VI Semester B.Com. Examination, April/May 2015  
(Fresh) (2014-15 and Onwards)  
COMMERCE  
Paper – 6.5 : Elective Paper – III : Corporate Financial Policy  

Time : 3 Hours  
Max. Marks : 100

**Instruction**: Answer should be completely either in **English** or in **Kannada**.

**SECTION – A**

Answer 10 sub-questions of the following, each question carries 2 marks.  
\((2\times10=20)\)

1. a) Mention any two advantages of equity shares.  
b) What is meant by ploughing back of profits?  
c) Give the meaning of preference share capital.  
d) Mention the types of mergers.  
e) What is vision?  
f) What are financial goals?  
g) What is horizontal merger?  
h) What is synergy?  
i) What is corporate valuation?  
j) Mention the purpose of corporate valuation.  
k) Mention any two differences between shares and debentures.  
l) What is sustained growth approach?

**SECTION – B**

Answer any four of the following, each question carries 8 marks.  
\((8\times4=32)\)

2. What are the components of mission statement?  
3. Briefly explain the factors influencing retained earnings.
4. Compute the level of EBIT at which the indifference point between the following financing alternative will occur:

   a) Ordinary share capital Rs. 10,00,000 or 15% debentures of Rs. 5,00,000 and ordinary share capital of Rs. 5,00,000.

   b) Ordinary share capital of Rs. 10,00,000 or 13% Preference share capital of Rs. 5,00,000 and ordinary share capital of Rs. 5,00,000.

   Assume that the corporate tax rate is 50% and the price of the ordinary share is Rs. 10 in each case.

5. A Company issues Rs. 5,00,000 10% redeemable debentures at a discount of 5%. The costs of floatation amount to Rs. 15,000. The debentures are redeemable after 5 years. Calculate before-tax and after-tax cost of debt assuming a tax rate of 50%.

6. A Ltd. wants to take over B Ltd. and the financial details of both the companies are as below:

   **Particulars**                       **A Ltd.**      **B Ltd.**
                                 **Rs.**        **Rs.**

   Equity share capital of Rs. 10 each  1,00,000        50,000
   Preference share capital             20,000          –
   Share premium                        –              2,000
   Profit and loss account              38,000          4,000
   10% debentures                       15,000          5,000

   **Total Liabilities**                **1,73,000**    **61,000**
   Fixed assets                        1,22,000        35,000
   Current assets                      51,000          26,000

   **Total assets**                     **1,73,000**    **61,000**
   Profit after tax and preference dividend 24,000        15,000
   Market price per share              24              27

You are required to determine the share exchange ratio to be offered to the shareholders of B Ltd., based on

   i) Net assets value and
   ii) Market price.
SECTION – C

Answer any 3 of the following questions; each question carries 16 marks. (16 x 3 = 48)

7. Explain the types of business environment.

8. Explain in detail the basis of corporate valuation.

9. Sunny Lamps Ltd. is taking over Moon Lamps Ltd. As per the understanding between the managements of the two companies, shareholders of Moon Lamps Ltd., would receive 0.7 shares of Sunny Lamps Ltd. for each share held by them. The relevant data for the two companies are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Sunny Lamps Ltd.</th>
<th>Moon Lamps Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sales (Rs. in Lakhs)</td>
<td>40</td>
<td>15</td>
</tr>
<tr>
<td>Profit after tax (Rs. in Lakhs)</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>Number of shares (Lakhs)</td>
<td>1.6</td>
<td>0.5</td>
</tr>
<tr>
<td>Earnings per share (EPS Rs.)</td>
<td>2.5</td>
<td>2</td>
</tr>
<tr>
<td>Market value per share (Rs.)</td>
<td>15</td>
<td>10</td>
</tr>
<tr>
<td>Price-earning ratio (P/E)</td>
<td>6</td>
<td>5</td>
</tr>
</tbody>
</table>

Ignoring the economies of scale and the operating synergy, you are required to calculate:

i) Premium paid by Sunny Lamps Ltd. to the shareholders of Moon Lamps Ltd.

ii) Number of shares after the merger

iii) Combined EPS

iv) Combined P/E ratio

v) Market value per share and

vi) Total market capitalization after the merger.
10. a) A firm has the following capital structure and after tax cost for different sources of funds used.

<table>
<thead>
<tr>
<th>Sources of Funds</th>
<th>Amount</th>
<th>After tax cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
<td>7,50,000</td>
<td>5%</td>
</tr>
<tr>
<td>Preference shares</td>
<td>6,00,000</td>
<td>10%</td>
</tr>
<tr>
<td>Equity shares</td>
<td>9,00,000</td>
<td>12%</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>7,50,000</td>
<td>11%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>30,00,000</td>
<td></td>
</tr>
</tbody>
</table>

You are required to compute the weighted average cost of capital.

b) A company has on its books the following amounts and specific costs of each type of capital.

<table>
<thead>
<tr>
<th>Type of capital</th>
<th>Book value</th>
<th>Market value</th>
<th>Specific costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
<td>2,00,000</td>
<td>1,90,000</td>
<td>5</td>
</tr>
<tr>
<td>Preference</td>
<td>50,000</td>
<td>55,000</td>
<td>8</td>
</tr>
<tr>
<td>Equity</td>
<td>3,00,000</td>
<td>6,00,000</td>
<td>15</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>1,00,000</td>
<td>–</td>
<td>13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6,50,000</td>
<td>8,45,000</td>
<td></td>
</tr>
</tbody>
</table>

Determine the weighted average cost of capital using:

a) Book value weights and
b) Market value weights.

How are they differing? Can you think of a situation where the weighted average cost of capital would be the same using either of the weights?