M.Com (Semester –III) (Accounting & Finance) Examination, January,2021

COO 311 : INVESTMENT AND FINANCING DECISIONS (OA-18 A)

Duration: 2 Hours Max. Marks: 60

Instructions:1) This paper consists of **nine** questions
2) Question No.**1** consists of **5 compulsory** questions of **2 marks** each
3) Answer **any 5** questions from Question **2,3,4,5,6,7,8 and 9**
4) Figures to the **right** indicate **marks.**

1. Answer the following questions. (5x2=10)

a) A new project under consideration requires a capital outlay of Rs.600 lakhs for which the funds can either be raised by the issue of equity shares of Rs.100 each or by the issue of equity shares of the value of Rs.400 lakhs and by the issue of 15% loan of Rs.200 lakhs. Find out the indifference level of Earnings Before Interest Tax (EBIT) given the tax rate at 50%.

b) Explain the concepts of Present Value and Future Value.

c) There are two firms Alpha and Omega which are exactly identical except that Alpha does not use any debt in its capital structure while Omega has Rs.1,00,000,5% debentures in its capital structure. Both the firms have Earnings Before Interest and Tax (EBIT) of Rs.25,000 p.a. and the capitalisation rate is 10%.
Assuming the corporate tax of 50%, Calculate the value of these firms according to MM Approach.

d) A project requires an investment of Rs.40,000 and the expected cash flows are Rs. 48,000 and Rs.16,000. Calculate the profitability index. (PV factor @10%, year 1= 0.909, year 2= 0.826)

e) What is Simulation Analysis?

2. From the following, prepare Income Statements of Firms P, Q and R. Briefly comment on each firm's performance. **10**

Particulars	Firm P	Firm Q	Firm R
Financial Leverage	3:1	4:1	2:1
Interest	Rs.200	Rs.300	Rs.1000
Operating Leverage	4:1	5:1	3:1
Variable cost as a percentage of Sales	66.67%	75%	50%
Income Tax Rate	35%	35%	35%

3. a) Farhan Traders Ltd. has Earnings Before Interest and Tax (EBIT) of Rs.4,00,000. The firm currently has outstanding debts of Rs.15,00,000 at an average cost (kd) of 10%. Its cost of equity capital (ke) is estimated to be 16% **06**

i) Determine the current value of the firm using the Traditional Valuation Approach.

ii) Determine the firm's overall capitalisation rate.

iii) The firm is considering to issue capital of Rs. 5,00,000 in order to redeem Rs.5,00,000 debt. The cost of debt is expected to be unaffected. However the firm's cost of equity capital is to be reduced to 14%, as a result of decrease in Leverage. Would you recommend the proposed action?

b) The capital structure of Bosco Ltd. as on 31/3/2020 is as follows **04**

Equity capital: 100 lacs equity shares of Rs. 10 each Rs. 10 crores
Reserves Rs. 2 crores
14% Debentures of 100 each Rs. 3 crores

For the year ended 31/3/2020 the company has paid equity dividend at 20%. As the company is a market leader with good future, dividend is likely to grow by 5% every year. The equity shares are now traded at Rs. 80 per share in the stock exchange. Income tax rate applicable to the Company is 50%. Calculate weighted cost of capital.

4. a) Elaborate the Functions of a Finance Manager. **08**

b) Why is maximising wealth a better goal than maximising profits? **02**

5. a) Explain the methods to compute the cost of equity capital. **05**

b) Discuss the Net Operating Income (NOI) Approach in Capital Structure Theories. **05**

6. A company has to select one of the two alternative project whose particulars are given below: **10**

	Years	**Project A**	**Project B**
Initial Outlay		1,18,720	1,00,760
Cash flow after tax:	1	1,00,000	10,000
	2	20,000	10,000
	3	10,000	20,000
	4	10,000	1,00,000

The company's cost of capital is 8%. Compute the NPV and IRR of each project and comment on the results.

The PV factor of Re.1 for different rates is given below:

8%	9%	10%	11%	12%	13%	14%
0.926	0.917	0.909	0.901	0.893	0.885	0.877
0.857	0.842	0.826	0.812	0.797	0.783	0.769
0.794	0.772	0.751	0.731	0.712	0.693	0.675
0.735	0.708	0.683	0.659	0.636	0.613	0.592

7. The Textile Manufacturing Company Ltd., is considering one of two mutually exclusive proposals, Projects M and N, which require cash outlays of Rs.8,50,000 and Rs.8,25,000 respectively. The certainty-equivalent (C.E) approach is used in incorporating risk in capital budgeting decisions. The current yield on government bonds is 6% and this is used as the risk free rate. The expected net cash flows and their certainty equivalents are as follows: **10**

Project M			Project N	
Year	Cash Flow (Rs.)	Certainty Equivalent Coefficient	Cash Flow (Rs.)	Certainty Equivalent Coefficient
1	4,50,000	0.8	4,50,000	0.9
2	5,00,000	0.7	4,50,000	0.8
3	5,00,000	0.5	5,00,000	0.7

Present value factors of Re.1 discounted at 6% at the end of year 1, 2 and 3 are 0.943, 0.890 and 0.840 respectively. Analyze which project should be accepted?

8. Briefly explain the techniques of risk analysis in Capital Budgeting. **10**

9. Capital budgeting is a complex process. Discuss. **10**

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