STELLA MARIS COLLEGE (AUTONOMOUS) CHENNAI – 86
(For candidates admitted during the academic year 2004– 05 & thereafter)

SUBJECT CODE : EC/PE/FM24

M. A. DEGREE EXAMINATION, APRIL 2009
BRANCH III – ECONOMICS
SECOND SEMESTER

COURSE : ELECTIVES
PAPER : FINANCIAL MANAGEMENT
TIME : 3 HOURS **MAX. MARKS : 100**

SECTION – A

ANSWER ANY FIVE QUESTIONS. ANSWER NOT TO EXCEED 300 WORDS.
(5 X 8 = 40)

1. Write short notes on:
   a) Capital Rationing b) Risk and Return c) Time value of money
   d) Internal Rate of Return
2. What do you understand by capital structure of corporation? Explain the factors that determine the capital structure of a firm.
3. Explain briefly the basic strategies of effective cash management.
4. A project needs an investment of Rs.2,78,500. The cost of capital is 12%. The net cash inflows are as under:

Year	Rs.
1	90,000
2	70,000
3	1,80,000
4	1,50,000
5	1,00,000

   Calculate the Internal Rate of Return and suggest whether the project should be accepted or not.
5. X Ltd. requires Rs.5 lakhs for investment in a new project. It has identified the following four financing options:
   a. Issue 50,000 equity shares of Rs.10 each.
   b. Issue of 25,000 equity shares of Rs.10 each and 2,500 8% debentures of Rs.100 each.
   c. Issue 20,000 equity shares of Rs.10 each, 2000 10% preference share of Rs.100 each, and 1000 8% debentures of Rs.100 each.

   Assuming the tax rate is 50% and EBIT after construction of the plant would be Rs.1 lakh, which financing option would you recommend?

6. Mr. X deposits Rs.2,000 at the end of every year for 5 years in his savings account paying 5 percent interest compounded annually. He wants to determine how much sum of money he will have at the end of the 5^{th} year.
7. The following information is available regarding the expected cash flows generated, and their probability for Company X. What is the expected return on the project? Assuming 10% as the discount rate, find out the present values of the expected monetary values.

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Year 1			Year 2			Year 3	
Cashflows Rs.	Probability		Cashflows Rs.	Probability		Cashflows Rs.	Probability
3,000	0.25		3,000	0.50		3,000	0.25
6,000	0.50		6,000	0.25		6,000	0.25
8,000	0.25		8,000	0.25		8,000	0.50

8. ABC Ltd. is considering investing in a project that costs Rs.5,00,000. The estimated salvage value is Rs.50,000 and working capital investment is Rs.25,000. The tax rate is 35%. The company uses straight line method of depreciation for tax purposes and the projected project has cash flows before tax and before depreciation as follows:

Year	CFBT
1	1,00,000
2	1,00,000
3	1,50,000
4	1,50,000
5	2,50,000

Determine a) Pay Back Period, b) Average Rate of Return

SECTION – B

ANSWER ANY THREE QUESTIONS. (3 X 20 = 60)

9. Explain how the scope of financial management has changed over time. What role a Finance Manager plays in a modern firm?

10. How is the goal of wealth maximization a better operative criterion than profit maximization?

11. Briefly discuss the various techniques used by the Financial Manager to help in selecting investments projects.

12. The capital structure of P Ltd consists of ordinary share capital of Rs.10,00,000 (shares of 100 each) and Rs.10,00,000 of 10% debentures. The selling price is Rs.10 per unit. Variable costs amount to Rs.6 per unit and fixed expenses amount to Rs.2,00,000. The income tax is assumed to be 50%. The sales level is expected to increase from 1,00,000 units to 1,20,000 units.
    a) You are required to calculate -
        (i) The percentage of increase in earnings per share
        (ii) The degree of financial leverage at 1,00,000 units and 1,20,000 units
        (iii) The degree of operating leverage at 1,00,000 untis and 1,20,000 units
    b) Comment on the behaviour of operating and financial leverage in relation to increase in production from 1,00,000 units to 1,20,000 units.

13. A company is contemplating to purchase a machine. Two machines A and B are available, each costing Rs.5 lakhs. In comparing the profitability of the machines, a discounting rate of 10% is to be used and machine is to be written off in five years by straight line method of depreciation with nil residue value. Cash inflows after tax are expected as follows:

Year	Machine A (Rs. In lakhs)	Machine B (Rs. In lakhs)
1	1.5	0.5
2	2.0	1.5
3	2.5	2.0
4	1.5	3.0
5	1.0	2.0

Indicate which machine would be profitable using the following methods of ranking investment proposals: i) Net Present Value and ii) Profitability Index. The discounting factors at 10% are:

Year	1	2	3	4	5
Discounting factor	0.909	0.826	0.751	0.683	0.621

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