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Curated By:-

CA, CPA Vinod Kumar Agarwal

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ABOUT

CA VINOD KUMAR AGARWAL

(AIR-2nd, 4th & 24th IN FOUNDATION, INTER & FINAL RESPECTIVELY)

SUMMARY

Founder Member of A.S. Foundation, India's Leading Academy for C.A. Course, CA Vinod Kumar Agarwal is a fellow member of ICAI and a past member of the Board of Studies, ICAI. With a teaching experience of twenty years, he has guided more than 1,00,000 students and is ranked as one of the best teachers for Accounts and Financial Management at Intermediate level and Financial Reporting and SFM at Final Level.

He has authored books on Accounts, Advanced Auditing for CA Final, Auditing for Intermediate, Accounting Standards, Ind AS, Costing and Financial Management, and his books have sold more than 2,00,000 copies.

PUBLICATIONS AND ACHIEVEMENTS

- A merit holder in all the three levels of exams conducted by ICAI (2nd rank, 4th rank, and 24th rank in CA Foundation, CA Intermediate an CA Final respectively).
- Scored 99 marks in Accountancy in CA Foundation.
- Authored books on Accounts, Advanced Auditing for CA Final, Auditing for Intermediate, Accounting Standards, Ind AS, Costing and Financial Management.
- Complied a book "No Truth, Only Interpretations", a book on motivation, inspiration and guidance.
- Compiled a book, "Mind Candy", a book on motivation.
- Compiled a book, "Sweet Voice", a book on inspirational quotes.
- Working experience with India's top firms Firms like M/s. S.B. Billimoria and A.F. Ferguson (both member firm of Deloitte).
- Published article in the Students Newsletter of ICAI on "Valuation of Equity Shares" and "Stock Market Index".
- Presented a paper on "Corporate Governance and Role of Auditor" in National Students Conference held in Goa.

EDUCATION

- Passed the Certified Public Accountant (CPA) (USA) exam in 2007.
- Post-graduation from Pune University with First Class.
- Graduation from B.M.C.C, Pune with distinction.
- Passed the Diploma in Business Finance Conducted by ICFAI, Hyderabad.
- Passed the Derivative Module test conducted by National Stock Exchange.
- Also appeared for UPSC exam and cleared Mains twice.

TEACHING EXPERIENCE

- Teaches Accounts, Advanced Accountancy, Financial management and Economics for Finance at CA Intermediate Level and Financial Reporting and Advanced Financial Management (AFM) at CA Final level.
- Pioneer of creating and distributing video tutorials in pen drives/google drive among students.
- Produced All India Toppers (1st Rank) in CPT examination and final examination apart from more than 250 all India merit- holders.
- More than 30000 Facebook subscribers, more than 42000 YouTube subscribers.
- Sold more than 40000 video lectures in pen-drive and google-drive mode.
- In 2019, launched a brand VKNOW, to become a national brand for digital learning.

TEACHING APPROACH

- Simple and effective way of teaching through concept building, class-room practice, home-exercise, and power-point presentation.
- A large variety of problems are solved in the class to meet the examination requirements.
- Notes are updated frequently covering amendments and exam problems.

Chapter - 4

COST OF CAPITAL

1. Cost of equity share or debt is called –
   (a) Related cost of capital
   (b) Easy to calculate cost of capital
   (c) Specific cost of capital
   (d) Burden on the shareholder

2. In which of the following method cost of equity capital is computed by dividing the dividend by market price per share or net proceeds per share?
   (a) Price Earning Method
   (b) Adjusted Price Method
   (c) Adjusted Dividend Method
   (d) Dividend Yield Method

3. In weighted average cost of capital, a company can affect its capital cost through-
   1. Policy of capital structure
   2. Policy of dividends
   3. Policy of investment

   Select the correct answer from the options given below:
   (a) 1 only
   (b) 2 & 3
   (c) 1 & 3
   (d) All 1, 2 & 3

4. Which of the following is correct formula to calculate cost of equity under dividend yield method?
   (A) $K_e = \frac{D}{P_0}$
   (B) $K_e = R_f + \beta (R_m - R_f)$
   (C) $K_e = \frac{D_1}{NP} + g$
   (D) $K_e = \frac{EPS}{P_0}$

5. ________ is the rate of return associated with the best investment opportunity for the firm and its shareholders that will be forgone if the projects presently under consideration by the firm were accepted.
   (a) Explicit Cost
   (b) Future Cost
   (c) Implicit Cost
   (d) Specific Cost

6. Which of the following model/ method makes use of beta (β) in calculation of cost of equity?
   (a) Risk Adjusted Discount Model
   (b) Capital Assets Pricing Method
   (c) MM Model
   (d) Price Earning Method

7. Marginal cost-
   (a) is the weighted average cost of new finance raised by the company.
   (b) is the additional cost of capital when the company goes for further raising of finance.
   (c) is the cost of raising an additional rupee of capital.
   (d) All of the above

8. The cost of equity share or debt is called specific cost of capital. When specific costs are combined, then we arrive at-
   (a) Maximum rate of return
   (b) Internal rate of return
   (c) Overall cost of capital
   (d) Accounting rate of return

9. Statement I:
   Where earnings, dividends and equity share price all grow at the same rate, the cost of equity capital may be computed by dividend growth method.
   Statement II
   When risk free rate is added to the market rate of return risk premium for the stock is arrived.
   Select the correct answer from the options given below:
   (a) Statement I is false but Statement II is true
   (b) Both Statement I and Statement II are false
   (c) Statement II is false but Statement I is true
   (d) Both Statement I and Statement II are true

10. Assertion (A):
    Cost of share capital would be based upon the expected rate of earnings of a company.
    Reason (R):
    Each investor expects a certain amount of earnings, whether distributed or not from the company in whose shares he invests.
    Select the correct answer from the options given below
    (a) A is true but R is false
    (b) A is false but R is true
    (c) A and R both are true but R is not correct explanation of A
    (d) A and R both are true and R is correct explanation of A

11. If we deduct 'risk free return' from 'market return' and multiply it with 'beta factor' & again add 'risk free return', the resultant figure will be –
    (a) Nil
    (b) Risk premium
    (c) Cost of equity
    (d) WACC of the firm

12. For each component of capital, a required rate of return is considered as:
    (a) Component cost
    (b) Evaluating cost
    (c) Asset cost
    (d) Asset depreciation value

13. ______ is the rate that the firm pays to procure financing.
    (a) Average Cost of Capital
    (b) Combine Cost
    (c) Economic Cost
    (d) Explicit Cost

14. Which of the following method of cost of equity is similar to the dividend price approach?
    (a) Discounted cash flow (DCF) method
    (b) Capital asset pricing model
    (c) Price earning method
    (d) After tax equity method

15. Preferred dividend is divided by preferred stock price multiply by (1- floatation cost) is used to calculate
    (a) Transaction cost of preferred stock
    (b) Financing of preferred stock
    (c) Weighted cost of capital
    (d) Component cost of preferred stock

16. Statement I:
    Cost of retained earnings is the opportunity cost of dividends forgone by shareholders.
    Statement II:
    The opportunity cost of reserve & surplus may be considered as their cost, which is equivalent to the income that would otherwise earn by placing these funds in alternative investment. Select the correct answer from the options given below:
    (a) Statement I is false but Statement II is true
    (b) Both Statement I and Statement II are false
    (c) Statement II is false but Statement I is true
    (d) Both Statement I and Statement II are true

17. How you will calculate expected dividend i.e. dividend at the end of year one?
    (a) D_1 = [Do (1 + g)]
    (b) D_1 = [Do(1 - t)]
    (c) D_1 = [Do X (1 - g)]
    (d) D_1 = [Do + (1 - g)] (1 - t)

18. In weighted average cost of capital, rising in interest rate leads to –
    (a) Increase in cost of debt
    (b) Increase the capital structure
    (c) Decrease in cost of debt
    (d) Decrease the capital structure

19. _____ is the cost which has already been incurred for financing a particular project.
    (a) Future Cost
    (b) Historical Cost
    (c) Implicit Cost
    (d) Opportunity Cost

20. In weighted average cost of capital, capital components are funds are usually offered by:
    (a) Stock market
    (b) Investors
    (c) Capitalist
    (d) Exchange index

21. Overall cost of capital is called as –
    (a) Composite cost of capital
    (b) Combined cost of capital
    (c) Both (A) and (B)
    (d) Neither (A) nor (B)

22. Premium which is considered as difference of expected return on common stock and current yield on Treasury bonds is called –
    (a) Past risk premium
    (b) Expected premium
    (c) Current risk premium
    (d) Beta premium

23. Which of the following figure is irrelevant while calculating cost of redeemable preference shares?
    (a) Flotation cost
    (b) Discount
    (c) EPS
    (d) Net proceeds

24. Select which of the following statement is correct?
    (a) Capital budget decision largely depends on the cost of capital of each source.
    (b) Capital structure is the mix or proportion of the different kinds of short term securities.
    (c) Cost of capital helps to evaluate the financial performance of the firm.

(d) As per MM approach, the cost of equity (K_e) is equal to capitalization rate of pure equity stream minus a premium for business risk.

Select the correct answer from the options given below:

(a) (I) and (II)
(b) (I), (III) and (IV)
(c) (II) and (III)
(d) (I) and (III)

25. An interest rate which is paid by firm as soon as it issues debt is classified as pre-tax –
(a) Term structure
(b) Market premium
(c) Risk premium
(d) Cost of debt

26. Which of the following is controllable factor affecting the cost of capital of the firm?
(a) Dividend policy
(b) Level of interest rates
(c) Tax rates
(d) All of the above

27. Which of the following is uncontrollable factor affecting the cost of capital of the firm?
(a) Investment Policy
(b) Capital Structure Policy
(c) Debt service charges
(d) None of the above

28. Type of cost which is used to raise common equity by reinvesting internal earnings is classified as
(a) Cost of common equity
(b) Cost of mortgage
(c) Cost of stocks
(d) Cost of reserve assets

29. Which of the following is correct formula to calculate cost of irredeemable preference shares?
(a) Preference dividend ÷ Net proceeds
(b) Preference dividend X (1 - t)
(c) [Preference dividend X (1 - t)] ÷ Net proceeds
(d) [Preference dividend ÷ Net proceeds] X (1 - t)

30. Which of the following factor affects the determination of cost of capital of the firm?
(a) General economic conditions
(b) Market conditions
(c) Operating and financing decisions
(d) All of the above

31. Cost of equity which is raised by reinvesting earnings internally must be higher than the –
(a) Cost of initial offering
(b) Cost of new common equity
(c) Cost of preferred equity
(d) Cost of floatation

32. After tax cost of debentures not redeemable during the life time of the company is -
(a) [Interest ÷ Net proceeds] X (1 - t)
(b) Interest X (1 - t) ÷ Net proceeds
(c) Interest X (1+ t) ÷ Net proceeds
(d) [Interest ÷ Net proceeds] X (1 + t)

33. Risk free rate is subtracted from expected market return is considered as:
(a) Country risk
(b) Diversifiable risk
(c) Equity risk premium
(d) Market risk premium

34. A firm's overall cost of capital:
(a) varies inversely with its cost of debt.
(b) is unaffected by changes in the tax rate.
(c) is another term for the firm's internal rate of return.
(d) is the required return on the total assets of a firm.

35. Which of the following is correct formula to calculate cost of redeemable debentures?

(A) $K_d = \dfrac{\left[I(1+t)-\left(\dfrac{R_v-S_v}{N}\right)\right]}{\left(\dfrac{R_v+S_v}{2}\right)}$

(B) $K_d = \dfrac{\left[I(1-t)+\left(\dfrac{R_v+S_v}{N}\right)\right]}{\left(\dfrac{R_v-S_v}{2}\right)}$

(C) $K_d = \dfrac{\left[I(1-t)+\left(\dfrac{R_v-S_v}{N}\right)\right]}{\left(\dfrac{R_v-S_v}{2}\right)}$

(D) $K_d = \dfrac{\left[I(1-t)+\left(\dfrac{R_v-S_v}{N}\right)\right]}{\left(\dfrac{R_v+S_v}{2}\right)}$

36. The weighted average cost of capital (K_o) results from a weighted average of the firm's debt and equity capital costs. At a debt ratio of zero, the firm is 100% equity financed. As debt is substituted for equity and as the debt ratio increases, the –
(a) K_o declines because the after-tax debt cost is less than the equity cost ($K_d < K_e$).
(b) K_o increases because the after-tax debt cost is less than the equity cost ($K_d < K_e$)
(c) K_o do not show any change and tend to remain same.
(d) None of the above

37. The overall (weighted average) cost of capital is composed of a weighted average of ______
(a) the cost of common equity and the cost of debt
(b) the cost of common equity and the cost of preferred stock .
(c) the cost of preferred stock and the cost of debt
(d) the cost of common equity, the cost of preferred stock, and the cost of debt

38. While calculating the WACC, cost of each component of the capital is weighted –
(a) In the ratio of 1:2:3:4
(b) by the relative proportion of that type of funds in the capital structure.
(c) by the relative proportion of that type of funds to total assets in the company
(d) Both (A) and (C)

39. For which of the following costs is it generally necessary to apply a tax adjustment to a yield measure?
(a) Cost of debt
(b) Cost of preferred stock
(c) Cost of common equity
(d) Cost of retained earnings

40. The cost of preference share capital is calculated –
(a) By dividing the fixed dividend per share by the price per preference share and then adding risk premium.
(b) By dividing the fixed dividend per share by the price per preference share and then adding growth rate.
(c) By dividing the fixed dividend per share by the price per preference share.
(d) By dividing the fixed dividend per share by the book value per preference share.

41. Statement I:
Cost of equity capital is the rate of return which equates the present value of expected dividends with the market share price.
Statement II:
Dividend Yield Method cannot be used to calculate cost of equity of units suffering losses.
Select correct answer from the options given below.
(a) Both Statements are false.
(b) Statement I is true but Statement II is false.
(c) Statement II is true but Statement I is false.
(d) Both Statements are true.

42. Which of the following is not a recognized approach for determining the cost of equity?
(a) Dividend discount model approach
(b) Before-tax cost of preferred stock plus risk premium approach
(c) Capital-asset pricing model approach
(d) Before-tax cost of debt plus risk premium approach

43. While calculating WACC on market value basis which of the following is not considered –
(a) After tax cost of debt
(b) Reserve and surplus
(c) Weight of each fund in capital structure
(d) Cost of term loan

44. CAPM describes the ______ between risk and return for securities.
(a) Linear relationship
(b) Hypothetical relationship
(c) No relationship
(d) Diagonal relationship.

45. Hari Mani Fashions is expected to pay an annual dividend of ₹ 0.80 a share next year. The market price of the stock is ₹ 22.40 and the growth rate is 5%. What is the firm's cost of equity?
(a) 7.58 per cent
(b) 7.91 per cent
(c) 8.24 per cent
(d) 8.57 per cent

46. Sweet Treats common stock is currently priced at ₹ 19.06 a share. The company just paid ₹ 1.15 per share as its annual dividend. The dividends have been increasing by 2.5% annually and are expected to continue doing the same. What is this firm's cost of equity?
(a) 8.68%
(b) 8.86%
(c) 6.18%
(d) 6.03%

47. Hari Mani Ltd. is planning for issue of 15% Preference Shares of ₹ 100 each, redeemable at par after 8 years. They are expected to be sold at a premium of 5%. Flotation cost is 9% of face value. Corporate tax is 35% and corporate dividend tax is 10%. The cost of preference shares on the basis of present value of future cash flow shall be –
Use following rates for your calculations:

	16%	18%
PV of ₹ 1 for 1 to 8 years	4.344	4.078
PV of ₹ 1 at 8th year	0.305	0.266

(a) 17.49%
(b) 16.22%
(c) 18.34%
(d) 19.20%

48. HM Ltd. is planning for issue of 15% Debentures of ₹ 100 each, redeemable at par after 5 years. They are expected to be sold at par. Flotation cost is 10% of face value. Corporate tax is 35%. Cost of debentures on the basis on present value of future cash flow shall be –
Use following rates 'for your calculations:

	12%	13%
PV of ₹ 1 for 1 to 5 years	3.605	3.517
PV of ₹ 1 at 5th year	0.567	0.543

(a) 11.37%
(b) 12.57%
(c) 14.87%
(d) 12.97%

49. Hari Mani Ltd. report its NOPAT ₹ 25,00,000. Its capital employed and economic value added is ₹ 60,00,000 & ₹ 19,00,000 respectively. What is overall cost of capital of Hari Mani Ltd.
(a) 10.9%
(b) 11%
(c) 10%
(d) 9.8%

50. Mr. Harish, purchases an equity share of growing company, Mani Ltd. for ₹ 210. He expects that the Mani Ltd. to pay dividend of ₹ 10.5, ₹ 11.025 & ₹ 11.575 in year 1, 2 & 3 respectively. He expects to sell shares at the end of year 3 at ₹ 243.10. Determine the growth rate in dividend.
(a) 4%
(b) 5%
(c) 6%
(d) 7%

51. Mr. Harish, purchases an equity share of growing company, Mani Ltd. for ₹ 525. He expects that the Mani Ltd. to pay dividend of ₹ 26.25, ₹ 27.83 & ₹ 29.50 in year 1, 2 & 3 respectively. He expects to sell shares at the end of year 3 at ₹ 607.75. What is the required rate of return of Mr. Harish on his equity investment?
(a) 11.50%
(b) 10.50%
(c) 10.05%
(d) 11.65%

52. Hari Mani Ltd. expected to pay dividend at ₹ 2 for the next year. As the company is a market leader with good future, dividend is likely to grow by 5% every year. The equity shares are now treaded at ₹ 80 per share in the stock exchange. Tax rate applicable to the company is 50%. The capital structure of the company also contains debt on which interest is payable @ 14%. The capital structure has ratio of Equity & Debt 80:20. WACC = ?
(a) 9.40%
(b) 7.40%
(c) 8.40%
(d) 7.98%

53. HM Ltd. has furnished the following information:

Earnings Per Share (EPS)	₹ 14
Dividend Payout Ratio	25%
Market Price Per Share	₹ 140
Rate of Tax	26%
Growth rate of dividend	9%

The company wants to raise additional capital of ₹ 10 lakhs including debt of ₹ 4 lakhs. Cost of debt (before tax) is 12% up to ₹ 2 lakhs and 14% beyond that. Compute the marginal weighted average cost of additional capital.
(a) 11.75%
(b) 10.75%
(c) 11.57%
(d) 12.57%

54. Hari Mani Ltd. has 12,000 equity shares of ₹ 100 each. Sale price is equity share ₹ 115 per share; flotation cost ₹ 5 per share. Expected dividend growth rate is 5% and expected dividend at the end of the financial year is ₹ 11 per share. What is the cost of equity shares of Hari Mani Ltd.?
(a) 0.1133
(b) 0.1278
(c) 0.1475
(d) 0.15

55. HM Ltd. has 10% Preference Share Capital of ₹ 4,50,000. Face value is ₹ 10. Issue price of preference share is ₹ 100 per share; flotation cost ₹ 2 per share. What is the cost of preference shares to HM Ltd.?
(a) 10.20%
(b) 9.10%
(c) 12.50%
(d) 11.22%

56. Hari Mani Ltd. has 8% Debentures (Face value ₹ 2,500) of ₹ 9,00,000 which are redeemable at 5% premium, sold at 98%, 3% flotation costs with maturity of 20 years. Corporate tax rate is 35%. The company paid debenture interest of ₹ 60,000 out of total interest payable of ₹ 72,000. After tax cost of debt is

(a) 8.7%
(b) 7.7%
(c) 5.7%
(d) 6.7%

57. Equity shares of Hari Mani Ltd. are quoted in stock exchange at ₹ 325 per share. New issue priced at ₹ 312.5 and flotation cost will be ₹ 12.5 per share. During 5 years dividend on equity shares have steadily grown from ₹ 26.5 to ₹ 35.48. Dividend at the end of current year is expected at ₹ 37.5 per share. It has retained earning of ₹ 30,00,000. Corporate tax is 35% and shareholders are in tax slab of 20%. Ignore dividend tax. Calculate cost of equity and cost of retained earnings?
(a) K_e = 18.50%; K_r = 14.80%
(b) K_e = 18.00%; K_r = 14.40%
(c) K_e = 17.54%; K_r = 14.03%
(d) K_e = 18.94%; K_r = 15.15%

58. The company proposes to issue 11 year 15% debentures of ₹ 500. Yield on debentures of similar maturity and risk class is 16%; flotation cost 3% of face value. Corporate tax is 35%. Issue price and after tax cost of debt would be
(a) Issue price = 486.75; K_d = 12.10%
(b) Issue price = 468.75; K_d = 11.10%
(c) Issue price = 475.68; K_d = 10.10%
(d) Issue price = 457.86; K_d = 12.12%

59. From the following details calculate the WACC:

Capital	Market Value(₹)	K_o
Equity shares	4,00,00,000	18.5%
Preference shares	20,80,000	14.29%
Debentures	67,50,000	10.95%

(a) 17.28%
(b) 16.52%
(c) 16.34%
(d) 17.93%

60. A Company has ₹ 180 Million of 10% Debentures having face value of ₹100. The debentures are redeemable after3 years and interest is paid annually. The current ex-interest debenture market value is ₹ 103.
Pre-tax cost of debentures on the basis of present value of future cash flow shall be –
Use following rates for your calculations:

	8%	9%
PV of ₹ 1 for 1 to 3 years	2.577	2.531
PV of ₹ 1 at 3rd year	0.794	0.772

(a) 9.32%
(b) 7.91%
(c) 8.02%
(d) 8.82%

61. The following is the capital structure of a company:

Source of Capital	*Book Value (₹)*
Equity Shares (₹ 100 each)	40,00,000
9% Pref. Shares (₹ 100)	10,00,000
11% Debentures	30,00,000
Retained Earnings	20,00,000
	1,00,00,000

Current market price of equity share is ₹ 200. For the last year the company had paid equity dividend at 25% and its dividend is likely to grow 5% every year. Corporate tax rate is 30% and shareholders personal income tax rate is 20%. Compute WACC on the basis of book value.
(a) 13.36%
(b) 14.50%
(c) 13.96%
(d) 12.32%

62. The following is the capital structure of a company:

Source of Capital	*Book Value*	*Market Value*
Equity Shares (₹ 100 each)	80	160
9% Pref. Shares (₹ 100)	20	24
11 Debentures	60	66
Retained Earnings	40	-

Current market price of equity share is ₹ 200. For the last year the company had paid equity dividend at 25% and its dividend is likely to grow 5% every year. Corporate tax rate is 30%. Compute WACC on the basis of market value.
(a) 14.5 per cent
(b) 13.5 per cent
(c) 12.9 per cent
(d) 14.1 per cent

63. Debt as percentage of total capital of the Hari Mani Ltd. is 20%. Its cost of equity is 16% and pre-tax cost of debt is 12%. Tax rate is 50%. What is overall cost of capital of Hari Mani Ltd.?
(a) 16%
(b) 14%
(c) 15%
(d) 16.6%

64. Debt as percentage of total capital of the HM Ltd. is 60%. Its cost of equity is 24% and pre-tax cost of debt is 20%. Tax rate is 50%. What is overall cost of capital of HM Ltd.?
(a) 14.6%
(b) 13.6%
(c) 17.6%
(d) 15.6%

65. HM Ltd. estimates the cost of equity and debt components of its capital for different levels of debt; equity mix as Follows:

	Debt as % of total capital	Cost of equity	Cost of debt (pre-tax)
I	0%	24%	18%
II	20%	24%	18%
III	40%	30%	24%
IV	60%	36%	30%

Tax Rate is 50%

Select the best capital mix for the company so that its overall cost of capital is minimum.

(a) I
(b) II
(c) III
(d) IV

66. The preferred stock of HM Ltd. pays an annual dividend of ₹ 6.50 a share and sells for ₹ 48 a share. What is HM's cost of preferred stock?

(a) 9.19%
(b) 7.38%
(c) 13.54%
(d) 9.46%

67. Calculate the weighted marginal cost of capital for the company, if it raises 10 Crores next year, given the following information:

(i) Next expected dividend is ₹ 3.60 and expected to grow at the rate of 7%.
(ii) Income-tax rate is 40%.
(iii) Amount will be raised by equity and debt in equal proportions.
(iv) Additional issue of equity shares will result in the next price per share being fixed at ₹ 32.
(v) Debt capital raised by way of term loans will cost 15% for the first ₹ 2.5 Crores and 16% for the balance.

Select the correct answer from the options given below:

(a) 12.775%
(b) 15.625%
(c) 13.775%
(d) 15.475%

68. Divisha Enterprises just paid an annual dividend of ₹ 1.56 per share. This dividend is expected to increase by 3 percent annually. Currently, the firm has a beta of 1.13 and a stock price of ₹ 28 a share. The risk-free rate is 3 percent and the market rate of return is 10.5 percent. What is your best estimate of Divisha 's cost of equity?

(a) 8.74 per cent
(b) 11.48 per cent
(c) 9.72 per cent
(d) 10.11 per cent

69. Divisha Ltd. has 12,000 bonds outstanding at a quoted price of 98% of face value. The bonds mature in 11 years and carry a 9% annual coupon. What is your best estimate of Divisha's after tax cost of debt if the applicable tax rate is 35%?

(a) 6.03%
(b) 5.77%
(c) 8.33%
(d) 7.04%

70. Divisha Industries has a capital structure of 55% common stock, 10% preferred stock, and 45% debt. The firm has a 60% dividend payout ratio, a beta of 0.89, and a tax rate of 38%. Given this, which one of the following statements is correct?

(a) The after tax cost of debt will be greater than the current yield-to-maturity on the firm's bonds.
(b) The firm's cost of preferred is most likely less than the firm's actual cost of debt.
(c) The firm's cost of equity is unaffected by a change in the firm's tax rate.
(d) The cost of equity can only be estimated using the SML approach.

71. HM Ltd. has a cost of equity of 12%, a pre-tax cost of debt of 7%, and a tax rate of 35%. What is the firm's weighted average cost of capital if the debt-equity ratio is 0.60?

(a) 9.21%
(b) 10.01%
(c) 10.13%
(d) 11.11%

72. HM Ltd. has ₹ 10 equity shares amounting to ₹ 15 Crore. The current market price per equity share is ₹ 60. The prevailing default risk free interest rate on 10 year GOI treasury bonds is 5.5%. The average market risk premium is 8%. The beta of the company is 1.1875. K_e = ?

(a) 15%
(b) 11%
(c) 12%
(d) 13%

73. HMD Ltd. has three divisions: H, M & D. Division H has the least risk and Division D has the most risk. HMD Ltd. has an after tax cost of debt of 4.6% and a cost of equity of 9.5%. Company is financed with 50% debt & 50% equity. Management has told the Divisional Manager of Division H that projects in that division are assigned a discount rate that is

1% less than the firm's weighted average cost of capital. What is the discount rate applicable to Division H?
(a) 6.65%
(b) 6.31%
(c) 7.18%
(d) 6.05%

74. HM Ltd. has ₹ 1,000, 9.5% debentures amounting to ₹ 1,500 Million. The debentures of HM Ltd. are redeemable after 3 years and are quoting at ₹ 981.05 per debenture. The beta of the company is 1.1785. The applicable income tax rate for the company is 35% K_d = ?
(a) 1.59%
(b) 6.87%
(c) 7.86%
(d) 8.67%

75. HM Ltd. has ₹ 100, 10.5% preference shares amounting to ₹ 100 Million. The preferred stock of the company is redeemable after 5 years is currently selling at ₹ 98.15 per preference share. The beta of the company is 1.7158. The applicable income tax rate for the company is 35%. K_p = ?
(a) 10%
(b) 11%
(c) 12%
(d) 3%

76. H Ltd. has 10,000 shares of common stock outstanding at a price per share of ₹ 46 and a rate of return of 14%. The Company has 5,000 shares of 7% preferred stock outstanding at. a price of ₹ 58 a share. The outstanding debt has a total face value of ₹ 2,00,000 and a market price equal to 98% of face value. Yield-to-maturity (YTM) on the debt is 8.03%. What is the firm's weighted average cost of capital?
(a) 10.62%
(b) 12.65%
(c) 8.62%
(d) 9.99%

77. Calculate the marginal cost of capital (MCC) for the firm if it raises ₹ 750 million for a new project. The firm plans to have a target debt to value ratio of 20%. The beta of new project is 1.4375. The debt capital will be raised through term loans. It will carry interest rate of 9.5% for the first ₹ 100 million and 10% for the next ₹ 50 million.

The current market price per equity share is ₹ 60. The prevailing default risk free interest rate on 10-year GUI treasury bonds is 5.5%. The average market risk premium is 8%.
(a) 14.86%
(b) 12.22%
(c) 13.04%
(d) 15.95%

78. Hari & Mani Ltd. has a cost of equity of 11% and a pre-tax cost of debt of 8.5%. The firm's target weighted average cost of capital is 9% and its tax rate is 35%. What is the firm's target debt-equity ratio?
(a) 0.6203
(b) 0.5756
(c) 0.5572
(d) 0.5113

79. The Company can issue 14% new debenture. The company's debenture is currently selling at ₹ 98. Face value of debenture is ₹ 100. The company's marginal tax rate is 50%. What is cost of debenture – (i) based on book value; (ii) based on market value?
(a) 14% & 14.28%
(b) 6% & 6.12%
(c) 7% & 7.14%
(d) 8% & 8.16%

80. Hari Ltd. requires amount of ₹ 5,00,000 to finance a project. It was decided to raise such finance by issue of debentures. Cost of debt is 10% (before tax) up to ₹ 2,00,000 and 13% (before tax) beyond that. Tax rate is 30%. What is the average marginal cost of capital of new finance of ₹ 5,00,000?
(a) 7.37%
(b) 11.5%
(c) 8.26%
(d) 9.12%

81. The data on Apparels Inc. is given below:

Current dividend (Rs.)	1.90
Growth rate in earnings (g)	10%
Required rate of return (k)	14%

The intrinsic value of the share is
(a) Rs.19.10
(b) Rs.21.00
(c) Rs.47.75
(d) Rs.52.25
(e) Rs.61.50.

82. Winch one of the following is not an assumption oi the constant perpetual growth valuation Model?
(a) Dividends grow at a constant rate for ever.
(b) The required rate of return must be greater than the dividend growth rate.

(c) The required rate of return can vary.
(d) The firm's risk and its cost of capital may change from time to time.
(e) Both (c) and (d) above.

83. The constant growth dividend discount model will not produce a logical value for a stock if' the dividend growth rate is
(a) Above its historical average
(b) Below its historical average
(c) Equal to the historical average
(d) Above the required rate of return on the stock
(e) Below' the required rate of return on the stock.

84. What is the value of a share of XYZ Ltd. under constant growth dividend capitalization approach if dividend (D_o) = 3, required rate of return by shareholders (r)= 24% and dividend growth rate (g)=10%?
(a) Rs.13.75.
(b) Rs.21.43.
(c) Rs.2 3.5 7
(d) Rs.23.93.
(e) Rs.75.05

85. Equity shams of XYZ ltd are quoted in the market at Rs 17.00. The dividend expected a year hence is Rs 1.00. The expected rate of dividend growth is 8%. The cost of equity capital to the company will be
(a) 13.88%
(b) 12.88%
(c) 1.08%
(d) 10%
(e) 11.97%

86. While calculating weighted average cost of capital
(a) Retained earnings are always excluded
(b) Bank borrowings for working capital are included
(c) Costs of issues are considered
(d) Weights are always based on the market value
(e) Preference shares are given more weight.

87. Cost of equity capital
(a) Is equal to the last dividend paid to the equity shareholders
(b) Is equal to the discounting factor winch equates the net amount realized from the issue to the future dividend payments
(c) Is lesser than the cost of debt capital
(d) Is equal to the dividend expectations of equity shareholders for the coming year
(e) All of the above.

88. Which of the following is the basic approach that has been suggested for determining the cost of retained earnings?
(a) Tax-adjusted rate of return approach
(b) Dividend capitalization approach
(c) Realized yield approach
(d) (b) and (C) above
(e) None of the above.

89. Which among the following is/are true according to the net income approach?
(a) The cost of debt and cost of equity capital remain unchanged when the leverage ratio varies.
(b) The cost of debt changes whereas the cost of equity remains unchanged when the leverage ratio varies.
(c) The cost of debt remains unchanged whereas the cost of equity changes when the leverage ratio varies.
(d) Both (a) and (c) above
(e) None of the above

MCQ - ANSWER

1	c	2	d	3	d	4	a	5	c	6	b	7	d	8	c	9	c	10	d
11	c	12	a	13	d	14	c	15	d	16	d	17	a	18	a	19	b	20	b
21	c	22	c	23	c	24	d	25	d	26	a	27	d	28	a	29	a	30	d
31	b	32	b	33	c	34	d	35	d	36	a	37	d	38	b	39	a	40	c
41	d	42	b	43	b	44	a	45	d	46	a	47	a	48	b	49	c	50	b
51	d	52	b	53	b	54	d	55	a	56	c	57	a	58	b	59	a	60	d
61	a	62	A	63	b	64	d	65	b	66	c	67	c	68	d	69	a	70	c
71	a	72	a	73	d	74	b	75	b	76	a	77	a	78	b	79	c	80	c
81	d	82	a	83	d	84	c	85	a	86	c	87	b	88	d	89	a		