PG – 263

I Semester M.Com. (FA) Examination, May 2024
(CBCS Scheme) (2020 – 21 and Onwards)
FINANCIAL ANALYSIS
Paper – 1.2 : Corporate Financial Management

Time : 3 Hours Max. Marks : 70

SECTION – A

1. Answer **any seven** out of ten. **Each** question carries **two** marks. **(7×2=14)**

   a) What is the pecking order theory of optimal capital structure ?

   b) How would you determine the cost of equity in the NOI approach ?

   c) Define the Modified Internal Rate of Return (MIRR).

   d) What is Opportunity Cost of Capital (OCC) ?

   e) Differentiate between risk and uncertainty.

   f) What is the objective of break-even analysis in capital budgeting ?

   g) Define Cash Conversion Cycle (CCC).

   h) List two potential consequences of excessive working capital.

   i) Identify three internal factors that influence dividend decisions.

   j) How does the dividend policy affect the firm's share price according to the MM theory ?

SECTION – B

Answer **any four** questions out of six. **Each** question carries **five** marks. **(4×5=20)**

2. What is optimal capital structure ? Explain how it maximizes shareholder wealth.

3. Company X and Company Y are in the same risk class and are identical in every respect except that Company X uses debt, while Company Y does not. The levered firm has ₹ 9,00,000 debentures, carrying 10 percent rate of interest.

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Both the firms earn 20 percent operating profit on their total assets of Rs. 15 lakhs. Assume perfect capital markets, rational investors and so on ; a tax rate of 35 percent and capitalization rate of 15 percent for an all-equity company.

a) Compute the value of firms X and Y using the Net Income (NI) Approach.

b) Compute the value of each firm using the Net Operating Income (NOI) Approach.

c) Using the NOI Approach, calculate the overall cost of capital (k_0) for firms X and Y.

4. What are the types of project selection under capital rationing and what are their pros and cons ?

5. The following details are provided by the GPS Limited :

Particulars	**Amount (₹)**
Equity Share Capital	65,00,000
12% Preference Share Capital	12,00,000
15% Redeemable Debentures	20,00,000
10% Convertible Debentures	8,00,000

The cost of equity capital for the company is 16.30% and income tax rate for the company is 30%. You are required to calculate the Weighted Average Cost of Capital (WACC) of the company.

6. How does inadequate working capital impact a company's operations and financial health ? Discuss.

7. The earnings per share of a company are Rs.16. The market rate of discount (capitalization rate) to the company is 12.5%. Retained earnings can be employed to yield a return of 10%. The company is considering a pay-out of 25% , 50% and 75%. Which of these would maximize the wealth of shareholders ? Use Walter's Approach.

SECTION – C

Answer **any three** of the following questions. **(3×12=36)**

8. Describe the various functional areas of modern financial management. How do they interconnect to achieve organizational goals ?

9. Shivam Ltd. is considering 2 mutually exclusive Projects A and B. Project A costs Rs. 36,000 and Project B Rs. 30,000. You have been given below the net present value probability distribution for each Project.

Project A		**Project B**	
NPV estimates	**Probability**	**NPV estimate**	**Probability**
15,000	0.2	15,000	0.1
12,000	0.3	12,000	0.4
6,000	0.3	6,000	0.4
3,000	0.2	3,000	0.1

   1) Compute the expected net present values of Project A and Project B.
   2) Compute the risk attached to each Project i.e. standard deviation of each probability distribution.
   3) Compute the probability index of each Project.
   4) Identify which Project do you recommend ? State with reasons.

10. Alpha Ltd. and Beta Ltd. are identical companies except for capital structure. Alpha Ltd. has 50 percent debt and 50 percent equity, whereas Beta Ltd. has 20 percent debt and 80 percent equity (All percentages are in market-value terms). The borrowing rate for both the companies is 8 percent in a no-tax world and capital markets are assumed to be perfect.

   a) i) If you own 2 percent of the shares of Alpha Ltd., Determine your return if the company has net operating income of Rs. 3,60,000 and the overall capitalisation rate of the company (K_0) is 18 percent.
      ii) Calculate the implied required rate of return on equity of Alpha Ltd.

   b) Beta Ltd. has the same net operating income as Alpha Ltd.
      i) Calculate the implied required rate of return on equity of Beta Ltd.
      ii) Analyse why it differs from that of Alpha Ltd.

11. A company belongs to a risk class for which the appropriate rate of capitalization is 10%. The total number of equity shares is 30,000. The current market price of an equity share is Rs. 80. The company is thinking to declare a dividend of Rs.4 per share at the end of the current year. The company expects to have a net income of Rs. 3,00,000. It has proposal of making investment of Rs. 6,00,000 in new proposals. If MM approach is adopted, show that payment or non-payment of dividend does not affect the value of equity shares of the company.

12. Answer the following :

Company XYZ, a medium-sized automotive manufacturer, is contemplating a significant expansion project due to increasing demand for its products. The management team is currently assessing financial decisions, particularly focusing on capital structure and financing options.

Capital Structure Analysis :

The management team is exploring various capital structure theories, including the Modigliani and Miller Approach, to guide their decision-making process. They are examining the trade-offs between the benefits of debt financing, such as tax advantages and leverage and the associated risks, such as bankruptcy costs and financial distress.

Practical EBIT-EPS Analysis :

Company XYZ aims to conduct an EBIT-EPS analysis to evaluate different financing alternatives for the expansion project. By studying how changes in Earnings Before Interest and Taxes (EBIT) impact Earnings Per Share (EPS) under various financing scenarios, the team seeks to make well-informed decisions.

Questions :

a) Discuss the relevance of the Modigliani and Miller Approach in guiding Company XYZ's capital structure decisions for its expansion project. What key factors should the management team consider when optimizing the company's capital structure ? **6**

b) Conduct an EBIT-EPS analysis for Company XYZ under three financing options : a) all-equity financing b) a mix of debt and equity and c) primarily debt-financed. Evaluate how changes in EBIT levels affect EPS for each option. Based on your analysis, recommend a financing option that maximizes EPS while minimizing financial risk for the company. **6**
