M.B.A. (Semester–IV) Examination

FINANCIAL DECISION ANALYSIS

Paper–4101/CGF

Time : 3 hours] [Maximum Marks : 70

Note :—(1) Attempt all questions.

(2) Figures to the right indicate marks.

(3) Use of factor table and scientific calculator is allowed.

SECTION–A

1. Ratios are indicators, sometimes pointers but not in themselves powerful tool of management – Discuss. 14

OR

Discuss the significance of projected cash flow statement in decision-making; In what respect cash flow statement is significantly different from fund flow statement? 14

SECTION–B

2. (a) What is a sale and lease back arrangement? Explain it with example. 7

(b) A company named Reddy's decided to replace the existing computer system of their organization. The original cost of old system was Rs. 25,000 and it was installed 5 years ago. Current market value of old system is Rs. 5,000. The depreciation of the old system was charged with life of 10 years. The depreciation of the new system will be charged with life over 5 years. Estimated salvage value of the old system was nil. Present cost of the new system is Rs. 50,000. Estimated salvage value of the new system is Rs. 1,000. Estimated cost savings with new system is Rs. 5,000 per year. Increase in sales with new system is assumed at 10% per year based on the original total sales of Rs. 1,00,000. Company follows straight line method of depreciation. Cost of capital of the company is 10% whereas tax rate is 30%. Whether Reddy's should accept the replacement proposal? 7

OR

(c) What do you mean by sequencing of decisions? Explain its significance. 7

(d) Caravan Ltd is considering the possibility of purchasing a multipurpose machine which cost Rs. 10.00 lakhs. The machine has an expected life of 5 years. The machine generates Rs. 6.00 lakhs per year before depreciation and tax and the management wishes to dispose the machine at the end of 5 years which will fetch Rs. 1.00 lakh. The depreciation allowable for the machine is 25% on written down value and the company's tax rate is 50%. The company approached a NBFC for a five year, lease for financing the assets which quoted the rate of Rs. 28 per thousand per month. The company wants you to evaluate the proposal with purchase option. The cost of capital is 12% and for lease option, it wants you to consider a discount rate of 16%.

	0	1	2	3	4	5
PV @ 12%	1.000	0.893	0.797	0.712	0.636	0.567
PV @ 16%	1.000	0.862	0.743	0.641	0.552	0.476

7

3. (a) Explain Modigliani and Miller's hypothesis for corporate dividend policy. What are its basic assumptions? 7

(b) A company is faced with the problem of choosing between two mutually exclusive projects. Project A requires a cash outlay of Rs. 1,00,000 and cash running expenses of Rs. 35,000 per year. On the other hand Project B will cost Rs. 1,50,000 and require cash running expenses of Rs. 20,000 per year. Both the machines have 8 years of life. Project A has a salvage of Rs. 4,000 and Project B has a salvage value of Rs. 14,000. The company's tax rate is 50% and it has a 10% required rate of return.

Assuming depreciation on straight line basis ascertain which project should be accepted. P.V. of annuity of Re. 1 for 8 years = 5.335 and P.V. of Re. 1 at the end of 8 years is 0.467, both at the discount rate of 10%. 7

OR

(c) How do you calculate net present value of a project? What are its merits and demerits? 7

(d) With the help of the following figures calculate the market price of a share of a company by using:

(i) Walter's formula

(ii) Dividend growth model (Gordon's formula)

EPS Rs. 10, dividend per share Rs. 6, cost of capital 20%, Internal rate of return on investment 25%, Retention ratio 60%. 7

SECTION–C

4. (a) Describe any two methods used for decision making with uncertainty. 7

(b) The technique of cost volume profit analysis can be a valuable aid to financial decision making Explain. 7

OR

(c) Risk and uncertainty are quiet inherent in capital budgeting – Explain the statement. 7

(d) What are the factors that influence capital expenditure decisions? 7

SECTION–D

5. XYZ Ltd is considering merger with ABC Ltd. XYZ Ltd's shares are currently traded at Rs. 25. It has 2,00,000 shares outstanding and its earnings after taxes(EAT) amount to Rs. 4,00,000. ABC Ltd has 1,00,000 shares outstanding. Its current market price is Rs. 12.50 and its EAT are Rs. 1,00,000. The merger will be effected by means of a stock swap (exchange) ABC Ltd has agreed to a plan under which XYZ Ltd will offer the current market value of ABC Ltd's shares.

(i) What are the pre-merger earnings per share and P/E ratios of both the companies?

(ii) If ABC Ltd's P/E ratio is 8, what is its current market price? What is the exchange ratio? What will XYZ Ltd's post merger EPS be?

(iii) What must the exchange ratio be for XYZ Ltd's that pre and post merger EPS are the same? 14