

PAPER 2- MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS
NOVEMBER, 2004

Answer any five questions

Question No.1 is compulsory. Answer any four questions from the rest. Figures in the margin indicate marks allotted to each question.

Working notes should form part of the answer.

Question 1

ABC Ltd., is considering a proposal to acquire a machine costing Rs.1,10,000 payable Rs.10,000 down and balance payable in 10 annual equal instalments at the end of each year inclusive of interest chargeable at 15%. Another option before it is to acquire the asset on a lease rental of Rs.15,000 per annum payable at the end of each year for 10 years. The following information is also available:

- (i) Terminal Scrap value of Rs.20,000 is realizable, if the asset is purchased.
- (ii) The company provides 10% depreciation on straight line method on the original cost.
- (iii) Income Tax rate is 50%.

You are required to compute and analyze cash flows and to advise as to which option is better. **(20 Marks)**

Question 2

- (a) XYZ Ltd., is considering merger with ABC Ltd., XYZ Ltd.'s shares currently traded at Rs.25. it has 2,00,000 shares outstanding and its earning after taxes (EAT) amount to Rs.4,00,000. ABC Ltd., has 1,00,000 shares outstanding; its current market price is Rs.12.50 and its EAT is Rs.1,00,000. 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 shares. **(8 Marks)**
 - 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 8, what is its current market price? What is the exchange ratio? What will XYZ Ltd.'s post merger EPS be?
 - iii. What must be exchange ratio be for XYZ Ltd.'s pre-merger and post-merger EPS to be the same?
- (b) A company pays a dividend of Rs.2.00 per share with a growth rate of 7%. The risk free rate is 9% and the market rate of return is 13%. The company has a beta factor of 1.50. however, due to a decision of the Finance Manager, beta is likely to increase to 1.75. Find out the present as well as the likely value of the share after the decision. **(6 Marks)**
- (c) RBI sold a 91 day T-bill of face value of Rs.10 at an yield of 6%. What was the issue price? **(2 Marks)**
- (d) Explain the term "Offer for sale". **(4 Marks)**

Question 3

- (a) A firm has projected the following cash flows from a project under evaluation : **(8 Marks)**

Year	Rs. lakhs
0	(70)
1	30
2	40
3	30

The above cash flows have been made at expected prices after recognizing inflation. The firm's cost of capital is 10%. The expected annual rate of inflation is 5%.

Show how the validity of the project is to be evaluated.

- (b) Write a note about the functions of merchant bankers. **(6 Marks)**
- (c) The following figures are collected from the annual report of XYZ Ltd.,: **(6 Marks)**

	Rs.
Net profit	30 lakhs
Outstanding 12% preference shares	100 lakhs
No. of equity shares	3 lakhs

Return on investment

20%

What should be the approximate dividend pay-out ratio so as to keep the share price at Rs.42 by using Walter model?

Question 4

- (a) On January 28, 2005 an importer customer requested a Bank to remit Singapore Dollar (SGD) 25,00,000 under an irrevocable LC. However due to Bank strikes, the Bank could effect the remittance only on February 4, 2005. The inter Bank market rates were as follows: **(8 Marks)**

	January 28	February 4
Bombay US\$1 =	Rs.45.85 / 45.90	45.91/45.97
London Pound 1 =	US\$ 1.7840 / 1.7850	1.7765 / 1.7775
Pound 1 =	SGD 3.1575 / 3.1590	3.1380 / 3.1390

The Bank wishes to retain an exchange margin of 0.125%. How much does the customer stand to gain or lose due to the delay? (Calculate rate in multiples of .0001)

- (b) Ram buys 10,000 shares of X Ltd., at Rs.22 and obtains a complete hedge of shorting 400 Nifties at Rs. 1,100 each. He closes out his position at the closing price of the next day at which point the share of X Ltd., has dropped 2% and the nifty future has dropped 1.5%. What is the overall profit/loss of this set of transaction? **(4 Marks)**
- (c) Write a brief note about regulation of NBFCs in India. **(8 Marks)**

Question 5

- (a) Project X and Project Y are under the evaluation of XY Co. The estimated cash flows and their probabilities are as below: **(12 Marks)**

Project X : Investment (year 0) Rs.70 lakhs.

Probability weights	0.30	0.40	0.3
Years	Rs. lakhs	Rs. lakhs	Rs. lakhs
1	30	50	65
2	30	40	55
3	30	40	45

Project Y: Investment (Year 0) Rs.80 lakhs

Probability weights	Annual cash flows thro' life (Rs. in lakhs)
0.20	40
0.50	45
0.30	50

- (a) Which project is better based on NPV. Criterion with a discount rate of 10%
 (b) Compute the standard deviation of the present value distribution and analyze the inherent risk of the projects.
- (b) A share of Tension - free Economy Ltd., is currently quoted at, a price earning ratio of 7.5 times. The retained earnings per share being 37.5% is Rs.3 per share. Compute: **(8 Marks)**
- The company's cost of equity, if investors expect annual growth rate of 12%
 - If anticipated growth rate is 13% p.a. calculate the indicated market price, with same cost of capital.
 - If the company's cost of capital is 18% and anticipated growth rate is 15% p.a. calculate the market price per share, assuming other conditions remain the same.

Question 6

- (a) The following information is provided relating to the acquiring company Efficient Ltd., and the target company Healthy Ltd., **(12 Marks)**

	Efficient Ltd.,	Healthy Ltd.,
No. of shares (F.V.Rs.10 each)	10.00 lakhs	7.5 lakhs
Market capitalization	500.00 lakhs	750.00 lakhs
P/E Ratio (times)	10.00	5.00
Reserves and Surplus	300.00 lakh	165.00 lakh
Promoter's Holding (No. of shares)	4.75 lakh	5.00 lakh

Board of Directors of both the Companies have decided to give a fair deal to the shareholders and accordingly for swap ratio the weights are decided as 40%, 25% and 35% respectively for Earnings, Book value and Market price of share of each company.

- Calculate the swap ratio and also calculate Promoter's holding % after acquisition.
- What is the EPS of Efficient Ltd., after acquisition of Healthy Ltd., ?
- What is the expected market price per share and market capitalization of Efficient Ltd., after acquisition, assuming P/E ratio of Firm Efficient Ltd., remains unchanged.
- Calculate the float market capitalization of the merged firm.

(b)

- Who can be appointed as Asset Management Company (AMC)? **(4 M arks)**
- Write the conditions to be fulfilled by an AMC.
- What are the obligations of AMC?

(c) Write short notes on the following :

(4 Marks)

- Debt securitization.
- Stock Lending Scheme – its meaning, advantages and risk involved.