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INSTITUTE OF MANAGEMENT
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JAIPURIA INSTITUTE OF MANAGEMENT, NOIDA

POST GRADUATE DIPLOMA IN MANAGEMENT

THIRD TRIMESTER (Batch 2017-19)

RE-APPEAR END-TERM EXAM, FEBRUARY-2018

Course Name	Financial Management-I	Course Code	FIN 202
Max. Time	2 hours	Max. Marks	40

Attempt all questions

Q.1 (8 marks)

A company currently has annual sales of Rs 500000 and an average collection period of 30 days. It is considering a more liberal credit policy. If the credit period is extended, the company expects sales and bad debt losses to increase in following manner:

Credit Policy	Increase in Credit Period	Increase in Sales(Rs)	Bad Debt% of Total Sales
A	10 days	25000	1.2
B	15 days	35000	1.5
C	30 days	40000	1.8
D	42 days	50000	2.2

The selling price per unit is Rs 2. Variable cost per unit is Rs 1.20. If the current bad debt loss is 1% of sales and ROI pre tax is 20%, which credit policy should be undertaken assume 360 days a year?

Q.2 (9 marks)

Zenith Ltd has the following capital structure

	Rs (Crores)	
	Book Value	Market Value
Ordinary Shares	20	50
Reserves	10	
Preference Shares	10	15
Debt	60	45

The tax rate is 30%

a) The firm's debenture has face Value Rs 100 Coupon rate 13% and floatation cost is 3% and will be redeemed after 10 years at premium of 5%
b) Rs 100 preference Shares with 11% dividend rate and will be redeemed at par after 10 years
c) The ordinary shares of the firm is selling for Rs 180 and the firm is expected to pay a dividend of Rs 15 and the dividend payment would grow at rate of 5%

Calculate WACC using both book value and market value method and what is the relevance of Cost of Capital in decision making

Q.3 (2+5+3 marks)

Torrent Manufacturing, an established producer of printing equipment, expects its sales to remain flat for the next 3 to 5 years. Weak economic outlook and an expectation of low technology development over that period, being the primary reasons. On the basis of his scenario, the firm's management has been instructed by its board to institute programs that will allow it to operate more efficiently, earn higher profits and most important, maximize share value.

In this regard, the firm's Chief Financial Officer, Aakash Dhingra has been charged with evaluating the firm's capital structure. Aakash believes that the current capital structure, which contains 10% debt and 90% equity, may lack adequate financial leverage. To evaluate the firm's capital structure, Aakash has gathered the data summarized in the following table on the current capital structure (10% debt ratio) and two alternative capital structures – Option A with 30% debt in the capital structure and Option B with 50% debt in the capital structure.

Sources of Capital	Capital Structures		
	Current	A	B
	(10% debt)	(30% debt)	(50% debt)
Long term debt	1 Million	3 Million	5 Million
Coupon interest rate	9%	10%	12%
Equity shares	100,000 shares	70,000 shares	40,000 shares
Total Capital	Rs 10 Million	Rs 10 Million	Rs 10 Million

Aakash expects the firm's earnings before interest and tax (EBIT) to remain at its current level of Rs 1.2 Million. The corporate tax rate is 40%.

a) Calculate cost of equity given the risk free rate being 6%, expected market return of 18% and equity beta of the firm is 1.2.

b) Calculate EPS and WACC for every capital structure alternative and comment on the following

i) Which capital structure will maximize Torrent's EPS at its expected level of EBIT of Rs. 1.2 Million

ii) Which capital structure will minimize Torrent's WACC at its expected level of EBIT of Rs. 1.2 Million

iii) On the basis of your finding above, which capital structure will you recommend for the Company and why?

c) Calculate the Degree of Financial Leverage and interpret the values.

Q.4 (4+3+1 marks)

A firm has two mutually exclusive proposals A and B under consideration requiring an initial outlay of Rs 1,000 each. Both the projects have life of 7 years with following cash flows:

Cash flows in Rs		
Year	Project A	Project B
0	-1000	-1000
1	50	500
2	100	350
3	250	250
4	300	60
5	400	100
6	450	100
7	500	150

a) Find out the NPVs of both the projects at cost of capital of 12% and 15%.

b) Find out the internal rate of returns (IRRs) for both the projects.

c) Which of the two projects is preferable if the cost of capital is i) 12%, ii) 15%.

Q.5 (5 marks)

For each of the companies described below, would you expect it to have a medium/high or a low dividend payout ratio? Explain Why.

1) A company with a large proportion of inside ownership, all of whom are high income individuals.
2) A growth company with an abundance of good investment opportunities
3) A company experiencing ordinary growth that has high liquidity and much unused borrowing capacity
4) A dividend paying company that experiences an unexpected drop in earnings from a trend.
5) A company with volatile earnings and high business risk.