UNIVERSITY OF GUJRAT

A WORLD CLASS UNIVERSITY

(M.Com Part-II) **Corporate Finance**

Roll No: ____________

in words: ____________

Cutting, Overwriting, Erasing, Fluid painting and use of Lead Pencil will earn no marks. Write answer of the Question No.1 and 2 on this sheet and handover it to the supervisory staff of examination within first 35 minutes.

Time Allowed: 35 Minutes ***(OBJECTIVE PART)*** ***Max. Marks: 32*** ***Sign of Supdt.***

1- a) Encircle the correct answer: ***1x8***

i) If price of a bond exceeds its par value:

a) Its yield will be equal to the coupon rate b) Its yield will be greater than coupon rate

c) Its yield will be less than coupon rate

ii) Diversification will decrease risk if:

a) Stocks are uncorrelated b) Stocks are perfect positively correlated

c) Stocks are perfect negatively correlated

iii) Underwriters can enter into agreement:

a) for issue of shares b) for issue of bonds c) Both a & b

iv) Venture capital firms invest in

a) High Tech Firms b) Firms which are already working c) Low Risk Business

v) Stock repurchase provides signals to the shareholders that:

a) Stocks value will increase in future b) Stocks value will decrease in future

c) Stocks value will remain constant in future

vi) According to Modi Gilani & Miller, a capital structure that maximizes value of firm also:

a) Minimizes the weighted average cost of capital provided that operating income is independent of capital structure

b) Maximizes the weighted average cost of capital c) Has no impact on weighted average cost of capital

vii) Value of an option increases with:

a) Rate of Interest b) Time to Maturity c) Both a & b

viii) A vertical merger involves companies:

a) At same Production Stage b) At different Production Stage c) Having complexed operations

b) Encircle True or False: ***1x4***

i) A call option gives the holder a right to buy an underlying security at a specific price and on or before a specific rate. **True \ False**

ii) Modi Gilani & Miller proposition 2 says that rate of return expected by shareholders of a firm increases as debt-equity ratio of that firm increases. **True \ False**

iii) To have an idea of working of a firm, venture capitalists may demand their representation on board of directors. **True \ False**

iv) Risk of a well diversified portfolio depends on the market risk of securities included in the portfolio. **True \ False**

c) Fill in the blanks meaningfully: ***1x4***

i) IRR and NPV techniques are based on ________________cash ________________.

ii) Cash budgeting requires to forecast future cash ________________________ and outflows.

iii) Managers are on the view that mergers are intended to __________cost and achieve economies of scale.

iv) Options, ________________, Future and ________________are well known types of derivative securities.

(Continued Overleaf)

2- Give short answers to the following questions: *2x8*

i) Change in financial structure affects the required rate of return on individual securities. Explain?

ii) Define and Explain the Bankruptcy Cost of a Company.

iii) List down the Advantages of Derivative Securities.

iv) Differentiate between Warrant and Call Option.

v) Differentiate between Cash Budget and Cash Flow Statement.

vi) Explain the Role of Production Manager in Inventory Management.

vii) Explain the Concept of Weighted Average Cost of Capital.

viii) Explain External Sources of Financing available to a company.

Total Marks: 32 + 68 = 100
Pass Marks = 40%

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Roll No: ____________

Time Allowed : 2:25 hrs
Max. Marks : 68

Attempt **FOUR** Questions in all. All Questions carry equal marks.

SUBJECTIVE PART

3- Arzoo Ltd. is interested in investing in some Projects and after some initial review, the following Projects are under consideration:

Figures of cash flows of these Projects are given in thousand (000) rupees.

	Project X	**Project Y**	**Project Z**
Initial investment:	Rs. 1,000	Rs. 2,000	Rs. 3,000
Cash Inflows:			
Year 1	Rs. 1,000	Rs. 1,000	Rs. 1,000
Year 2	Rs. 0	Rs. 1,000	Rs. 1,000
Year 3	Rs. 0	Rs. 4,000	Rs. 0
Year 4	Rs. 0	Rs. 1,000	Rs. 1,000
Year 5	Rs. 0	Rs. 1,000	Rs. 1,000

Required:

a) Mention the Projects having Positive NPV, if opportunity cost of capital is 10%. *5*
b) Calculate Pay Back Period of each Project. *3*
c) If cut off period is 3 years, which Project or Projects should Arzoo Ltd. accept using pay back period? *3*
d) Calculate the Discounted Pay Back Period of each Project. *3*
e) If Cut Off Period is 3 years, which Project or Projects should Arzoo Ltd. accept based on Discounted Pay back period rule? *3*

4- Arif Habib investment bank is having two shares "X" and "Y" available for making investment. The expected rate of return from "X" is 12% and from "Y" is 8%. The standard deviation of return is 8% for "X" and 5% for "Y". The correlation coefficient between the returns is 2. The following three portfolios are available for this investment:

Portfolio	**% in X**	**% in Y**
1	50	50
2	25	75
3	75	25

Required:

a) Compute the expected return and standard deviation of each of the above portfolios. *7*
b) How would your answer change if correlation coefficient is 1.5? *7*
c) Is Arif Habib investment bank's portfolios offer better or worse return than one invested entirely in share "Y"? *3*

5- The total market value of common stock of a company is 6 million rupees and total value of its debt is 4 million rupees. Its treasurer estimates that the beta of stock is currently 1.5 and that the expected risk premium on the market is 6%. The T-Bill rate is 4%. For simplicity, it can be assumed that debt of company is risk free and the company is in no tax bracket.

Required:

a) What is the Required Rate of Return on this Company's Stock? *8*
b) Estimate the Company's Cost of Capital. *5*
c) Suppose that the company wants to diversify in another business of shoe making. The beta of unleveraged shoe manufacturer is 1.2. Then estimate the Required Rate of Return on this new venture. *4*

6- Tayyib Textile Ltd. made a right issue at Rs. 5 a share of one new share for every 4 shares already held in 2002. There were 10 million shares of Tayyib Textile Ltd. outstanding before this issue and share price in the market was Rs. 6 per share.

Required:

a) What was the total amount of new money raised? *5*
b) What was the value of right to buy one new share? *4*
c) What was the prospective stock price after the issue? *4*
d) How far could the total value of the company fall before shareholders would be unwilling to take up their rights? *4*

(Continued Overleaf)

7- a) The balance sheet of Ibrahim Fibres Ltd. is as under:

Ibrahim Fibers Ltd.
Balance Sheet
As on Dec. 31, 2012

Assets	**Rs.**	**Liabilities & Capital**	**Rs.**
Cash and Marketable Securities	100,000	Bank Loan	280,000
Inventory	50,000	Account Payable	120,000
Account Receivables	200,000	Long Term Debt	1,800,000
Fixed Assets	2,100,000	Equity	400,000
Other Assets	150,000		
	2,600,000		**2,600,000**

The long term debts of the company is secured by its fixed assets, but it also used short term bank financing. It pays 10% interest on the bank debt and 9% interest on the secured debt. Ibrahim Fibers has 10 thousand shares of stock outstanding, trading at Rs. 90 per share. The expected return on Ibrahim Fibers common stock is 18%.

Required:

Calculate Ibrahim Fibers Weighted Average Cost of Capital assuming that book and market value of Ibrahim Fibers Ltd's debt are the same. The marginal tax rate is 35%. *8*

b) Imtiaz Traders is a nationwide distributer of furniture. Presently, the company is using central billing system for credit sale of 180 million rupees annually. Imtiaz traders has been offered by its banker to establish a new concentration banking system for a fee of 100,000 rupees per year. The bank estimates that mailing and collection time can be reduced by 3 days. You are required to explain:

i) By how much Imtiaz Traders cash balances be increased under the new system? *3*

ii) How much extra interest income will be generated by the new system, if the extra funds are used to reduce borrowing under Imtiaz Traders line of credit with its bank? *3*

iii) Assuming that borrowing rate is 12%, should Imtiaz Traders accept offer of its bank if collection cost under the old system are 40,000 rupees per year. *3*

8- A Petrochemicals Company is solely financed by common stock and has 25 million shares outstanding with a market price of Rs. 10 per share. It now announces that it intends to issue 160 million rupees of debt and to use the proceeds to buy back common stock.

a) How will the market price of stock be affected by this announcement? *4*

b) How many shares can this company buy back with 160 million rupees of new debt that it issues? *4*

c) What is market value of firm (equity and debt) after the change in capital structure? *3*

d) What will be the debt ratio of this company after change in its capital structure? *3*

e) Who (if anyone) gains or loses? *3*