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

SUBJECT CODE : **CM/PS/FM36**

M.Com. DEGREE EXAMINATION NOVEMBER 2009
COMMERCE
THIRD SEMESTER

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

SECTION – A

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

1. "Financial management is more than procurement of funds". Explain.
2. "Individuals have a time preference for money". State the reasons for such a preference.
3. Evaluate 'Debt and Equity' as sources of fund from the point of view of a firm.
4. Critically evaluate the Pay-back method of Capital budgeting.
5. The share capital of a company is Rs.10 lakhs in shares of Rs.10 each. The company has Rs.6,00,000 in 10% debentures. The sales of the firm are 3,00,000 units per annum at a selling price of Rs.5 per unit and a variable cost of Rs.3 per unit. The Fixed cost amounts to Rs.2,00,000. Tax rate is 35%.
   Calculate:
   i) Degree of Operating leverage; Financial leverage and Combined leverage
   ii) If sales increases by 10%, what will be the percentage increase in EBIT and EPS?
6. Prepare a Cash budget for the months, April – June from the details given below:

   a) Estimated sales:
      February Rs.12,00,000
      March Rs.12,00,000
      April Rs.16,00,000
      May Rs.20,00,000
      June Rs.18,00,000
   b) 20% of the sales are for cash. Debtors are given 2 months credit.
   c) Purchases amount to 60% of sales and are made in the month prior to the sale. However payment for such purchases are made in the month following the sale.
   d) Variable expenses constitute 10% of sales and there is a time lag of ½ month in these payments.
   e) Fixed expenses amount to Rs.75,000 per month, which includes Rs.5,000 depreciation.
   f) Interest on deposits amounting to Rs.1,60,000 is due in April and tax payment of Rs 80,000 is due in June.
   g) A commission of 5% on sales is payable in the month following the sale.
   h) Cash balance on 1st April is estimated at Rs.1,50,000.

7. From the following details calculate the working capital requirement (at cash cost):
Estimated production during the year 1,20,000 units. Selling price per unit is Rs.5 and the expected ratios of cost to the selling price are Raw material 60%, Direct wages 10% and Overheads 20%.
Raw material storage period is 2 months and Finished goods 3 months.
Credit allowed by creditors is 2 months and allowed to debtors is 3 months.
Wages and overheads are paid on the 1st of each month for the previous month.
Cash in hand Rs.40,000 is to be maintained.
Each unit is expected to be in process for 1 month.The raw material being fed into process immediately and labour and overhead costs accrue evenly during the month.

8. X Ltd is planning a new product which is expected to have a life of 3 years. It requires an initial investment of Rs.1,20,000. The estimated sales in units and the corresponding probabilities for the three years are given below:

Year 1 (Sales in units)	Probability	Year 2 (Sales in units)	Probability	Year 3 (Sales in units)	Probability
5,000	0.2	5,000	0.4	5,000	0.8
10,000	0.5	10,000	0.6	10,000	0.2
20,000	0.3	-	-	-	-

The selling price of the product is fixed at Rs.10 and the variable cost is expected to be Rs.2 in the first year, Rs.3 in second year and Rs.4 in the third year.
Fixed expenses are Rs.10,000 per annum.
Assuming that there is no tax and the cost of capital is 10% per annum, calculate the Net Present value of the project.
Pv of Re.1 at 10% - 1st year 0.91; 2nd year 0.83; 3rd year 0.75

SECTION – B

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

9. Write short notes on:
   a) Capital rationing
   b) Financial lease
   c) Decentralized cash collections
   d) Significance of Capital budgeting

10. The following is the capital structure of XYZ Ltd:

Equity share capital of Rs.10 each	Rs.15,00,000
11% Preference share capital of Rs.100 each	Rs. 1,00,000
13.5% debentures of Rs.100 each	Rs.10,00,000
15% term loan	Rs.12,50,000
Retained earnings	Rs.20,00,000

The market price of the company's share is Rs.40 and it is expected that the next dividend would be Rs.3.60 per share. The growth rate in dividend is expected to be 7%.
   a) Preference shares redeemable after 10 years are currently selling at Rs.75 per share.
   b) Debentures redeemable after 6 years are selling at Rs.80 per debenture.
   c) The tax rate for the Company is 40%.

Calculate weighted average cost of capital, using:
   a) Book value as weights
   b) Market value as weights

11. Swastik Ltd. manufacturers of special purpose machine tools, have two divisions which are periodically assisted by visiting teams of consultants. The management is worried about the steady increase of expense in this regard over the years. An analysis of last years expenses reveals the following:

Consultant's remuneration	Rs.2,50,000
Travel and conveyance	1,50,000
Accommodation expenses	6,00,000
Boarding charges	2,00,000
Special allowances	50,000
	12,50,000

The management estimates accommodation expenses to increase by Rs.2,00,000 annually.

As part of the cost reduction drive, Swastik Ltd are proposing to construct centre to take care of the accommodation requirements of the consultants. This centre will additionally save the company Rs.50,000 in boarding charges and Rs.2,00,000 in the cost of Executive Training Programmes hitherto conducted outside the company's premises, every year.

The following details are available regarding the construction and maintenance of the new centre:

a) Land : at a cost of Rs.8,00,000 already owned by the company, will be used.
b) Construction cost : Rs.15,00,000 including special furnishings.
c) Cost of annual maintenance : Rs.1,50,000.
d) Construction cost will be written off over 5 years being the useful life.

Assuming that the write-off of construction cost as aforesaid will be available for tax purposes, the rate of tax will be 50% and that the desired rate of return is 15%; you are required to analyse the feasibility of the proposal and make recommendations.

The relevant Present Values Factors are:

Year	1	2	3	4	5
PV Factor	0.87	0.76	0.66	0.57	0.50

12. ABC Ltd plans to expand assets by 50% to finance the expansion. It plans to choose between straight 12% debt issue and equity shares. Its Balance sheet and Profit and Loss a/c are as follows:

Balance Sheet:

	Rs.		Rs.
Equity capital (Rs.10)	100,00,000	Total assets	200,00,000
Retained earnings	60,00,000		
11% debenture	40,00,000		
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	200,00,000		200,00,000

Profit & Loss A/c:

	Rs.
EBIT	60,00,000
Less: interest on 11% Debenture	4,40,000
EBT	55,60,000
Less: tax 50%	27,80,000
EAT	27,80,000
EPS	2.78

P/E	7.5
Market price	20.85

If debt is used for financing, the cost would be 12% and the P/E ratio would be 5. If equity is used the shares can be sold at Rs.12.50 per share and the P/E ratio will be 7.5 times.

a) Assuming EBIT after expansion would be Rs.1 crore, calculate the EPS and the market price of the share under the two options.
b) Also calculate the indifferent point EBIT under the two options.

13. The FFM Ltd is in the tax bracket of 35% and discounts its cash flows at 16%. In the acquisition of an asset worth Rs.10,00,000, it is given two offers-either to acquire the asset by taking a bank loan @ 15% per annum repayable in five yearly instalments of Rs.2,00,000 each plus interest or to lease-in the asset at yearly rentals of Rs.3,24,000 for five years. In both cases, the instalment is payable at the end of the year. Applicable rate of depreciation is 15% using 'written down value' (WDV) method. The asset is expected to have a salvage value of Rs.2,00,000 at the end of 5 years. Ignore tax saving on loss on sale of asset. You are required to suggest the better alternative.

Note: P.V. factor at 16%- Year1 – 0.862; Year 2 – 0.743; Year 3 – 0.641; Year 4 – 0.552; and Year 5 – 0.476

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