

Time: Three Hours

Marks: 100

Instructions:

1. Simple calculators are permitted.
2. Attempt any five questions.

Q.1). Evaluate the following statement: "Managers should not focus on the current stock value because doing so will lead to an overemphasis on short-term profits at the expense of long-term profits." Under what conditions will maximizing firm value also enrich society?

(Marks 20)

Q.2). A company is considering an investment proposal to install new machinery at a cost of Rs 100000. The facility has a life expectancy of 5 years and no salvage value. The tax rate is 30 percent. Assume the company uses straight line depreciation and the same is allowed for the tax purposes. The estimated cash flows before depreciation and tax (CFBT) from the investment proposal are as follows:

Year	1	2	3	4	5
CFBT (Rs.)	20000	28500	35600	36900	41000

Compute payback period, net present value at 10 percent discount rate and profitability index at 10 percent discount rate.

(Marks 20)

Q.3). If the use of financial leverage magnifies the earnings per share under favourable economic conditions, why do companies not employ very large amount of debt in their capital structure?

(Marks 20)

Q.4). A. H&H, a leading fabricator of precious metal alloys, pays out only 23% of its earnings as dividends. The average dividend payout ratio for metal fabricating firms is 45%. The average growth rate in earnings for the entire sector is 10%, while H&H is expected to grow 23%. Should H&H pay more in dividends just to get closer to the average payout ratio? Why or why not?

B. Dividends create a tax disadvantage for investors. Is this statement true for all investors and all markets? Under what conditions it is not true?

C. "An increase in dividends operates as a positive financial signal." Explain the statement.

(Mark 6+7+7=20)

Q.5). A. What benefits and costs are associated with the extension of credit?

B. Investing a firm's cash in stocks rather than treasury bills should increase value because you can expect to earn a higher return. Is this statement true? Why or why not?

(Marks 10+10=20)

Q.6). A. What is Relative Valuation Approach? What are its merits and demerits? When does it work the best? Which assets can only be priced?

B. Pluto Ltd., a manufacturer of automotive supplies, generated a Rs 650000 in free cash flow to the firm (prior to debt payments but after reinvestment needs and taxes) last year.

The firm has a cost of capital of 8.5% and debt outstanding of Rs 3880000. The firm has 665000 shares outstanding. The cash flows are expected to grow 4.5% a year in perpetuity.

a. Estimate the value of Pluto Ltd. (as a firm)

b. Estimate the value of equity in Pluto Ltd.

c. If the stock is trading at Rs 32 per share, how under-or overvalued is the stock?

(Marks 10+10=20)

NATIONAL LAW UNIVERSITY, JODHPUR

End Term Examination April- May, 2025

UG VI Semester

Subject: Finance III (Financial Management)

Time: Three Hours

Marks: 100

Instructions:

1. *Simple calculators are permitted.*
2. *Attempt any five questions.*

Q.1). Can the goal of maximization of stock value conflict with other goals, such as avoiding unethical or illegal behaviour? In particular, do you think subjects like customer and employee safety, the environment, and the general good of society fit in this framework, or are they essentially ignored? Provide some specific scenarios to illustrate your answer.

(Marks 20)

Q.2). Answer the following:

- (i) Why is Cost of capital used by a company as a minimum benchmark for its yield?
- (ii) Is it true that retained earnings have zero cost? Why or why not?
- (iii) Why is the cost of debt considered to be lesser than cost of preference and cost of equity?
- (iv) In broad terms, why are some risks diversifiable? Why are some risks non-diversifiable? Does it follow that an investor can control the level of diversifiable risk in a portfolio, but not the level of non-diversifiable risk?

(Marks 4*5=20)

Q.3). A. Unicorn Ltd., which makes linear integrated circuits for power management, is a firm that has not used debt in the financing of its projects. The managers of the firm contend that they do not borrow money because they weren't maintaining financial flexibility. How does not borrowing money increase financial flexibility?

B. Jdpr Power is a regulated electric utility that has equity with a market value of Rs 1500 crores and debt outstanding of Rs 3000 crores. A consultant notes that a high debt ratio is relative to the average across all firms, which is 27 percent and suggest that the firm is over levered.

- (i) Why would you expect an electric utility to be able to maintain a higher debt ratio than the average company?
- (ii) Did the fact that the company is regulated monopoly affect its capacity to carry debt?

C. Two firms are considering borrowing: One firm has excellent prospects in terms of future projects and is in an area in which cash flows are volatile and future needs are difficult to assess. The other firm has more stable cash flows and fewer project opportunities and predicts its future

needs with more precision. Other things remaining equal, which of these two firms should borrow more and why?

(Marks 6+7+7=20)

Q.4). A. The following information is available in respect of a firm:

Capitalization rate (k_e)	10%
Earnings per share (E)	Rs 40

Assume rate of return on investments (r): 16 percent

Show the effect of dividend policy on the market price of shares, assuming dividend payout ratio as zero percent and 100 percent, using Walter's Model. Interpret the results.

B. New Age EC Co. is a young, high-growth e-commerce firm. It pays no dividends, though the average dividend payout for other firms in the e-commerce sector is 10 percent. Justify the dividend policy of New Age EC Co.

(Marks 10+10 = 20)

Q.5). Yellow Ltd. has current sales of Rs 600000 per annum. To push up sales, Yellow Ltd. is considering a more liberal credit policy as one of the strategies. The current average collection period of the company is 30 days. Proposed increases in collection period and their impact on sales and default rate (on total sales) are given below: -

Credit policy	Increase in collection period (Days)	Increase in sales (Rs)	Default rate (%)
A	15	Rs 25000	0.5
B	30	Rs 60000	1
C	40	Rs 70000	2

Yellow Ltd. is selling its product at Rs 10 each. Average cost per unit at the current level is Rs 8 and variable cost is Rs 6. If Yellow Ltd. requires a rate of return of 20 percent on its investment, which credit policy do you recommend and why? Assume all sales are on credit basis and 360 days a year.

(Marks 15+5=20)

Q.6). A. Craftsoft is a software firm. It is trading at a Price Earnings (PE) ratio of 15, but the average software firm has a PE ratio of 30. Does this mean that Craftsoft is undervalued? If not, why not?

B. Assume that B Ltd. is interested in selling its information, space, and defense systems division. The division reported cash flows before debt payments but after reinvestment needs of \$393 million in 2024. The cash flows are expected to grow at 5 percent a year in the long term. The cost of capital for the division is 9 percent. Estimate the value of the division.

(Marks 10+10=20)