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

SUBJECT CODE : **CM/SC/FM44**

**B.Com. DEGREE EXAMINATION APRIL 2008**
COMMERCE
FOURTH SEMESTER

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

**SECTION – A**

ANSWER ALL QUESTIONS: ( 10 x 3 = 30 )

1. What is Pay back period.

2. Explain indifference point EBIT.

3. What Economic Order Quantity.

4. Explain Lock Box System.

5. Write short notes on constant dividend payout ratio.

6. Operating leverage 2.5; Fixed cost Rs.30,000; Variable cost is 60% of sales. Calculate sales.

7. Annual requirement 40,000 units; Cost per unit Rs.16/-; Cost of placing an order Rs.480/-; Rent, insurance etc. per unit, per annum 80 paise; Annual return on investment 10%. Calculate Economic Order Quantity.

8. From the following data, compute the operating cycle in days.
   Raw material consumption Rs.4,320/- per annum
   Cost of goods sold Rs.9,000 per annum
   Sales Rs.13,680/- per annum
   Average stock of raw material Rs.168/-
   Average stock of of finished goods Rs.500/-
   Average debtors Rs.950/-
   Credit period allowed by creditors 16 days
   Assume a year consists of 360 days.

9. Combined leverage 4; operating leverage 2; EBIT Rs.1,00,000; Interest rate on debentures 10%. Calculate value of Debenture.

10. a) The market price of an equity share is Rs.40/-. The next expected dividend is Rs.2/- per share. The Growth rate of dividend is 12%. Calculate the cost of equity.
    b) The cost of equity is 15%. The growth rate is 10% and the next dividend is expected to be Rs.4/-. What will be the market price of the share?

## SECTION – B

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

11. a) 'Debt is cheaper than Equity'. Explain.

b) 'Wealth maximization should be the goal of a Finance Manager'. Explain.

12. Define Working Capital. What are the factors that determine the working capital needs of a firm?

13. A Ltd., plans to implement a project for which Rs.30 lakhs are required. It has indentified 2 financing plans as follows:
Plan I Issue Rs.30 lakhs in equity shares of Rs.10 each at a premium of Rs.5 per share.
Plan II Issue Rs.15 lakhs in equity shares of Rs.10 each at a premium of Rs.5 per share and Rs.15 lakhs in 10% Debentures.

If the tax rate is 50%; calculate the EBIT level at which the company would be indifferent between the 2 financing options.

14. 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 | SALES (Rs.) | PURCHASES (Rs.) | WAGES (Rs.) | PRODUCTION 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 | 50,000 | 30,000 | 14,000 |

a) 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.
b) 20% of the purchases are for cash. Suppliers allow 1 month credit.
c) Lag in payment of wages ½ month.
d) Production overheads are payable in the same month and include Rs.2,000 p.m. as depreciation.
e) Budgeted cash balance on 1$^{st}$ April 2008 Rs.40,000/-

15. A project requires a machine costing Rs.3,00,000. It has a life of 3 years and a scrap value of Rs.60,000 at the end of its life. The annual operating profit after tax is expected to be as follows:

| YEAR | P.A.T. (Rs.) | PV OF Re.1 @ 18% | PV OF Re.1 @ 22% |
|---|---|---|---|
| 1$^{st}$ | 10,000 | 0.847 | 0.820 |
| 2$^{nd}$ | 60,700 | 0.718 | 0.672 |
| 3$^{rd}$ | 80,000 | 0.609 | 0.551 |

If the tax rate is 50% and the machine is to be depreciated on Straight Line basis, calculate Net present value if cost of capital is 18%. Also calculate internal rate of return of the project.

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16. ABC Motors purchases 9,000 units of spare parts for its annual requirements, ordering one month usage at a time. Each spare part costs Rs.20. The ordering cost per order is Rs.15 and the carrying charges are 15% of unit cost. You have been asked to suggest a more economical purchasing policy for the company. What advice would you offer, and how much would it save the company per year?

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

| | EXISTING POLICY | OPTION I | OPTION II |
|---|---|---|---|
| Credit Policy (days) | 30 | 14 | 60 |
| Sales (Rs./lakhs) | 10 | 9.6 | 12 |
| Bad debts (% of sales) | 5 | 3.33 | 6 |
| Administration cost (Rs./lakhs) | 0.2 | 0.12 | 0.25 |
| Average effective collection period(days) | 45 | 21 | 75 |

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

## SECTION – C

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

18. What are the factors to be considered in framing the dividend policy of a firm? Explain the legal requirements regarding payment of dividends.

19. The following is the capital structure of Simons company Ltd. as 31st March:

| | |
|---|---|
| Equity shares : 10,000 shares (of Rs.100 each) | Rs.10,00,000 |
| Reserves | Rs.5,00,000 |
| 12% Preferences 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 and it is expected that a dividend of Rs.10 per share would be declared at the end of the current year. The dividend growth rate is 6%.
Debentures have a market price of Rs.90, repayable at par at par 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 of weights.

20. AB Ltd provides the following particulars relating to its working:

(i) Cost/profit per unit:

| | (Rs.) |
|---|---|
| Raw meterial cost | 84 |
| Direct labour cost | 36 |
| Overheads | 36 |
| Total cost | 156 |

| | |
|---|---|
| Profit | 44 |
| Selling price | 200 |

(ii) Average amount of stock:

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

(iii) Credit allowed by suppliers – 1 month

(iv) Credit allowed to customers – 2 months

(v) Average time lag in the payment of wages ½ month, overhead expenses 1 ½ month

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

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

(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 60,000 units per annum, work out the working capital requirements.

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

| | (Rs.) |
|---|---|
| Equity capital (Rs.10) | 10,00,000 |
| 12% Preference capital (Rs.10) | 3,00,000 |
| Reserves | 2,00,000 |
| 10% Debentures | 5,00,000 |
| | 20,00,000 |

The Company is planning an expansion program, which will require an investment of Rs.10,00,000. After expansion the EBIT is expected to be Rs.6 lakhs. The company has identified three financing options for the expansion.

a) Issue Equity shares at a premium of Rs.15 per share.
b) Issue 12% Debentures.
c) Issue 20,000 equity shares of Rs.10 each at a premium of 10% and the balance by a loan from ICICI bank at 12%.

Assuming a tax rate of 50%, which financing option would you recommend, if the P/E ratio under the three plans after expansion would be 12, 9 and 8 respectively.

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