**31703** **M-4457**

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# I Semester M.Com. Examination, December 2017
## (Scheme : CBCS)
## COMMERCE
## HC : Financial Decisions

**Time :3 Hours** **Max. Marks : 70**

*Note : Statistical/Financial Tables and Non-programmable Calculators permitted inside the examination hall.*

## PART - A

Answer any five of questions. Each question carries five marks. **[5×5=25]**

*Q1)* What are the essential features of 'Wealth maximization' as a goal of finance?

*Q2)* Explain the benefits of NPV as a method of project evaluation.

*Q3)* What are the basic problems of IRR? Illustrate with suitable examples?

*Q4)* Explain the concept of 'home-made-leverage'. Illustrate with a suitable example.

*Q5)* State Walter's Model on dividend decision.

*Q6)* A firm is considering a project with a cash outlay of Rs. 45 lakhs. The project is expected to produce NCF of Rs.16 lakhs in years 1 and 2 and Rs. 18 lakhs in its terminal year 3. The discount rate applicable is 10%. Find DPB of the project.

*Q7)* Consider the following project:

| Year | (NCF Rs.in lakh) |
|---|---|
| 0 | –1200 |
| 1 | 800 |
| 2 | 500 |
| 3 | 200 |

Find IRR of the project.

*P.T.O.*

*Q8)* On the basis of following data, illustrate the concept of NI approach. Draw a diagram representing NI approach.

| | Existing capital structure | proposed capital structure |
|---|---|---|
| 1.EBIT | Rs.1000 | Rs.1000 |
| 2.Debt at 10% Interest | Rs.1000 | Rs.4000 |
| 3.Equity Capitalization Rate | 15% | 15% |

## PART - B

Answer any three questions. Each question carries ten marks.

**[3×10=30]**

*Q9)* Examine the Traditional Theory on the relationship between cost of capital and capital structure.

*Q10)* "The value of a firm depends on its earnings capacity and not on how earnings are split" Discuss with reference to MM's hypothesis on dividend decision.

*Q11)* The capital structure of BB Ltd as on 31.03.2017 consisted of the following.

| | (Rs in lakh |
|---|---|
| Equity (20 lakh shares of Rs. 100 each) | 2000 |
| 12.5% Perpetual Bonds (Face value of Rs 1000 each) | 500 |
| 13% Debentures (Face value of Rs 1000 each) | 1800 |
| Loans from financial institutions (at 10% interest) | 900 |
| Perferred capital (2lakh shares of Rs.100 each) | 200 |
| Retained earnings | 6000 |

Additional information.

a) Market value of each share : Rs. 554

b) Growth rate of earrings : 5.5%

c) Current divided Rs. 5 per share

d) Market value of each bond : The 1,090

e) Market value of each debenture : The 1,120 (yield 11.5%)

f) Market value of each preference share: Rs. 95

g) Marginal tax rate: 25%

Compute the WACC on the basis of book - value weights.

*Q12)* A Company is evaluating two mutually exclusive projects R and S. Both the projects involve a cash outlay of Rs. 200 Mill each and are expected to yield NCFs as follows:

NCFs –Rs.Mill

| year | Project R | Project S |
|---|---|---|
| 1 | Rs.330 | Rs.80 |
| 2 | | 80 |
| 3 | | 280 |

Determine:

a) NPV of both the projects applying a discount rate of 10 percent.

b) IRR of both the projects.

c) Do NPV and IRR suggest the same project? If not, advice the management as to which project to be selected on the basis of reinvestment rate of 15%

*Q13)* TT Ltd is considering a project with NCF profile as stated below:

| Year | NCFs(Rs. Mill) |
|---|---|
| 0 | –1500 |
| 1 | –810 |
| 2 | 2520 |
| 3 | 810 |
| 4 | –220 |

TT's cost of capital is 10%

a) Do you think project N does have multiple IRR problem?

b) If your answer to sub question (i) above is yes, suggest how you could resolve the problem by calculating modified internal rate or return.

## PART - C

*Q14)*Case study (Compulsory): [1×15=15]

Sumax Ltd has the practice of selecting capital projects on the basis of their ENPV and risk profile. It has determined the following discrete probability distribution for net cash flows from two contemplated projects A and B.

NCF (Rs. in Lakh)

| | Period1 | | Period 2 | |
|---|---|---|---|---|
| | Project A | Project B | Project A | Project B |
| Eco. Probability | Rs. | Rs. | Rs. | Rs. |
| V. Excellent 0.10 | 4,000 | 8,000 | 3,000 | 6,000 |
| Excellent 0.20 | 3,000 | 4,000 | 3,000 | 5,000 |
| Good 0.30 | 2,000 | 2,000 | 3,000 | 4,000 |
| Average 0.40 | 1,000 | 500 | 3,000 | 500 |

a) Assume that risk-free rate is 6 per cent and both the proposals require an initial outlay of Rs.4,000 lakhs each

b) Determine the expected NCFs of both the projects.

c) Determine Expected NPV of both the projects

d) If these are mutually exclusive projects, which one do you suggest?

e) Do you think there is a need for determining the level of riskiness of project ENPV?

f) Find the S.D of ENPV of both the projects.

g) Find the probability of ENPV being Positive for both the projects.

h) Which project do you suggest now?