

GUJARAT TECHNOLOGICAL UNIVERSITY
MBA - SEMESTER-III • EXAMINATION – SUMMER • 2014

Subject Code: 2830201**Date: 29-05-2014****Subject Name: Strategic Financial Management (SFM)****Time: 14:30 pm – 17:30 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)** “Financial Planning identifies advance actions, develops options, forecasts what is likely to happen and provides benchmarks against which future performance may be measured.” Discuss. **07**
- (b)** Discuss in detail the various components of a feasibility study. **07**
- Q.2 (a)** Discuss the advantages and limitations of NPV and IRR. Elaborate on the scenarios under which these two measures give contradictory results. **07**
- (b)** ABC Ltd. is an all equity financed firm. It is thinking of investing in a project that will involve an initial outlay of Rs.20 crores. It is expected that the project will generate FCFs (net of taxes) of Rs. 3 cr. each year over a period of 5 years. The project has a similar business risk as the firm. The firm’s unlevered cost of capital is 16%. ABC is contemplating borrowing Rs. 20 crores at 10% for five years from a financial institute to finance the project. The principal is repayable in four equal annual installments starting from the end of year 2. The firm will have to incur floatation costs of Rs. 20 lakhs to raise debt from the financial institution. The corporate tax rate is 34%. Calculate the project’s Adjusted Present Value. **07**
- OR**
- (b)** A company is evaluating two mutually exclusive projects. Project X will cost Rs. 10,000 now and generate cash flows of Rs. 5000 each year over its life of four years. Project Y will cost Rs. 2500 now and generate cash flows of Rs. 3000 each year over its life of three years. Which project will you select assuming that the cost capital is 10%? **07**
- Q.3 (a)** Discuss Gordon’s basic valuation model. What are the implications of this model? **07**
- (b)** A project involves an outlay of Rs.100,000. Its expected cash flow at the end of the year 1 is Rs. 40,000. Thereafter it decreases every year by Rs. 2000. It has an economic life of 6 years. The certainty equivalent factor is $CEF_t = 1 - 0.05t$. Calculate the net present value of the project if the risk free rate of return is 10%. **07**
- OR**
- Q.3 (a)** Discuss the rationale for share buy-backs. What are the common objections to buy-backs? **07**

- (b) XYZ corporation is considering the risk characteristic of a certain project. The firm has identified that the following factors, with their respective expected values, have bearing on the NPV of the project. 07

Initial Investment	Rs. 30,000
Cost of Capital	10%
Quantity manufactured and sold annually	1400
Price per unit	Rs.30
Variable cost per unit	Rs.20
Fixed Costs	Rs. 3000
Depreciation	Rs. 2000
Tax Rate	50%
Life of the project	5 years
Net Salvage Value	Nil

Assume that the underlying variables can take the values given below:

Underlying Variable	Pessimistic	Optimistic
Quantity manufactured and sold	800	1800
Price per unit	Rs. 20	Rs. 50
Variable cost per unit	Rs. 15	Rs. 40

Calculate the sensitivity of net present value to variations in the quantity manufactured.

- Q.4 (a)** What are the different forms of mergers, acquisitions and restructuring? 07
- (b)** Alpha corporation plans to acquire Beta corporation. The following information is available 07

	Alpha Corporation	Beta Corporation
Total Current earnings, E	Rs. 50 mn	Rs. 20 mn
No. of outstanding shares, S	20 mn	10 mn
Market Price per share, P	Rs. 30	Rs. 20

- i. What is the maximum exchange ratio acceptable to the shareholders of Alpha if the PE ratio of the combined entity is 12 and there is no synergy gain?
- ii. What is the minimum exchange ratio acceptable to the shareholders of Beta if the PE ratio of the combined entity is 11 and there is a synergy benefit of 5%?
- iii. Assuming that there is no synergy gain, at what level of PE multiples will the lines ER_1 and ER_2 intersect?

OR

- Q.4 (a)** What are the various bases on which the exchange ratio in case of a merger is commonly determined in practice? Critically evaluate them. 07

- (b) Black & Company plans to acquire White & Company. The relevant financial details of the two firms prior to the merger announcement are: **07**

	Black & Company	White & Company
Market Price per Share	Rs. 70	Rs.32
Number of outstanding shares	20 million	15 million

The merger is expected to generate gains which have a present value of Rs. 200 million. The exchange ratio agreed to 0.5.

What is the true cost of the merger from the point of view of White & Company?

- Q.5 (a)** Suggest ways and means of integrating financing policies with corporate strategies. **07**

- (b) Alternatives Fuel Limited (AFL) have three ways of producing solar energy that have different composition of costs but identical levels of profit. **07**

These alternatives denoted as A, B and C are have variable costs of 70%, 60% and 50% respectively. The fixed costs of alternatives A, B and C are Rs. 10 lakhs, Rs.20 lakhs and Rs.30 lakhs for targeted levels of sales of Rs. 100 lakhs. Find the operating leverage under the three alternatives.

Assume that AFL has decided on the cost structure B. They have three alternatives for financing the project designated as Plan I, II and III corresponding to debt levels of Rs. 50, 60 and 70 lakhs respectively at a cost of 12%.

Find the degree of financial leverage and the degree of total leverage for each of the three financing plans.

OR

- Q.5 (a)** “Loss of Capital structure flexibility can erode shareholders value.” Discuss. **07**

- (b) New Ventures limited is planning a plantation project costing Rs. 300 crores. It is considering two financing alternatives. Under the first alternative, it can issue shares for Rs. 50 worth Rs. 200 crores and raise remaining Rs. 100 crore at 12%. Under the second alternative, it can issue shares worth Rs. 150 crore again at a price of Rs. 50 per share and raise the remaining Rs.150 crores by loan at 14%. The firm pays 30% tax. **07**

Under the first alternative, it can issue shares for Rs. 50 worth Rs. 200 crores and raise remaining Rs. 100 crore at 12%. Under the second alternative, it can issue shares worth Rs. 150 crore again at a price of Rs. 50 per share and raise the remaining Rs.150 crores by loan at 14%. The firm pays 30% tax.

- i. Establish the EPS and EBIT relationship under the two financing plans.
- ii. What would be your recommendation if you are confident that the firm will achieve a return on asset of a) 12.5% and b) 17.5%?
- iii. At what level of EBIT, the two financing alternatives are indifferent to EPS?
