Seat No.: ________ Enrolment No.___________

# GUJARAT TECHNOLOGICAL UNIVERSITY

**MBA – SEMESTER 03– • EXAMINATION – SUMMER-2018**

**Subject Code: 2830201** **Date:03/05/2018**

**Subject Name: Strategic Financial Management**

**Time: 2:30 PM To 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. No. | Question Text and Option | Marks |
|---|---|---|
| **Q.1 (a)** | While defining the cash flows on the investment side, interest cost is not considered because: | **6** |

1. While defining the cash flows on the investment side, interest cost is not considered because:

| | | | |
|---|---|---|---|
| A. | It is a proxy to the rate of return | B | Historical interest rates have no relevance |
| C. | It is included in the cost of capital | D | None of the above |

2. Which one of the following can have effect on the market price of stocks?

| | | | |
|---|---|---|---|
| A. | Current earnings | B. | Growth prospects |
| C. | Risk | D | All of the above |

3 Cost of retained earnings is

| | | | |
|---|---|---|---|
| A. | Nil | B. | Nearly equal to cost of preference share |
| C. | Nearly equal to cost of equity | D. | Nearly equal to average cost of debt |

4. The main aim of finance management is to increase

| | | | |
|---|---|---|---|
| A. | Sales revenue | B. | Shareholders' Wealth |
| C. | Market Share | D. | Profit |

5. Setting up an entirely new project which is not concerned with the existing business is known as

| | | | |
|---|---|---|---|
| A. | Forward integration | B | Backward integration |
| C. | Diversification | D | Expansion |

Which of the following can be a motivator for share buy backs?

| | | | | |
|---|---|---|---|---|
| 6. | A. | Price stability | B. | Idle cash |
| | C. | Tax advantage | D. | All of the above |

**Q.1** **(b)** 1. Economic Value Added **04**
2. Financial Break Even Point
3. Poison Pill
4. Risk Adjusted Discount Rate

**Q.1** **(c)** Write a short note on Agency Theory. **04**

**Q.2** **(a)** Briefly explain determinants of dividend policy. **07**

**(b)** Acqua Limited is a company listed at the stock exchange and the current market price of its share is Rs 200. The earnings and dividends of the company are growing at 10% every year. The last dividend paid by the company was Rs 12. The beta of the firm is 1.2. The risk free rate is 6% and the expected market return is 16%. Find out the cost of equity of Acqua Limited using Dividend Growth Model and CAPM. **07**

**OR**

**(b)** What is Feasibility Study? If Apple wants to start new project in Gujarat then which components you study under your Feasibility Report? **07**

**Q.3** **(a)** Define industrial sickness. What are the factor causing industrial sicknesses? **07**

**(b)** Delta Ltd.is all equity financed company having three projects on hand i.e. Project A, B and C with $Rf = 9\%$ and $Rm = 14\%$ Using following information you are required to calculate (i) Expected Rate of Return of the Company (ii) The Weighted Average Cost of Capital of the Company. The following are project beta and project weights **07**

Project Beta
Project A =1.2
Project B = 0.9
Project C = 1.5

Project weight:
Project A = 0.4
Project B = 0.3
Project C = 0.3

**OR**

**Q.3** **(a)** Describe the decision tree approach with the help of an example. How is this technique useful in capital budgeting? **07**

**(b)** Alpha Limited is considering investing in two mutually exclusive projects. The expected cash flows and the associated certainty equivalents for each projects are as follows **07**

| | Project 1 | | Project 2 | |
|---|---|---|---|---|
| Year | Cashflow | Certainty Equivalents | Cashflow | Certainty Equivalent s |
| 0 | -60000 | 1 | -80000 | 1 |
| 1 | 30000 | 0.95 | 50000 | 0.9 |
| 2 | 30000 | 0.85 | 40000 | 0.8 |
| 3 | 20000 | 0.70 | 30000 | 0.7 |
| 4 | 20000 | 0.65 | 20000 | 0.6 |

The risk free rate of return is 5 per cent. Which project should be selected?

**Q.4** **(a)** Explain the terms bonus shares and stock split. What is the rationale for companies to go for either? **07**

**(b)** The following information is given about Two Firms A and B which are in the same type of business. Firm A has financed all operations by Equity whereas Firm B has used Equity and Debt 50 per cent each. Other parameters for both the firms are as follows: **07**

Sales Revenue: Rs 1 Crore
Selling Price: Rs 160
Unit Variable Cost: Rs 100
Fixed Costs: Rs 25,00,000
Interest on Debt of Firm B: Rs 2,50,000
From this information you are required to calculate Degree of Operating Leverage, Degree of Financial Leverage and Degree of Total Leverage for both the Firms.

**OR**

**Q.4** **(a)** Shaping an appropriate capital structure is considered one of the most important roles of a finance manager. According to you what factors a finance manager must consider while deciding capital structure of a firm? **07**

**(b)** What is Market Value Added?(MVA). Find the MVA in following two situations **07**
1) Equity Market capitalization= Rs 3400 Crore; Equity share capital= Rs 2000 Crore and Retained Earnings= Rs 600 Crore
2) Equity Market capitalization= Rs 900 Crore; Equity share capital= Rs 1200 Crore and Accumulated losses= Rs 200 Crore

**Q.5** Biochem company has currently an ordinary share capital of Rs. 25 Lakhs, consisting of 25,000 equity shares of Rs. 100 each. The management is planning to raise another Rs. 20 Lakhs to finance a major programme of expansion through one of four possible financial plans. The options are: **14**

1) Entire through ordinary shares
2) Rs. 10 Lakhs through ordinary share and Rs. 10 Lakhs through long term borrowings at 8% p.a.
3) Rs. 5 Lakhs through ordinary share and Rs. 15 Lakhs through long term borrowings at 9% p.a.
4) Rs. 10 Lakhs through ordinary shares and Rs. 10 Lakhs through preference shares with 5% dividend

The company's expected EBIT will be Rs. 8,00,000. Assuming a corporate tax rate of 50%, determine the EPS in each alternative and also comment on the implications of Financial Leverage

**OR**

**Q.5** Fun Foods is a growing confectionary firm. The following is the present capital structure of the firm **14**

| Particulars | Amount (Rs in Lacs) |
|---|---|
| Equity shares of Rs 100 each | 20 |
| Retained Earnings | 10 |
| 9% Preference Shares | 12 |
| 7% Debentures | 8 |
| Total | 50 |

The Company's EBIT is at the rate of 12 percent on its capital employed which will remain unchanged after expansion. The expansion involves additional financing of Rs 25 lacs for which the following alternatives are available to it.

(i) Alternative 1: Issue 20,000 equity shares at a premium of Rs 25 per share
(ii) Alternative 2: Issue 10% preference shares
(iii) Alternative 3: Issue 8% Debentures

It is estimated that the P/E Ratio in case of equity shares, preference shares and debentures financing would be 15, 12 and 10 respectively. The tax rate is 35 per cent.

The owner of the company Mr Punj is in dilemma regarding which plan of financing he should select.

However, he is sure that his goal is to select the plan in which MPS (Market Price Per Share) is the highest. He has consulted you and asked you to calculate MPS under each of these three plans and suggest him which plan should be chosen.

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