[A12]

SARDAR PATEL UNIVERSITY
T Y BBA EXAMINATION
2016
TUESDAY, APRIL 5

Time : 10.30am to 12.30pm

Total Marks: 60

Advanced Financial Management II [UM06EBBA02] - VI SEMESTER

NOTE:	[1] Figures to the right indicate full marks of each question.
	[2] All questions carry equal marks.
	[3] All working notes are part of the answer.

Q1[a] Enlist the guiding principles of capital structure decision and discuss the simplifying assumptions commonly made to study the relationship between capital structure and firm value? **[07]**

Q1[b] Assuming no taxes and given the EBIT, Interest (I) @ 10% and equity capitalization rate (ke) below, calculate the total market value of each firm. **[08]**

Firms	EBIT (Rs)	Interest (Rs)	Ke (%)
X	2,00,000	20,000	12
Y	3,00,000	60,000	16
Z	5,00,000	2,00,000	15
W	6,00,000	2,40,000	18

Also, determine the weighted average cost of capital for each firm.

OR

Q1[a] Explain concept of optimum capital structure. Show the behaviour of Ko, Ke and Kd under NI, NOI and Traditional approach. **[08]**

Q1[b] The two companies, U and L, belong to an equivalent risk class. These two firms are identical in every respect except that company U is unlevered while company L has 10% debentures of Rs. 30 lakh. The other relevant information regarding their valuation and capitalization rates are as follows: **[07]**

Particulars	Firm U(Rs)	Firm L(Rs)
EBIT	7,50,000	7,50,000
Interest on debt	-----	3,00,000
Earnings to equityholders (NI)	7,50,000	4,50,000
Equity capitalization rate (ke)	0.15	0.20
Market value of equity (S)	50,00,000	22,50,000
Market value of debt (B)	-----	30,00,000
Total value of firm (S+B) = V	50,00,000	52,50,000
Overall capitalization rate (ko)	0.15	0.143
Debt –equity ratio (B/S)	0	1.33

1. An investor owns 10% equity shares of Co. L. Show the arbitrage process and the amount by which he could reduce his outlay through the use of leverage.
2. According to MM, when will this arbitrage process come to an end?

Q2[a] Describe variables influencing dividend decision. **[08]**

Q2[b] A company's EPS is Rs. 20 on a share of Rs. 100. It has an internal rate return of 25%. Capitalization of its risk class is 12.5%. If Walter's model is used; **[07]**
1. What should be the optimum payout ratio? What would be the market price at that ratio?
2. Suppose the company has a payout of 25% of EPS, What would be price per share? How shall the market price of the share be affected?

OR

Q2[a]	Explain and Illustrate Gordon's model of dividend decision.	[07]
Q2[b]	A company has a cost of equity capital of 10%, the current market value of the firm (V) is Rs. 20,00,000 (Rs 20 per share). Assume values for I (new investment) Rs. 6,80,000, Y (earnings) Rs. 1,50,000 and D (dividends) Re 1 per share at the end of the year. Show that under the MM assumptions, the payment of dividend does not affect the value of the firm.	[08]

Q3[a]	Explain and illustrate Risk-adjusted discount rate approach.	[07]
Q3[b]	A firm has an investment proposal requiring an outlay of Rs. 80,000. The expected useful economic life of the project is 2 years. The CFAT in the 1st year can be Rs. 50,000 (probability 0.4) or Rs. 60,000 (probability 0.6). Net cashflows in year 2 will depend on the outcome in year 1. Discount rate 10%. The CFAT in year 2 will be as follows:	[08]

If CFAT in year 1 is Rs. 50,000 then		If CFAT in year 1 is Rs. 60,000 then	
CFAT in year 2(Rs)	Probability	CFAT in year 2(Rs)	Probability
24,000	0.2	40,000	0.4
32,000	0.3	50,000	0.5
44,000	0.5	60,000	0.1

Use decision tree approach for this project. Assess the NPV of the project, if the worst outcome emerges and if the best outcome emerges. What is the probability of such outcomes?

OR

Q3[a]	The X Ltd is considering a proposal for the purchase of a new machine requiring an outlay of Rs. 1500 lakh. Its estimate of the cash flow distribution for the 3 year life of the machine is given below: [Amount in Rs. Lakh]	[08]

Period 1		Period 2		Period 3	
CASHFLOW	PROB.	CASHFLOW	PROB.	CASHFLOW	PROB.
800	.1	800	.1	1200	.2
600	.2	700	.3	900	.5
400	.4	600	.4	600	.2
200	.3	500	.2	300	.1

The probability distribution is assumed to be independent. Risk free rate is 5%. From the above information, determine the following:

[i] Expected NPV of the project;

[ii] Standard deviation of the probability distribution of NPV

Q3[b]	Explain standard deviation and co-efficient of variation as precise measures of risk.	[07]

Q4[a]	What are the major determinants of foreign exchange rates?	[07]
Q4[b]	Discuss various hedging techniques available against the foreign exchange exposure.	[08]

OR

Q4	Answer following questions:	[15]

1. Explain various foreign exchange rates.
2. Distinguish between forward contracts and future contracts.
3. What are the types of foreign exchange exposure?

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