DECEMBER 2013 EXAMINATION

FM 05/eFM05
CORPORATE FINANCE

Time: Three Hours **Maximum Marks: 100**

Note :

The paper is divided in three sections: Section A, Section B and Section C. There are 7 questions in Section-A, students are required to attempt ANY FOUR. Section-B has 5 questions, attempt ANY THREE. All the questions of Section-C (Case Study) are compulsory.

Section-A
(Each question is of 10 Marks)

1. What is financial management? What are the traditional and modern approaches of financial management?

2. An equipment requires an initial investment of Rs. 11000. Annual cash inflow is estimated at Rs. 4000 for 5 years. Cost of capital is 20%. What is the

a) PV of cash inflow

b) NPV of the project

Present Value interest factor PVIF (20%, 5yrs) = 0.402
Present Value interest factor for an annuity PVIFA (20%, 5yrs) = 2.991

3. Working result of two machines are given below:

	Machine X(Rs)	Machine Y(Rs.)
Cost of Machine	45000	45000
Sales per year	100000	80000
Total cost per year (excluding depreciation)	36000	30000
Expected life	2 years	3 years

Which of the two should be preferred? Advice according to the ARR method.

4. In case of a levered firm suppose the corporate tax rate is 50 percent, the tax rate on interest income is 40 percent and the tax rate on equity income is equal to zero. Calculate the value of the tax shields from one dollar of debt.

5. What is the difference between the net income approach and the net operating income approach towards capital structure?

6. What are floats? What do you understand by the term net float? What does it mean when net float is positive?

7. Explain the concept of lockboxes and cash concentration. How is it used to reduce the collection delay?

Section-B
(Each question is of 15 Marks)

8. What are the five methods of capital budget appraisal? Write short notes.

9. What is leverage? Explain the difference between operating and finance leverage. How can a combined leverage be used to maximize the value of a company.

10. How do we finance our working capital? What are the sources of cash in terms of changes in long term debt, equity, current liabilities, current assets and fixed assets?

11. A firm has terms of net 30 and ACP of 30 days. Offering term: 2/10. Suppose 50% of the customers pay within the net period to avail discount. What will be the new Average collection period? If the firm's annual sales are Rs.15 million (before discount), what will happen to the investments in receivables?

12. What are the different ways of restructuring in an organization? Write short notes on the terms :

i. Leverage Buyout
ii. Going Private
iii. Master limited Partnership

Section-C
Case Study (15 Marks)

Mr. Rakesh Saxena is excited about his new job as a Finance Manager at Hindalco Manufacturing. On the second day of his new job he has been assigned the task of deciding how to finance the working capital of the company. He has collected and verified the following facts:

The company has an investment of Rs. 50 crore in assets. Of which Rs. 30 crore is invested in fixed assets and the balance in current assets. The company is expected to yield a return of 18% before interest and taxes. The tax rate is assumed to be 35%. The firm maintains a debt ratio of 60%. Thus the firm's assets are financed by 40% equity.

The firm has to decide whether it should use a 12% short-term debt or a 14% long-term debt to finance its current assets.

The CFO wants to know how the different financing plans would impact the return on equity funds differently. He has to recommend the financing strategy the next day. He has been told that he has to raise a minimum of 20% of debt from short term sources even in conservative strategy.

Case Questions:

13.

a) Kindly look at the effects of the three different strategies i.e. conservative, moderate and aggressive on the ROE.

b) What would be the percentage of short term financing in comparison to total financing.

c) Which strategy would you adopt and why.