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

SUBJECT CODE: CM/MC/CF54

B.Com. DEGREE EXAMINATION NOVEMBER 2010
COMMERCE
FIFTH SEMESTER

COURSE : MAJOR CORE
PAPER : CORPORATE FINANCE
TIME : 3 HOURS **MAX. MARKS : 100**

SECTION – A

ANSWER ALL QUESTIONS: **(30 x1 = 30)**

1. Historically, P/E ratios have tended to be _________.
   a. higher when inflation has been high.
   b. lower when inflation has been high.
   c. uncorrelated with inflation rates but correlated with other macroeconomic variables.
   d. uncorrelated with any macroeconomic variables including inflation rates.
   e. none of the above

2. The ______is a common term for the market consensus value of the required return on a stock.
   a. dividend payout ratio b. intrinsic value c. market capitalization rate
   d. plowback rate e. none of the above

3. Firm X is unlevered .Tax rate is 50%. EBIT is 6 lakhs. Equity capitalization rate is 10%. The value of the firm
   a) Rs. 40.5 lakhs b) Rs. 40 lakhs c) Rs. 45 lakhs d) Rs. 38 lakhs

4. An increase in a firm's financial leverage will:
   a. increase the variability in earnings per share
   b. reduce the operating risk of the firm.
   c. increase the value of the firm in a non-MM world
   d. increase the WACC.

5. Financial risk refers to the:
   a. risk of owning equity securities b. risk faced by equity holders when debt is used
   c. general business risk of the firm d. possibility that interest rates will increase

6. Operating leverage refers to
   a. Tendency of the operating profit to vary disproportionately with sales.
   b. Percentage of cost of goods sold on sales
   c. Percentage of debt coverage on total profit.
   d. Percentage of change in contribution on total sales

7. Average cost of capital refers to
   a. Average rate of return a firm must earn on investments .
   b. The average rate of return associated with the best investment opportunity.
   c. Refers to the cost of capital funds which has already been incurred.
   d. Weighted average cost based on each component of funds employed

8. Permanent working capital refers to
   a. Excess of current assets over current liabilities
   b. Firms investment in total current assets or circulating capita
   c. The minimum amount of investments in core current assets
   d. Additional current assets required permanently

9. Bowel Model is associated with
   a. working capital management
   b. capital structure theory
   c. dividend payout theory
   d. management of cash flow

10. Miller-Orr model is suitable in those circumstances
    a. When the demand for cash is steady
    b. Carrying cost and transaction cost are to be kept minimum
    c. When the cash flow is inadequate
    d. When the demand for cash is not steady

11. The current market price of a company share is Rs.180.Dividend per share is Rs.9. Dividend are expected to grow at 6%. Cost of equity capital shall be
    a. 14% b. 12% c. 10% d. 11%

12. Consumption of material per month 10,000 Kg. Order placing cost per order Rs.50. Cost per kg of material Rs.2. Storage cost 8% on average inventory. EOQ Will be
    a. 3000 kg b. 2600 kg c. 2500 kg d. 2700 kg

13. An increase in dividends might not increase price and may actually decrease stock price if:
    a. the dividend increase cannot be sustained.
    b. the firm does not maintain an exact dividend payout ratio.
    c. the firm has too much retained earnings.
    d. the firm has excess cash reserves.

14. A policy of dividend "smoothing" refers to:
    a. maintaining a constant dividend payout ratio.
    b. keeping the regular dividend at the same level indefinitely.
    c. maintaining a steady progression of dividend increases over time.
    d. alternating cash dividends with stock dividends.

15. A company has Rs.50 lakhs in debt outstanding with a coupon rate of 12 percent. Currently the YTM on these bonds is 14 percent. If the tax rate is 40 percent, what is the after tax cost of debt?
    a. 14.0% b. 12.0% c. 5.6% d. 8.4%

16. Low Tech Company has an expected ROE of 10%. The dividend growth rate will be ________ if the firm follows a policy of paying 40% of earnings in the form of dividends.
    a. 6.0% b. 4.8% c. 7.2% d. 3.0% e. none of the above

17. Music Doctors Company has an expected ROE of 14%. The dividend growth rate will be ________ if the firm follows a policy of paying 60% of earnings in the form of dividends.
    a. 4.8% b. 5.6% c. 7.2% d. 6.0% e. none of the above

18. Beta is a measure of:
    a. The total risk of an asset or portfolio b. Unsystematic risk
    c. Unique risk d. Systematic risk

19. if you invest Rs. 5000 today at a compound rate of 9% what will its future value after 30 years ?
    a. Rs. 75,870 b. Rs. 68,500 c. Rs. 6,340 d. Rs. 1,00,500

20. 20.what is the present value of Rs. 10,00,000 receivable after 30 years from now, if the discount rate is 10%?
    a. Rs. 6,000 b. Rs. 5,800 c. Rs. 7,500 d. Rs. 5,700

21. Project cost Rs 20 lakhs. Annual profit after 12% depreciation but before tax 50% is Rs.3 lakhs. The payback period will be
    a. 7 years b. 5 years c. 6 years d. 7.5 years

22. Sales of a firm Rs. 1,00,000. Variable cost Rs. 40,000, fixed cost Rs. 30,000. Interest Rs. 10,000.The composite leverage will be
    a. 5 b. 6 c. 3 d. 4.5

23. A company has $5 million in debt outstanding with a coupon rate of 12 percent. Currently the YTM on these bonds is 14 percent. If the tax rate is 40 percent, what is the after tax cost of debt?
    a. 14.0% b. 12.0% c. 5.6% d. 8.4%

24. The term structure of interest rates is
    a. the structure of how interest rates move over time.
    b. the relationship among interest rates of different bonds with the same maturity.
    c. the relationship among interest rates on bonds with different maturities.
    d. the relationship among the term to maturity of different bonds.

25. For a given return on assets,
    a. the lower is bank capital, the higher is the return for the owners of the bank.
    b. the lower is bank capital, the lower is the credit risk for the owners of the bank.
    c. the lower is bank capital, the lower is the return for the owners of the bank.
    d. both (a) and (c) of the above.

26. Face value of a debenture Rs.1000. Annual interest rate 12%. Expected interest rate 15% maturity period 5 years. Value of debenture will be
    a. Rs. 800 b. Rs. 900 c. Rs. 950 d. Rs. 1050

27. Irredeemable preference shares are issued by a company some time back for Rs. 100 each carrying dividend rate 10%, now they are eligible for 15%. The value of preference shares will be
    a. Rs. 70 b. Rs. 82 c. Rs. 67 d. Rs. 80

28. A project cost Rs 1,60,000, expected cash flow Rs. 40,000 for 5 years. IRR WILL BE
    a. 10% b. 12% c. 8% d. 9%

29. Credit sales for 2009-10 6,00,000. Accounts receivable as on 1/4/2009 70,000. Accounts receivable as on 31/3/2010 50000. The average age of receivable will be
    a. 1.4 Month b. 1.6 Month c. 2.1 Month d. 1.2 Month

30. Monthly cash requirement Rs. 60,000. Fixed cost per transaction Rs. 10. Interest rate on marketable securities 6%. Optimum cash balance will be
    a. Rs. 20,000 b. Rs. 30,000 c. Rs. 15,000 d. Rs. 25,000

SECTION – B

ANSWER ANY FIVE QUESTIONS: (5 x 8 = 40)

31. A new project under Construction by your company requires an investment of Rs.300 lakhs. Interest on term loan is 12% and tax rate is 30%. The debt-equity ratio is 2:1. Calculate the point of indifference of the project.

32. An analyst has gathered the following information about a company:

    stocks sells for $50 per share

    last dividend (D 0) was $2.00

    growth rate is a constant 5 percent

    the company would incur a flotation cost of 15 percent if it sold new common stock

    net income for the coming year is expected to be $500,000

    the firm's payout ratio is 60 percent

    its common equity ratio is 30 percent

    If the firm has a capital budget of $1,000,000, what component cost of common equity will be built into the weighted average cost of capital for the last dollar of capital the company raises?

33. X Ltd. is contemplating adding a new product line. The new product line would be marketable for only five years, after that time it would have to be discontinued. The costs and revenues that would be associated with the line are:

	Rs.
Cost of equipment required	80,000
Working Capital needed	70,000
Salvage value of equipment in 5 years	10,000
Annual sales revenues	75,000
Annual out of pocket costs for salaries, advertising	45,000
Overhaul cost for the equipment required in the 4th year	5,000

The company's cost of capital is 12%. Would you recommend that the new line be introduced? Ignore income tax.

The present value of Re.1 for 5 years at 12% discount factor is .893, .797, .712, .636 and .567

34. What is corporate restructuring? What motivates an enterprises to engage in restructuring exercise?

35. Explain the various methods used for evaluating investment proposals.

36. X ltd is keen on reporting an EPS of Rs. 6 per share after acquiring Y ltd . The following financial data is available.

Particulars	X LTD	Y LTD
EPS per share	5.00	5.00
MARKET PRICE per share	60.00	50.00
NO OF SHARES	10,00,000	8,00,000

There is an expected synergy gain of 5%. What exchange ratio will result in a post merger earning of 6 .00 per share for X ltd ?

37. A Company's share is quoted at Rs.30 currently. The company pays a dividend of Rs. 1 per share. And the investors expect a growth rate of 5 % per year. Compute (i) the equity cost of capital (ii) if the cost of capital is 8% and the anticipated growth rate is 5% per annum. Calculate the market price if they desire to maintain the same dividend rate.

SECTION – C

(30)

1. **Case study**

DHPL is a small sized firm manufacturing hand tools. It manufacturing plan is situated in Haryana. The company's sales in the year ending on 31st March 2009 were Rs.1000 million (Rs.100 crore) on an asset base of Rs.650 million. The net profit of the company was Rs.76 million. The management of the company wants to improve profitability further. The required rate of return of the company is 14 percent.

The company is currently considering an investment proposal. One is to expand its manufacturing capacity. The estimated cost of the new equipment is Rs.250 million. It is expected to have an economic life of 10 years. The accountant forecasts that net cash inflows would be Rs.45 million per annum for the first three years, Rs.68 million per annum from year four to year eight and for the remaining two years Rs.30million per annum. The plant can be sold for Rs.55 million at the end of its economic life.

The company would need to raise debt to the extent of Rs.200 million. The company has the following options of borrowing Rs.200 million:

a. The company can borrow funds from a nationalized bank at the interest rate of 14 percent for 10 years. It will be required to pay equal annual installment of interest and repayment of principal.

b. A financial institution has offered to lend money to DHPL at 13.5 per annum but it needs to pay equated quarterly installment of interest and repayment of principal.

Questions:

1. Should the company expand its capacity? Show the computation of NPV
2. What is the annual installment of bank loan?
3. Calculate the quarterly installments of the Financial Institution loan?
4. Should the company borrow from the bank or from the financial institution?
5. What is the current cash inflow?

OR

2. Ramesh Corporation, a manufacturer of consumer plastic products, is evaluating its capital structure. The balance sheet of the company is as follows (in lakhs):

Assets		Liabilities	
Fixed Assets	4000	Debt	2500
Current Assets	1000	Equity	2500

In addition, you are provided the following information:

(a) The debt is in the form of long term bonds, with an interest of 10%. The bonds are currently rated AA and are selling at a yield of 12% (the market value of the bonds is 80% of the face value).
(b) The firm currently has 50 lakh shares outstanding, and the current market price is Rs.80 per share. The firm pays a dividend of Rs. 4 per share and has a price/earnings ratio of 10.
(c) The stock currently has a beta of 1.2. The six-month Treasury bill rate is 8%.
(d) The tax rate for this firm is 40%.
(i) What is the debt/equity ratio for this firm in book value terms and in market value terms?
(ii) What is the debt/(debt+equity) ratio for this firm in book value terms? in market value terms?
(iii) What is the firm's after-tax cost of debt?
(iv) What is the firm's cost of equity?
(v) What is the firm's current cost of capital?
(vi) Calculate the EPS.