

PAPER 2- MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS
NOVEMBER, 2003

Answer any Five Questions

All working notes should form part of the answer. Wherever appropriate, suitable assumptions may be made.
 Present value / Annuity tables would be supplied on demand.

Question 1

- (a) Explain the term "Buy-Outs". **(8 Marks)**
 (b) The Textile Manufacturing Company Ltd., is considering one of two mutually exclusive proposals, Projects M and N, which require cash outlays of Rs.8,50,000 and Rs.8,25,000 respectively. The certainty –equivalent (C.E) approach is used in incorporating risk in capital budgeting decisions. The current yield on government bonds is 6% and this is used as the risk free rate. The expected net cash flows and their certainty equivalents are as follows: **(12 Marks)**

	Project M		Project N	
Year end	Cash flow Rs.	C.E.	Cash flow Rs.	C.E.
1	4,50,000	0.8	4,50,000	0.9
2	5,00,000	0.7	4,50,000	0.8
3	5,00,000	0.5	5,00,000	0.7

Present value factors of Re.1 discounted at 6% at the end of year 1,2 and 3 are 0.943, 0.890 and 0.794 respectively.

Required:

- (i) Which project should be accepted?
 (ii) If risk adjusted discount rate method is used, which project would be appraised with a higher rate and why?

Question 2

- (a) Explain , how to establish a Mutual Fund **(6 Marks)**
 (b) Mr.A can earn a return of 16 per cent by investing in equity shares on his own. Now he is considering a recently announced equity based mutual fund scheme in which initial expenses are 5.5 per cent and annual recurring expenses are 1.5 per cent. How much should the mutual fund earn to provide Mr.A a return of 16 per cent? **(4 Marks)**
 (c) The rates of return on the security of Company x and market portfolio for 10 periods are given below: **(10 Marks)**

Period	Return of Security X (%)	Return on Market portfolio (%)
1	20	22
2	22	20
3	25	18
4	21	16
5	18	20
6	-5	8
7	17	-6
8	19	5
9	-7	6
10	20	11

- (i) What is the beta of Security X?
 (ii) What is the characteristic line for security X?

Question 3

(a) M/s. Agfa Industries is planning to issue a debenture series on the following terms:

(8 Marks)

Face value	Rs.100
Term of maturity	10 yrs.
Yearly coupon rate - years	
1 – 4	9%
5-8	10%
9-10	14%

The current market rate on similar debentures is 15 per cent per annum. The company proposes to price the issue in such a manner that it can yield 16 per cent compounded rate of return to the investors. The Company also proposes to redeem the debentures at 5 per cent premium on maturity. Determine the issue price of the debentures.

(b) Write short notes on any **three** of the following :

(3×4=12 Marks)

- Marking to market
- Treasury Bills
- Social Cost Benefit Analysis
- Credit rating in India.
- Green shoe option.

Question 4

(a) Write a brief note on project appraisal under inflationary conditions.

(8 Marks)

(b) M Ltd., has to make a payment on 30th January, 2004 of Rs.80 lakhs. It has surplus cash today, i.e., 31st October, 2003; and has decided to invest sufficient cash in a Bank's certificate of Deposit scheme offering an yield of 8% p.a. on simple interest basis. What is the amount to be invested now?

(4 Marks)

(c) M Co., Ltd., is studying the possible acquisition of N Co. Ltd., by way of merger. The following data are available in respect of the companies:

(8 Marks)

Particulars	M Co. Ltd.,	N Co. Ltd.,
Earnings after tax (Rs.)	80,00,000	24,00,000
No. of equity shares	16,00,000	4,00,000
Market value per share (Rs.)	200	160

- If the merger goes through by exchange of equity and the exchange ratio is based on the current market price, what is the new earnings per share of M Co., Ltd., ?
- N Co., Ltd., wants to be sure that the earnings available to its shareholders will not be diminished by the merger. What should be the exchange ratio in that case?

Question 5

(a) Write a short note on "Book building".

(4 Marks)

(b) ABC Co., have taken a 6 month loan from their foreign collaborators for U.S. Dollars 2 millions. Interest payable on maturity is at LIBOR plus 1.0%. Current 6 month LIBOR is 2%.

(10 Marks)

Enquiries regarding exchange rates with their Bank elicit the following information :

Spot USD	Rs.48.5275
6 months forward	Rs.48.4575

- What would be their total commitment in Rupees, if they enter into a forward contract?
 - Will you advise them to do so? Explain giving reasons.
- (c) A company operating in Japan has today effected sales to an Indian Company, the payment being due 3 months from the date of invoice. The invoice amount is 108 lakhs yen. At today's spot rate, it is equivalent to Rs.30 lakhs. It is anticipated that the exchange rate will decline by 10% over the 3 months period and in order to protect the yen payments, the importers proposes to take appropriate action in the

foreign exchange market. The 3 months forward rate is presently quoted as 3.3 yen per Rupee. You are required to calculate the expected loss and to show how it can be hedged by a forward contract.

Question 6

- (a) Explain reforming the public sector enterprises (PSE's) through Greenfield privatization. **(8 Marks)**
 (b) Capital structure of Sun Ltd., as at 31.3.2003 was as under: **(12 Marks)**

	(Rs. in lakhs)
Equity share capital	80
8% preference share capital	40
12% debentures	64
Reserves	32

Sun Ltd., earns a profit of Rs.32 lakhs annually on an average before deduction of income-tax, which works out to 35% and interest on debentures.

Normal return on equity shares of companies similarly placed is 9.6% provided:

- (a) Profit after tax covers fixed interest and fixed dividends at least 3 times.
 (b) Capital gearing ratio is 0.75.
 (c) Yield on share is calculated at 50% of profits distributed and at 5% on undistributed profits.

Sun Ltd., has been regularly paying equity dividend of 8%. Compute the value per equity share of the company.