

Seat No.: _____
No. _____

Enrolment

GUJARAT TECHNOLOGICAL UNIVERSITY
MBA - SEMESTER-II • EXAMINATION – SUMMER 2013

Subject Code: 2820003

Date: 17-05-2013

Subject Name: Financial Management

Time: 10:30am – 01:30pm

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) The current dividend on an equity share of Maxim Limited is Rs.4.00. Assume that Maxim's dividend will grow at the rate of 18 percent per year for the next 5 years. Thereafter, the growth rate is expected to fall and stabilize at 10 percent. Equity investors require a return of 15 percent from Maxim's equity shares. What is the intrinsic value of Maxim's equity share? **07**

(b) The present credit terms of Glocus Corporation are 2/10, net 40. Its sales are Rs.650 million, its average collection period is 30 days, its variable costs to sales ratio, V , is 0.75, and its cost of capital is 10 percent. The proportion of sales on which customers currently take discount, is 0.3. Glocus is considering relaxing its credit terms to 3/10, net 40. Such a relaxation is expected to increase sales by Rs.30 million, increase the proportion of discount sales to 0.5, and reduce the ACP to 20 days. Glocus's tax rate is 35 percent. What will be the effect of liberalising the cash discount on residual income? **07**

Q.2 (a) You are supplied with the following information in respect of XYZ Ltd for the ensuing year: **07**

Production of the year, 69,000 units

Finished goods in store, 3 months

Raw material in store, 2 months consumption

Production process, 1 month

Credit allowed by creditors, 2 months

Credit given to debtors, 3 months

Selling price per unit, Rs 50

Raw material, 50 per cent of selling price

Direct wages, 10 per cent of selling price

Manufacturing and administrative overheads, 16 per cent of selling price

Selling overheads, 4 per cent of selling price

There is a regular production and sales cycle and wages overheads accrue evenly. Wages are paid in the next month of accrual. Material is introduced in the beginning of the production cycle. Conversion costs (wages, manufacturing and other administrative overheads) are assumed to be equivalent to 50 per cent. You are required to ascertain its working capital requirement.

(b) Define lease. How does it differ from a hire purchase? **07**

OR

(b) Why a preference share is called a hybrid security? Do you agree that it combines the worst features of ordinary shares and bonds? **07**

- Q.3 (a)** Sangeeta Enterprises is determining the cash flow for a project involving replacement of an old machine by a new machine. The old machine bought a few years ago has a book value of Rs.2,800,000 and it can be sold to realise a post tax salvage value of Rs.2,200,000. It has a remaining life of five years after which its net salvage value is expected to be Rs.900,000. It is being depreciated annually at a rate of 30 percent the WDV method. The working capital associated with this machine is Rs.1,000,000. **07**

The new machine costs Rs.8,000,000. It is expected to fetch a net salvage value of Rs.3,500,000 after five years. The depreciation rate applicable to it is 25 percent under the WDV method. The new machine is expected to bring a saving of Rs.1,000,000 annually in manufacturing costs (other than depreciation). The incremental working capital associated with the new machine is Rs.600,000. The tax rate applicable to the firm is 33 percent. Estimate the cash flow associated with the replacement project.

- (b)** A company has to choose one of the following two mutually exclusive projects. Both the projects will be depreciated on a straight-line basis. The firm's cost of capital is 10 per cent and the tax rate is 35 per cent. The before tax cash flows are: **07**

Project	C ₀	C ₁	C ₂	C ₃	C ₄	C ₅
X	-20000	4200	4800	7000	8000	2000
Y	-15000	4200	4500	4000	5000	1000

Which project should the firm accept if the following criteria are used: (a) net present value (b) profitability index

OR

- Q.3 (a)** The following is the Simonsø company ltd as on 31st March current year **07**
- | | |
|--|-----------------|
| Equity share: 10,000 shares (of Rs 100 each) | Rs 10,00,000 |
| 12% Preference shares (of Rs 100 each) | 4,00,000 |
| 10% Debentures | <u>6,00,000</u> |
| | 20,00,000 |

The market price of the company's share is Rs 110 and it is expected that a dividend of Rs 10 per share would be declared at the end of the current year. The dividend growth rate is 6 per cent.

If the company is in the 35 per cent tax bracket, compute the weighted average cost of capital based on book value weights and market value weights.

- (b)** Define cost of capital. Explain its significance in financial decision making. **07**

- Q.4 (a)** Consider the following information for Strong Ltd: (*Rs in lakh*) **07**
- | | |
|------------|------|
| EBIT | 1120 |
| EBT | 320 |
| Fixed Cost | 700 |
- Calculate percentage in EPS if sales increases by 5 percent.
- (b)** Write an explanatory note on private placement and preferential allotment **07**

OR

- Q.4 (a)** The following information is available for two firms, Anil Corporation and Sunil Corporation. **07**

	Anil	Sunil
Net operating income	Rs.3,200,000	Rs.3,200,000
Interest on debt	Nil	Rs. 4,80,000
Cost of equity	16%	16%
Cost of debt	12%	

Calculate the market value of equity, market value of debt, and market value of the firm for Anil Corporation and Sunil Corporation. What is the average cost of capital for each of the firms?

- Q.4 (b)** Companies U and L are identical in every respect except that the former does not use debt in its capital structure, while the latter employs Rs. 6 lakh of 15 per cent debt. Assuming that all the assumptions are met, the corporate tax rate is 35 per cent, The EBIT is Rs. 2,00,000 and the equity capitalization rate of the unlevered company is 20 percent, what will be the value of the firms, U and L? Also determine the weighted average cost of capital for both the firms. **07**

- Q.5 (a)** X Ltd. has 8 lakh equity shares outstanding at the beginning of the current year. The current market price per share is Rs. 120. The Board of directors of the company is contemplating Rs. 6.4 per share as dividend. The rate of capitalization, appropriate to the risk-class to which the company belongs, is 9.6 per cent. **07**

(i) Based on M-M approach, calculate the market price of the share of the company, when the dividend is- (a) declared and (b) not declared.

(ii) How many new shares are to be issued by the company, if the company desires to fund an investment budget of Rs. 3.20 crore by the end of the year assuming net income for the year will be Rs. 1.60 crore?

- (b)** What is meant by buyback of shares? What are its effects? **07**

OR

- Q.5 (a)** The EPS of a company is Rs. 16. The market capitalization rate applicable to the company is 12.5 per cent. Retained earnings can be employed to yield a return of 10 per cent. The company is considering a pay-out of 25 per cent, 50 per cent and 75 per cent. Which of these would maximize the wealth of shareholders as per Walter's model? **07**

- (b)** What are the different pay out methods? How do shareholders react to these methods? **07**
