**Corporate Finance**

**December 2024 Examination**

**1. ABC Limited has equity with a market value of Rs. 20 Lacs and debt with a market value of Rs. 15 Lacs. The Balance sheet of the company showed the Capital Structure as under:**

|  |  |
| --- | --- |
| **Capital Structure** | **BV** |
| **Share Capital** | **10,00,000** |
| **Debentures** | **5,00,000** |
| **Bank Loan** | **8,00,000** |

**Cost of debt is 9%. The risk-free rate is 8% and the market rate is 18%. The beta of the company is 0.15. The firm pays no taxes.**

**a. What is ABC Limited’s debt to equity ratio?**

**b. What is ABC Limited’s weighted average cost of capital based on Market value as well as Book value? Answer up to 2 decimal places.**

**c. ABC Limited is in growing stage and soon the company will be under 35% tax bracket, in such a scenario the company is thinking to raise the debt up to 70%. Under these conditions, what will be the new DE ratio and the new cost of capital of the company?**

**d. What is the impact of change in DE ratio as above on the Company and why? (10 marks)**

**Ans 1.**

**Introduction**

Corporate finance deals with the management of a company's financial resources, focusing on capital structure, financing strategies, and risk-return trade-offs. The capital structure of a firm—how it finances its operations through a combination of debt and equity—is crucial for determining the firm’s weighted average cost of capital (WACC). The WACC is the average rate a company expects to pay for financing its capital, and it plays a pivotal role in investment decisions. It includes the cost of both debt and equity, weighted by their respective proportions in the company's capital structure. Understanding and optimizing the debt-to-equity (DE) ratio is essential for balancing financial risk and return. This scenario presents ABC Limited’s current capital structure and explores the potential impacts of raising additional debt under new tax conditions. In this context, calculating the DE ratio and the WACC, both

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**2. XYZ Ltd. is evaluating a new project proposal with a cash outlay of Rs. 80,000. Cash inflows are 25,000 , 28,200 , 32,000, 12,000, 15,000. The project is being funded entirely by a bank loan raised at an interest rate of 9% p.a. Currently there is no tax applicability to the firm. Evaluate the project using NPV and IRR methodologies.**

**The Board of Directors want a minimum of 12% as its rate of return on the project. Will the company take up the project?**

**How will the situation be different if the company is subject to a tax of 25%? (10 marks)**

**Ans 2.**

**Introduction**

Project evaluation is a critical part of corporate finance, allowing firms to assess the viability and profitability of potential investments. Companies often use methodologies like Net Present Value (NPV) and Internal Rate of Return (IRR) to determine whether a project will generate a satisfactory return. NPV measures the difference between the present value of cash inflows and outflows, while IRR calculates the discount rate at which the present value of inflows equals outflows, effectively giving the project's rate of return. XYZ Ltd. is considering a new project with an initial outlay of Rs. 80,000 and a series of future cash inflows. The project will be funded entirely by a bank loan at 9%, and the firm is currently tax-exempt. The Board of Directors has set a required rate of return of 12%. This analysis will calculate the project’s NPV and IRR to assess its profitability. Additionally, we will explore how the outcome would change if the company were subject to a 25% tax rate.

**Concept and Calculation**

**a. Net Present Value (NPV)**

The NPV method compares the present value of a project’s expected cash inflows with its initial cash

**3a. Maya bought a house of value Rs. 65,00,000. She got a loan of 80% of the value of the house from the bank. The bank offered her a loan for 10 years @ 8.5% interest payable annually. Calculate the equated annual payment to be made by her and draw up her annual payment schedule. (5 marks)**

**Introduction**

When individuals take out a loan to purchase a house, they typically repay the loan in equal installments over a set period. This process, known as equated annual payments, allows borrowers to make consistent payments that cover both interest and principal. Maya has taken out a loan for 80% of the value of her house, which amounts to Rs. 65,00,000. The loan is for 10 years with an interest rate of 8.5%, payable annually. To determine Maya's annual

**b) With the following data, calculate DSO and Debtor Turnover Ratio (in no. of times) for FY 2021-22. What is better for the company, a higher ratio or lower ratio? Give brief reasons? (In one line) (5 marks)**

|  |  |  |
| --- | --- | --- |
|  | **FY 2021-22** | **FY 2020-21** |
| **Sales** | **1,500,000** | **1,650,000** |
| **Receivables** | **30,000** | **35,000** |
| **60% of the sales are on credit basis** | | |

**Ans 3b.**

**Introduction**

Days Sales Outstanding (DSO) and Debtor Turnover Ratio are essential financial metrics used to assess how efficiently a company collects its receivables from customers. DSO measures the average number of days it takes a company to collect payments after making a sale, while the Debtor Turnover Ratio indicates how many times the receivables are collected during a specific period. Both metrics provide insight into a company's cash flow management and credit policies. For FY 2021-22, we are given the