



LOYOLA COLLEGE (AUTONOMOUS) CHENNAI – 600 034

M.Com. DEGREE EXAMINATION – COMMERCE

SECOND SEMESTER – APRIL 2025

PCO2MC02 – STRATEGIC FINANCIAL MANAGEMENT



Date: 26-04-2025

Dept. No.

Max. : 100 Marks

Time: 01:00 PM - 04:00 PM

SECTION A – K1 (CO1)

Answer ALL the questions

(5 x 1 = 5)

1 State whether each of the following statements is 'True' or 'False'

- a) Wealth maximization means maximizing the Net Present Value of a course of action.
- b) A highly geared company exposes to financial risk.
- c) The value of a levered firm is higher than that of an unlevered firm on account of corporate taxes.
- d) The return after the pay-off period is not considered in case of internal rate of return method.
- e) Walter's model is based on the relationship between 'r' and 'k'.

SECTION A – K2 (CO1)

Answer ALL the questions

(5 x 1 = 5)

2 Answer the following:

- a) What is time value of money?
- b) How does trading on equity relate to financial leverage?
- c) Define the concept of 'cost of capital'.
- d) Distinguish between risk and uncertainty.
- e) State any two advantages of Lease Financing.

SECTION B – K3 (CO2)

Answer any THREE of the following:

(3 x 10 = 30)

- 3 Explain as to how the wealth maximization objective is superior to profit maximization objective.
- 4 What are aggressive and conservative current assets financing policies? State your preference with reasons.
- 5 Explain 'Financial and Operating Leases' with their advantages and limitations.
- 6
 - a) Write a brief note on Net Income (NI) Approach.
 - b) X Ltd is expecting annual EBIT of ₹ 1,00,000. The company has ₹ 4,00,000 of 10% debentures. The equity capitalization rate is 12.5%. The company desires to redeem debentures of ₹ 1,00,000 by issuing additional shares of ₹ 1,00,000.

You are required to calculate the value of the firm and the overall cost of capital as per Net Income Approach.

7 A company has to select one of the following two projects:

Particulars	Project A ₹	Project B ₹
Cost	11,000	10,000
Cash inflows: Year 1	6,000	1,000
Cash inflows: Year 2	2,000	1,000
Cash inflows: Year 3	1,000	2,000
Cash inflows: Year 4	5,000	10,000

Using the internal rate of return method suggest which project is preferable.

SECTION C – K4 (CO3)**Answer any TWO of the following:****(2 x 12.5 = 25)**

8 Define Optimum Capital Structure and Explain the various factors determining the optimum capital structure of a company.

9 The following data relates to Y Ltd:

Sales	₹ 4,00,000
Variable cost	₹ 1,20,000
Fixed Operating Cost	₹ 2,00,000
Interest on Debentures	₹ 10,000

1) Using the concept of leverage, by what percentage will taxable income increase if sales increase by 12%.

2) Using the concept of operating leverage by what percentage will EBIT increase if there is a 20% increase in sales?

3) Using the concept of financial leverage, by what percentage will taxable income increase if EBIT increases by 12%.

10 The following is the capital structure of MM Ltd as on 31st March, 2023:

Source of Funds	₹
Equity Capital: 50,000 shares of ₹ 20 each	10,00,000
11% Preference Shares of ₹ 100 each	4,50,000
9% Debentures	5,50,000

Additional Information:

- ₹ 100 per debenture redeemable at par, has 2% floatation cost and 10 years of maturity. The market price per debenture is ₹ 115.
- ₹ 100 per preference share redeemable at par, has 3% floatation cost and 10 years maturity. The market price per preference share is ₹ 125.
- Equity share has ₹ 4 floatation cost and market price per share of ₹ 24. The expected dividend is ₹ 2 per share with annual growth of 5%.
- The corporate income tax rate is 35%.

Calculate weighted average cost of capital (WACC) using market value weights.

11 S Ltd has a contribution/sales ratio 20% and average book debts of ₹ 10,00,000 which it collects in an average collection period 24 days. The company reorganized its credit administration department recently and introduced a cash discount of 5% to speed up collection of outstanding. The incentive is payable to customers making payment within 10 days. When the company reviewed the position after few months it was found that the average collection period had actually fallen to 20 days only and the average book debts had increased to ₹ 10,50,000 mainly as a result of some increase in sales. It was also noticed that only about half the total sales availed of the cash discount. The company's cost of raising additional funds is 20%. Do you recommend continuance of the cash discount? Take 360 days a year.

SECTION D – K5 (CO4)**Answer any ONE of the following:****(1 x 15 = 15)**

12 A firm is planning to acquire a new machine that requires an initial cash outlay of ₹ 12,000. The machine has a useful economic life of two years without any salvage value thereafter. The cash flows and their related probabilities for the two years are as given below:

In the first year:

Event	Cash inflows ₹	Probability
A	4,800	0.2
B	6,600	0.6
C	9,000	0.2

In the second year the cash inflows corresponding the events A, B and C have the following possible probable occurrences:

Event	Cash Inflows ₹	Probability	Event	Cash Inflows ₹	Probability	Event	Cash Inflows ₹	Probability
A1	2,400	0.3	B1	7,800	0.2	C1	9,600	0.1
A2	6,000	0.4	B2	9,000	0.6	C2	12,000	0.8
A3	9,000	0.3	B3	9,600	0.2	C32	14,400	0.1

Given that the required rate of return is 9%. Suggest the acceptability of this project by applying the technique of decision tree analysis.

- 13** XYZ Ltd is presently operating at 75% level, producing 36,000 units per annum. In view of favourable market conditions, it has been decided that from 1st January 2022, the Company would operate at 90% capacity. The following information are available:
Existing cost – price structure per unit is given below:
- | | |
|----------------------|-----|
| Raw Material | ₹ 4 |
| Wages | ₹ 2 |
| Overheads (Variable) | ₹ 2 |
| Overheads (Fixed) | ₹ 1 |
| Profits | ₹ 1 |
- It is expected that the cost of raw material, wages and expenses are sale per unit will remain unchanged in 2022.
Raw Materials remain in stores for 2 months before these are issued to production. These units remain in production process for 1 month.
Finished goods remain in godown for 2 months.
Credit allowed to debtors is 2 months. Credit allowed by creditors is 3 months.
Lag in payments of wages and overheads is 1 month. It may be assumed that wages and overhead accrue evenly throughout the production cycle.
You are required to calculate the working capital requirements on an estimated basis to sustain the increased production level. Assumptions made if any, should be clearly indicated.

SECTION E – K6 (CO5)

Answer any ONE of the following:

(1 x 20 = 20)

- 14** P Ltd wishes to raise ₹ 100,00,000 for a diversification project. Current estimate of earnings before interest and taxes from the new project is ₹ 22,00,000 per annum.
Cost of debt will be 15% for amounts up to and including ₹ 40,00,000; 16% for additional amounts up to and including ₹ 50,00,000 and 18% for additional amounts above ₹ 50,00,000.
The equity shares of ₹ 10 face value of the company have a current market value of ₹ 40. This is expected to fall to ₹ 32 if debts exceeding ₹ 50,00,000 are raised. The following options are under consideration of the company:
- | Option | Equity | Debt |
|--------|--------|------|
| I | 50% | 50% |
| II | 60% | 40% |
| III | 40% | 60% |
- Determine the earning per share (EPS) for each option and state which option the company should exercise. Tax rate applicable to the company is 50%.
- 15** A firm has the choice of buying an equipment at a cost of ₹ 1,00,000 with borrowed funds at a cost of 18% p.a repayable in five annual instalments of ₹ 32,000 or to take on lease same on an annual rental of ₹ 32,000. The firm is in the tax bracket of 40%
Assume the salvage value of the equipment at the end of the period is zero. The firm uses straight line depreciation. Which alternative do you recommend?

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