Additional information:

- On 1 January 2012, ABC has 600 million, Rs. 1 shares issued and subscribed.
- On 1 January 2013, there was a "1 for 3" rights issue at an issue price of Rs. 3.20 per share taking the total number of shares to 800 million. There were no other changes to share capital in the 3 year period shown above.
- Assume that depreciation is the only non-cash item included in profit/(loss) after tax above.

Over two-thirds of the shares are held by large financial institutions such as pension funds. insurance companies and investment vehicles. The remaining shares are held by directors of the company and private individuals.



A (Printed Pages 8)

# MS-3095

## M.B.A. (Fourth Semester)

## Examination, 2015

## FINANCIAL DECISIONS ANALYSIS

## (FP-421)

***Time Allowed : Three Hours ]*** ***[ Maximum Marks : 70***

Note : Answer five questions in all. Questions No. 1 is compulsory. In addition attempt one question from each unit. Use of financial scientific calculator is permitted.

1. Read the attached case and answer the following questions:

   (a) Analyze ABC's dividend policy in the years 2012 to 2014 based on the given data by supporting your answer with calculations of the following:

   (i) Dividend per share

   (ii) Dividend cover based on profit/(loss) after tax

   (iii) Free cash flow generated in the year (before dividend payments)

   (Maximum 6 marks for calculations out of 10)

(b) Advise the management on the benefits and drawbacks of the current dividend policy and possible alternative dividend policies. (10 marks)

(c) Discuss the interrelationship between financing decisions investment and dividend decision with reference to ABC. (10 marks)

Unit-I

2. (a) According to CAPM, only systematic risk is relevant. Do you agree with the statement? 5

(b) You have invested in the following securities: 5

| | D | E | F |
|---|---|---|---|
| Expected return | 12% | 14% | 9% |
| Standard deviation of returns | 3% | 5% | 3% |
| Beta | 1.65 | 1.2 | 0.89 |
| Amount invested in each security | Rs.50,000 | Rs.1,25,000 | Rs.75,000 |

(i) Compute the expected return on the portfolio.

(ii) Compute the beta of the portfolio

3. (a) Explain why portfolio risk is not the weighted average of the risk of individual securities constituting the portfolio 5





quisition criteria is no dilution in EPS? 5

(ii) Calculate the post-merger EPS, if Mega Corporation accepts an offer of Rs. 24 a share in a share-for-share exchange assuming immediate synergistic earnings of Rs. 0.4 Crores will occur as a result of acquisition. 5

Case

ABC is a listed company on BSE. The company manufactures spectacles and contact lenses. As designs and technology are constantly changing, the company needs to invest heavily in research and development in order to remain competitive.

ABC financial year ends on Dec. 31. Financial data for the last 3 years appears below:

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| Year to 31 December: | Rs Million | Rs. Milliion | Rs.Million |
| Dividend | 120 | 160 | 170 |
| Profit/(loss)after tax | 300 | 300 | (100) |
| Depreciation included in Profit/(loss) | 100 | 100 | 120 |
| On-going capital expenditure | 160 | 700 | 300 |
| Data as at 31 December: | | | |
| Long term Borrowings | Rs.2,000 milli. | Rs.1,820mil. | Rs.2,090mill. |
| Share price | Rs. 4.00 | Rs. 3.50 | Rs.3.00 |

| Year I | | Year 2 | |
|---|---|---|---|
| Cash flow | Probability | Cash flow | Probability |
| Rs. 4,000 | 0.25 | Rs.4,000 | 0.40 |
| Rs. 5,000 | 0.50 | Rs.7,000 | 0.30 |
| Rs. 6,000 | 0.25 | Rs.10,000 | 0.30 |

If the required rate of return is 8% and the risk free rate is 5% which alternative is preferable? 6

5. (a) Discuss ways companies can attempt to create value through required returns. 5

(b) Bharti Coal is planning to enter oil drilling business and is booking for a proxy company to measure the risk involved in it. A-One Oil Co., a listed company is suggested as an appropriate benchmark. A-One has a debt equity ratio of 0.3, a beta of 1.25 and tax rate of 35%.

Bharti Coal has debt equity ratio of 0.50. The cost of debt funds in its capital structure is 12%. The company is taxed at the rate of 35%.

(i) If Bharti Coal maintains 50% debt-equity ratio, what beta it should use for evaluating the rate of return for oil drilling business?





(ii) If risk free rate of return is 9% and the expected return on market portfolio is 12% what return should Bharti Coal require from its new business? $2.5 \times 2$

Unit-III

6. (a) Detail the various factors to be considered in capital structure decision? 5

(b) The equity section of Zee entertainers as on March 30, 2015 appears below:

| | |
|---|---|
| Common shares, | Rs. 300,00,000 |
| (Rs.50par value, | 600,000 Shares) |
| Share Premium | Rs.150,00,000 |
| Reserves | Rs.500,00,000 |
| Shareholders Equity Rs. | 1000,00,000 |

On March 31, the company declared a 2 for 1 split and the 10% stock dividend. The price of the share on March 30, 2015 was Rs. 400. Reconstruct the equity section to reflect the decisions. 5

7. Write short notes on the following: $2.5 \times 4$

(i) Regulatory provisions regarding dividend in India.

(ii) Share repurchases

(iii) Financial signaling

(iv) Agency costs

Unit-IV

8. (a) Bring out the differences among sell-off, Spin off and equity carve outs in the context of corporate restructuring. 5

(b) Explain variants of each of the following basic methods of valuation: 2½×2

(i) Market-based valuation

(ii) Earnings-based valuation

9. Heavy Industries Corporation is considering acquiring Mega Co. in a share-for-share. exchange. Selected financial data on the two companies is as under:

| | Heavy Ind. Corp. | Mega Corp. |
|---|---|---|
| Sales(Cr.) | Rs. 60 | 7.5 |
| Net Income(Cr) | Rs.3 | 1.0 |
| No of common shares (Cr) | 0.6 | 0.4 |
| EPS | Rs.5.00 | Rs.2.50 |
| MPS | Rs.50.0 | Rs.20.0 |
| Price to Earnings ratio | 10 | 8 |

(i) What is the maximum exchange ratio Heavy Industries would agree to if its ac-





(b) Which of the following portfolios would appear on the efficient frontier of available portfolios? 5

| Protfolio | Rate of return | Standard deviation |
|---|---|---|
| J | 24% | 12% |
| K | 9% | 02% |
| L | 13% | 08% |
| M | 22% | 12% |
| N | 19% | 13% |
| O | 16% | 07% |
| P | 07% | 02% |
| Q | 12% | 09% |

Unit-II

4. (a) Discuss the considerations involved in estimating the project cash flows. 4

(b) A manufacturer is considering to sell one of its machines, The selling price of the machine is dependent on the tender, the possible outcome from the tender are:

| After tax receipts | Probability |
|---|---|
| Rs. 15,000 | 0.2 |
| Rs. 10,000 | 0.6 |
| Rs. 5,000 | 0.2 |

The other alternative is to keep the machine in the firm. The cash flows for the next two years are independent of each other as under.



P.T.O.