K.J. Somaiya Institute of Management Studies & Research

Course PGDM- Exe – II Tri End Term Exam

Corporate Finance & Valuation

Time: 3 hours **Marks: 50** **Date : 27/03/2018**

Note: 1) Attempt *any five* questions
2) All questions carry ten marks each
3) Be reasonable and explicit in making assumptions (if any)
4) You may use interest factor tables and scientific calculator
5) First five solved questions will be evaluated

1. A company's capital structure consists of the following:

Equity share of Rs 100 each	Rs 20 Lakhs
Retained earnings	Rs 10 Lakhs
9% preference shares	Rs 12 Lakhs
7% debentures	Rs 8 Lakhs
Total	**Rs 50 Lakhs**

The company earns 12% on its capital. The income tax rate is 50%. The company requires a sum of Rs 25 Lakhs to finance its expansion program for which the following alternative are available to it:

a) Issue of 20,000 equity shares at a premium of Rs 25 per share
b) Issue of 10% preference shares
c) Issue of 8% debentures

It is estimated that the P/E ratios in the cases of equity, preference and debentures financing would be 21.4 , 17 and 15.7 respectively. Which of the 3 financing alternatives would you recommend and why ?

2. ABC Ltd earned INR 4,00,000 after taxes in 2004 and paid out 50 per cent of its earnings as cash dividends. The market price of the equity is INR 7 per share. The equity capitalization account is as follows:

Common equity (INR 1 par value 1,00,000 shares)	INR 1,00,000
Additional paid-in capital	INR 50,000
Retained earnings	INR 2,50,000
Total equity	INR 4,00,000

- If the company declared a stock dividend of 4 per cent, what would be the new structure of the shareholder's equity account?
- Assume that the company pays no stock dividend. What would happen to the earnings per share for 2004? What would be the dividends per share?
- If 5 per cent stock dividends are declared, what would be the EPS and the DPS?
- What would be the price of the stock after 5 per cent stock dividends?

3. From the following data, compute the duration of operating cycle for each of the two years and comment on the increase/decrease:

	Year 1	**Year 2**
Stock:		
Raw materials	20,000	27,000
Work-in-progress	14,000	18,000
Finished goods	21,000	24,000
Purchases	96,000	1,35,000
Cost of goods sold	1,40,000	1,80,000
Sales	1,60,000	2,00,000
Debtors	32,000	50,000
Creditors	16,000	18,000

Assume 360 Days per year for computational purposes

4. Attempt *both subparts* in about 150 words (Each subpart carries 5 marks)

a) Your company, a major electrical equipment manufacturer in the private sector, has decided to expand its activities by getting into telecommunications as well. This expansion exercise is expected to cost you Rs. 1,500 crore, if implemented within one year. As the Finance manager of the company, how would you go about raising the funds required?

b) Gamma manufactures Ltd. intends to raise finance for the expansion of its established business in new markets. It is contemplating making a foray in the European markets. Discuss the probable sources of finances available to Gamma manufacturing Ltd.

5. As a winner of a competition, you can choose one of the following prizes:

1. Rs. 800000 now
2. Rs. 2000000 at the end of 8 years
3. Rs. 100000 per year forever
4. Rs. 130000 per year for 12 years
5. An annuity of Rs. 150000 starting immediately and lasting until 9th year

If the interest rate is 12 percent, which prize would you choose and why?

6. Attempt *both subparts* in about 150 words (Each subpart carries 5 marks)

a) Explain as to how the wealth maximization objective is superior to the profit maximization objective.

b) Explain the important functions of financial management.

7. Paresh Rawal Company Ltd is considering selecting a machine out of two mutually exclusive machines. The company's cost of capital is 12% and corporate tax rate is 30%. Other information relating to both machines is as follows-

	Machine –A	Machine – B
Cost of machine	Rs 15, 00,000	Rs 20, 00,000
Expected Life	5 years	5 years
Annual Income (Before tax and depreciation)	Rs 6, 25,000	Rs 8, 75,000

Depreciation is to be charged on straight line basis. You are required to calculate:-

i. Payback period
ii. Net present value
iii. Profitability Index