

**PAPER 2: MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS
NOVEMBER 2002**

Answer any Five Questions

All working notes should form part of the answer.

Wherever appropriate, suitable assumptions should be made.

Present value / Annuity tables would be supplied on demand.

Question 1

- (a) What is the sensitivity analysis in Capital Budgeting? **(6 Marks)**
 (b) Skylark Airways is planning to acquire a light commercial aircraft for flying class clients at an investment of Rs.50,00,000/- . The expected cash flow after tax for the next three years is as follows: **(14 Marks)**

Year 1		Year 2		Year 3	
CFAT	Probability	CFAT	Probability	CFAT	Probability
14,00,000	0.1	15,00,000	0.1	18,00,000	0.2
18,00,000	0.2	20,00,000	0.3	25,00,000	0.5
25,00,000	0.4	32,00,000	0.4	35,00,000	0.2
40,00,000	0.3	45,00,000	0.2	48,00,000	0.1

- (c) The Company wishes to take into consideration all possible risk factors relating to an airline operations. the company wants to know:
- the expected NPV of this venture assuming independent probability distribution with 6 per cent risk free rate of interest.
 - the possible deviation in the expected value.
 - how would standard deviation of the present value distribution help in Capital Budgeting decisions?

Question 2

- (a) Distinguish between Forward Contracts and Futures Contracts? **(6 Marks)**
 (b) On 1st April , 3 months interest rate in the US and Germany are 6.5 percent and 4.5 per cent per annum respectively. The \$/DM spot rate is 0.6560. what would be the forward rate for DM for delivery on 30th June? **(4 Marks)**
 (c) In International Monetary Market an international forward bid for December, 15on pound sterling is \$ 1.2816 at the same time that the price of IMM sterling future for delivery on December, 15 is \$ 1.2806. the contract size of pound sterling is pound 62,500. how could the dealer use arbitrage in profit from this situation and how much profit is earned.? **(4 Marks)**
 (d) Write a brief note on American Depository Receipts. **(6 Marks)**

Question 3

- (a) Company X is contemplating the purchase of Company Y. Company X has 3,00,000 shares having a market price of Rs.30 per share, while Company Y has 2,00,000 shares selling at Rs.20 per share. The EPS are Rs.4.00 and Rs.2.25 for Company X and Y respectively. Managements of both companies are discussing two alternative proposals for exchange of shares as indicated below: **(10 Marks)**
- in proportion to the relative earnings per share of two companies.
 - 0.05 share of Company X for one share of Company Y (.5:1).
- You are required
- To calculate the Earnings Per Share (EPS) after merger under two alternatives; and
 - To show the impact on EPS for the shareholders of two companies under both the alternatives.
- (b) Explain the following : **(5×2=10 Marks)**
- Take over by Reverse Bid
 - Demerger.

Question 4

- (a) Write a note on the important financial issues to be taken into consideration while negotiating for foreign technical collaborations. **(10 Marks)**
- (b) Following is the data regarding six securities : **(10 Marks)**

	A	B	C	D	E	F
Return (%)	8	8	12	4	9	8
Risk (Standard Deviation)	4	5	12	4	5	6

- Assuming three will have to be selected, state which ones will be picked.
- Assuming perfect correlation, show whether it is preferable to invest 75% in A and 25% in B or to invest 100% in E.

Question 5

Agrani Ltd., is in the business of manufacturing bearings. Some more product lines are being planned to be added to the existing system. The machinery required may be bought or may be taken on lease. The cost of machine is Rs.40,00,000 having a useful life of 5 years with the salvage value of Rs.8,00,000. the full purchase value of machine can be financed by 20% loan repayable in five equal installments failing due at the end of each year. Alternatively, the machine can be procured on a 5 years lease, year-end lease rentals being Rs.12,00,000 per annum. The Company follows the written down value method of depreciation at the rate of 25%. Company's tax rate is 35% and cost of capital is 16 per cent : **(20 Marks)**

- Advise the company which option it should choose – lease or borrow.
- Assess the proposal from the lessor's point of view examining whether leasing the machine is financially viable at 14% cost of capital (Detailed working notes should be given. Calculations can be rounded off to Rs.lakhs.)

Question 6

- What are the determinants of Dividend Policy? **(8 Marks)**
- Sahu & Co., earns Rs.6 per share having capitalization rate of 10 per cent and has a return on investment at the rate of 20 per cent. According to Walter's model, what should be the price per share at 30 per cent dividend payout ratio? Is this the optimum payout ratio as per Walter? **(6 Marks)**
- Write short notes on any two of the following? **(3×2=6 Marks)**
 - Options
 - Book-building
 - Forfeiting