Seat No.: __________ Enrolment No.____________

GUJARAT TECHNOLOGICAL UNIVERSITY

MBA Semester –II Examination Dec. - 2011

Subject code: 820003 **Date: 12/12/2011**

Subject Name: Financial Management

Time: 10.30 am – 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) E Co. is contemplating a debenture issue on the following terms: **07**
Face Value = Rs 100 per debenture
Term to maturity = 7 years
Coupon rate of interest:
1 – 2 years = 8% p.a.
3 – 4 tears = 12% p.a.
5 – 7 years = 15% p.a.
The current market rate of interest on similar debentures is 15% p.a. The company proposes to price the issue so as to yield (compounded) return of 16% p.a. to the investors. Determine the issue price. Assume the redemption on debentures at a premium of 5%.

(b) A real estate firm has rented out one of their apartment for 5 years at an annual rent of Rs. 6,00,000 with the stipulation that rent will increase by 5% in every year. If the firm's required rate of return is 14%, what is the present value of the expected rent? **07**

Q.2 (a) Discuss the various sources of working capital finance. **07**

(b) From the following particulars with respect to a particular item of materials of a manufacturing company, calculate the best quantity to order. **07**

Ordering quantity (Kg)	Price per Kg (Rs)
Less than 250	6.00
250 but less than 800	5.90
800 but less than 2,000	5.80
2,000 but less than 4,000	5.70
4,000 and above	5.60

The annual demand for the material is 4,000 kg. Stock holding costs are 20% of material cost p.a. The delivery cost per order is Rs. 6.00.

OR

(b) The following forecasts have been made for ABC Ltd for the period January to April 2010. **07**

(Rs ‘ 00)

	Jan	Feb	March	April
Sales	75,000	1,05,000	1,80,000	1,05,000
Raw Material	70,000	1,00,000	80,000	85,000
Manufacturing Exps	10,000	20,000	29,000	16,000
Loan Instalment	1,000	11,000	21,000	21,000

Additional Information

(i) All sales are made on credit basis. 2/3 of debtors are collected in the same month and balance in the next month. There is no expected bad debt. The debtors on January 1, 2010 were Rs. 30,00,000.

(ii) The minimum cash balance, the firm must have is estimated to be Rs. 5,00,000, however, the cash balance on January 1 was Rs. 6,50,000.

(iii) Borrowing if any, can be made in multiple of Rs.10,000 only.

Prepare the cash budget for the period of four months. (ignore interest on borrowings)

Q.3 **(a)** A firm whose cost of capital is 10% is considering two mutually exclusive projects X and Y, the details of which are: **07**

	Year	Project X (Rs)	Project Y (Rs)
Cost	0	70,000	70,000
Cash Inflows	1	10,000	50,000
	2	20,000	40,000
	3	30,000	20,000
	4	45,000	10,000
	5	60,000	10,000

Compute the Net present Value at 10%, Profitability Index at 10% and Internal Rate of Return for the two projects and suggest which project should be selected & Why ?

(b) The capital structure of B Ltd. as on 31-03-2007 is as follows: **07**

(Rs. Crores)

Equity Capital 100 lakhs equity shares of Rs 10 each	10
Reserves	2
14%debentures of Rs. 100 each	3

For the year ended 31-03-2007 the company has paid equity dividend at 20%. As the company is a market leader with good future, dividend is likely to grow by 5% every year. The equity shares are now traded at Rs. 80 per share in the stock exchange. Income tax rate applicable to the company is 50%

Required :

(i) The current weighted cost of capital

(ii) The company has plans to raise a further Rs. 5 crores by way of long term loan at 16% interest. When this takes place the market value of the equity shares is expected to fall to Rs. 50 per share. What will be the new weighted average cost of capital of the company?

OR

Q.3 **(a)** K Ltd plans to undertake a project for placing a new product in the market. The company's cut-off rate is 12%. It was estimated that the project would cost Rs. 40,00,000 in plant and machinery in addition to working capital of Rs. 10,00,000 which will be recovered in full when the project's 5 year life is over. **07**

The scrap value of plant and machinery at the end of 5 years was estimated at Rs. 5,00,000. After providing for depreciation on straight line basis, profit after tax were estimated as follows:

Year	**1**	**2**	**3**	**4**	**5**
PAT (Rs)	3,00,000	8,00,000	13,00,000	5,00,000	4,00,000

Evaluate the project under: (i) Payback period method (ii) Average rate of return method, and (iii) Net present value method.

(b) Under what circumstances do the net present value and the internal rate of return method differ? Which method would you prefer and why? **07**

Q.4 **(a)** The balance sheet of W Ltd. is as follow : **07**

Liabilities	**Rs.**	**Assets**	**Rs.**
Equity share capital	60,000	Fixed assets	1,50,000
Retained earnings	20,000	Current Assets	50,000
10% Long Term Debt	80,000		
Current Liabilities	40,000		
	2,00,000		**2,00,000**

The company's Total Assets turnover ratio is 3, its Fixed operating costs are Rs. 1,00,000 and its variable operating cost ratio is 40%. The income-tax rate is 50%. Calculate for the company the different types of leverages given that the face value of the share is Rs. 10.

(b) Briefly explain the factors that influence the planning of the capital structure in practice. **07**

OR

Q.4 **(a)** The capital structure of the P. Ltd. consists of an ordinary share capital of Rs.10,00,000 (shares of Rs. 100 per value) and Rs. 10,00,000 of 10% debentures. The unit sales increased by 20 per cent from 1,00,000 units to 1,20,000 units, the selling price is Rs. 10 per unit, variable costs amount to Rs.6 per unit and fixed expenses amount to Rs. 2,00,000. The income-tax rate is assumed to be 35 per cent. **07**

1) You are required to calculate the following :

(i) The percentage increase in earnings per share.

(ii) The degree of financial leverage at 1,00,000 units and 1,20,000 units.

(iii) The degree of operating leverage at 1,00,000 units and 1,20,000 units.

2) Comment on the behaviour of operating and financial leverage in relation to increase of production from 1,00,000 to 1,20,000 units.

(b) 'A debenture is a long term promissory note for raising loan capital'. Discuss giving features of debenture and its pros and cons. **07**

Q.5 **(a)** D Ltd belongs to a risk class for which the approximate capitalization rate is 10%. It currently has an outstanding 30,000 shares which are selling in market at Rs. 80. The company is expecting a net income of Rs. 4,00,000 and it has a profitable investment proposal that costs Rs. 6,00,000. The company is interested to declare a dividend of Rs. 4 per share at the end of financial year. Show that under M-M hypothesis the payment of dividend does not effect the value of the firm. **07**

(b) What is a stable dividend policy? Give the merits and dangers of stability of dividend. **07**

OR

Q.5 **(a)** Determine the market value of equity shares of the company from the following information: **07**

Earnings of the company = Rs. 5,00,000

Dividend paid = Rs. 3,00,000

Number of shares outstanding = 1,00,000

Price – earning ratio = 8

Rate of return on investment = 15%

Are you satisfied with the current dividend policy of the firm? If not, what should be the optimal dividend payout ratio? Use Walter's model

(b) Critically evaluate the assumptions underlying M-M's dividend irrelevance hypothesis. **07**

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