Seat No.: __________ Enrolment No.____________

GUJARAT TECHNOLOGICAL UNIVERSITY

MBA Semester –III Examination Dec. – 2011

Subject code: 2830201 **Date: 13/12/2011**

Subject Name: Strategic Financial Management

Time: 10.30 am – 01.30 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)** Explain the role of Strategic Financial Management & its functions in business. **07**

(b) What are the points to be given importance in project planning in the post liberalization and global scenario? **07**

Q.2 **(a)** Under what circumstances is the business valuation exercise undertaken by corporate finance managers and investors? **07**

(b) The following information pertains to XYZ Ltd. **07**

Net Profit	Rs. 60 lakh
Outstanding 12% preference Shares	Rs.200 lakh
No. of outstanding equity shares	6 lakh
Return on Investment	20%
Equity capitalization rate	16%

Required:

i) What should be dividend payout ratio so as to keep the share price at Rs. 41.25 by using Walter Model?

ii) What is the optimum dividend payout ratio according to Walter Model?

OR

(b) Darshna Mills Ltd. is considering two mutually exclusive investment proposals for its expansion program. Proposal A requires an initial investment of Rs. 7,50,000 and yearly cash operating cost of Rs. 50,000. Proposal B requires an initial investment of Rs. 5,00,000 and yearly cash operating cost of Rs. 1,00,000. The life of the equipments used in both the proposals will be 12 years, with no salvage value; depreciation is on straight line basis for tax purpose. The anticipated increase in revenue is Rs. 1,50,000 per year in both the investment proposals. The firm's tax rate is 35 percent and its cost of capital is 15 percent. Which investment proposal should be undertaken by the company? **07**

Q.3 **(a)** Explain **07**

i) Capital Budget under Inflation.

ii) Reasons of Project Failure.

(b) A company has the following estimates of the present values of the future cash flows after taxes associated with the investment proposal, concerned with expanding the plant capacity. It intends to use a decision tree approach to get a clear picture of the possible outcomes of this investment. The plant expansion is expected to cost Rs. 3,00,000. The respective PVs of future CFAT and probabilities are as follows. **07**

With Expansion	Without Expansion	Probabilities
3,00,000	2,00,000	0.2
5,00,000	2,00,000	0.4
9,00,000	3,50,000	0.4

Advice the company regarding the financial feasibility of the project

OR

Q.3 **(a)** Explain **07**

i) Sensitivity Analysis in Capital budgeting.

ii) Implications of Corporate Restructuring.

(b) The market value of two companies Surya Ltd. and Chandra Ltd. are Rs. 175 lakh and Rs. 75 lakh respectively. The share capital of Surya Ltd. consists of 3.5 lakh ordinary shares of Rs. 10 each and that of Chandra Ltd. is 2.2 lakh ordinary shares of Rs. 10 each. **07**

Surya Ltd. is proposing to take over Chandra Ltd. The pre-merger earnings are Rs. 19 lakh for Surya Ltd. and Rs. 10 Lakh for Chandra Ltd. The merger is expected to result into a gain of Rs. 4 lakh in the form of post tax cost savings. The pre-merger P/E ratios is 10 for Surya Ltd. and 8 for Chandra Ltd. The possible combined P/E ratios are 9 & 10.

You are required to calculate

a) Minimum Combined P/E ratio to justify the merger

b) Exchange ratio of shares if combined P/E ratio is 9.

c) Exchange ratio of shares if combined P/E ratio is 10.

Q.4 **(a)** What is financial restructuring? What are the key components of financial restructuring scheme? Develop a financial restructuring scheme for a financially troubled firm. **07**

(b) A company employs certainty-equivalent approach in the evaluation of risky investments. The capital budgeting department of the company has developed the following information regarding a new project. **07**

Year	**Expected CFAT (Rs. Thousands)**	**Certainty Equivalent Quotient**
0	(200)	1.0
1	160	0.8
2	140	0.7
3	130	0.6
4	120	0.4
5	80	0.3

The firm’s cost of capital is 18 percent; its cost of debt is 9 percent and the riskless rate of interest in the market on the government securities is 6 percent. Should the project be accepted? **OR**

Q.4 **(a)** Ongoing restructuring is must for survival due to globalization, liberalization and economic reforms. Discuss. **07**

Q.4 (b) Calculate the Economic Value Added (EVA) with the help of the following information of S Ltd. **07**

Financial Leverage	1.4
Capital Structure	Equity capital, Rs. 170 lakh
	Reserves and surplus, Rs 130 lakh
	10% debentures, Rs 400 lakh
Cost of Equity	17.50%
Income Tax Rate	30%

Q.5 (a) Explain the significance of operating and financial leverage analysis for a finance manager in corporate profit and financial structure planning. **07**

(b) A financial advisor of Krutika Industries Ltd. is confronted with two alternative financing plans for raising Rs 10 lakh that is needed for plant expansion and modernization. One choice is 12% Debt issue. The other is to issue 8,000 equity shares at the current market price per share of Rs 125. **07**

The modernization and expansion program is expected to increase the firm's operating profits (EBIT) by Rs. 2,00,000 annually. The firm's condensed financial statements for the current year are given below.

Balance Sheet as on March 31 current year

	Amount	Assets	Amount
Current Liabilities	500000	Current Assets	1600000
10 % Long term Loan	1500000	Plant & Equipment (Net)	3400000
Reserves and Surplus	1000000		
Equity capital (Shares of Rs. 100 each)	2000000		
	5000000		5000000

Income statement for the current year

Operating profits	800000
Less Interest Expenses (0.10 x Rs 15,00,000)	150000
Income before taxes	650000
Less Taxes (@0.35)	227500
Net Income	422500
Earnings per share	21.12
Dividend per share	10.56

However the finance advisor is concerned about the effect that issuing debt might have on the firm. The average debt ratio for firm in industry is 45 percent. He believes that if this ratio is exceeded, the P/E ratio will be 7 because of the potentially greater risk. If the firm increases its equity capital, he expects the P/E ratio to increase to 8.5. He also wonders as to what will happen to the dividend yield under each plan. The firm follows a practice of paying dividends equal to 50 percent of net income.

a) Determine the debt ratio, under each plan, after the securities are issued.
b) Determine the expected net income in the next year, expected EPS and expected market price of the equity shares.
c) Which form of financing should the company use to follow a policy of maximizing market value of the shares?

OR

Q.5 (a) Enlist the key factors which govern the capital structure decisions and explain in detail any three factors. **07**

(b) The Evergreen company has a choice of raising an additional sum of Rs 50 lakh either by the sale of 10 percent debentures or by issue of additional equity shares of Rs. 50 per share. The current capital structure of the company consists of 10 lakh ordinary shares. **07**

i) At what level of earnings before interest and tax (EBIT) after the new capital is required, would earnings per share (EPS) be the same whether new funds are raised by issuing ordinary shares or by issuing debentures?

ii) Also determine the level of EBIT at which uncommitted earnings per share (UEPS) would be the same if sinking fund obligations amount to Rs. 5 lakhs per year. Assume a 35 percent tax rate.

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