Seat No.: _____ Enrolment No._____

GUJARAT TECHNOLOGICAL UNIVERSITY

MBA - SEMESTER–II • EXAMINATION – WINTER 2013

Subject Code: 820003 **Date: 26-12-2013**

Subject Name: Financial Management (FM)

Time: 2.30 pm – 5.30 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) A company pays a dividend of Rs 2.00 per share with a growth rate of 7%. The risk free rate is 9% and the market rate of return is 13%. The company has a beta factor of 1.60. However, due to a decision of the finance manager, beta is likely to increase to 1.75. Find out the present as well as likely value of the share after the decision. **07**

(b) Preet Ltd is borrowing Rs 50 lakh for a period of 4 years at interest rate of 15% repayable in equal instalments at the end of each year. Find out the instalment amount, the interest paid each year and total interest paid for the loan. **07**

Q.2 (a) A company plans to manufacture and sell 400 units of a domestic appliance per month at a price of Rs 600 each. The ratio of costs to selling price are as follows: **07**

	(% of selling price)
Raw materials	30%
Packing materials	10%
Direct labour	15%
Direct expense	5%

Fixed overheads are estimated at Rs 4, 32,000 per annum.
The following norms are maintained for inventory management:
Raw materials 30 days
Packing materials 15 days
Finished goods 200 units
Work-in-progress 7 days (Work in progress include with raw material cost at 100% and 50% of wages, overheads and expenses)

Other particulars are given below:
(a) Credit sales represent 80% of total sales and the dealers enjoy 30 working days credit. Balance 20% is cash sales.
(b) Creditors allow 21 working days credit for payment.
(c) Lag in payment of overheads and expenses is 15 working days.
(d) Cash requirements to be 12% of net working capital.
(e) Working days in a year are taken as 300 for budgeting purpose.
Prepare a Working Capital requirement forecast for the budget year.

(b) Define Financial Management and the scope of financial management. What role should the financial manager play in a modern enterprise? **07**

OR

(b) What is an ordinary share? How does it differ from a preference share and debenture? Explain its most important features. **07**

Q.3 (a) The present capital structure of a company is as follows: **07**

	Rs (million)
Equity share (Face value = Rs 10)	240
Reserves	360
11% Preference Share	120
12% Debenture	120
14% Term Loan	360
	1200

Additionally the following information available:

Company's equity beta	1.06
Yield on long term treasury bond	10%
Stock market risk premium	6%
Current ex-dividend equity share price	Rs 15
Current ex-dividend Preference share price	Rs 12
Current ex-dividend Debenture market value Rs 102.50 per	Rs 100
Corporate tax rate	40%

The debenture is redeemable after 3 years and interest paid annually. Ignoring flotation cost, calculate the company's weighted average cost of capital (WACC) by Book Value basis and Market value basis.

(b) 'The conflict in the project choice by using NPV and IRR criterion arises because of skewness in cash flows'. Explain. **07**

OR

Q.3 (a) Zenith Industrial Ltd. is thinking of investing in a project costing Rs. 20 lakhs. The life of the project is five years and the estimated salvage value of the project is zero. Straight line method of charging depreciation is followed. The tax rate is 50%. The expected cash flows before tax are as follows : **07**

Year	1	2	3	4	5
Estimated Cash flow before depreciation and tax (Rs. lakhs)	4	6	8	8	10

You are required to determine the: (i) Payback Period for the investment, (ii) Average Rate of Return on the investment, (iii) Net Present Value at 10% Cost of Capital, (iv) Benefit-Cost Ratio at 10%.

(b) Give meaning of leasing, hire purchase and venture capital. Distinguish between leasing and hire purchase. **07**

Q.4 (a) A firm has sales of Rs. 10, 00,000, variable cost of 70% total costs Rs. 9, 00,000 and debt of Rs 5, 00,000 at 10% rate of interest, and tax rate is 40%. What is the operating, financial, combined leverages and Earning after tax? If the firm wants to double up its earnings before interest and tax (EBIT), how much of a rise in sales would be needed on a percentage basis? **07**

(b) Define Inventory management and explain the various tools and techniques used for inventory management. **07**

OR

Q.4 (a) V Ltd has a present annual sale of 5,000 units at Rs 600 per unit. The variable cost is Rs 400 per unit and fixed cost amount to Rs 3, 00,000 per annum. The present credit period allowed by the company is 1 month. The company is considering a proposal to increase the credit period to 2 months and 3 months and has made the following estimates: **07**

	Existing	Proposed	
Credit policy	1 month	2 month	3 month
Increase in sales	-	15%	30%
% of bad debts	1%	3%	5%

There will be increase in fixed cost by Rs 50,000 on account of increase of sales beyond 25% of present level. The company plans on pre tax return of 20% on investment in receivable. You are required to calculate the most viable credit.

(b) Explain Modigliani & Miller position in capital structure theory contribution and illustrate how the arbitrage mechanism works with the help of an example. **07**

Q.5 (a) Agile Ltd. belongs to a risk class of which the appropriate capitalisation rate is 10%. It currently has 1, 00,000 shares selling at Rs. 100 each. The firm is contemplating declaration of a dividend of Rs.6 per share at the end of the current fiscal year which has just begun. Answer the following questions based on Modigliani and Miller Model and assumption of no taxes: **07**

(i) What will be the price of the shares at the end of the year if a dividend is not declared?
(ii) What will be the price if dividend is declared?
(iii) Assuming that the firm pays dividend, has net income of Rs. 10 lakhs and new investments of Rs. 20 lakhs during the period, how many new shares must be issued?

(b) Explain the essence of Walter's model while stating underlying assumptions of the model. What is Walter's formula for determining market price of shares? **07**

OR

Q.5 (a) Z Co. has a capital structure of 30% debt and 70% equity. The company is considering various investment proposals costing less than Rs 30 Lakhs. The company does not want to disturb its present capital structure. The cost of raising the debt and equity are as follows: **07**

Project Cost	**Cost of Debt**	**Cost of Equity**
Above Rs 5 Lakhs	9%	13%
Above Rs 5 Lakhs and upto Rs 20 Lakhs	10%	14%
Above Rs 20 Lakhs and upto Rs 40 Lakhs	11%	15%
Above Rs 40 Lakhs and upto Rs 1 Crore	12%	15.55%

Assuming the tax rate is 50%, compute the cost of two projects A and B, whose fund requirements are Rs 8 Lakhs and Rs 22 Lakhs respectively. If the project are expected to yield after tax return of 11%, determine under what conditions if would be acceptable.

(b) Describe the traditional view on the optimum capital structure. Compare and contrast this view with the NOI approach and the NI approach. **07**

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