STELLA MARIS COLLEGE (AUTONOMOUS) CHENNAI – 600 086.
(For candidates admitted during the academic year 2008-2009 & thereafter)

SUBJECT CODE: CM/MC/CF54

B.Com. DEGREE EXAMINATION NOVEMBER 2011
COMMERCE
FIFTH SEMESTER

COURSE	**:**	**MAJOR CORE**
PAPER	**:**	**CORPORATE FINANCE**
TIME	**:**	**3 HOURS**

MAX. MARKS : 100

SECTION – A
ANSWER ALL QUESTIONS (30 X 1 = 30)

I. Fill in the blanks :

1. _____________ refers to makeup of a firm's capitalization.
2. Optimum leverage can be defined as that mix of debt and equity which will __________ the market value of the firm.
3. Financial leverage indicates disproportionate change in taxable income as a result of change in ________________.
4. ______________ cash flow techniques takes in to account the time value of money.
5. Networking capital is that portion of a firm's current assets which is financed by ______________.
6. ______________ is determined at a level for which aggregate if ordering cost and carrying cost is the minimum.
7. ______________ refers to the firm's Investment in total current assets or circulating assets.
8. ______________ involves merger and acquisitions of firm's belonging to different countries of the world.
9. The most appropriate dividend policy is payment of ______________per share.
10. A firm having ' r ' < k can be termed as a ____________ firm.

II. State whether the following statements are TRUE or FALSE

11. The term capital structure includes also the Financial Structure.
12. Cost of Capital comprises both business risk and financial risk.
13. Dividend on preference share capital is ignored while calculating operating leverage.
14. Internal Rate of Return and Net present value are synonymous terms.
15. Higher the credit period, the greater are the chances of the recovery of debt.
16. Cash management is a trade off between cost of carrying cash and necessity of maintaining liquidity.
17. In case of Trading firm, the operating cycle is longer than that for a manufacturing firm.
18. In case of horizontal merger, the companies merging are in the same area of business.
19. Take-over is an external method of expansion.
20. Walter's model is based on the relationship between 'r' and 'k'.

III. Choose the correct answer from the following:

21. The tendency of the operating profit to vary disproportionately with sales:
    a) Financial leverage b) Combined leverage c) Operating leverage

22. Depreciation is included in cost in case of:
    a) Net present value method b) Accounting rate of return method c) Payback method.

23. Whether the following would result in increase, decrease or no change in working capital:- Change in method of depreciation leads to :
    a) Increase in W.C b) Decrease in W.C c) No change in W.C

24. A healthy company merges into a financially weak company and the former company is dissolved:
    a) Horizontal Merger b) Vertical Merger c) Reverse Merger.

25. A Company having easy access to capital markets can follow a dividend policy:
    a) Constant dividend policy b) Liberal dividend policy c) Stringent dividend policy.

26. The minimum rate of return, a firm must earn on its investment to maintain the market value of its equity shares:
    a) Average cost of capital b) Explicit cost of capital c) Cost of Capital.

27. While evaluating capital investment proposals, the present value of cash flow is considered in case of:
    a) Payback method b) Net present value method c) Internal rate of return method.

28. The level of inventory at which the firm should place an order to replenish the inventory:
    a) Safety stock level b) Maximum stock level c) Re-order level.

29. A higher 'accounts receivable turnover ratio' means:
    a) Lower debt collection period b) Higher debt collection period c) Lower sales

30. Corporate Restructuring may take the form of increasing the existing capacity of the business and does not involve any additional technical expertise:
    a) Diversification b) Expansion c) Collaboration.

SECTION – B

ANSWER ANY FIVE QUESTIONS (5 X 8 = 40)

31. Discuss the factors to be considered in determining working capital requirement of a firm.
32. Explain in detail the different types of Merger under corporate restructuring and advantages of Merger.
33. The Capital structure of the progressive corporation consists of an ordinary share capital of Rs. 10,00,000 (Shares of Rs.100 per value) and Rs. 10,00,000 of 10% debentures. Sales increased by 20% from 1,00,000 units to 1,20,000 units, the selling price is Rs. 10 per unit. Variable cost amounts to Rs. 6 per unit and fixed expenses amounts to Rs. 2,00,000. The income tax rate is assumed to be 50%.
    You are required to calculate the following:
    i) The Earnings per share (EPS) and % increase in EPS.
    ii) The Financial leverage at 1,00,000 units and 1,20,000 units.
    iii) The Operating leverage at 1,00,000 units and 1,20,000 units.
    iv) The combine leverage at 1,00,000 units and 1,20,000 units.
    Comment on the leverage behaviour.

34. Raja Ltd. Wants to replace its existing plant. It has received three mutually exclusive proposals I, II and III. The plant under the three proposals are expected to cost Rs.2,50,000 each and have an estimated life of 5 years, 4 years and 3 years respectively. The company's required rate of return is 10%. The anticipated net cash inflows after tax and P V factor at 10% for respective years of plants are as follows:

Year	P/V Factor	Plant I (Rs.)	Plant II (Rs.)	Plant III (Rs.)
1	0.909	80,000	1,10,000	1,30,000
2	0.826	60,000	90,000	1,10,000
3	0.751	60,000	85,000	20,000
4	0.683	60,000	35,000	-
5	0.621	1,80,000	-	-

Which of the above proposals would you recommend to the management for acceptance. You may use N P V technique for evaluation.

35. From the following information, prepare an estimate of working capital requirements:
i) Projected annual sales 52,000 units ii) Selling price Rs. 60 per unit
iii) Raw material cost 40% of selling price
iv)Direct Labour cost 30% of selling price v) Overheads 20% of selling price.
Raw materials remain is stock on an average for 3 weeks. Goods remain in production process for 4 weeks on an average. 5 weeks are allowed to debtors to pay while firm gets 3 weeks credit from suppliers. Finished goods remain in stock for one month. Lag in payment of wages and overhead expenses is two weeks. 50% of the sales are on cash basis. Assume that goods in process are 100% complete with respect to materials but only50% in conversion cost. Assume 52 weeks make one year and 4 weeks make one month.

36. Company X is contemplating the purchase of Company Y. Company X has 3,00,000shares haing a market price of Rs.30 per share, while company Y has 2,00,000 shares selling at Rs. 20 per share. The EPS are Rs. 4 ad Rs. 2.25 for company X and Y respectively. Managements of both companies are discussing two alternative proposals for exchange of shares as indicated below:
i) in proportion to the relative earnings per share of two companies
ii) 0.5share of company X for one share of company Y (.5:1)
You are required to (i) calculate the earnings per share after merger under two alternatives and (ii) to show the impact on EPS for the shareholders of two companies under both the alternatives.

37. Following are the details regarding three companies A Ltd., B Ltd. And C Ltd.,

A LTD.	B LTD.	C LTD.
r = 15%	r = 5%	r = 10%
Ke = 10%	Ke = 10%	Ke = 10%
E = Rs. 8	E = Rs. 8	E = Rs. 8

Calculate the value of an equity share of each of these Companies applying Walter's formula when dividend payment ratio (D/P ratio) is: (a) 50% (b) 75% and (c) 25%.

SECTION – C

ANSWER ANY ONE QUESTION (1 X 30 = 30)

CASE STUDY :

38. The Eastern Limited has appointed you as its finance manager.The company wants to implement a project for which Rs.50 lakhs is required to be raised from the market as a means of financing the project. This project is expected to yield earnings before interest and Taxes of Rs. 10 lakhs. At the time of deciding the financial plan, the Company considers the objective of maximizing earnings per share. It has three alternatives to finance the project:

(i) Debentures of Rs. 5 lakhs and balance through Equity,

(ii) Debentures of Rs. 20 lakhs and balance as Equity,

(iii) Debentures of Rs. 30 lakhs and balance as Equity.

The cost of debentures	upto Rs. 5 lakhs	--	10%
	over Rs. 5 lakhs and up to Rs. 20 lakhs	--	15%
	over Rs. 20 lakhs.	--	20%

The shares of the Company is currently selling at Rs. 150, but is expected to decline to Rs. 125 in case the Borrowed funds exceed Rs. 20 lakhs.

The Tax rate applicable to the Company is 50%.

(i) Determine the amount of Equity financing and the Number of Equity Shares in each alternative.

(ii) What is the Market Price per share in each alternative

(iii) Determine the Earnings per Share (EPS)in each alternative.

(iv) Which form of financing should the company choose?

(v) Determine the Indifference points between financial plans (i) and (ii); and (i) and (iii).

(vi) Prove the indifference points.

39.ABC Ltd has the following capital structure:

Debentures (Rs. 100 per debenture)	Rs. 8,00,000
Preference Shares (Rs. 100 per share)	Rs. 2,00,000
Equity Shares (Rs. 10 per share)	Rs.10,00,000
	20,00,000

All the above securities are traded in the capital market.

Recent prices are:

Debentures Rs. 110 per debenture, preference shares Rs. 120 per share and Equity shares Rs. 22 per share.

Anticipated external financing opportunities are:

(a) Rs. 100 per debenture redeemable at par; 10 years maturity; 13% coupon rate, 4% floatation costs, sale price Rs. 100.

(b) Rs. 100 preference share redeemable at par; 10 year maturity, 14% dividend rate, 5% Floatation costs; Sale price Rs. 100.

(c) Equity shares; Rs. 2 per share floatation costs, sale price Rs. 22 per share.
In addition, the dividend expected on the equity share at the end of the year is Rs. 2 per share; the anticipated growth rate in dividend is 7%.

(d) The corporate tax rate is 35%.

As a Financial analyst of the company, you are required to determine

(i) Firm's After –tax Cost of Debt?

(ii) Firm's Cost of Preference?

(iii) Firm's Cost of Equity?

(iv) Weighted Average cost of capital using Book Value Weights.

(v) Weighted Average cost of capital using Market Value Weights.

(vi) Estimated Market price of the equity share if the anticipated growth rate of the firm (a) rises to 8% and (b) falls to 3%.