

MANAGEMENT PROGRAMME

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Term-End Examination

December, 2012

MS-42 : CAPITAL INVESTMENT AND
FINANCING DECISIONS*Time : 3 hours**Maximum Marks : 100*

Note : Attempt any five questions. All questions carry equal marks. Use of calculators is allowed. Time value tables would be provided if asked for.

1. The existing capital structure of ABC Ltd. is as follows :

Equity shares of Rs.100 each	Rs. 40,00,000
Retained earnings	Rs. 10,00,000
9% Preference shares	Rs. 25,00,000
7% Debentures	Rs. 25,00,000

Company earns a return of 12% and the tax rate on its income is 50%. Company wants to raise Rs. 25,00,000 for its expansion project for which it is considering following alternatives :

- Issue of 20,000 equity shares at a premium of Rs. 25 per share
- Issue of 10% preference shares and
- Issue of 9% debentures.

It is Projected that the company's P/E ratios in the case of equity, preference and debentures financing are 20,17 and 16 respectively. Which alternative would you consider to be the best. Give reasons for your choice.

2. A company is considering raising of additional funds of Rs. 100 lakhs by one of the two alternative, methods, viz. 14% institutional term loan and 13% non convertible debentures. The term loan option would attract no major incidental cost. The debentures would have to be issued at a discount of 2.5% and would involve floatation cost of Rs. 1 lakh. Advise the company as to the better option based on the effective cost of capital in each case. Assume a tax rate of 50%.
3. What do you understand by Economic Appraisal of a project ? Discuss the various aspects of economic appraisal and explain their significance.
4. What is Certainty Equivalent ? Explain the relationship between certainty equivalent and risk adjusted discount rate.
5. List the various instruments through which corporates can procure finance and discuss the circumstances under which they are used to procure finance.

6. Write short notes on the following :
- (a) Asset securitisation
 - (b) Venture Capital
 - (c) Sensitivity analysis
 - (d) Internal rate return method of capital budgeting
7. What are the different payout methods of dividends ? Explain the Modigliani-Miller hypothesis regarding dividend policy.
8. What is Financial Engineering ? Explain the factors which motivate the finance managers to undertake financial engineering.
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