TIME: 1 Hour

MAX. MARKS: 30 Marks

SECTION A

Answer any FIVE of the following questions. Each question carries two marks.   **(5x2=10)**

1. Define capital budgeting
2. What is optimal capital structure?
3. According to Walter model define growth firms and declining firms
4. What is arbitrage according MM capital structure theory?
5. Give the meaning of risk adjusted discount rate
6. A company is considering Projects X and Y with following information:

Project	Expected NPV (Rs.)	Standard deviation
X	18,000	6,500
Y	22,000	7,200

Which project will you recommend based on Coefficient of variation?
7. State the principle of traditional approach theory of capital structure

SECTION B

Answer any TWO of the following questions. Each question carries ten marks.   **(2x10=20)**

8. There are two projects X and Y, each involves an investment of Rs. 40,000. The expected cash inflows and the certainty coefficients are as under:

Year	Project X		Project Y	
	Cash inflows	Certainty coefficients	Cash Inflows	Certainty coefficients
1	25,000	0.8	20,000	0.9
2	20,000	0.7	30,000	0.8
3	20,000	0.9	20,000	0.7

Risk free cut off rate is 10% (Discount Rate). Suggest which of the two projects should be preferred using discounted certainty coefficients approach.

9. The following is the data regarding two companies' 'X' and 'Y' belonging to the same equivalent risk class:

Particulars	Company X	Company Y
Number of shares	90,000	1,50,000
Market price of the share	Rs. 1.20	Rs. 1.00
6% Debentures	60,000	Nil
Profit before interest	Rs. 18,000	Rs. 18,000

All profits after debenture interest are distributed as dividends. You are required explain how under Modigliani & Miller approach, an investor holding 10% of shares in company X will be better off in switching his holding to company Y.

10. The earnings per share of a company is Rs. 8 and the rate of capitalisation applicable to the company is 10%. The company can adopt a payout ratio of 25% or 50% or 75%. Using Walter's model of dividend payout, compute the market value of the company's share if the productivity of retained earnings is (1) 15% (2) 10% and (3) 5%.