Seat No.: ________ Enrolment No.___________

GUJARAT TECHNOLOGICAL UNIVERSITY

MBA – SEMESTER 02 – EXAMINATION – SUMMER 2017

Subject Code: 2820003 **Date: 31/05/2017**

Subject Name: Financial Management

Time: 10.30 AM TO 01.30 PM **Total Marks: 70**

Instructions:

1. **Attempt all questions.**
2. **Make suitable assumptions wherever necessary.**
3. **Figures to the right indicate full marks.**

Q.1. (a) Select the most appropriate answer for the following MCQs. **06**

1. What is the long-run objective of financial management?

A. Maximize earnings per share
B. Maximize return on investment
C. Maximize the shareholders' wealth
D. Maximize market share

2. In which of the following situations, a project is acceptable?

A. When a project has conventional cash flows pattern
B. When a project has a non-conventional cash flow pattern
C. When a project has a discounted rate lower than the inflation rate
D. When a project has a positive net present value

3. Which of the following is not a secured form of financing?

A. Debenture B. Bond
C. Term Loan D. Commercial Paper

4. Which of the following is a discounted technique of capital budgeting?

A. Accounting rate of return B. Pay-back period
C. Internal rate of return D. None of the above

5. The long-term financing instrument is_______

A. Commercial Paper B. Equity Capital
C. Accruals D. Trade Credit

6. In which technique, the par value of the share is reduced?

A. Bonus Share B. Right Issue
C. Stock Split D. Both A and C

Q.1. (b) Briefly explain the following terms: **04**

1. Beta of a portfolio
2. Economic Order Quantity
3. Working Capital
4. Bonus Shares

Q.1. (c) Discuss the salient features of Debentures. **04**

Q.2. (a) Critically evaluate the goals of profit maximization and wealth maximization. **07**

Q.2. (b) The required return on the market portfolio is 10%. The beta of the stock is 2.0 The required return on the stock is 16%. The expected dividend growth on stock is 5%. The price per share of the stock is Rs.30. What is the expected dividend per share of the stock next year? What will be the combined effect of the following on the price per share of stock? **07**

1. The beta of the stock falls to 1.5
2. The expected growth rate of dividend on stock decreases to 3%.
3. The decrease in the degree of risk aversion reduces the differential between the return on market portfolio and the risk free return by one third.

OR

Q.2. (b) Two investment options are available to Mr. Yatin. The first option promises to pay Rs. 75,000 at the end of 8 years to investors who deposit Rs. 7,000 annually for 8 years. The second scheme promises to pay Rs. 50,000 at the end of five years on an annual **07**

deposit of Rs. 7,000 for five years. Mr. Yatin is confused as to which of the two schemes give him better returns? Please guide him.

Q.3. (a) Discuss the reasons why firms pay dividends? **07**

Q.3. (b) Kyara Ltd is planning a plantation project costing Rs. 30,00,000. The company is considering two alternatives. Under the first alternative, it can issue shares of Rs. 20,00,000 at Rs.50 each. And raise the remaining amount of Rs.10,00,000 by loan at the rate of 12%. Under the second alternative, it can issue shares worth Rs. 15,00,000 at a price of Rs.50 each. It can raise the reaming Rs. 15,00,000 by loan at 14%. The firm pays tax at 30%. The company wants to know the level of EBIT at which both these alternatives are indifferent to EPS. Also calculate Degree of Financial Leverage (DFL) for both the firms if the projected EBIT is Rs.50,00,000. **07**

OR

Q.3. (a) Discuss the Net Present Value (NPV), Internal Rate of Return (IRR) and Benefit-Cost ratio as discounting criteria of capital budgeting. **07**

Q.3. (b) Vedanta company is considering the proposal for buying a new machine. The details of the same are presented as below: **07**

Purchase Price	Rs. 2,90,000
Installation Expenses	Rs. 10,000
Useful Life	6 years
Salvage Value	Nil
Tax	30%
Cost of capital	10%

Profit Before Tax

Year	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**
PBT (Rs.)	1,50,000	1,80,000	2,00,000	2,10,000	1,60,000	2,25,000

You are supposed to calculate Payback period and Net Present Value (NPV) from the above mentioned information.

Q.4. (a) State Modigliani and Miller Proposition I for the capital structure and illustrate how the arbitrage mechanism works with the help of an example. **07**

Q.4. (b) The net profit for the Tirth corporation for the year 2016 is Rs. 20,00,000. The number of outstanding shares are 5,00,000. The rate of return on the investment is 18%. The rate of return required by the shareholders is 15%. Calculate the price per share as per Walter Model and Gordon Model if the dividend payout ratio is 40% and 60%. **07**

OR

Q.4. (a) Discuss leasing and hire purchase as sources of financing. **07**

Q.4. (b) Two firms, Akash Ltd. and Prakash Ltd., are planning a project with the debt levels of Rs. 50,00,000 and Rs.70,00,000 respectively. The cost of debt for Akash ltd and Prakash Ltd. will be 12% and 15% respectively. The earnings before interest and tax are projected to be Rs. 30,00,000 for both the firms annually. The cost of equity for Akash and Prakash Ltd is 22% and 24% respectively. Based upon this information, find out the earnings for both the firms, if the tax rate is 30%. Also calculate the overall cost of capital for both the firms as per net income approach. **07**

Q.5. Sarthi Corporation enjoyed a fairly healthy growth rate till two years ago. Intense competition in the last few years has slowed down the growth rate considerably. The existing sales are Rs. 18,00,000. The company provides 30 days of credit to its eligible customers as per its credit standards. Besides, its present credit terms are 1/10, net 30. Mr. Rao, the marketing head, argued for relaxing the credit policy and increasing the discount percentage to increase the sales. Mr. Shah, the finance head, promised to consider this proposal, provided these relaxations will have a positive impact on the residual income. **14**

You have recently been appointed as a financial consultant. The finance head has asked you to examine the effect of extending the credit period and providing more generous discount.

After talking to the executives in the marketing, production and finance departments, you have gathered the following information.

50% of the customers are availing the cash discount facility.

The contribution ratio for the corporation is 20%. The post-tax cost of fund is 15%. The tax rate is 30%. The average collection period is 20 days.

If the company extends the credit period to 60 days, the sales will increase by Rs. 2,00,000. The bad debt losses on additional sales is expected to be 5%. The average collection period will increase to 50 days.

If the company relaxes its discount terms to 2/10, net 30, its sales to customers will increase by Rs. 1,00,000. The percentage of customers who avail the cash discount will increase to 70%. The average collection period will decrease to 16 days.

You are required to calculate:

1. What will be the effect to extending the credit period on the residual income?
2. What will be the effect of relaxing the cash discount on residual income?

Examine the impact of these changes individually on residual income. Also suggest which of these changes, should the company implement?

OR

Q.5. Swagat Pvt Ltd. is in the business of hospitality. The sales forecast for the firm for January to March 2017 is as follows. **14**

Month	Sales (Rs. in Lakh)
January	22
February	25
March	30

The actual sales of the last two months of the previous calendar year have been Rs. 18 lakh and Rs. 20 lakh respectively. The firm is selling 25% on cash basis. Out of the credit sales, 65% is realized in the month following the sales while 35% is realized in the second month. The firm has made inter-corporate deposit of Rs. 50 lakh that fetch 10% per annum. The interest is received half yearly (in March and September). The non-operating cash outflow expected in the month of February is projected as Rs.30 lakh.

A capital expenditure is due for the replacement of the asset in the month of January. The expenses is estimated to be Rs. 10 lakh. The production department has given the following details regarding the cost of production.

Direct material has been estimated at 51.5% of the sales.
Labour and other overhead expenses have been projected at 21.75% of the sales.
The expenses are paid in the month incurred.

Company's cash balance as on December 2016 was Rs.1 lakh. The company has a policy of maintaining a cash balance at 5% of its expected monthly sales per month. Surplus cash, if any is invested and the deficit is borrowed.

You are requested to prepare a monthly forecast for the company for the months January to March 2017, indicating the cash deficit/ surplus each month.

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