

STELLA MARIS COLLEGE (AUTONOMOUS) CHENNAI – 600 086.
(For candidates admitted during the academic year 2015 – 16 and thereafter)
SUBJECT CODE: 15CM/PC/FM24

M.Com. DEGREE EXAMINATION APRIL 2017
COMMERCE
SECOND SEMESTER

COURSE : CORE
PAPER : FINANCIAL MANAGEMENT AND POLICY
TIME : 3 HOURS **MAX. MARKS: 100**

SECTION – A

ANSWER ANY SIX QUESTIONS: (6 x 10 = 60)

1. Enumerate the objectives of a Firm.
2. What is the significance of Cost of Capital?
3. Explain in detail the factors that affect a dividend policy.
4. If an investor has an opportunity of receiving Rs. 1,000, 1,500, Rs. 800, Rs. 1,100 and Rs. 400 respectively at the end of one through five years. Find out the present value of this stream of uneven cash flows, if the investor's interest rate is 8 per cent?
5. A company is considering two mutually exclusive projects. The company uses a certainty equivalent approach. The estimated cash flow and certainty equivalents for each project as follows:

Year	Project 1		Project 2	
	Cash Flow Rs	Certainty Equivalents	Cash Flow	Certainty equivalents
0	-30,000	1.00	-40,000	1.00
1	15,000	.95	25,000	.90
2	15,000	.85	20,000	.80
3	10,000	.70	15,000	.70
4	10,000	.65	10,000	.60

Which project should be accepted, if the risk free discount rate is 5 per cent?

6. Assuming that a firm pays tax at a 50 per cent rate, compute the after-tax cost of capital in the following cases:
 - a) An ordinary share selling at a current market price of Rs 120, and paying a current dividend of Rs 9 per share which is expected to grow at a rate of 8 per cent.
 - b) An ordinary share of a company which engages no external financing is selling for Rs.50. The earnings per share are Rs.7.50 of which sixty per cent is paid in dividends. The company reinvests retained earnings at a rate of 10 per cent.
7. The EPS of a company are Rs10. It has rate of return of 15% & the capitalization rate of risk is 12.5%. If Walter's model is used:
 - a. What should be the optimum payout ratio of the firm?
 - b. What would be the price of the share at this payout ratio?
 - c. How shall the price of the share be affected if a different payout ratio was employed?
8. X Ltd is expecting an annual EBIT of Rs1 lakh. The co. has Rs 4 lakh in 10% debentures. The cost of equity capital or capitalization rate is 12.5%. You are required to calculate the total value of the firm. Also state the overall cost of capital.

SECTION – B

ANSWER ANY TWO QUESTIONS:

(2 x 20 = 40)

9. Discuss the conventional techniques to handle risk.
10. Write short notes on Cost of debt, Cost of Preference capital and Cost of Equity Capital.
11. Television Ltd. has a proposal for manufacturing car television. The Project would involve cost of plant of Rs 550 lakh, installation cost of Rs. 50 lakh and working capital of Rs. 125 lakh. The annual capacity of the plant is to manufacture 20,000 sets. The price per set would be Rs. 12,000. The variable cost ratio is expected to be 65 per cent. The fixed cost per annum should be Rs. 300 lakh (without including depreciation). The company would have to incur promotion expenditure of Rs. 120 Lakh in the first year. Written-down depreciation rate for tax purposes is 25 per cent. Working capital requirement is estimated to be 25% of sales. The company expects that the plant's capacity utilization over its economic life of 7 years will be as follows:

Year	1	2	3	4	5	6	7
Capacity utilization (%)	25	40	50	75	100	100	100

The terminal value of the project is expected to be 20 per cent of its original cost. Calculate the project's NPV assuming a target required rate of 14 per cent.

12. The Servex company has the following capital structure on 30 June 1994:
- | | |
|----------------------------------|--------------|
| Ordinary shares (200,000 shares) | Rs.40,00,000 |
| 10% preference shares | 10,00,000 |
| 14% Debentures | 30,00,000 |

80,00,000

The share of the company sells for Rs. 20. It is expected that company will pay next year a dividend of Rs. 2 per share which will grow at 7 per cent forever. Assume a 50 per cent tax rate.

You are required to:

- Compute a weighted average cost of capital based on existing capital structure.
- Compute the new weighted average cost of capital if the company raises an additional Rs. 20,00,000 debt by issuing 15 per cent debenture. This would result in increasing the expected dividend to Rs. 3 and leave the growth rate unchanged, but the price of share will fall to Rs. 15 per share.
- Compute the cost of capital if in (b) above growth rate increases to 10 per cent.

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