Seat No.: _____ Enrolment No.______

GUJARAT TECHNOLOGICAL UNIVERSITY

MBA. Sem-II Remedial Examination December 2010

Subject code: 820003 **Subject Name: Financial Management**

Date: 20 /12 /2010 **Time: 10.30 am – 01.00 pm**

Total Marks: 70

Instructions:

1. **Attempt all questions.**
2. **Make suitable assumptions wherever necessary.**
3. **Figures to the right indicate full marks.**
4. **Present & Future Value Tables will be provided on request.**

Q.1 (a) Indicate whether the following statements are true or false with valid reason or necessary example: **07**

(1) Much of the theory in corporate finance is based on the assumption that the goal of the firm should be to maximize the profit of its current stakeholders.
(2) Retained Earnings represents a hybrid form of financing – it takes some characteristics of equity and some attributes of debt.
(3) The Modigliani and Miller position (MM) is similar to the net income approach.
(4) The EBIT level at which EPS is same for two alternative financial plans is referred to as the Financial Break Even Point
(5) The radical position argues that a low dividend payout ratio decreases share value.
(6) In a bonus share, the par value per share is reduced and the number of shares is increased.
(7) The Profitability Index of a project is 1 where NPV > 0 and Discounting rate > IRR.

(b) XYZ Bank pays 16% interest and compounds interest quarterly. If one puts Rs.10000 initially into a saving account, how much will it have grown in 8.5 years? **03**

(c) The earnings of a company have been growing at 15% over the past several years and are expected to increase at this rate for the next seven years and thereafter, at 9% in perpetuity. It is currently earning Rs. 4 per share and paying Rs. 2 per dividend. What shall be the present value of the share with a discount rate of 12% for the first seven years and 10% thereafter? **04**

Q.2 (a) A proforma cost sheet of a company provides the following particulars: **07**

Raw Material	Rs. 80 per unit
Direct Labour	Rs. 30 per unit
Overheads	Rs. 60 per unit
Total Cost	Rs.170 per unit
Profit	Rs. 30 per unit
Selling Price	Rs.200 per unit

The following further particulars are available:

(i) Raw material in stock, on an average one month, materials in process, on average half a month, finished goods in stock, on an average one month.

(ii) Credit allowed by suppliers is one month, credit allowed to debtors is two months, lag in payment of wages is one and a half weeks, lag in payment of overhead expenses is one month, one-fourth of the output is sold against cash, cash in hand and at bank is expected to be Rs. 25000.

You are required to prepare a statement showing working capital needed to finance a level of activity of 1,04,000 units of production. You may assume that production is carried evenly throughout the year, and wages and overheads accrue similarly.

(b) D-Mart Company has current sales of Rs. 30 crore. To push up sales, the company is considering a more liberal credit policy. The current average collection period of the company is 25 days. If the collection period is extended, sales increase in the following manner: **07**

Credit Policy	Increase in Collection Period	Increase in Sales (Rs. in Lakhs)
Option I	15 days	12
Option II	35 days	27

The company is selling its product at Rs. 10 each. Average cost per unit at the current level is Rs. 8 and variable cost per unit Rs. 6. If the company required a return of 12% on its investment, which credit policy is desirable? (Assume a 360-day year)

OR

(b) A firm's estimated demand for a material during the next year is 2500 units. Acquisition costs are Rs. 400 per order and carrying cost is Rs. 50 per unit. The safety stock is set at 25%of the EOQ. The daily usage is 10 units and lead time is 10 days. Determine (a) the EOQ, (b) the safety stock, and (c) the reorder point. **07**

Q.3 **(a)** For Projects X and Y, the following cash flows are given: **07**

Year	Project X (Cash Flows)	Project Y (Cash Flows)
0	-750	-750
1	+350	+250
2	+350	+250
3	+159	+460

Calculate the Net Present Value (NPV) of each project for discount rate @10%.
Calculate the Internal Rate of Return (IRR) of each project.

(b) A firm has 80,00,000 ordinary shares outstanding. The current market price is Rs. 25 and the book value is Rs.18 per share. The firm's earnings per share is Rs. 3.60 and dividend per share is Rs. 1.44. How much is the growth rate assuming that the past performance will continue? Calculate the cost of equity capital. **07**

OR

Q.3 **(a)** The BBC Company is evaluating a project, which will cost Rs. 100000 and will have no salvage value at the end of its 5-year life. The project will save costs of Rs. 40000 a year. If the firm's tax rate is 50% and the after-tax cost of capital is 18%, what is the Net Present Value (NPV) of the project? Assume straight-line depreciation for tax purposes. **07**

(b) The K&J Company has two alternative investment projects, A and B. A, short lived project, will cost Rs. 150000 initially and involve annual operating cash expenses of Rs. 40000 for 4 years, B, on the other hand, will cost Rs. 200000 and involve annual operating expenses of Rs. 25000 for 7 years. Projects have no salvage value. The discount rate is 12% Which project do you recommend? **07**

Q.4 **(a)** Venus is a large manufacturing organization in the private sector, In 2009, the company has a gross sales of Rs. 980.2 crore, Net worth – Rs. 152.31 crore, Borrowing – Rs. 165.47 crore, EBIT- Rs. 43.17 crore, Interest – Rs 34.39 crore and Fixed cost (excluding interest) – Rs. 118.23 crore. You are required to calculate (1) Debt/Equity Ratio (2) Operating Leverage (3) Financial Leverage (4) Combined Leverage and (5) Interest coverage Ratio. Interpret your results and comment on the Venus's debt policy. **07**

(b) Write Notes on: **07**

(i) Features of Venture Capital
(ii) Private Placement

OR

Q.4 **(a)** Write Notes on: **07**
(i) Leveraged Lease
(ii) Factoring

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

Q.5 **(a)** A company earns Rs. 10 per share at an internal rate of 15%. The firm has a policy of paying 40% of earning as dividends. If the required rate of return is 10%, determine the price of the share under (i) Walter's Model and (ii) Gorden's Model. **07**

(b) Explain a stock split? Why is it used? How does it differ from a bonus shares? **07**

OR

Q.5 **(a)** The shares of Firm A and Firm B have identical risk. Both have an after-tax required rate of return of 15%. Firm A pays no dividend, while Firm B is a high dividend paying firm. The price of Firm A's share is expected to be Rs. 60 after one year and the price of Firm B Rs. 50 with Rs. 10 dividend per share. Assume that the income tax rate is 40% and capital gain tax rate is 20%. Determine the current price of Firm A's and Firm B's shares. **07**

(b) What is meant by the buyback of shares? What are its effects? Is it really beneficial to the company and shareholders? **07**

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