

**GUJARAT NATIONAL LAW UNIVERSITY
GANDHINAGAR**

Course: Financial Management
Semester-I (Batch: 2016-18)

MBA End Semester Examination: October-2016

Date: 24th October, 2016

Duration: 3 hours

Max. Marks: 60

Instructions:

- Read the questions properly and write the answers in the given answer book.
- The respective marks for each question are indicated in-line.
- Do not write anything on the question paper.
- Indicate correct question numbers in front of the answers.
- No questions or clarifications can be sought during the exam period, answer as it is, giving reason, if any.
- Use of scientific calculator is permitted.
- Use of present value and future value tables are permitted.

Answer any six of the following questions

Marks

- Q.1 (a) Your Client has a debt of Rs.30,00,000. The rate of interest is 10%. He has the following choices; (5+5=10)

(i) Paying Rs.20,00,000 now and Rs.10,00,000 after 3 years..

(ii) Pay as per the following schedule.

End of Year	1	2	3	4	5
Payment	Rs.12,00,000	Rs.3,00,000	Rs.15,00,000	Rs.5,00,000	Rs.8,00,000

(iii) Rs.8,00,000 at the beginning of each year for next 5 years.

(iv) Rs.8,50,000 at the end of each year for 5 years.

He asks you for a prudent financial advice. Which one will you advise?

- (b) On a fixed deposit of Rs.5,00,000, Punjab National Bank offers you an interest rate of 10% compounded annually. Whereas, Karur Vysya Bank offers 9.9% compounded half yearly, Yes Bank offers a rate of 9.8% compounded monthly and Axis Bank offers a rate of 9.65% compounded continuously. Which offer is financially profitable for you?
- Q.2 (a) A firm is evaluating a proposal with an initial investment of Rs.1,80,000. It is expected to generate cash inflows of Rs.70,000, Rs.50,000, Rs.60,000, Rs.80,000 and Rs.55,000 at the end of each year for the next 5 years. Determine the **Internal Rate of Return (IRR)** of the Proposal. Recommend whether the project should be accepted, if the Cost of Capital (WACC) of the company is 18%. (5+5=10)
(Note: The use of payback method is simply to find a starting point)
- (b) A firm is evaluating a proposal with an initial investment of Rs.2,00,000. It is expected to generate cash inflows of Rs.70,000, Rs.60,000, Rs.50,000, Rs.60,000 and Rs.40,000 at the end of each year for next 5 years. Determine the Net Present Value and Payback Period in terms of discounted cash inflows.
The overall cost of capital of the firm is composed of, in the following manner.

Class	Contribution	Expected Return	Class	Contribution	Expected Return
Equity Shares	40%	15%	Loan from ICICI	10%	09%
Bonds	10%	08%	Debentures	15%	12%

- Q.3 (a) The share capital of a company is Rs.10,00,000 with shares of face value of Rs.10. It has 10% Debt capital of Rs.6,00,000. The sales of the firm is 3,00,000 units per annum at a selling price of Rs.5 per unit and variable cost of Rs.3 per unit. The annual fixed operating costs amount to Rs.2,00,000. The company pays tax at the rate of 30%. If the sales is expected to increase by 20%, determine the following (5+5=10)
- i. Percentage increase in Earning per Share (EPS)
 - ii. Combined Leverage at both the existing and expected level of sales
- (b) A company issued 12% debentures of Rs.1,00,000, redeemable at the end of 5 years. The debentures were issued at 10% premium and will be redeemed at 20% premium. The company incurred expenses of Rs.10,000 for obtaining credit rating and Rs.5,000 for legal advice at the time of issue. Determine the Cost of Debt if tax rate prevalent is 33%.

- Q.4 A firm presently has Rs.1,00,000 of fixed capital requirement and market value. It is currently fully financed by equity. The current cost of equity is 10%. The Return on Investment is also 10% fixed for all times. However, it is interested to use debt as the prevailing market conditions are favorable. The firm is interested to try combinations of 30%, 60% and 80% debt and remaining equity respectively. The cost of debt is 8%. Examine the value of the firm under Net Income Approach and Net Operating Income Approach. (10)

In the same firm, the following changes are expected in the cost of equity and cost of debt as a response to change in debt equity ratio.

Debt/Equity Ratio	(Current Cost of Equity- 10%) Expected Cost of Equity (k_e)	(Current Cost of Debt- 8%) Expected Cost of Debt (k_d)
30/70	10%	08%
60/40	12%	09%
80/20	15%	12%
100/0	18%	14%

Examine the value of the firm under traditional approach for combinations of debt and equity of 30/70, 80/20 and 100/0.

- Q.5 M/s Jovi Ltd. has reported an Earning per Share (EPS) of Rs.20 which is likely to remain constant for over a year. Its cost of equity capital (k_e) will also remain constant at 10% over the year. Find out the market price of the share of M/s Jovi Ltd. under different rates of return (r), of 8%, 10% and 12%, and different payout ratios of 20%, 40% and 60% under both Walter's model and Gordon's model of dividend relevance. (10)

- Q.6 (a) The following forecast is made about a proposal which is being evaluated by a firm. (5+5=10)

Initial Investment	Rs.60,000
Cash Inflows (annual)	Rs.15,000
Life of the project	6 years
Return presently Expected by the Investors	12%

Analyze sensitivity (how much percentage rise/fall will push the project into zero NPV) of different variables such as **Initial Investment**, **Annual Cash Inflows** and **Discount Rate** with respect to the NPV of the proposal.

- (b) A company is considering two equal size projects involving equal investment with an equal life span of one year each. Determine Standard Deviation and Co-efficient of Variation of both the projects and analyze the **risk profile** of both the projects.

A		B	
Cash Flows (Rs.)	Probability (%)	Cash Flows (Rs.)	Probability (%)
10,000	20	13,000	10
12,000	10	14,000	20
18,000	30	17,000	30
16,000	30	11,000	10
14,000	10	9,000	30

- Q.7 Discuss both propositions of Modigliani and Miller (MM) approach of irrelevance of capital structure. (10)

- Q.8 Write short notes on the following. (5x2=10)

- Risk Adjusted Discount Rate
- Certainty Equivalent
- Annuity Due
- Cost of Perpetual Debt
- Degree of Financial Leverage
