GUJARAT NATIONAL LAW UNIVERSITY
GANDHINAGAR

Course: **Financial Management**
Semester-V (Batch: 2013-18)

End Semester Examination: Oct-Nov. 2015

Date: 30th October, 2015
Duration: 3 hours **Max. Marks: 50**

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 any thing on the question paper.
- 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, Calculator in Mobile Phone is not allowed.**

Part-A

Marks

Q.1 Balance sheet of X-press Ltd. as on March 31, 2015 shows 10 years, 12% Debentures worth Rs.80,00,000. These debentures were issued on 1st April, 2012. The management proposes to create sinking fund, from the financial year 2015-16, to redeem these debentures. The management plans to appropriate the fixed amount at the end of each financial year, and invest the same in the government securities assuring 8% annualized return. (04)

What annual appropriation should be made to accumulate the fund to redeem the debentures? What would be your answer if the appropriation is made in the beginning of each of the financial year from 2015-16 onwards?

Q.2 (a) "Finance function is concerned with the allocation of funds to specific assets and obtaining the best mix of financing in relation to overall valuation of the firm" Discuss. (4+2= 06)

(b) Current market price of a company's share is Rs. 200. The expected dividend per share for the next year is Rs. 18. The company's payout ratio is 30 per cent and internal rate of return is 5 per cent.
What is the company's cost of equity?

Part-B

Answer **any four** of the following questions

Q.3 (a) Saral Ltd. wishes to determine the weighted average cost of capital for evaluating a new project proposal. You have been supplied with the following information: (06)

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Equity Shares Capital	12,50,000	Fixed Assets	25,00,000
Retained Earnings	4,50,000	Current Assets	15,00,000
Pref. Share Capital	4,50,000		
Debentures	9,00,000		
Current Liabilities	9,50,000		
	40,00,000		40,00,000

The company while maintaining its present capital structure, wishes to issue the following additional securities for raising its finance.

i. 20 years, 14% debentures of Rs. 2500 face value at par, redeemable at 5 % premium. Floatation cost will be 2 %.
ii. 15 % preference shares: Sale price Rs. 100 per share, 2 % floatation cost.
iii. Equity shares: Sale price Rs. 115 per share, floatation cost Rs. 5 per share.

The corporate tax rate is @ 35%, The expected dividend at the end of the current financial year is Rs. 11 per share and expected to grow @ 8% every year. Calculate WACC.

(b) Fame Ltd. wants to maintain a minimum cash balance of Rs.100,000. The estimated standard deviation of the daily cash flows is Rs.1000. The cost for each transaction of buying and selling marketable securities is fixed at Rs.70. The annual interest rate on marketable securities is 24%. Using the Miller-Orr model of cash management, formulate the company's cash management policy. (04)

Q.4 A large FMCG company is considering acquiring a small company for integration. The following is the financial data of target companies. (10)

(Rs. in Lacs)

Particulars	Alfa Ltd.	Beta Ltd.
Sales	325.95	325.95
Variable Cost	130.38	107.55
Contribution	195.57	218.40
Fixed Cost	158.07	184.20
EBIT	37.50	34.20
Interest	27.81	20.85
PBT	9.69	13.35
Tax @ 35 %	3.39	4.68
PAT	6.30	8.67
Total Assets	278.10	278.10
Equity	92.70	139.05
Debt	185.40	139.05

Determine Operating, Financial and Combined Leverage of both the firms. What would be the effect on company's profitability and risk if sales fluctuate by 10%? If the decision is to be based on the risk profiles, and the acquirer company wants to choose a less risky firm, which one should it acquire?

Q.5 (a) Discuss Modigliani & Miller approach of Dividend Irrelevance. (5+5=10)
(b) Write a note on "present value of annuity due". Also show the formulae for calculation.

Q.6 Reserve 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 12% over the year. Determine and interpret the market price of the share of Reserve Ltd. under different combinations of rates of return (r) and different payout ratios under both Walter's model and Gordon's model of dividend relevance as shown in the table. (10)

Rate of Return (r) / Model	10%	15%
Walter's (Payout Ratios)	20/80	20/80
	50/50	50/50
	80/20	80/20
Gordon's (Payout Ratios)	20/80	20/80
	50/50	50/50
	80/20	80/20

Q.7 A firm presently has Rs.2,00,000 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 favourable. 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%	8%
60/40	13%	10%
80/20	15%	12%
100/0	18%	14%

Examine the value of the firm under traditional approach for combinations of debt and equity of 60/40, 80/20 and 100/0.

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