Seat No.: ________ Enrolment No.___________

GUJARAT TECHNOLOGICAL UNIVERSITY

MBA – SEMESTER 3– • EXAMINATION – WINTER 2016

Subject Code: 2830201 **Date: 03/01/2017**
Subject Name: Strategic Financial Management (SFM)
Time: 02:30 pm to 05:30 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) **6**

1. The contractor takes complete responsibility to construct, erect, commission and supply the plant and keep it ready to operate by owner in :
   A. LROT contract B. BOT Contract
   C. BOO Contract D. EPC Contract
2. SGR cannot be achieved in one of the following ways, without increase in further equity:
   A. Increase in profit Margin B. Increase in net worth of the firm
   C. Decrease in proportion of assets to sales D Increase in debt component proportionate to equity
3. The price of a company's Share has risen from Rs. 10 to Rs. 400. Small Investors are complaining that this is affecting their ability to buy shares in the company. Which one of the following might overcome the problem?
   A. A Share Buy back B. A Share Split
   C. Issuing new Stock option D. A Share Consolidation
4. A Dividend policy of the firm and his market price of share is determined by :
   A. Earnings Per Share B. Dividend yield
   C. Price Earnings Ratio D. Book value
5. Ruby ltd. is to pay dividend of Rs. 2.15 at the end of the year and is expected to grow at 11.2% per year forever. If the required rate of return on the company's stock is 15.2% p.a., its intrinsic value will be:
   A. Rs. 59.77 B. Rs. 53.75
   C. Rs. 52.50 D. Rs. 50.50
6. If greater the risk associated with receiving of future economic benefit, the _______________ discount rate is adopted.
   A. Lower B. Normal
   C. Higher D. Positive

Q.1 (b) Define the following terms **04**

(a) LOB (Line of Balance)
(b) LLP
(c) SGR (Sustainable Growth Rate)
(d) P/ E ratio and Earning yield

Q.1 (c) Explain: Gordan Model of Dividend Theory. **04**

Q.2 **(a)** The Balance sheet of Hindustan Ltd. As on March 31, 2010 is as follows: **07**

Liabilities	**Rs. Lakhs**	**assets**	**Rs lakhs**
Share capital	200	Fixed assets	500
Reserves	140	Inventories	300
Long term loans	360	Receivables	240
Short term loans	200	Cash and bank	60
Payables	120		
Provisions	80		
Total	**1100**	**total**	**1100**

Sales for the year were Rs. 600 lakhs. For the year ending on 31 March 2011 sales are expected to increase by 20%. The profit margin and dividend payout ratio are expected to be 4% & 50% respectively. You are required to :

(I) Quantify the amount of external fund required.

(II) Determine the mode of raising fund given the following parameters:
(a) Current ratio should at-least be 1.33
(b) Ratio of fixed assets to Long term loans should be 1.5
(c) Long term debt to equity ratio should not exceed 1.05

Note: Assume assets will increase pari pasu with sales.

(b) One of the MNC of Germany wants to establish the Project in Gujarat state. Guide them about various steps involved in setting up of a Project and discuss any five steps in detail. 07

OR

(b) What do you mean by Strategic Financial Management? Discuss the steps involved in Financial Planning Process. 07

Q.3 **(a)** The XYZ Ltd. has to make a choice between debt issue and equity issue for its expansion programme. It current position is as under: **07**

Equity Capital (Rs. 10 per share)	50000
Long term Debenture @ 5%	20000
Reserve and Surpluses	30000
Total Capitalisation	100000
Sales	300000
Total Costs	269000
Income before interest and taxes	31000
Interest	1000
Earnings before taxes	30000
Income Tax	10500
Income after taxes	19500

The expansion programme is estimated to cost Rs. 50000. If this is financed through debt, the rate of interest on new debt will be 7% and the price earnings ratio will be 6. If the expansion programme is financed through equity, new shares can be sold netting Rs. 25 per share; and the price earnings ratio will be 7. The expansion will generate additional sales of Rs. 1,50,000 with return of 10% on sales before interest and taxes. If the company is to follow a policy of maximizing the market value of its shares, which form of financing it choose?

(b) What is meant by leverage analysis? What are different type of leverage associated with business and how it effect to business? Why must the finance manager keep in mind the degree of Financial leverage in evaluating various financing plans? **07**

OR

Q.3 **(a)** India Ltd. has 50000 equity shares of Rs. 10 each outstanding on 1st January. The shares are currently quoted at par in the market. The Company now intends to pay dividend of Rs. 2 per share for the current calendar year. It belongs to a risk class whose appropriate capitalization rate is 15 %. Using Modigliani- Miller Model and assuming no taxes, ascertain the price of the company's share at it is likely to prevail at the end of the year (a) when dividend is declared and (b) when dividend is not declared. (c) Also find out the number of new equity shares that the company must issue to meet its investment needs of Rs. 2,00,000, assuming net income of Rs. 1,10,000 and also assume that dividend is paid. **07**

(b) The following information is supplied to you about a company. 07

Earning of the company	Rs. 15,00,000
Dividend paid	Rs. 5,00,000
Number of issued shares	1,00,000
Price earnings ratio	10
Rate of Return on investment (%)	15

(i)Determine the theoretical market price of the share.

(II) Are you satisfied with the current dividend policy of the firm? If not what should be the optimal dividend payment ratio in this case? Prove your answer.

Q.4 **(a)** Apple Ltd. Is having an issued and subscribed capital of 5,00,000 equity shares of Rs. 10 Each fully paid up. The Company's after tax profit for the year 2010 amounting to Rs. 28 Lakhs. The Average present stock exchange price of the company's share is Rs. 19. The P/E ratio of the four Listed Companies to be as under, their type of business seems to be similar to permanent magnets Ltd. Are: **07**

Company	20013	2014	2015
Alfa Ltd.	5.7	6.3	7.1
Beta Ltd.	6.5	5.9	6.8
Theta Ltd.	7.4	6.8	7.0
Gama Ltd.	5.0	5.9	6.1

Determine the valuation of the business and value per share based on average P/E ratio of the Industry.

(b) (i) Explain the reasons for the Project Failure **07**
(ii) NOI Approach of capital structure theory is superior to NI Approach of capital Structure theory. Justify.

OR

Q.4 **(a)** The Gujarat Textile Manufacturing Company Ltd. Is Considering one of the two mutually exclusive proposals, Project M and Project N, which requires cash outlay of Rs 8,50,000 and 8,25,000 respectively. The Certainty equivalent approach is used in incorporating risk in capital budgeting decisions. The current yield on government bond is 6% and this is used as risk free rate. The expected net cash **07**

flow and their certainty equivalents are as follows.

Year ended	Project M	Project M	Project N	Project N
	Cash flows (Rs.)	**C. E**	**Cash flows (Rs.)**	**C. E**
1	4,50,000	0.8	4,50,000	0.96
2	5,00,000	0.7	4,50,000	0.8
3	5,00,000	0.5	5,00,000	0.7

Recommend company:
(i) Which project should be accepted?
(ii) If the adjusted discounted rate method is used. Which project would be appraised with a higher rate and why?

(b) The ABC Ltd. has declared dividend during the past five years as follows : **07**

Year	2010	2011	2012	2013	2014
Rate of Dividend (%)	12	14	18	21	24

The average rate of return prevailing in the same industry is 15%. Determine the value per share of Rs. 10 of ABC Ltd. based on Dividend Yield Method.

Q.5 Star Industries Ltd. Is considering the replacement of one of the its moulding machines. The existing machine is in good operating condition, but is smaller than required if the firm is to expand its operations. It is 4 years old, has a current salvage value of Rs. 200000 and remaining life of 6 years. The machine was initially purchased for Rs. 10 lakh and is being depreciated at 20 % on the basis of written down value method. **14**

The new machine will cost Rs. 15 lakh and will be subject to same method as well as same rate of depreciation. It is expected to have a useful life of 6 years, salvage value of Rs. 150000 at the sixth year end. The management anticipates that with the expanded operation, there will be need of an additional net working capital of Rs. 1 lakh. The new machine will allow the firm to expand current operations and thereby increase annual revenue by 500000; variable cost to volume ratio is 30%. Fixed costs (excluding depreciation) are likely to remain unchanged. The corporate tax rate is 35% its cost of capital is 10% .The company has several machines in the block of 20% depreciation.

Give Your recommendation to the company: Should the company replace existing machine? Yes/ No. Justify. Recommend the company.

OR

Q.5 A Omega Manufacturing company is planning to expand its assets by 50%. All Financing for this expansion will come from external sources. The expansion will generate additional sale of the Rs. 3 Lakhs with return of 25% on sales before interest and taxes. The finance department of the company has submitted following plans for the consideration of the board. **14**

Plan 1: Issue of 10% debentures

Plan 2: Issue of 10% debenture for the half the required amount and balance in equity shares to be issued at 25% premium.

Plan 3: Issue of Equity at 25 % Premium

Balance sheet of the Company as on 31st March

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Equity Capital (Rs. 10 per share)	4,00,000	Total Assets	12,00,000
8% Debentures	3,00,000		
Retained Earnings	2,00,000		
Current Liabilities	3,00,000		
	12,00,000		12,00,000

Income statement for the year ending March 31

Sales	19,00,000
Operating Costs	16,00,000
EBIT	3,00,000
Interest	24,000
Earning After Interest	2,76,000
Taxes	96,600
EAT	1,79,400
EPS	4.48

(I) You are required to determine the number of equity shares that will be issues if financial plan 3 is adopted.

(II) Determine the indifference point between (a) Plan 1 and Plan 2 (b) Plan 1 and Plan 3 (Plan 2 and Plan 3

(III) Assume that the price earnings ratio is expected to remain unchanged at 8 if plan 3 is adopted, but is likely to drop to 6 if either plan 1 or plan 2 is used to finance the expansion. Determine the expected market price of the share in each of the situations.

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