PGDM, 2018-20

Corporate Finance

IB 303

Trimester – III, End-term Examination: March 2019

Time allowed: 2 Hrs 30 Min

Max Marks: 50

Roll No: ____________

Instruction: Students are required to write Roll No on every page of the question paper, writing anything except the Roll No will be treated as **Unfair Means.** All other instructions on the reverse of Admit Card should be followed meticulously. Please carry a non-programmable calculator.

Section: A (15 Marks).

Attempt 3 out of 5 questions, each question carries 5 marks.

1. Under an educational loan, Samir receives four annual instalments of Rs. 10000 each, the first payment being made at the present moment. The loan is to be repaid in lump sum at the end of three years from now along with 6% interest pa. Calculate the amount repayable.

2. Which yields the higher rate of interest for every Rs. 1000 in a bank or an NSC giving the following maturity values respectively?

   i) Rs. 1629 after 5 years in a Bank FD

   ii) Rs. 1901 after 6 years in NSC

3. The Trident Company Ltd. has two bond issues (series 1, and series 2) outstanding. Series 1 has a maturity of 5 years, and series 2 has a maturity of 3 years. Both bonds pay Rs. 1000 annual interest plus Rs.10,000 at maturity. Compute the value of each of these bonds when the going rate of interest is
i) 6 percent, and ii) 10 percent?

4. Describe the major characteristics of operating leverage and financial leverage.

5. How the reinvestment rate play an important role in NPV, IRR, and MIRR methods of capital budgeting?

Sec B

(Attempt 2 out of 3 questions, each question carries 10 marks.)

6. The Pacific Princess luxury cruise line is contemplating leasing an additional cruise ship to expand service from the Hawaiian Islands to Long Beach or San Diego. A financial analysis by staff personnel resulted in the following

projections for a five-year planning horizon:

	Long Beach ($)	**San Diego ($)**
Cost	2000000	3000000
PV of expected cash flow @ k=15%	2500000	3600000

i) Calculate the net present value for each service. Which is more desirable

according to the NPV criterion?

ii) Calculate the profitability index for each service. Which is more desirable

according to the PI criterion?

iii) Under what conditions would either or both of the services be undertaken? (3+3+4)

7. Money, Inc., has no debt outstanding and a total market value of $150,000. Earnings before interest and taxes, EBIT, are projected to be $14,000 if economic conditions are normal. If there is strong expansion in the economy, then EBIT will be 30 percent higher. If there is a recession, then EBIT will be 60 percent lower. Money is considering a $60,000 debt issue with a 5 percent interest rate. The proceeds will be used to repurchase shares of stock. There are currently 2,500 shares outstanding. The company has a market-to-book ratio of 1.0. Ignore taxes for parts a and b.

a. Calculate return on equity, ROE, under each of the three economic scenarios before any debt is issued. Also, calculate the percentage changes in ROE for economic expansion and recession, assuming no taxes.
b. Repeat part (a) assuming the firm goes through with the proposed recapitalization.
c. Repeat parts (a) and (b) of this problem assuming the firm has a tax rate of 35 percent. (3+3+4)

8. a) 'Increased leverage also brings in additional risk'. Discuss critically.
b) 'The price of a bond is really dependent upon the coupon rate, market rate, and the term period'. Discuss.
c) 'Volatility of a stock may also get translated into larger profit'. Discuss. (3+3+4)

Sec C (15 marks)

9. Calculate the amount of working capital requirement for ABCD Ltd. from the following information:

Particulars	Amount (INR) per unit
Raw Material	320
Direct Labour	120
Overhead	240
Total cost	680
Profit	120
Selling Price	800

Raw materials are held in stock on an average for two months. Materials are in process on an average for half-a-month. Finished goods are in stock on an average for one and half month. Credit allowed by suppliers is half month and credit allowed to debtors is two months. Time lag in payment of wages is 1week. Time lag in payment of overhead expenses is two weeks. Half of the sales are made on cash basis. Cash in hand and at the bank is expected to be INR 100,000; and expected level of production amounts to 1,19,600 units for a year of 52 weeks. Assume that production is carried on evenly throughout the year and a time period of four weeks is equivalent to a month.