STELLA MARIS COLLEGE (AUTONOMOUS) CHENNAI – 600 086.
(For candidates admitted during the academic year 2008–2009 & thereafter)

SUBJECT CODE : CM/MC/FM44

B.Com. DEGREE EXAMINATION, APRIL 2011
COMMERCE
FOURTH SEMESTER

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

ANSWER ALL QUESTIONS: **(10 x 3 = 30)**

SECTION – A

1. Distinguish between 'permanent' and 'temporary' working capital.

2. "Debt is cheaper than Equity". Explain.

3. What are mutually exclusive projects? How do they differ from independent projects?

4. Differentiate between 'business risk' and 'financial risk'.

5. State whether the following statements are True or False.
   a) Retained earnings are at cost free source of funds.
   b) Excessive investment in working capital results in high profitability and high liquidity.
   c) A project is accepted if its internal rate of return is higher than the cost of capital.

6. A Ltd's equity shares are currently selling at Rs.125. The company expects to pay Rs.10 per share as dividend at the end of the coming year. The estimated growth rate in dividend is 6%. The company expects to incur 4% as floatation costs. Calculate the cost of existing equity and the cost of new equity capital.

7. A finance company offers to pay you 12% interest per annum, compounded quarterly. If you invest Rs.10000 today, what will be the value of your deposit at the end of 2 years?

8. What is the present value of a perpetual annuity of Rs.1500 if the rate of interest is 10% per annum?

9. A Ltd has a capital structure consisting of Rs.90,000 equity capital of Rs.100 each and Rs.40,000 10% debentures. Its earnings before interest and tax is Rs.31,000. If the tax rate is 50% calculate the cost of equity. Market price of equity share is Rs.150.

10. X Ltd plans to computerise its stores by investing Rs.1,50,000 in computers, which have a life of 5 years and no salvage value. The computers will result in an annual saving of Rs.1,20,000 in expenses. However, it would require Rs.50,000 annual maintenance expenses. It the tax rate is 50% and depreciation is provided in the Straight Line Method, calculate the Payback period for the computers.

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SECTION – B

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

11. Define Working capital. Explain the factors affecting the working capital of the firm.

12. Critically evaluate the payback period method of capital budgeting.

13. What is Wealth Maximisation? How is it superior to Profit Maximisation as a goal of Financial Management?

14. From the following data, compute the operating cycle of a firm:

Credit sales	Rs.7,20,000 per annum
Cost of goods produced	Rs.5,40,000 per annum
Cost of goods sold	Rs.6,30,000 per annum
Cost of raw material consumed	Rs.1,80,000 per annum
Average stock of raw material	Rs.8,000
Average stock of work in progress	Rs.4,500
Average stock of finished goods	Rs.17,500
Average debtors	Rs.40,000

Creditors payment period is 8 days. Assume a year has 360 working days.

15. Calculate the cost of new debentures, new preference shares and new equity shares from the point of view of a company, if anticipated external financing opportunities are as follows:
    a) 13% debentures of Rs.100 each issued at 5% discount and redeemable after 5 years at 5% premium. Floatation cost is 4% of issue price.
    b) 15% preference shares of Rs.100 each issued at par and redeemable after 5 years at par. Floatation cost is 5% of issue price.
    c) Equity shares of Rs.10 each issued at Rs.80. Floatation cost 5%. Expected EPS is Rs.5 and dividend payout ratio is 60%. Anticipated growth rate in dividend is 5%.

    Assume tax rate is 40%.

16. a) Why does money have a time value?

    b) At the time of his retirement, R is offered the following options, by his company.
        i) Receive Rs.60,000 immediately
        ii) Receive Rs.20,000 immediately, Rs.30,000 at the end of 4 years and Rs.30,000 at the end of 8 years.
        iii) Receive Rs.10000 now and another 9 annual payments of Rs.10000 each.

        If the rate of interest expected by R is 10%, which option should he accept?

    c) A deposits annually Rs.4,000 in a bank which offers 10% interest per annum. What will be the value of the deposit at the end of 5 years, assuming
        i) The first deposit is made immediately.
        ii) The first deposit is made at the end of one year from now.

17. XYZ Ltd is considering purchase of a machine costing Rs.1,20,000. The machine will have a life of 5 years and no scrap value. The cash inflows from the machine are as follows:

Year	Cash inflow (Rs.)
1	30,000
2	45,000
3	50,000
4	55,000

Calculate the internal rate of return for this machine.

SECTION – C

ANSWER ANY TWO QUESTIONS: (2 x 15 = 30)

18. X Ltd sells its product at Rs.50 per unit. Its cost of sales consists of raw material 50%, labour 20% and overheads 10% of sales per unit. From the data given below, prepare its requirement of working capital at cash cost for a budgeted production and sales of 78000 units per annum.
Raw material storage period 2 weeks
Processing time 1 week
Finished goods storage period 2 weeks
Debtors are allowed 4 weeks credit and suppliers allow 3 weeks credit.
Lag in payment of overheads 2 weeks
Lag in payment of wages 4 weeks
Cash in hand should be maintained at 20% of the total current liabilities.
25% of sales are for cash
The entire raw material is introduced at the beginning of the process.
Wages and overheads accrue evenly during the processing time.

19. The following is the capital structure of A Ltd:

Equity capital Rs.10 each	Rs. 5 lakhs
Reserves	Rs.3 lakhs
12% Preference share capital Rs.10 each	Rs.2 lakhs
14% Debentures Rs.100 each	Rs.4 lakhs

The equity shares of the company are currently sold in the market at Rs.40 per share. The last dividend paid is Rs.4 per share and the dividend is expected to grow at 8% per annum. The tax rate is 30%.
Calculate the weighted average cost of capital, using book value as weights.
The company plans an expansion in the next year, which will be financed by Rs.5,00,000 16% bank loan. What will be the revised weighted average cost of capital, using market value as weights, if the dividend expected next year is Rs.4.50, the growth rate in dividend increases to 10% per annum and the likely market price of equity will be Rs.45?

20. X Ltd is planning to buy a machine costing Rs.22 lakhs. The life of the machine is 5 years and the estimated salvage value is Rs.2 lakhs at the end of its life. In addition, a working capital of Rs.1 lakh is to be invested. The expected cash flow before depreciation and tax are as follows:

Year	Sales(Rs.in lacs)
1	10
2	15
3	20
4	25
5	15

Operating expenses excluding depreciation are 60% of sales.
You are required to calculate:

a) Pay back period
b) Return on average investment
c) Net present value
d) Profitability index

Assume cost of capital to be 10% and tax rate 50%.

21. W Ltd has a machine which has been in operation for 3 years. Its remaining useful life is 8 years with no salvage value at the end of its life. If sold now, it can realize its book value. The company is considering replacing this machine by an improved version. Relevant information is as follows:

	Existing machine	New machine
Cost (Rs.)	3,30,000	10,00,000
Estimated life	11 years	8 years
Salvage value (Rs.)	nil	40,000
Annual production (units)	30,000	75,000
Selling price per unit (Rs.)	15	15
Material per unit (Rs.)	4	4
Labour cost per hour(Rs.)	40	70
Fixed expenses per annum(Rs.)	50,000	65,000
Labour hours per annum (hrs)	3,000	3,000

The company follows the straight line method of depreciation. Tax rate is 30% and the cost of capital 12%.
Should the machine be replaced?