Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/MBA (NEW)/SEM-3FT & 5PT/FM-302/2010-11

2010-11
CORPORATE FINANCE

Time Allotted : 3 Hours | Full Marks : 70

The figures in the margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

GROUP – A
(Multiple Choice Type Questions)

1. Choose the correct alternatives for any *ten* of the following : $10 \times 1 = 10$

   i) "Golden Parachute" is

      a) A hostile takeover strategy for an acquirer

      b) An option that allows the underwriter of a new issue to buy a resale additional shares

      c) A situation in which a large block of stock is held by an unfriendly company, forcing the target company to repurchase the stock at a premium

      d) A large termination payment due to a company's management if they lose their jobs as the result of a merger.

ii) Which of the following statements is/are true ?

a) A buyout consummated mainly with debt is called a leveraged buyout

b) In a spin-off, a company is broken up into two or more independent companies

c) An enterprise in which the government holds more than 51% is called a government controlled enterprise.

d) A company formed by merger of two companies splitting up once again into two companies is called reverse merger.

iii) Agency cost arises due to

a) Cost overrun in implementing new projects

b) Failure of budgeted cost

c) Restrictions imposed by the supplier of debt capital

d) Rise in the cost of production.

iv) The financial goal of a public sector firm fully owned by the government is to

a) Maximize the book value per share

b) Maximize the profits earned by the firm

c) Maximize the present value of stream of equity returns

d) Maximize the return of equity.

v) Which of the following is not a function of a finance manager ?

a) Mobilization of funds

b) Deployment of funds

c) Control over use of funds

d) Manipulate the share price of the company.

vi) The market value of the firm is the result of

a) Dividend decisions

b) Working capital decisions

c) Trade-off between cost and risk

d) Trade-off between risk and return.

vii) The net present value of a particular investment project represents

a) Present investment required to undertake the project

b) The rate of return that the project will earn for the investing business

c) The discounted value of the inflows from the project

d) The increase and decrease in the wealth that the project will generate for the investing business.

viii) A business is considering an investment which will generate a cash flow in exactly five years time. The discount rate associated with the investment is 15% a year. To calculate the present value we have to multiply the amount of the cash flows to be received in five year's time by

a) $(1\cdot15)^5$ b) $(0\cdot15)^5$

c) $1/(1\cdot15)^5$ d) $1/(0\cdot15)^5$.

ix) The internal rate of return can be best described as

a) The return required by the managers of the business

b) The rate which the business has to pay to raise finance for an investment

c) The discount rate at which a set of cash flows have a zero NPV

d) The discount rate at which a set of cash flows have a positive NPV.

x) Which of the following is related to the control function of the financial manager ?

a) Interaction with the bankers for arranging a short-term loan

b) Comparing the costs and benefits of different sources of finance

c) Analysis of variance between the targeted costs and actual costs incurred

d) Assessing the costs and benefits of a project under consideration.

xi) A project can have as many IRRS as it has

a) Cash inflows

b) Cash outflows

c) Changes in sign of the cash flows

d) Periods of cash flow.

xii) At IRR, the NPV of the project is

a) the maximum

b) zero

c) slightly more than zero

d) less than zero.

GROUP – B

(Short Answer Type Questions)

Answer any *three* of the following. $3 \times 5 = 15$

2. What is the difference between maximizing stock holders, wealth and stock prices ?

3. Supreme Infrastructure would like to replace an old generator which has a book value of Rs. 50,000/- and a remaining life of 10 years and could be sold for Rs. 15,000/- net of capital gains taxes, right now. It would be replaced with a new generator that costs Rs. 1,50,000/- and has a depreciable life of 10 years, and annual operating costs are Rs. 40,000/- lower than the old generator. Assuming straight-line depreciation for the old and the new generators, a 40% tax rate, and no salvage value on either generator in 10 years. Is the replacement decision a good decision financially ?

4. Explain Compound Options and Rainbow Options with examples.

5. "Debt adds discipline to the investment process." Explain.

6. Remac Software is a small software firm in high growth. The firm is all equity financed. In the current year, the firm earned $20 million in the after-tax operating income on capital invested of $60 million. The firm's cost of equity is 15%. If it is assumed that the firm will be able to grow its economic value added 15% a year for the next five years and there will be on excess returns after the year 5. Estimate value of the firm. How much of this value comes from EVA and how much from capital invested ?

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. $3 \times 15 = 45$

7. In 1996, A Ltd. announced its intention to acquire B. Ltd. Provided synergy as a rational. On the announcement of the merger A Ltd. Stock Price which was Rs. 57 dropped to Rs. 52·50, while B Ltd.'s stock price surged form Rs. 31 to Rs. 37·50. A Ltd. had 400 million shares and B Ltd. had 50 million shares outstanding at the time of the announcement.

   a) Estimate the value, if any that financial markets are attaching to synergy in this merger.

   b) How would you reconcile the market reaction to the rationale presented by management for the acquisition ?

8. Super Cement Industries Ltd. is considering the replacement of one of its grinding machines. The existing machine is 4 years old and has a current salvage value of Rs. 1,00,000. The machine was initially purchased for Rs. 10,00,000 and depreciated at 25% WDV method. The new machine will cost Rs. 15,00,000 and has a useful life of 6 years and salvage value of Rs. 1,50,000 at the end of sixth year. It will also be subjected to same method of depreciation. The new machine will increase annual revenues by Rs. 7,00,000. The variable cost to volume ratio is 30%. Cost of capital is 10% and corporate tax rate is 30%. There are other machines in the block of 25% depreciation. Should the company go for replacement ?

9. a) Ravi Electronics Ltd. is considering to install a larger machine for its plant in Pune. It has selected two machines but it has the budget to purchase only one. Machine *A* requires an initial investment of Rs. 5,00,000 and will generate CFAT of Rs. 2,00,000 per year for next 5 years. Machine *B* requires an initial investment of Rs. 6,00,000 and will generate CFAT of Rs. 1,80,000 per year for 8 year. Assuming 10% as cost of capital which machine should be purchased ? Explain on the basis of equivalent annual value.

   b) Describe how sensitivity analysis can be used to understand risk related to cash flows of a project. Give example. 10 + 5

10. a) Briefly discuss the main reasons for acquisitions & takeovers. 5

   b) It is given that Company *A* will acquire Company *B* with shares of common stock. The financial details are given hereunder :

Particulars	**Company A (Rs.)**	**Company B (Rs.)**
Present Earnings	20 million	5 million
EPS	4·00	2·50
Market Price	64	30
P/E	16	12

It is given that Company *B* has agreed on an offer of Rs. 35 in common stock of Company. Anlayze the merger proposal for both companies. 10

11. a) Explain the concept of risk and return in respect to valuation of shares. 5

b) A bond has the undernoted features :

Face Value = Rs. 1000/-

Coupon rate = 11% p.a. payable annually.

Tenure = 3 years

Redemption-Bullet, at par.

Current market price = Rs. 1,100/-

If rate of return expected by the market on a similar security is 10% p.a.,

i) Compute is intrinsic value.

ii) Is the bond overvalued or undervalued ?

iii) Compute its current yield

iv) Set up the equation for YTM of the Bond. 10

12. Write short notes on any *three* of the following : 3×5

a) Real option

b) Pros and cons of EVA

c) Horizontal Merger and vertical Merger

d) Monte Carlo simulation

e) Buy-Back of shares

f) Decision Tree.