

**PAPER 2- MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS
MAY, 2003**

Answer any five questions

All working notes should form part of the answer.

Wherever appropriate suitable assumptions should be made.

Present value / annuity tables should be given on demand.

Question 1

- (a) What is a “derivative”? Briefly explain the recommendations of the L.C.Gupta Committee on derivatives. **(6 Marks)**

Or

Brief explain Capital Asset Pricing Model (CAPM).

- (b) Cyber Company is considering two mutually exclusive projects. Investment outlay of both the projects is Rs.5,00,000 and each is expected to have a life of 5 years. Under three possible situations their annual cash flows and probabilities are as under:

Situation	Probabilities	Cash flows (Rs.)	
		Project A	Project b
Good	0.3	6,00,000	5,00,000
Normal	0.4	4,00,000	4,00,000
Waste	0.3	2,00,000	3,00,000

The cost of capital is 7 percent, which project should be accepted? Explain with workings.

- (c) A company is considering Projects X and Y with following information :

Project	Expected NPV (Rs.)	Standard Deviation
X	1,22,000	90,000
Y	2,25,000	1,20,000

- (i) Which project will you recommend based on the above data?
 (ii) Explain whether your opinion will change, if you use coefficient of variation as a measure of risk.
 (iii) Which measures is more appropriate in this situation and why?
- (d) Pragya Limited has issued 75,000 equity shares of Rs.10 each. The current market price per share is Rs.24. The company has a plan to make a rights issue of one new equity share at a price of Rs.16 for every four shares held. **(8 Marks)**

Your are required to:

- (i) Calculate the theoretical post-rights price per share;
 (ii) Calculate the theoretical value of the right alone;
 (iii) Show the effect of the right issue on the wealth of a shareholder, who has 1,000 shares assuming he sells the entire rights; and
 (iv) Show the effect, if the same shareholder does not take any action and ignores the issue.

Question 2

- (a) Write short notes on the role of Mutual funds in the financial market. **(6 Marks)**
 (b) In March, 2003, the Multinational Industries makes the following assessment of dollar rates per British pound to prevail as on 1.9.03: **(6 Marks)**

\$/ Pound	Probability
1.60	0.15
1.70	0.20
1.80	0.25
1.90	0.20
2.00	0.20

- (i) What is the expected spot rate for 1.9.03?

- (ii) If, as of March, 2003, the 6-month forward rate is \$1.80, should the firm sell forward its pound receivables due in September, 2003?
- (c) An investor is holding 1,000 shares of Flatlass Company. Presently the rate of dividend being paid by the company is Rs.2 per share and the share is being sold at Rs.25 per share in the market. However several factors are likely to change during the course of the year as indicated below: **(8 Marks)**

	Existing	Revised
Risk free rate	12%	10%
Market risk premium	6%	4%
Beta value	1.4	1.25
Expected growth rate	5%	9%

In view of the above factors whether the investor should buy, hold or sell the shares ? And why?

Question 3

- (a) Write a note on buy-back of shares by companies. **(10 Marks)**
- (b) X Ltd., has 8 lakhs equity shares outstanding at the beginning of the year 2003. The current market price per share is Rs.120. The Board of Directors of the company is contemplating Rs.6.4 per share as dividend. The rate of capitalization, appropriate to the risk-class to which the company belongs, is 9.6%: **(10 Marks)**
- Based on M-M Approach, calculate the market price of the share of the company, when the dividend is – (a) declared ; and (b) not declared.
 - How many new shares are to be issued by the company, if the company desires to fund an investment budget of 3.20 crores by the end of the year assuming net income for the year will be Rs.1.60 crores?

Question 4

- (a) Armada Leasing Company is considering a proposal to lease out a school bus. The bus can be purchased for Rs.5,00,00 and, in turn, be leased out at Rs.1,25,000 per year for 8 years with payments occurring at the end of each year: **(16 Marks)**
- Estimate the internal rate of return for the company assuming tax is ignored.
 - What should be the yearly lease payment charged by the company in order to earn 20 per cent annual compounded rate of return before expenses and taxes?
 - Calculate the annual lease rent to be charged so as to amount to 20% after tax annual compound rate of return, based on the following assumptions:
 - Tax rate is 40%;
 - Straight line depreciation;
 - Annual expenses of Rs.50,000; and
 - Resale value Rs.1,00,000 after the turn.
- (b) Write short notes on Global Depository Receipts and Euro Convertible Bonds.

Question 5

- (a) Write short notes on commercial paper.
- (b) A mutual fund that had a net asset value of Rs.20 at the beginning of month – t made income and capital gain distribution of Re.0.0375 and Re.0.03 per share respectively during the month, and then ended the month with a net asset value of Rs.20.06. Calculate monthly return.
- (c) XYZ Ltd., is considering merger with ABC Ltd., XYZ Ltd.'s shares are currently traded at Rs.20. it has 2,50,000 shares outstanding and its earnings after taxes (EAT) amount to Rs.5,00,000. ABC Ltd., has 1,25,000 shares outstanding ; its current market price is Rs.10 and its EAT are Rs.1,25,000. 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 share :

- i. What is the pre-merger earnings per share (EPS) and P/E ratios of both the companies ?
- ii. If ABC Ltd.'s P/E ratio is 6.4, what is its current market price? What is the exchange ratio? What will XYZ Ltd's post-merger EPS be?
- iii. What should be the exchange ratio, if XYZ Ltd.,s pre-merger and post-merger EPS are to be the same?

Question 6

(a) Explain the role of Merchant Bankers in Public issues.

(6Marks)

(b) Your client is holding the following securities:

(6Marks)

Particulars of securities	Cost Rs.	Dividends Rs.	Market price Rs.	BETA
Equity shares :				
Co.X	8,000	800	8,200	0.8
Co.Y	10,000	800	10,500	0.7
Co. Z	16,000	800	22,500	0.5
PSV Bonds	34,000	3,400	32,300	1.0

Assuming a Risk – free rate of 15%, Calculate:

- Expected rate of return in each, using the Capital Asset Pricing Model (CAPM)
- Average return of the portfolio.

(c) A company is presently working with an earning before interest and taxes (EBIT) of Rs.45 lakhs. Its present borrowings are:

(8 Marks)

	(Rs. Lakhs)
12% term loan	150
Working capital	
Borrowing from Bank at 15%	100
Public deposit at 11%	45

The sales of the company is growing and to support this the company proposes to obtain additional borrowing of Rs.50 lakhs expected to cost 16%. The increase in EBIT is expected to be 16%.

Calculate the change in interest coverage ratio after the additional borrowing and commitment.