

2024

COMMERCE

Paper : CC-301

(Strategic Financial Management and Business Valuation)

Full Marks : 40

*The figures in the margin indicate full marks.**Candidates are required to give their answers in their own words as far as practicable.*Answer **any two** questions from each **Module**.**Module - 1****(Strategic Financial Management)**

1. (a) While evaluating the mutually exclusive investment proposals, there may be conflict in ranking of such proposals under NPV and IRR methods. State the situations under which conflict may arise and state how you would resolve the conflicts.
- (b) X Ltd. is considering the following investment proposal with a capital budget of ₹ 17,50,000. Suggest the proposals to be selected assuming the proposals are (i) divisible in nature and (ii) indivisible in nature.

Project	Investment ₹	Cash Inflow After Tax ₹
A	7,50,000	9,00,000
B	5,00,000	6,25,000
C	6,25,000	10,00,000
D	15,00,000	19,00,000

3+7

2. (a) What do you mean by Permanent Working Capital and Temporary Working Capital?
- (b) A firm estimates that its half-yearly cash requirement will be ₹ 5,00,000. The firm invests its cash balance in marketable securities yielding a return of 8% and the conversion cost of each lot of marketable securities is ₹ 100. Determine the optimum cash balance to be maintained by the firm.
- (c) What is Financial Break-even Point? 3+5+2

Please Turn Over

(3085)

3. (a) The capital structure of XYZ Ltd. are as follows :

Equity Capital (in share of ₹ 10 each, fully paid-up at par)	₹ 60 Crores
10% Preference Capital (in shares of ₹ 100 each, fully paid-up)	₹ 4 Crores
Retained Earnings	₹ 80 Crores
14% Debentures (of ₹ 100 each)	₹ 40 Crores
15% Term Loans	₹ 50 Crores

Determine the weighted average cost of capital under market value weights for the company, if it raises ₹ 40 crores next year. The relevant information is given below :

- The amount will be raised by equity and debt in equal proportions.
- The debt capital raised by way of term loans will cost 15% for the first ₹ 10 Crores and 16% for the next ₹ 10 Crores.
- The next expected dividend on equity shares is ₹ 3.60 per share; the dividend per share is expected to grow at the rate of 5%. The market price per share is ₹ 30. After increase of capital the market price of share will drop to ₹ 25 per share.
- Preference shares are currently traded at ₹ 80 per share
- The income tax rate for the company is 30%.

(b) "Debt capital works as a tax shield."— Justify the statement.

7+3

4. (a) Discuss criticism of irrelevance theory of M-M on dividend.

(b) MN Ltd. has capital of ₹ 10,00,000 in equity shares of ₹ 100 each. The shares are currently quoted at par. Last year EPS was ₹ 10/-. The company proposes the declaration of dividend of ₹ 10 at the end of current financial year.

The company has net income of ₹ 2,80,000 and an approved proposal of making a new investment of ₹ 5,00,000.

Calculate the followings :

- Market price per share after the end of current financial year
  - When dividend is declared
  - When dividend is not declared
- Number of new shares that must be issued assuming that dividend is declared.
- Value of the firm when dividend is declared and when the same is not declared. Show number of new shares to be issued when dividend is not declared. 3+(2+2+3)

**Module - 2**  
**(Business Valuation)**

5. (a) Fill up the blanks :

- (i) A theory that explains why the total value from the combination resulted from an acquisition is greater than the sum of the values of the component companies operating independently is known as \_\_\_\_\_.
- (ii) Free cash flow to equity can be computed as the difference between net income of the firm and reinvestment \* (1 - \_\_\_\_\_ ratio).
- (iii) The main reason behind every integration in the form of \_\_\_\_\_ merger in value chain management so as to reduce uncertainty over the availability or quality of supplies.
- (iv) EBITDA can be computed as \_\_\_\_\_ + depreciation + amortisation.
- (v) The cash flow approach of enterprise valuation assumes that the value of a company is the sum total of the value of its individual assets which can be realised in cash by \_\_\_\_\_ of such assets.

(b) Comment on the following statements in the context of valuation of a firm.

- (i) Free cash flow to equity of a levered firm is always less than the free cash flow of the firm.
- (ii) Dividend discount model of valuation of firm is viewed as outmoded as it considers dividend as the only cash flow received by equity owners.
- (iii) Other things remaining equal, an increase in financial leverage will increase the beta of the equity of a firm.
- (iv) If the growth rate is expected to drop significantly after the initial growth phase of the firm, the payout ratio should be higher in the stable phase than in the growth phase.
- (v) Industry benchmark growth rate is considered as the growth rate beyond explicit forecast period of a firm. (1×5)+(1×5)

6. (a) Discuss the implication of the following changes on the valuation of a firm, if other things remaining unchanged :

- (i) A reduction in corporate tax rate by the government from an existing 30 percent to 20 percent.
- (ii) To reduce the overall cost of capital, the management of the firm decided to issue fresh debt at a much-reduced cost.
- (iii) The firm increased the reinvestment rate from an existing 40 per cent to 50 per cent.
- (iv) A change in an amortization policy of a firm so as to increase in percentage of amortization to EBITDA.
- (v) Increase in the growth rate of a firm significantly by entering into new business segments.

**Please Turn Over**

**(3085)**

- (b) The terminal period is to commence from next financial year. The current growth rate is 13 per cent on earnings whereas next year onwards earnings is expected to grow @ 5 per cent. The cost of capital shall be 14 per cent. If the EBIT reported for the current financial year is ₹ 250 lacs and the reinvestment rate is to be maintained at 60 per cent, can you estimate the terminal value of this firm, assume marginal tax rate to be 25 per cent. (1×5)+5

7. Estimate the value of the firm based on the given information :

- (i) Free cash flow for the current financial year = ₹ 900 lacs
- (ii) High growth period is 5 years
- (iii) Stable growth period is 5 years
- (iv) Growth rate during high growth period is 10 per cent
- (v) Growth rate during stable growth period is 5 per cent
- (vi) Growth rate beyond explicit forecast period is 2 per cent
- (vii) Cost of Capital = 15 per cent
- (viii) Marginal tax rate = 25 per cent. 10

8. Assume that you have been asked to estimate the PE ratio for a firm that has the following characteristics :

- (i) Length of high growth = 5 years
  - (ii) Growth rate in first five years = 25%
  - (iii) Growth rate after five years = 8%
  - (iv) Payout ratio in first five years = 20%
  - (v) Payout ratio after five years = 50%
  - (vi) Treasury bond rate = 6%
  - (vii) Risk premium = 5.5%
  - (viii) Beta = 1.12. 10
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