P P SAVANI UNIVERSITY

Second Semester of MBA Examination

May 2022

SLMB7140 Financial Management

27.05.2022, Friday **Time: 09:00 a.m. To 11:30 a.m.** **Maximum Marks: 60**

Instructions:

1. The question paper comprises of two sections.
2. Section I and II must be attempted in same answer sheet.
3. Use of scientific calculator is **NOT** allowed.

SECTION – I

Q – 1 Attempt **ANY TWO (2x5)** **[10]**

(i) Explain the Objectives and significance of Financial Management.

(ii) Role of Finance Manager – discuss briefly.

(iii) "Cost of equity capital and cost of retained earnings are same" – Evaluate this statement.

Q – 2 The kesari engineering ltd. has the following cap. Structure, considered to be optimum on 30-6-21. **[10]**

14% Debentures	Rs. 937500
10% Preference Shares	Rs. 312500
Ordinary Equity	Rs. 3750000
Total	Rs. 5000000

The company has 150000 shares outstanding. The share is selling for Rs.25 per share and the expected div. per share is Rs.1.50 which is expected to grow at 10%.

The company is contemplating to raise additional funds Rs.10 lakhs to finance expansion. It can sell new pref. shares at a price of Rs.23, less floatation cost of Rs.3 per share. It is expected that a div. of Rs.2 per share will be paid on pref.; the new debt can be issued at 17% interest. The firm pays taxes at 50% and intends to maintain its cap. Structure. (i) Calculate the tax after cost. (a) of new debt (b) of new pref. capital (c) ordinary equity assuming new equity come only from retained earnings which are just sufficient for the purpose. (ii) Calculate the marginal cost of cap. Assuming no new shares is sold.

OR

Q – 2 Lohia Chemicals Ltd has the following book value capital structure on 31 March 2022: **[10]**

Source of Finance	Amount (Rs.)	Proportion (%)	Cost (%)
Share Capital	450,000	45	18
Reserves and Surplus	150,000	15	18
Preference share capital	100,000	10	11
Debt	300,000	30	8
Total	**1,000,000**	**100**	-

(i) Find out Weighted Average Cost of Capital for existing capital structure.

(ii) Assuming Lohia Chemicals Ltd has 45,000,000 equity shares outstanding and that the current market price per share is Rs. 20. Assume that the market values and the book values of debt and the preference share capital are the same. Find out Weighted Average Cost of Capital as per market value weights.

Q - 3 (a) Consider the bonds of the united pharma which are selling for Rs.119. The bonds carry a coupon interest rate of 15% and mature in 10 years with Rs.100 par value. Although they are selling for Rs.119. T.n. verma, a potential investor considers them to be worth only **[05]**

Rs.109. What are the expected rates of return for the bonds and verma's required rate of return?

Q - 3 (b) A large sized chemical company has been expected to grow at 14% per year for the next four years and then to grow indefinitely at the same rate as the national economy, i.e. 5%. The required rate of return on equity shares is 12%. Assume that the company paid a div. of Rs.2 per share last year (D0=2). Determine the market price of the shares today. **[05]**

OR

Q - 3 (a) XYZ Ltd. issues 2,000 10% preference shares of Rs.100 each at Rs. 95 each. The company proposes to redeem the preference shares at the end of 10th year from the date of issue. CALCULATE the cost of preference share? **[05]**

Q - 3 (b) ABC Ltd paid a dividend of Rs 2 per share last year (D0), which is expected to grow at 10 per cent. If the current market price is Rs 40 and the required rate of return is 18 per cent, compute the expected dividend yield and capital gains yield next year. **[05]**

SECTION – II

Q – 1 Attempt **ANY TWO (2x5)** **[10]**

(i) Discuss briefly about the assumptions of MM hypothesis.

(ii) Write in brief about Financial Leverage

(iii) Write a note on Combined Leverage

Q – 2 Unique Ph. Ltd. had 1 lakh outstanding equity shares of Rs.10 each on January 1, 2009. The shares are currently being quoted at par in the market. The company intends to pay a div. of Rs.2 per share for the current year. It belongs to a risk class whose appropriate cap. Rate is 15%. Determine the price of the company's shares using MM model **[10]**

(i) When div. is declared.

(ii) When div. is not declared.

Also find out the no. of equity shares. The company must issue to meet its investment needs of Rs.4 Lakhs, assuming a net income of Rs.2.20 Lakhs and assuming that the div. is paid.

OR

Q - 2 (a) The EPS of ABC ltd. is Rs.10 and the rate of capitalization applicable to it is 10%. The company has before in the options of adopting a payout of 20% or 40% or 80%. Using Walter's model, compute the market value of the company's shares if the productivity of retained earnings is: (i) 20% (ii) 10% or (iii) 8% **[05]**

Q - 2 (b) The EPS of accompany is Rs.10. It has an internal rate of return is 15% and the cap. Rate of its risk class is 12.5%. If Walter model is used: **[05]**

(I) what should be the optimum payout ratio?

(II) What would be the price of share be affected if 20% payout were employed?

Q – 3 A firm's sales, variable costs and fixed cost amount to Rs 75,00,000, Rs 42,00,000 and Rs 6,00,000 respectively. It has borrowed Rs 45,00,000 at 9 per cent and its equity capital totals Rs. 55,00,000. **[10]**

(a) What is the firm's ROI?

(b) Does it have favourable financial leverage?

(c) If the firm belongs to an industry whose asset turnover is 3, does it have a high or low asset leverage?

(d) What are the operating, financial and combined leverages of the firm?

(e) If the sales drop to Rs 50,00,000, what will the new EBIT be?

(f) At what level will the EBT of the firm equal to zero?

OR

Q - 3 (a) A firm sells its products for Rs 50 per unit, has variable operating costs of Rs 30 per unit and fixed operating costs of Rs 5,000 per year. Its current level of sales is 300 units. Determine the degree of operating leverage. What will happen to EBIT if sales change: (a) rise to 350 units, and (b) decrease to 250 units? **[05]**

Q - 3 (b) Calculate the operating leverage for each of the four firms, A, B, C and D from the following price and cost data. What conclusions can you draw with respect to levels of fixed cost and the degree of operating leverage result? Explain. Assume number of units sold is 5,000. **[05]**

Firms	**A**	**B**	**C**	**D**
Sale price per unit (Rs.)	20	32	50	70
Variable cost per unit (Rs.)	6	16	20	50
Fixed operating cost (Rs.)	80000	40000	200000	NIL

****