Seat No.: ________ Enrolment No.___________

GUJARAT TECHNOLOGICAL UNIVERSITY

MBA - SEMESTER–III • EXAMINATION – SUMMER • 2015

Subject Code: 2830201 Date: 01-06-2015

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)** A particular project has a four-year life with yearly projected net profit of Rs. 10,000 after charging yearly Depreciation of Rs. 8,000 in order to write-off the capital cost of Rs. 32,000. Out of the Capital cost Rs. 20,000 is payable immediately (Year 0) and balance in the next year (which will be the Year 1 for evaluation). Stock amounting to Rs. 6,000 (to be invested in Year 0) will be required throughout the project and for Debtors a further sum of Rs. 8,000 will have to be invested in Year 1. The working capital will be recouped in Year 5. **7**

It is expected that the machinery will fetch a residual value of Rs. 2,000 at the end of 4th year. Income Tax is payable @ 40% and the Depreciation equals the taxation writting down allowances of 25% per annum. Income Tax is paid after 9 months after the end of the year when profit is made. The residual value of Rs. 2,000 will also bear Tax @ 40%. Although the project is for 4 years, for computation of Tax and realisation of working capital, the computation will be required up to 5 years.

Taking Discount factor of 10%, calculate NPV of the project and give your comments regarding its acceptability.

(NPV Factors @ 10% - Year 1-0.9091; Yr. 2-0.8264; Yr. 3-0.7513; Yr. 4-0.6830; Yr. 5-0.6209).

(b) ABC Ltd. wants to raise Rs. 5, 00,000 as additional capital. It has two mutually exclusive alternative financial plans. The current EBIT is Rs. 17, 00,000 which is likely to remain unchanged. The relevant Information is – **7**

Present Capital Structure: 3,00,000 Equity shares of Rs. 10 each and 10% Bonds of Rs. 20,00,000.

Tax Rate:	50%
Current EBIT:	Rs. 17,00,000
Current EPS:	Rs. 2.50
Current Market Price:	Rs. 25 per share
Financial Plan I:	20,000 Equity Shares at Rs. 25 per share.
Financial Plan II:	12% Debentures of Rs. 5, 00,000.

What is the indifference level of EBIT? Identify the financial break-even levels.

Q 2 **(a)** Determine the interface of financial policy with corporate strategic management. **7**

(b) What is Feasibility Study? If Maruti wants to start new project in Gujarat then which components you study under your Feasibility Report? **7**

OR

(b) What are the invisible walls in project estimating? **7**

Q 3 **(a)** A firm is considering two investment projects, project A requires a net cash outlay of Rs. 6,000; B requires Rs. 5,000. Both projects have an estimated life of 3 years. The net cash inflows have been estimated as: For project A, year 1, a 0.40 chance of Rs. 2,000 and a 0.60 chance of Rs. 3,000; year 2, a 0.30 chance of Rs. 4,000 and a 0.70 chance of Rs. 2,000; year 3, a 0.50 chance of Rs. 3,000 and a 0.50 chance of Rs. 2,200; For project B, year 1, a 0.30 chance of Rs. 1,000 and a 0.70 chance of Rs. 2,000; year 2, a 0.20 chance of Rs. 2,000 and a 0.80 chance of Rs. 1,000; year 3, a 0.40 chance of Rs. 2,000 and a 0.60 chance of Rs. 4,000. Assume a 10 percent discount rate. Which project should be accepted and why? **7**

(NPV Factors @ 10% - Year 1-0.9091; Yr. 2-0.8264; Yr. 3-0.7513)

(b) "The certainty equivalent approach is theoretically superior to the risk adjusted discount rate." Do you agree? Give reasons. **7**

OR

Q 3 **(a)** Project X & Project Y has similar life and yield. The initial investment is Rs.80 lakhs each. Both the projects are new business model and hence cash flow cannot be accurately projected. The probability distributions for the first year for both the projects are given below and are expected to be same for the entire tenure of the projects. **7**

Project X		Project Y	
Cash flow (Rs.Lakhs)	Probability	Cash flow Rs. Lakhs)	Probability
12	0.10	8	0.10
14	0.20	12	0.25
16	0.40	16	0.30
18	0.20	20	0.25
20	0.10	24	0.10

Decide which projected to be selected using coefficient of variation.

(b) Describe the decision tree approach with the help of an example. How is this technique useful in capital budgeting? **7**

Q 4 **(a)** The following details relating to a company are given: **7**

Sales per annum	1,00,000 units
Variable Cost	Rs. 90 per unit
Fixed Cost including interest per annum	Rs. 18,00,000
P/V ratio	25%
10% Debentures	Rs. 30,00,000
Equity Share capital (shares of Rs. 10 each)	Rs. 40,00,000
Corporate Tax Rate	30%

Calculate:
(i) Operating Leverage
(ii) Financial Leverage
(iii) Combined Leverage
(iv) Earnings per share

Q 4 **(b)** Differentiate between 'Restructuring' and 'Financial reorganization' of the company. What steps are taken in pursuing financial reorganization of a company? **7**

OR

Q 4 **(a)** Preet Ltd. provides you the following detail, you are requested to find the value of equity share of the company: **7**

2,000, 9% Preference Share of Rs. 100 each	Rs. 2,00,000

50,000 Equity Share of Rs. 10 each, Rs. 8 per share paid up	Rs. 4,00,000
Expected profit per year before tax	Rs. 2,18,000
Rate of tax	40%
Transfer to General Reserve every year	20% of profit
Normal Rate of earning	15%

Q 4 **(b)** Define 'sick industry company'. What are the factor causing industrial sicknesses? **7**

Q 5 **(a)** The Beta Co-efficient of Target Ltd. is 1.4. The company has been maintaining 8% rate of growth in dividends and earnings. The last dividend paid was Rs. 4 per share. Return on Government securities is 10%. Return on market portfolio is 15%. The current market price of one share of Target Ltd. is Rs. 36. **7**

(i) What will be the equilibrium price per share of Target Ltd.?

(ii) Would you advise purchasing the share?

Q 5 **(b)** "Bonus shares represent simply a division of corporate pie into a large number of pieces" Discuss. **7**

OR

Q 5 **(a)** XL Limited provides you with following figures: **7**

	Rs
Profit	2,60,000
Less: Interest on Debentures @ 12%	60,000
	2,00,000
Income tax @ 50%	1,00,000
Profit after tax	**1,00,000**
Number of Equity shares (of Rs.10 each)	40,000
EPS (Earning per share)	2.50
Ruling price in market	25
PE Ratio (i.e. Price/EPS)	10

The Company has undistributed reserves of Rs. 6, 00,000. The company needs Rs 2, 00,000 for expansion. This amount will earn at the same rate as funds already employed. You are informed that a debt equity ratio Debt/ (Debt+ Equity) more than 35% will push the P/E Ratio down to 8 and raise the interest rate on additional amount borrowed to 14%. You are required to ascertain the probable price of the share.

i) If the additional funds are raised as debt; and

ii) If the amount is raised by issuing equity shares.

Q 5 **(a)** How can the effect of profitability on designing an appropriate capital structure be analysed? Illustrate your answer with help of EBIT – EPS analysis. **7**

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