STELLA MARIS COLLEGE (AUTONOMOUS) CHENNAI – 600 086.
(For candidates admitted during the academic year 2004-2005 & thereafter)

SUBJECT CODE : **CM/PS/FM35**

M.Com. DEGREE EXAMINATION NOVEMBER 2008
COMMERCE
THIRD SEMESTER

COURSE : **SPECIALISATION – CORE**
PAPER : **FINANCIAL MANAGEMENT**
TIME : **3 HOURS** **MAX. MARKS : 100**

SECTION – A

ANSWER ANY FIVE QUESTIONS: (5 x 8 = 40)

1. Explain the techniques a firm can employ to speed up its cash collections.

2. Define working capital and explain the factors affecting the requirement of working capital.

3. What is 'Capital rationing'? Does it lead to sub optimal investment decisions?

4. Sales Rs.70,000, variable cost 60% of sales, Fixed cost Rs.16,000, 9% debentures Rs.40,000, 12% Preference Capital Rs.20,000, Tax rate 50%.
Calculate DOL, DFL and DCL and interpret the results.

5. X Ltd., gives you the following budgeted data from which you are required to prepare a cash budget for the months of April and May 2008.

Month (Rs.)	Sales (Rs.)	Purchases (Rs.)	Wages (Rs.)	Overheads (Rs.)
February	60,000	30,000	20,000	10,000
March	70,000	40,000	25,000	12,000
April	90,000	50,000	30,000	15,000
May	1,00,000	60,000	32,000	14,000

50% of the sales are for cash. Credit sales are collected as follows: 60% in the month following the sale, 30% in the next month following and 10% are bad debts.
20% of the purchases are for cash. Suppliers allow 1 month credit.
Lag in payment of wages ½ month.
Production overheads are payable in the same month and include Rs.1,000 p.m. as depreciation.
Budgeted cash balance on 1st April 2008 Rs.40,000/-.

6. Agro Products Ltd is considering the following credit policy alternatives:

	EXISTING	OPTION I	OPTION II
Credit Policy (days)	30	20	60
Sales (Rs./lakhs)	10	9.5	12
Bad debts (% of sales)	5	3	6

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Administration cost (Rs./lakhs)	0.2	0.1	0.2
Average effective collection period (days)	45	24	75

The company realizes a contribution of 40% of sales and requires 20% per annum as return on investment. Value debtors at variable Cost. Which credit policy is most suitable for the company? Assume a year is 360 days.

7. A company plans to buy a machine requiring an investment of Rs.10 lakhs. The machine has a life of 5 years and a scrap value of Rs. 50,000 at the end of its life. An additional investment of Rs.50,000 is required in working capital. The machine is expected to earn the following profits before depreciation and tax.

YEAR	PBDT (Rs.)	PV of Re.1 at 10%
1	1,60,000	0.909
2	5,00,000	0.826
3	6,00,000	0.751
4	4,00,000	0.683
5	4,00,000	0.621

The machine is to be depreciated under 'Straight Line method'.

If the tax rate is 50% and the cost of capital is 10%, calculate:
a) net present value b) return on average investment.

8. A Ltd has a machine which has been in use for 2 years. It has a remaining useful life of 10 years with no salvage value. Its current market price is Rs.1 lakh. The management is considering a proposal to replace the machine with an improved model. Relevant particulars are as follows:

	Existing machine	New machine
Cost	Rs.2,40,000	Rs.5,00,000
Estimated life	12 years	10 years
Salvage value	nil	nil
Production per annum (units)	30,000	60,000
Selling price per unit	Rs.10	Rs.10
Material cost per unit	Rs.2	Rs.2
Other expenses	Rs.16,000	Rs.11,000
Working capital	Rs.25,000	Rs.45,000
Labour cost	Re.1	Re.1.50

The company following a Straight Line method of depreciation and is subject to 50% tax. Should the existing machine be replaced?
Assume that the Company's required rate of return is 15%.

Note :
PV of an annuity of Re.1 at 15% rate of discount for 10 years is 5.019.
PV of Re.1 at 15% rate of discount received at the end of 10th year is 0.247.

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SECTION – B

ANSWER ANY THREE QUESTIONS: (3 x 20 = 60)

9. Write short notes on:
   a) Wealth maximization
   b) Trading on equity
   c) Operating cycle
   d) Stability of dividends

10. XY Ltd provides the following particulars relating to its working:

i) Cost / Profit per unit:

	(Rs.)
Raw material cost	8
Direct labour cost	4
Overheads (including Re.1 depreciation)	3
Total cost	15
Profit	5
Selling price	20

ii) Average amount of stock:

Raw material	2 months
Work-in-progress	½ month
Finished goods	1 month

iii) Credit allowed by suppliers – 1 month

iv) Credit allowed by customers – 2 months

v) Average time lag in the payment of:

Wages	1 month
Overhead expenses payable in advance	½ month

vi) Materials are introduced at the beginning of the process., Wages and Overheads accrue evenly during the processing time.

vii) Required cash and bank balance 10% of gross working capital, excluding cash.

viii) 25% of the output is sold for cash.

ix) Provide 10% as reserve for contingencies on net working capital.

For an expected sale of 1,20,000 units per annum, work out the working capital requirement.

11. The following is the capital structure of ABC Ltd. as on 31st March:

Equity share: 10,000 shares (of Rs.100 each)	Rs.10,00,000
Reserves	Rs. 5,00,000
12% Preference shares (of Rs.100 each)	4,00,000
10% Debentures Rs.100 each	6,00,000
14% ICICI Bank loan	5,00,000
	Rs.30,00,000

The market price of the company's share is Rs.110. The last dividend paid was Rs.10. The growth rate in dividend is 10%.

Debentures have a market price of Rs.90. It is repayable at par at the end of 5 years.
Preference shares are quoted in the market at Rs.95 they are redeemable at a premium of 5% at the end of 5 years.
If the company is in the 40% tax bracket, compute the weighted average cost of capital, using:
a) book value as weights
b) market value as weight.

12. ABC Ltd. is considering the acquisition of a machine costing Rs.10,00,000 and using the same for 5 years. It identifies two options for acquiring the same.
Option 1 : Borrow Rs.10,00,000 @ 16% interest rate. The interest is payable at the end of each year, and the loan repaid in annual installments of Rs.2 lacs, payable at the end of each year. The machine can be sold at the end of 5 years for Rs.1,00,000.
Option 2 : Lease the asset for a period of 5 years at a yearly rental of Rs.4,00,000 payable in the first two years and Rs.3,50,000 for the remaining 3 years. The rental is payable at the end of each year.
Assuming the tax rate is 50%, and the cost of capital is 8%, which option would you recommend?
The company hopes to earn the following profits before depreciation, income tax and lease rental during the 5 years of its life.
Year 1 – Rs.4,00,000; Year 2 – Rs.5,00,000; Year 3 – Rs.6,00,000;
Year 4 – Rs.7,00,000; Year 5 – Rs.5,50,000
PV of Re.1 at 8% p.a. is
Year 1 – 0.93; Year 2 – 0.86; Year 3 – 0.79; Year 4 – 0.74; Year 5 – 0.68.

13. The existing capital employed by ABC Ltd consists of:

	Rs.
Equity capital (Rs.10)	8,00,000
12% Preference capital (Rs.10)	3,00,000
Reserves	2,00,000
10% Debentures	7,00,000
	20,00,000

The existing EBIT of the company is Rs.3,60,000.
The Company is planning an expansion program, which will require an investment of Rs.10,00,000. After expansion the rate of return on capital employed is expected to increase by 2% from the existing rate. The company has identified two financing options for the expansion.
a) Issue Equity shares at a premium of Rs.15 per share.
b) Issue 12% Debentures.
Assuming a tax rate of 50%, which financing option would you recommend, if the P/E ratio under the two plans after expansion would be 10 and 8 respectively. Also calculate the indifference point EBIT of the two plans.

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