LOYOLA COLLEGE (AUTONOMOUS), CHENNAI – 600 034

M.Com. DEGREE EXAMINATION – **COMMERCE**

FIRST SEMESTER – **APRIL 2016**

CO 1807 - FINANCIAL MANAGEMENT

Date: 28-04-2016 Dept. No. Max. : 100 Marks
Time: 01:00-04:00

Section – A

Answer all questions:- **(10 x 2 = 20)**

1. Define Financial Management.
2. Specify the various theories on Capital Structure.
3. What do you mean by "Arbitrage Process".
4. Explain the two types of working capital?
5. What is the importance of cost of capital?
6. Discuss PBP method.
7. State any two credit policies.
8. Illustrate Lock Box System?
9. A firm issues debentures of Rs.1,00,000 and realises Rs.98,000 after allowing 2% commission to brokers. The debentures carry an interest rate of 10%. The debentures are due for maturity at the end of the 10^{th} year. You are required to calculate the effective cost of debt before tax.
10. A company has sales of Rs. l lakhs. The variable costs are 40% of the sales while the fixed operating costs amount to Rs.30,000. The amount of interest on long - term debt is Rs.10,000.
    You are required to calculate the composite leverage.

Section – B

Answer any FOUR questions: **(4 x 10 = 40)**

11. Discuss the objectives of financial management.
12. Explain the various factors affecting the payment of dividend policy.
13. Variable Expenses as a percentage of sales to 75%, Interest Rs.300: Operating Leverage= 6, Financial Leverage = 4 Tax rate = 50%.Prepare Income statement
14. X Ltd issued 12% preference shares of Rs.100 each at Rs.95, repayable in two equal installments at the end of the 10^{th} and 11^{th} year respectively. Calculate the cost of preference shares.
15. A firm has 5 different items in its inventory. Suggest an ABC classifications of these items.

Item No.	Average No. of units in stock	Average cost per unit in Rs
1	20,000	60.00
2	10,000	100.00
3	32,000	11.00
4	28,000	10.00
5	60,000	3.40

16. A project requires investments of Rs.1,00,000.It is expected to yield the following cash inflows.

Year	Cash Inflow Rs.
1	30,000
2	40,000
3	60,000.

Assume discount rate at 10% and 15%. Calculate IRR.

17. Calculate the value of an equity shares of company X Ltd. and Y Ltd. from the following particulars by applying Walters formula when dividend pay ratio (O/P ratio) is (a)60% and (b)70% (c) 50%

		X Ltd.	Y Ltd.
r	=	15%	20%
Ke	=	10%	10%
E	=	Rs.10	Rs. 10

Section – C

Answer any TWO questions: **(2 x 20 = 40)**

18. R Ltd. has the following capital structure.

	Rs.
Equity capital (Rs.20 each)	40 lakhs
6% pref. share capital (Rs.100 each)	10 ”
8% Debentures	30 ”

Market price of equity is Rs. 20

The current dividend is Rs.2 per share which is expected to grow at 7% per annum. The tax rate is 50%

Calculate:–

(i) Weighted average COC based on book value

(ii) The new weighted average COC if the company an additional Rs.20 lakhs, as 10% Debentures to **finance for** expansion. This would resulted in increasing expected dividend per share to Rs.3 and increase growth rate of dividend to 10%. But the market price of equity share will fall to Rs.15.

19. AB ltd gives you the following figures

EBIT	3,00,000
Less: 12 % Debenture Int	60,000
	2,40,000
Less: Income tax @ 50%	1,20,000
EAT	1,20,000

No. of Equity shares = 40,000

$$EPS = \frac{1,20,000}{40,000} = \text{Rs 3 per share}$$

Market price per share = Rs.30

$$\text{Price Earning Ratio (PE)} = \frac{\text{Market Price Per share}}{\text{EPS}} = \frac{30}{3} = 10$$

The company has undistributed reserves of Rs.6,00,000 It requires Rs.2,00,000 for expansion. This amount will earn the same rate of return on funds employed as it is earned now.
You are informed that the Debt-Equity ratio = (Debt/ Debt + Equity) higher than 35% will reduce the PE ratio to 8 and raise the interest rate on additional funds burrowed to 14%.The company would prefer to raise the entire funds required through equity or through debt. Which would you recommend?

20. A highly profitable company plans to put up a windmill to generate electricity. The details of which are as follows:

a. The cost of windmill Rs 3,00,00,000 with 10 years life and no residual value .
b. The cost of land Rs 15,00,000 which will appreciate to 60,00,000 at the end of 10 years.
c. Subsidy of government Rs 15,00,000 will be received at the end of one year.
d. Electricity will be sold at Rs 2.25 per unit in year 1, increasing by 0.25 paisa per year up to 7th year and thereafter by 0.50 paisa till the 10th year.
e. The cost of capital is 15% and tax rate is 50%. Ignore tax on capital profit.
f. Maintenance cost is Rs 4,00,000 in the first year and will increase by 2,00,000 per year thereafter.
g. Windmill is subject to 100% depreciation in year 1 as per the income tax act.
h. Electricity generated will be Rs 25,00,000 units per annum , 4% of which will be given free to the state electricity board.

Ascertain the viability of the project.

21. A ltd. Produces 120000 units p.a. Its percentage of cost to selling price: Raw materials 60%, Wages 10%, and OHS 20%. Selling price Rs. 5 per unit.

a. Raw materials in stock for 2 months.
b. WIP in stock for 1 month.
c. Finished Goods in stock for 3 months.
d. Creditors allow 2 months credit and debtors get 3 months credit.
e. Wages and OHS are paid on the first of each month for the previous month.
f. Cash in hand Rs. 40000.

Calculate cash cost of Working capital.

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