Name: **Enrolment No:**	UPES UNIVERSITY OF TOMORROW

End Semester Examination, May 2024

Course: Strategic Financial Management **Semester: VI**
Program: INT BBA - MBA (FIN) **Time: 03 Hrs.**
Course Code: FINC3013 **Max. Marks: 100**
Instructions: 1. Attempt all questions; 2. Use of calculators including scientific calculators is allowed

SECTION A
10Qx2M= 20 Marks

S. No.		Marks	CO
Q 1	**MULTIPLE CHOICE**: Choose the one alternative that best completes the statement or answers the question. (Write the question number and the choice letter A, B, C, or D only on your answer sheet).		
1.1	__________ is the process of evaluating and selecting long-term investments consistent with the firm's goal of owner wealth maximization. A) Recapitalizing assets B) Capital budgeting C) Ratio analysis D) Restructuring debt	**2**	**CO1**
1.2	The __________ is the discount rate that equates the present value of the cash inflows with the initial investment. A) payback period B) average rate of return C) cost of capital D) internal rate of return	**2**	**CO1**
1.3	Consider a project that has an initial investment and positive future cash flows. As the cost of capital is decreased _____________. A) IRR increases while NPV remains constant. B) IRR and NPV both decrease. C) IRR increases while NPV remains the same. D) IRR remains the same, while NPV increases.	**2**	**CO1**
1.4	In calculating the costs of the individual components of a firm's financing, the corporate tax rate is important to which of the following component cost formulas? A) Ordinary shares. B) Debt. C) Preferred stock. D) None of the above.	**2**	**CO1**
1.5	The term "capital structure" refers to: A) the manner in which a firm obtains its long-term sources of funding. B) the length of time needed to repay debt. C) whether the firm invests in capital budgeting projects. D) which specific assets the firm should invest in.	**2**	**CO1**

1.6	Which form of financing do firms prefer to use first according to the pecking-order theory? A) regular debt B) common stock C) preferred stock D) internal funds	**2**	**CO1**
1.7	The *dividend-payout ratio* is equal to A) the dividend yield plus the capital gains yield. B) dividends per share (DPS) divided by earnings per share (EPS). C) dividends per share divided by par value per share. D) dividends per share divided by current price per share.	**2**	**CO1**
1.8	***Net working capital*** refers to: A) total assets minus fixed assets. B) current assets minus current liabilities. C) current assets minus inventories. D) current assets	**2**	**CO1**
1.9	Suppose BREX Corp. believes its recent stock price increase has made the price of the stock too expensive for the average investor. To remedy this situation, BREX could ________________. A) pay a liquidating dividend B) complete a reverse stock split C) pay a regular cash dividend D) complete a stock split	**2**	**CO1**
1.10	Which one of the following will **NOT** affect the operating cycle? A) increasing the payables turnover from 7 times to 10 times B) increasing the days sales in receivables (DSO) C) decreasing the inventory turnover rate D) increasing the average receivables balance	**2**	**CO1**
SECTION B **4Qx5M= 20 Marks**			
2.1	Explain the concept of the clientele effect in the context of dividend policy.?	**5**	CO2
2.2	A corporation is considering expanding operations to meet growing demand. With the capital expansion, the current accounts are expected to change. Management expects cash to increase by Rs. 20,000, accounts receivable by Rs. 40,000, and inventories by Rs. 60,000. At the same time accounts payable will increase by Rs. 50,000, accrued liabilities by Rs. 10,000, and long-term debt by Rs. 100,000. What is the change in the net working capital?	**5**	CO2
2.3	If the risk-free rate is 5.0%, the market risk premium is 10% find the company's cost of equity using CAPM if: a) the company's beta is 1.20 b) the company's beta is 0.8	**5**	CO2
2.4	Signaling theory suggests that when a company issues new stocks, its stock price will fall. Why?	**5**	CO2
SECTION-C **3Qx10M= 30 Marks**			

<table>
<tr><td>3.1</td><td>Examine the following assertion:

“In the Modigliani and Miller model, capital structure is irrelevant. When we consider the role of corporate taxes, debt financing is favored over equity financing. It is only when we consider the costs of financial distress and agency costs that a unique debt-equity mix maximizes the total value of the firm.”

Identify the key claim or proposition being made. Explain the reasoning behind this assertion.</td><td>10</td><td>CO3</td></tr>
<tr><td>3.2</td><td>Consider the following financial statement information (for the year).
<table>
<tr><td>Item</td><td>Beginning
(Rs)</td><td>Ending
(Rs)</td></tr>
<tr><td>Inventory</td><td>2575</td><td>3025</td></tr>
<tr><td>Accounts receivable</td><td>1575</td><td>2025</td></tr>
<tr><td>Accounts payable</td><td>2525</td><td>2675</td></tr>
</table>
Net sales= Rs. 16,425
Cost of goods sold = Rs. 14,600
Calculate the operating and cash conversion cycles.
(Consider a 365- day year)</td><td>10</td><td>CO3</td></tr>
<tr><td>3.3</td><td>Why is Capital Budgeting an important technique for companies wishing to assess an investment in projects? Which technique (NPV, IRR, Payback period) would you recommend to management and why?</td><td>10</td><td>CO3</td></tr>
<tr><td colspan="4">SECTION-D
2Qx15M = 30 Marks</td></tr>
<tr><td>4.1</td><td>The Ekta Distribution Company is planning a Rs. 100 crore expansion of its chain of discount service stations to several neighboring states. This expansion will be financed, in part, with debt issued with a coupon interest rate of 6.8 percent. The bonds have a 10-year maturity and a Rs. 1,000 face value, and they will be sold to net Ekta Rs. 975 per bond. Ekta’s marginal tax rate is 40 percent.
Preferred Stock will cost Ekta 7.5 percent after taxes. Ekta’s common stock pays a dividend of Rs. 2 per share. The current market price per share is Rs. 35. Ekta’s dividends are expected to increase at an annual rate of 5 percent for the foreseeable future. Ekta expects to generate sufficient retained earnings to meet the common equity portion of the funding needed for the expansion.
Ekta ’s target capital structure is as follows:
Debt = 20%
Preferred stock = 10%
Common equity = 70%
Calculate the weighted cost of capital that is appropriate to use in evaluating this expansion program.</td><td>15</td><td>CO4</td></tr>
</table>

4.2	You are considering two mutually exclusive projects. The expected values for each project's end-of-year cash flows are:	15	CO4

Year	**Project A**	**Project B**
0	-$1,000,000	-$1,000,000
1	$500,000	$500,000
2	$700,000	$600,000
3	$600,000	$700,000
4	$500,000	$800,000

You have decided to evaluate these projects using the certainty equivalent method. The certainty equivalent coefficients for each project's cash flows are given below:

Year	**Project A**	**Project B**
0	1.00	1.00
1	0.95	0.90
2	0.90	0.70
3	0.80	0.60
4	0.70	0.50

a) Given that the risk-free rate of return is 5% per annum, what is the NPV of each project?

b) Briefly discuss and justify which project, if any, should be preferred.