMIMS UNIVERSITY
School of Distance Learning

Capital Investment & Financing Decisions
ADBFM/DFM/PGDFM

Date: 8.6.2007

Time: 11.00 am to 2.00 pm

Marks: 100

Section A

Answer any two questions. Each question will carry 20 marks.

1. The earnings per share of a company are Rs 10. It has an internal rate of return of 15 per cent and the capitalization rate of its risk class is 12.5 per cent. If Walter's model is used: (i) what should be the optimum payout ratio of the firm? (ii) What would be the price of the share at this payout? (iii) How shall the price of the share be affected if a different payout were employed?

2. Assuming that a firm pays tax at a 50 per cent rate, compute the after tax cost of capital in the following cases:
 - i. A 8.5 per cent preference share sold at par.
 - ii. A perpetual bond sold at par, coupon rate of interest being 7 per cent.
 - iii. A ten year, 8 per cent, Rs 1000 per bond sold at Rs 950 less 4 per cent underwriting commission.
 - iv. A preference share sold at Rs 100 with a 9 per cent dividend and a redemption price of Rs 110 if the company redeems it in five years.
 - v. An ordinary share selling at a current market price of Rs 120, and paying a current dividend of Rs 9 per share, which is expected to grow at a rate of 8 per cent.
 - vi. An ordinary share of a company, which engages no external financing, is selling for Rs 50. The earnings per share are Rs 7.50 of which sixty

per cent is paid in dividends. The company reinvests retained earnings at a rate of 10 per cent.

3. A company is considering the following investment projects:

Projects	Cash Flows			
	Co	C1	C2	C3
A	-10,000	+10,000		
B	-10,000	+ 7,500	+7,500	
C	-10,000	+ 2,000	+4,000	+12,000
D	-10,000	+10,000	+3,000	+ 3,000

(a). Rank the project according to each of the following methods:

(i) ARR and

(ii) NPV

Assume discount rates of 10.

(b) Assuming the projects are independent, which one should be accepted? If the projects are mutually exclusive, which project is the best?

4. Calmex is situated in North India. It specializes in manufacturing overhead water tanks. The management of Calmex has identified a niche market in certain Southern cities that need a particular size of water tank, not currently manufactured by the company. The company is therefore thinking of producing a new type of overhead water tank. The survey of the company's marketing department reveals that the company could sell 1,20,000 tanks each year for six years at a price of Rs 1,500 each. The company's current facilities cannot be used to manufacture the new-size tanks. Therefore, it will have to buy new machinery. A manufacturer has offered two options to the company. The first option is that the company could buy four small machines with the capacity of manufacturing

30,000 tanks each at Rs 115 million each. The machine operation and manufacturing cost of each tank will be Rs 535. Alternatively, Calmex can buy a larger machine with a capacity of 1,20,000 units per annum for Rs 500 million. The machine operation and manufacturing costs of each tank will be Rs 450. The company has a required rate of return of 12 per cent. Assume that the company does not pay any taxes.

Which option should the company accept? Use the most suitable method of evaluation to give your recommendation.

Section - B

Answer any three questions. Each question will carry 20 marks.

5. Why is that the investor relationship gains more importance in corporate form of business organization rather than the other forms of business structures. Does it really matter or apply for other forms of business organizations? If so, how?
6. Discuss various steps involved in a merger?
7. What are the characteristics of capital market? How is it different from money market?
8. What do you mean by globalization? What are the major global sources of corporate financing?
9. Evaluate the profit maximization as an objective of a corporate organization.
10. Ramesh has promised to give his son Rs 1,00,000 in cash on his son's 25th birthday. Today is his 16th birthday. He wants to know two things: (a) If he decides to make annual payments into a fund after one year, how much will each have to be if the fund pays 8 per cent? (b) If he decides to invest a lump sum in the account after one year and let it compound annual, how much will the lump sum be? (c) if in (a) the payments are made in the beginning of the year, how much will be the value of annuity?
