TUTOR MARKED ASSIGNMENT

COURSE CODE	**:**	**MCO-07**
COURSE TITLE	**:**	**Financial Management**
ASSIGNMENT CODE	**:**	**MCO-07/TMA/2026-2027**
COVERAGE	**:**	**ALL BLOCKS**

Maximum Marks: 100

Attempt all the questions:

1) **a)** Why do we use cash flow analysis instead of profit analysis in capital budgeting decisions? What are the general principles of cash flow estimation? **(10+10)**

b) ABC Ltd. is considering the purchase of a machine costing ₹1,50,000. The project requires an additional investment in working capital of ₹20,000, which is recoverable at the end of the project's life. The expected cash flows are as follows:

Year 1: ₹25,000
Year 2: ₹35,000
Year 3: ₹45,000
Year 4: ₹55,000
Year 5: ₹60,000
The machine is expected to have a salvage value of ₹15,000 at the end of Year 5.
Required:
1. Calculate the Payback Period.
2. Comment on the project's liquidity position based on the payback criterion.

2) **a)** Dividend policy plays a significant role in determining the market value of equity shares. Discuss the concept of **dividend-based share valuation** and explain the major models used for valuing equity shares. **(10+10)**

b) An equity analyst is evaluating the shares of **ABC Ltd.** The company has recently paid a dividend of **₹6 per share**. Dividends are expected to grow at a constant rate of **5% per annum** in the future. The required rate of return expected by investors is **13%**.

Required:
1. Calculate the intrinsic value of the equity share using **Gordon's Growth Model**.
2. If the current market price of the share is **₹78**, determine whether the share is overvalued or undervalued.

3) **a)** What is lease financing? Discuss different types of leases and outline their advantages and disadvantages. **(10+10)**

1) a) Why do we use cash flow analysis instead of profit analysis in capital budgeting decisions? What are the general principles of cash flow estimation? (10)

Answer

Capital budgeting decisions involve committing money today in the expectation of benefits over several future years. For this reason, the correct basis for evaluating an investment is the cash that the project will actually generate or absorb, not the accounting profit shown in the profit and loss account. Profit is useful for reporting performance, but it is affected by accounting conventions and includes several items that do not involve an immediate movement of cash.

Why cash flow analysis is preferred

1. **Cash represents real economic benefits.** Investment decisions require an actual outlay of funds, and the project must ultimately return cash to the firm. Cash can be used to pay suppliers, wages, taxes, interest and dividends. Accounting profit itself cannot meet these obligations unless it is converted into cash.
2. **Profit contains non-cash charges.** Depreciation is deducted while computing accounting profit even though it does not involve a current cash payment. For capital budgeting, depreciation matters mainly because it affects taxable income and therefore the tax cash flow. The focus remains on cash after tax rather than the book profit figure.
3. **Accounting policies can change reported profit.** Different depreciation methods, inventory valuation methods or provisions may change reported profit without changing the project's basic cash-generating ability. Cash flow analysis reduces this distortion and makes alternative projects more comparable.
4. **Timing of benefits is essential.** A rupee received earlier is worth more than a rupee received later. Capital budgeting techniques such as NPV and IRR therefore require the timing of each cash flow. A single accounting profit number for a year does not adequately show when cash is actually received or paid.
5. **Investment appraisal is based on incremental wealth.** The important question is how the firm's cash flows will change if the project is accepted compared with the position if it is rejected. Incremental cash flows directly measure this