Jagan Institute of Management Studies

End-Term Examination, December, 2016 – January, 2017
Trimester II – PGDM/PGDM(IB)/PGDM(RM) 2016-18

Financial Management I

ET_PG/IB/RM_FM-I_2612

Time: 3 Hrs. *M. Marks: 70*

INSTRUCTIONS: Attempt any SIX questions including Q1 which is compulsory.

Q 1 A firm is considering a new project for which the following information is available:

i) The total outlay on the project is 100 lacs consisting of 60 lacs on plant & machinery & 40 lacs on gross working capital. The entire investment shall take place at the beginning of the project.

ii) The project will be financed with 40 lacs of equity capital, 30 lacs of long term debt, 20 lacs of short term borrowing and 10 lacs of trade credit. The interest rate on debentures is 10% and interest on short term borrowings will be 12%. The shareholders, though, expect a return of 15% from the project.

iii) The life of project is expected to be 5 years and the salvage value of plant after 5 years will be 10% of the capitalized value. The working capital shall be liquidated at 35 lacs.

iv) The project shall generate incremental revenue of 100 lacs in first year and increase variable cost by 45 lacs in first year. The fixed costs (excluding depreciation) are expected to go up by 10 lacs.

v) Subsequently revenue and variable costs are expected to increase by 20% p.a (in quantum without inflation)

vi) Applicable tax rate for the firm is 35%

vii) Evaluate the project using Payback period, NPV & IRR. Should the firm invest in this project?

Make appropriate assumptions wherever required. You are required to show calculations for cash flow estimation and project evaluation. **20**

Q 2 a) What approaches are used to analyze the risk and uncertainty in the capital budgeting decisions? Describe any one of them with the help of suitable examples. **5**

b) "An investment with high return variability has high risk". What are the various measures of risk? **5**

Q 3 The objective of a corporate should be to increase its profits so that the shareholders' wealth can be maximised. Do you agree with the statement? Give rationale. **10**

Q 4 Financial markets are markets in which users of funds raise funds through issues of financial instruments. Explain the types of financial market a corporate house can access to raise finance. **10**

Q 5 100% leverage leads to an optimal capital structure. Do you agree? Give rationale for your opinion and also elaborate NI, NOI and Traditional approaches for determining the value of the firm with the change in capital structure. **10**

Q 6 Suppose a firm has a capital structure exclusively comprising of ordinary shares amounting to Rs. 10,00,000. The firm now wishes to raise additional Rs. 10,00,000 for expansion. The firm has four alternative financial plans:

i) It can raise the entire amount in the form of equity capital.

ii) It can raise 50 per cent as equity capital and 50 per cent as 5% debentures.

iii) It can raise the entire amount as 6% debentures.

iv) It can raise 50 per cent as equity capital and 50 per cent as 5% preference capital.

Further assume that the existing EBIT is Rs. 250,000, the tax rate is 30 per cent, outstanding ordinary shares are 10,000 @ Rs. 100 per share and the market price per share is Rs. 100 under all the four alternatives. Which financing plan should the firm select? **10**

Q 7 Flag Products Limited (FPL) has been maintaining a capital structure of Rs. 25 Crores, 15 Crores and 60 Crores for 10% debt, 12% preference and equity capital respectively which it believes is optimal. In market, debt of FPL is selling at 20% discount to the face value of Rs. 100 and preference share is selling at par Rs. 100. FPL growing at 15% per annum had paid the dividend of Rs. 4 per share in the previous year, and its share of face value of Rs. 10 is trading at Rs. 60 in market. The corporate tax payable by the firm is 40%. What is the WACC for FPL based on book value and market value weights? **10**

Q 8 You are required to contribute Rs.2000 per year in a pension plan for 10 years from the end of the current year. The plan will pay pension annually for a period of 20 years and the first payment will start after 16 years from now. If this plan is arranged through a savings bank that pays interest @ 7% per annum on the deposited funds, what is the size of the yearly pension? **5**

b) The following historical rate of return (%) information is provided for Funky Software Co. and the stock market:

Year	**Funky return**	**Market Return**
2007	12	15
2008	9	13
2009	-11	14
2010	8	-9
2011	11	12
2012	4	9

c) What is the beta value of the Funky Software Co. scrip?

d) If the market return is 20%, what would be the scrip return? **5**

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