**Strategic Financial Management**

**December 2022 Examination**

**Q1. Bharat Limited has to make a decision to select any one project. The projects are: project 1 – investment in rubber rollers and project 2 – manufacture of automobile components. The initial investments are Rs.1,35,000 for project 1 and Rs.2,40,000 for project 2. There will be no scrap value at the end of the life of both projects. The opportunity cost of capital of the company is 16 percent. The annual incomes are as under:**

|  |  |  |
| --- | --- | --- |
| **Year** | **Project 1** | **Project 2** |
| 1 | - | 60,000 |
| 2 | 30,000 | 84,000 |
| 3 | 1,32,000 | 96,000 |
| 4 | 84,000 | 1,02,000 |
| 5 | 84,000 | 90,000 |

**You are required to compute the Net present value for Project 1 and Project 2. Discuss the criteria to accept or reject a project based on NPV. What other criteria can be looked into to decide on which project to accept? (10 Marks)**

**Ans 1.**

**Introduction**

The term "net present value" refers to the current value of all future cash flows generated by a project, including the initial capital expenditure. It is commonly used in capital planning to determine which projects are most likely to generate the most profit. Net present value is a capital budgeting analysis technique used to estimate the profitability of a long-term project. The NPV formula's idea is to compare an initial investment to a project's future cash flows.

The NPV formula takes into account the fact that $1 today is not the same as $1 tomorrow. Because money now can be used to generate future returns, a certain amount of money today is

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**Q2. Walter and Gordon both proposed a model of share valuation which states the relationship between dividend policies and the market value of the firm. Both models are similar to each other yet have differences. Discuss the similarities and differences of both models using a numerical example. (10 Marks)**

**Ans 2.**

**Introduction**

Walter model clearly demonstrates the significance of the relationship between the firm's internal rate of return (r) and its cost of capital (k) in determining the dividend policy that will maximize shareholder wealth. The following assumptions underpin Walter's model:

* All investments are funded by retained earnings; no debt or new equity is issued.
* The internal rate of return (r) and cost of capital (k) of the firm are constant;
* All earnings are either distributed as dividends or immediately reinvested internally.
* Beginning earnings and dividends are constant. The earnings per share (E) and divided per share (D) values in the model may be changed to determine results, but any given value of E and D is assumed to remain constant forever in determining a given value.

**Q3. Government of India has approved the issue of Deep discount bonds of Rural Electrification Corporation Limited with a face value of Rs. 30,000 having a life of 10 years. The planned yield for the investors is 12 percent.**

**a. Assuming a yield of 12 percent, at what price would you buy the bond? (5 Marks)**

**b. If the bond is issued at Rs. 8,000, compute the yield assuming the bond is held till maturity? (5 Marks)**

**Ans 3a.**

**Introduction**

Bond yield is the return an investor receives on a bond and can be calculated in a variety of ways. The annual interest rate established when the bond is issued is known as the coupon rate. The current yield is determined by the bond's price as well as the coupon, or interest payment.

Additional bond yield calculations include yield to maturity (YTM), bond equivalent yield (BEY), and effective annual yield (EAY).

**Ans 3b.**

**Introduction**

Yield to maturity (YTM) is the total return expected on a bond if it is held until maturity. Yield to maturity is a long-term bond yield that is expressed in annual terms. In other words, it is the internal rate of return (IRR) of a bond investment if the investor holds the bond until maturity