**JAIPURIA INSTITUTE OF MANAGEMENT, INDORE**

**PGDM**

**SECOND TRIMESTER (Batch 2019-21)**

**END TERM IMPROVEMENT EXAMINATION, FEBRUARY -2020**

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| Course Name | **Corporate Finance** | Course Code | **FIN201** |
| Max. Time | **2 hours** | Max. Marks | **40** |

**INSTRUCTIONS: Attempt all Qs. TVM tables are not allowed.**

**Q.1** 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%.

1. 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.
2. Calculate EPS and WACC for every capital structure alternative and comment on the following
   1. Which capital structure will maximize Torrent’s EPS at its expected level of EBIT of Rs. 1.2 Million
   2. Which capital structure will minimize Torrent’s WACC at its expected level of EBIT of Rs. 1.2 Million
   3. On the basis of your finding above, which capital structure will you recommend for the Company and why?
3. Calculate the Degree of Financial Leverage and interpret the values.

**(2+8+5 = 15 Marks)**

**Q.2** A firm has Rs 10 lakhs paid up capital, retained earnings of Rs 50000 and 10000 equity shares. There is Rs. 50000 of earnings available for distribution to the shareholders. It has a Fixed asset of Rs 8 lakhs and current Assets of Rs 3 Lakhs. Create a Balance sheet of the firm.

(a) Explain the effect of a cash dividend of Rs 2 per share on the company’s balance sheet.

(b) Explain the effect of a stock dividend of 1: 1 on the company’s balance sheet.

**(5+5 = 10 Marks)**

**Q.3** By obtaining a lock box Nizam’s manufacturing was able to reduce its total cash collection time by two days. The firm has annual sales of Euro 570000 and sales per day can be assumed to be same throughout 365 days. Company can earn 4.75 percent annual interest. Assuming that the lock box costs Euro 50 per year, calculate the savings that can be attributed to the lock box.

**(5 Marks)**

**Q.4** XYZ Cements Limited sells its products on a gross profit of 20% on sales. The following information is extracted from its annual accounts for the current year ended 31st December.

Rs.

Sales at 3 months’ credit 40,00,000

Raw material 12,00,000

Wages paid – average time lag 15 days 9,60,000

Manufacturing expenses paid – one month in arrears 12,00,000

Administrative expenses paid - one month in arrears 4,80,000

Sales promotion expenses – payable half yearly in arrears 2,00,000

The company enjoy one month’s credit from the suppliers of raw materials and maintains a 2 month’s stock of raw materials and one and half month’s stock of finished goods. The cash balance is maintained at Rs. 1,00,000 as a precautionary measure. Assuming a 10% margin, find out the working capital requirements of XYZ Cements Ltd.

**(10 Marks)**