University Books Finance - MMS-III
Exam.

ADVANCED FINANCIAL MANAGEMENT

7/2 : Ilnd-F-1108

Con. 5321-08. (FURTHER REVISED COURSE) BB-8528

(3 Hours) [Total Marks : 60

N.B. (1) The question paper has **two** sections : **A** and **B**. Students must attempt questions from only **one** of these **two** sections.
(2) Total **five** questions are to be attempted. All **five** questions must be either from **Section A** or from **Section B**.
(3) On the **top** of the answer sheet the students must **mention** which **section** they have chosen.
(4) Correct and to-the-point answers to theoretical questions will be assessed like practical problems. Thus, students attempting more theoretical questions will not be at a disadvantage.
(5) If students attempt more than **five** questions, only **first five** will be considered.
(6) **All** questions carry **equal** marks.

Section A

1. Elite India Ltd., a four year young company, is growing rapidly. Presently it has 80,000 equity shares of Rs. 50 each and 10% debentures of Rs. 20,00,000. 12
The summary of income statement for last year is given below :—

		Rs.
Sales		50,00,000
Less : V. Expenses	25,00,000	
F. Expenses	9,00,000	34,00,000
EBIT		16,00,000
Interest		2,00,000
EBT		14,00,000
Tax (35%)		4,90,000
PAT		9,10,000
EPS		11·38

The company further wants to expand its activities for which it is planning to make an additional investment of Rs. 20,00,000.
There are two financing options : either 40,000 equity shares of Rs. 50 each, or debt funds of Rs. 20,00,000 at 12% interest.
The company wants to assess its position for two levels of sales projections for next year viz. Rs. 70,00,000 and Rs. 1,20,00,000.
The ratio of variable expenses to sales will remain the same next year and fixed expenses will be Rs. 13,00,000 at Rs. 70,00,000 sales and Rs. 26,00,000 at Rs. 1,20,00,000 sales.
For both the levels of sales projections the P/E ratio is expected to be 2·5 in case of debt option and 3 in case of equity option.
If the objective of the company is to maximize the market price of its shares then which financing option should it go for if the sales are Rs. 70,00,000 and if the sales are Rs. 1,20,00,000 ?

2. A company wants to assess the feasibility of a new project. It is not able to estimate the sales revenue and expenses and is not clear about sensitivity analysis. Using hypothetical figures explain to the company how it can do feasibility analysis of the project for three different levels viz. Pessimistic, expected and optimistic. 12

3. Explain with examples any two methods of corporate valuation which can be used to calculate the value of a company. 12

4. Explain the various financing options in respect of infrastructure projects. 12

5. What are the benefits to investors because of the existence of financial intermediaries ? Which are the important financial intermediaries in the Indian financial system ? Explain. 12

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6. (a) Explain the important functions of an investment banker and his role in primary issue management. 12
   (b) Explain, in brief, the process and methodology followed by a rating agency to rate a financial instrument.

7. What are the possible causes of an industrial unit becoming a sick unit ? What, according to you, can be a typical revival programme to revive a sick unit ? 12

8. Answer any **two** of the following :— 12
   (a) Explain the role of SEBI, in brief, as the regulator of financial markets.
   (b) Explain in simple words 'Financial Interest Rate Swaps'.
   (c) Explain offshore/onshore instruments and multiple option bonds.

9. Explain in brief, any **three**, of the following :— 12
   (a) Due diligence
   (b) FIPB and joint venture formulation
   (c) Loan syndication
   (d) Process of bond valuation
   (e) Procedure of IPO
   (f) Any five factors which determine the capital structure of a company.

Section B

1. The balance sheet of International Trade Ltd. as on 31 st March, 2008 is as under :— 12

(All figures are in lacs)

Liabilities	Rs.	Assets	Rs.
Equity Capital (Rs. 10 per share)	90	Building	150
		Machinery	75
10% Long Term debt	120	Stock	50
Retained Earnings	30	Debtors	20
Current Liabilities	60	Cash	5
	300		**300**

The total assets turnover ratio of the company is 3, its fixed operating cost is 1/6 of sales and variable operating cost is 50% of sales. The corporate tax rate is 35%.
You are required to :
(i) Calculate the operating, financial and combined leverage
(ii) Calculate the market price of the share if the P/E multiple is 2·5
(iii) Calculate the level of EBIT if the EPS is (a) Rs. 15 (b) Rs. 25.

2. The existing capital structure of Textile India Ltd. is as under :— 12

	Rs.
Equity shares of Rs. 100 each	40,00,000
Retained Earnings	10,00,000
9% Preference shares	25,00,000
7% Debentures	25,00,000

The company wants to raise Rs. 25,00,000 for its expansion project for which it is considering the following options :—
(a) Issue of 20000 equity shares at a premium of Rs. 25 per share
or
(b) Issue of 10% preference shares
or
(c) Issue of 9% debentures.
Company's return on capital employed is 12% (on existing as well as new funds) and Corporate tax rate is 35%.
It is expected that the P/E multiples in case of the above three options would be 16, 13 and 12 respectively. Suggest the company, which alternative it should select and why ?

3. (a) ABC Co. Ltd. has net present value of net assets Rs. 100 lac which includes cash balance of Rs. 10 lac. It has 1,00,000 equity shares and no preference capital or debt funds. The company has to make the decision about declaring dividend. At the same time it is also exploring the possibility of investing in a new project. The company has three options :— 12

(i) Do not declare any dividend and invest the available cash of Rs. 10 lac in the new project. The present value of the future cash flows generated by this project is Rs. 20 lac.

or

(ii) Pay Rs. 10 per share as dividend. This will take away the entire cash balance of Rs. 10 lac.

or

(iii) Pay dividend as suggested in the second option and also invest in a new project through a fresh equity issue of 1 lac shares of Rs. 10 each. This investment will have the same effect on the company as in the first option, i.e. Rs. 20 lac NPV from the project.

Give your recommendation to the Company as to which is the best option if the Company wants to maximize the shareholder value.

(b) The following information is available in respect of a company :

Capitalisation rate (Ke) = 0·12
EPS = Rs. 15
Rate of return on investment (r) : (i) 0·15 (ii) 0·10.

The Company wants to know the effect on the market price of its shares under the two possibilities of r (i.e. 0·15 and 0·10) under the two options (i) if it does not declare any dividend and (ii) if it declares Rs. 15 as dividend.
Using Walter's model explain the results obtained by you.

4. The income statement and balance sheet of Five Star Ltd. is given below :— 12

Income Statement

	Rs. (in lac)	
Sales	500	
Interest on investments	10	
Profit on sale of old assets	5	
Total Income		515
Less :		
Manufacturing cost	180	
Admn. Cost	60	
Selling and distribution cost	50	
Depreciation	30	
Loss on sale of an old M/C	5	325
EBIT		190
Less : Interest		20
EBT		170
Less : Tax (30%)		51
PAT		119
EPS 119 lac/5 lac		Rs/23·8
P/E ratio		2

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Equity Capital	50	Building	80
(Rs. 10 share)		Machinery	70
Retained earnings	40	Stock	10
Long term loan	60	Debtors	12
Creditors	15	Bank	6
Provisions	13		
	178		178

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The cost of equity and cost of debt is 10% and 12% respectively. The company pays 30% corporate tax.

From the information given you are required to calculate the EVA. Also, calculate MVA on the basis of Market Value of equity capital.

5. Describe the important sources of financing long term projects which can be used by the Indian companies. If they approach the financial institutions for long term finances, what important norms and policies financial institutions would apply to provide such finances ? 12

6. The Balance Sheet for the current year of a company is given below (All the figures are in Rs. lac) :— 12

Liabilities	Rs.	Assets	Rs.
Equity Capital	100	Land & Building	200
Retained Earnings	120	Machinery	30
Term Loan	160	Furniture	30
Short Term Borrowings	120	Bills Receivables	100
Creditors	100	Debtors	60
Provisions	40	Stock	180
		Bank	40
	640		640

Other Information : Sales Rs. 800

V. Expenses Rs. 560

F. Expenses Rs. 160

The following are the projections for the next year :—

(1) The sales are expected to be Rs. 1,000.
(2) F. expenses will increase by 25%.,
(3) No change in the ratio of variable expenses to sales.
(4) Interest expenses will be Rs. 20.
(5) No change in fixed assets. Ignore depreciation.
(6) Bank balance and other current assets will increase in proportion to sales.
(7) Tax to be provided at 35%. This will be the only provision next year.
(8) Creditors will increase in proportion to sales.

You are required to prepare the projected income statement and balance sheet of the company for the next year.

If the company is required to raise funds (i.e. if liability side is less), they will be raised in the order of short term borrowings, term loan and if required, equity capital. It is a policy of the company to maintain current ratio of minimum 1·25 : 1 and ensure that the long term loans do not exceed 40% of total long term funds.

If the asset side is less then the difference will be considered as cash balance available.

7. Explain the important functions of either Credit Rating Information Services of India Ltd. (CRISIL) or Information and Credit Rating Services Ltd. (ICRA). 12

8. Which are the important financial intermediaries in the Indian financial system ? How are they beneficial to the investors ? Explain. 12

9. Explain in brief, any **three**, of the following :— 12

(a) Important financial derivatives
(b) MOU between government and a PSU
(c) Venture capital funding in India
(d) Revival of a sick unit and viability study
(e) Regulation of financial markets in India
(f) Procedure pertaining to IPOs.