Quadrant IV – Assessment (Module –wise)

Programme: Bachelor of Commerce

Subject: Business Management

Paper Code: COD119

Paper Title: (DSE 5) Financial Management II

Unit: Unit II- Cost of Capital & Its Measurement

Module Name: Cost of Debt & Preference Capital

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Give the full form of the following abbreviations:

1. RV
2. MV
3. NP

For each of the following, choose the most appropriate answer from the given options.

1. Debentures carry a
    a. Fixed rate of interest
    b. Fixed rate of dividend
    c. Rate of interest varies.

2. Debentures and Preference shares can be issued at
    a. At a premium
    b. At a discount
    c. Both of the above

3. Interest or dividend is calculated on
    a. Face value
    b. Amount obtained after adjusting for premium or discount
    c. None of the above

Short Answer – I (short notes - say 20 to 50 words)

1. Write a short note on debentures as a source of finance.
2. Enumerate the features of Preference share capital.

Short Answer – II (extended – say 50 to 100 words)
NIL

Match the columns.

Sr. no	Column A		Column B
1	debt	a	Dividend
2	Preference shares	b	Preference shares
3	Priority over equity share holders	c	Debentures
4	Compulsory payment of interest	d	Perpetual debt
5	Irredeemable debt	e	Creditors of company

Numerical/Problems to Solve

1. **COST OF DEBT**

   a. **Cost of perpetual/ irredeemable debt**

1. X ltd issues Rs. 50000 8% debentures at par. Tax rate is 50%. Compute the cost of debt capital.
2. Y ltd issues Rs. 50000 8% debentures at 10% premium. Tax rate is 60%. Compute the cost of debt capital.
3. B ltd issues Rs. 1,00,000 9% debentures at 10% premium. The cost of floatation is 2%. Tax rate is 60%. Compute the cost of debt capital.

   b. **Cost of redeemable debt**

1. a company issues Rs. 10,00,000 10% redeemable debentures at a discount of 5%. The cost of floatation is Rs. 30000. The debentures are redeemable after 5 years. Calculate before tax and after tax cost of debt assuming a tax rate of 50%.
2. A 5 year Rs. 100 debenture of firm can be sold for a net price of Rs. 96.50. the coupon rate of interest is 14% and the debenture will be redeemed at 5% premium on maturity. The firm's tax rate is 40%. Compute the after tax cost of debenture.
3. Assuming that a firm pays tax at 50% rate, compute the after tax cost of debt capital in the following case: A 10 year, 8% Rs. 1000 per bond sold at Rs. 950 less 4% underwriting commission.

4. A company issues 15% debentures of Rs. 1000 face value to be redeemed after 10 years. The debenture is expected to be sold at 5% discount. It will also involve a floatation cost of 5%. The company's tax rate is 50%. What would the cost of debt be?

2. COST OF PREFERENCE CAPITAL

a. Cost of irredeemable preference shares

1. A company issues 10000 10% preference shares of Rs. 100 each. Cost of issue is Rs. 2 per share. Calculate the cost of preference share capital if these shares are issued (a) at par, (b) at 10% premium (c) at 5% discount.
2. A company issues 14% irredeemable preference shares of the face value of Rs. 100 each, floatation cost is 5%. What is the cost of preference shares if they are issued at
   1. Par
   2. 10% premium
   3. 5% discount

b. Cost of redeemable preference shares

1. A company issues 10000 10% preference shares of Rs. 100 each redeemable after 10 years at a premium of 5%. Cost of issue is Rs. 2 per share. Calculate the cost of preference share capital.

Self-reflection

what happens to the Cost of Debentures or Preference Shares when they are sold at a premium or at a discount? Does it increase or decrease as compared to the coupon rate of interest or dividend?

Create something new (higher order cognition)
NIL