

2025

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 - I

(Strategic Financial Management)

1. (a) How will you select the investment proposals under Capital Rationing Situation?
 (b) Consider the following information relating to the two capital investment proposals – X and Y. Calculate Net Present Value and Internal Rate of Return of the proposals and suggest which one should be accepted.

	X (in ₹)	Y (in ₹)
Investment	2,50,000	2,50,000
Cash Inflow		
Year 1	3,75,000	1,00,000
Year 2	–	1,00,000
Year 3	–	3,50,000

Overall Cost of Capital = 12%.

2+8

2. (a) Briefly explain Hedging Approach and Conservative Approach related to Working Capital Management.
 (b) How would you determine Optimum Cash Balance to be maintained by a firm when
 (i) total cash requirement for a particular period is known or can be ascertained with almost certainty, and
 (ii) daily cash requirement of the firm is not certain, i.e., cash requirement changes? 4+6

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

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14% Debentures (of ₹ 100 each)	₹ 40 Crores
15% Term Loans	₹ 50 Crores

Determine the weighted marginal cost of capital schedule for the company, if it raises ₹ 40 crores next year. The relevant information is given below :

- (i) The amount will be raised by equity and debt in equal proportions;
 - (ii) The debt capital raised by way of term loans will cost 15% for the first ₹ 10 Crores and 16% for the next ₹ 10 Crores.
 - (iii) 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.
 - (iv) The income tax rate for the company is 25%.
- (b) Write a short note on 'Pure Play Method' as a technique for measuring Divisional Cost of Capital. 'Debt capital works as a tax shield.'— Justify the statement. 6+(2+2)
4. (a) Discuss the criticism of irrelevance theory of M-M on capital structure.
- (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 ₹ 8. 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 approved a proposal of making a new investment of ₹ 5,00,000.

Calculate :

- (i) Market price per share after the end of current financial year —
 - (A) when dividend is declared;
 - (B) when dividend is not declared.
- (ii) Number of new shares that must be issued assuming that dividend is declared.
- (iii) Value of the firm when dividend is declared and when the same is not declared. Also show number of new shares to be issued when dividend is not declared. 3+(2+2+3)

Module - 2

5. (a) Assume a corporate tax rate of 20 percent for the following :
- (i) Firm A's growth rate is 9 percent. Reinvestment rate is 40 percent. EBITDA = ₹ 680 lakhs; EBIT = ₹ 450 lakhs. Calculate reinvestment amount.
 - (ii) If sales turnover of Firm B is ₹ 36 crores, growing at 12 percent, having an operating profit margin of 40 percent and reinvestment requirement is ₹ 3.60 crores, find the FCFE.
 - (iii) Total Capital employed of Firm C is ₹ 6000 lakhs with a debt to capital ratio of 1 : 6, having an investment in non-operating assets of ₹ 500 lakhs, compute ROIC if operating profit is ₹ 2200 lakhs.

- (iv) Firm D's, cost of equity exceeds growth by 4 percent, whereas ROE exceeds growth by 8 percent having an EPS of ₹ 25, determine PBV ratio.
- (v) The reinvestment needs of Firm E is ₹ 300 lakhs, having a growth rate of 10 percent and net income of ₹ 1200 lakhs, calculate equity reinvestment rate if debt ratio is 50 percent.
- (b) Net Income of Firm N is half of Firm M, which stood at ₹ 2500 lakhs. Value to EBITDA multiple of Firm 'M' is 2.5 times of Firm 'N', both are similar and comparable levered firms, which are subjected to same marginal tax rate, whereby Firm M enjoys a lower cost of capital of 12 percent in comparison to Firm N's 15 percent. If both the firms allocate 25 percent towards depreciation and amortisation (DA) and 40 percent towards reinvestment out of its core income respectively, estimate the growth rate of Firm M, which is 1.2 times of Firm N's growth. $(1 \times 5) + 5$
6. (a) Free cash flow of the firm for the current financial year is ₹ 1,350 lakhs. Capital employed amounts to ₹ 2,600 lakhs including a cash balance of ₹ 200 lakhs whereby the book value of equity is ₹ 1,800 lakhs. The required rate of return of the equity investors is 16 percent and the overall tax-adjusted cost of capital of the firm is 12 percent. Compute the value to equity if the expected growth rate in operating revenues and earnings per share is 10 percent and 12 percent respectively. Assume a tax rate of 25 percent.
- (b) Estimate market value of the firm based on the following information :
- Book Value of debt capital = ₹ 600 lacs
- Book Value of equity capital = ₹ 1200 lacs
- Explicit forecast growth period = 5 years
- ROC (high growth period) = 15 percent
- ROC (stable growth period) = 5 percent
- RIR (high growth) = 50 percent
- RIR (stable growth) = 20 percent
- Cost of capital during high growth = 10 percent
- Cost of capital during stable period = 12 percent. $5 + 5$
7. (a) ABC rashtriya udyog, which operates chain of hotels and restaurants, reported dramatic growth in earnings and revenues between 2015 and 2024. During this period, earnings grew from ₹ 8 per share in 2015 to ₹ 78 per share in 2025. The dividends paid in 2025 amounted to only ₹ 2 per share. The earnings growth rate is expected to ease to 10% a year from 2026 to 2030, and to 6% a year after that. The payout ratio is expected to increase to 10% from 2026 to 2030, and to 50% after that. The beta of the stock was 1.55, but it is expected to decline to 1.25 for the 2026 to 2030 time period and to 1.10 after that. (The treasury bond rate is 6%, and the risk premium is 5.5%.)
- (i) Estimate the PE ratio for ABC rashtriya udyog.
- (ii) Estimate how much higher the PE ratio would have been if it had been able to maintain the growth rate in earnings that it had posted between 2016 and 2025. (Assume that the dividend payout ratios remain unaffected.)

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(b) Estimate the value of the firm (assume marginal tax rate @ 25 percent) based on the following information:

- (i) Operating income for the FY26 projected to be ₹ 2300 lakhs
- (ii) Reinvestment rate during the high growth period = 50%
- (iii) Expected ROIC during the next 5 years = 25%
- (iv) Beyond the 5th year, firm's earnings shall stabilize whereby ROIC may decline to 14% and the reinvestment rate is to be maintained at 40%.
- (v) Investors required rate of return during high growth period is 15% which might increase to 1.1 times of ROIC during the stable period.
- (vi) The firm may infuse fresh capital in its business. (3+2)+5

8. (a) You have been asked to analyze the synergy in a merger of two start-up software firms. Both the firms are doing well in terms of gaining substantial market share and adding offshore clients. 90 percent of the customer base of each firm is separate and only about 10 percent or less are common clients. The management of both the firms are in favour of the merger as they expect it will give rise to revenue synergies rather than just cost cutting, driven by complementary vertical strengths and minimal client overlap. You have been provided with the following information for the ongoing financial year :

	Cloud 9 Services Ltd.	Tech 10 Digital Services Ltd.
Nos. of Ordinary shares (in millions)	12.5	6.0
Book Value of each ordinary share (in ₹)	10	1
Earnings per ordinary share (in ₹)	2.0	0.5
Unlevered Beta	1.2	1.2
Market Risk premium	5.0	5.0

Both the firms are expected to grow at 8 percent a year and are subjected to tax rates of 25 percent. Estimate the value of both the software firms as stand-alone firms. If the combined entity post-merger is expected to generate an additional 15 percent of revenues, which can possibly enhance their combined bottom line by 10 percent, YoY, starting next year, and a saving of ₹ 0.14 million, starting right away, Estimate the value of synergy. (The treasury bond rate is 6 percent.)

(b) Fill up the blanks :

- (i) _____ are severance contracts that compensate managers for losing their jobs after a takeover.
- (ii) _____ are securities carrying special rights exercisable by a triggering event such as the announcements of a tender offer or a specified ownership position in the firm's stock,
- (iii) _____ tactics such as leveraged recapitalizations may incur a huge amount of debt and increase the ownership position of insiders.
- (iv) _____ are anti-takeover amendments which imposes new conditions on the transfer of managerial control.

Or

- (b) Comment on the following statements in the context of valuation of a firm :
- (i) Increasing the financial leverage always increases the equity beta of a firm regardless of tax rate or other factors.
 - (ii) Multiples like EV/EBITDA is preferred over PE ratio while comparing firms with negative operating income.
 - (iii) The stock price will exceed the book value of equity, if the return on equity exceeds the cost of equity.
 - (iv) The Dividend Discount Model (DDM) is obsolete for firm valuation because it considers dividends as the only cash flow received by equity owners. 6+(1×4)
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