LOYOLA COLLEGE (AUTONOMOUS), CHENNAI – 600 034

M.Com. DEGREE EXAMINATION – COMMERCE

FIRST SEMESTER – **APRIL 2014**

CO 1807/4800 - FINANCIAL MANAGEMENT

Date : 28/03/2014 Dept. No. Max. : 100 Marks
Time : 09:00-12:00

Part – A

Answer ALL Questions **10 x 2 = 20**

1. What are the goals of Financial Management?
2. How do you interpret Operating Leverage?
3. Write a note on Net operating Income approach for Capital Structure.
4. Write the formula for calculating cost of Redeemable Preference Share.
5. Explain the term 'Arbitrage Process '
6. Illustrate IRR?
7. How for is Lock Box system useful to Cash Management.
8. What is the present value of cash inflow of ` 1, 000 receivable after 10 years at 6% interest rate?
9. A ltd. Issues 12% preference shares of ` 100 each redeemable after 12 years at par. The amount realized on issue is ` 95. Calculate the cost of preference shares.
10. What will be the future value of Rs. 1,000 deposits every year at 10% interest, at the end of 5 years?

PART – B

Answer any Five Questions: **5 x 8 = 40**

11. Discuss the various factors affecting Working Capital Management?

12. What are the advantages of Lease Agreements?

13 A ltd issued ` 100 , 15% debt at par repayable in 3 annual installments of ` 30, ` 30 and ` 40 at the end of the 7^{th} , 8^{th} and 9^{th} year respectively. The issue cost is 3% and tax rate is 60%. Calculate the cost of debt.

14. Variable expenses as a percentage of sales is 75%; interest ` 300; Operating leverage = 6; financial leverage = 4; tax rate = 50%. Prepare income statement?

15. A Ltd. is considering an investment in two projects A and B, whose cash inflows are given below :-

Year	Project A (in `)	Project B(in `)
0	- 10,000	- 10,000
1	4,000	5,000
2	4,000	6,000
3	4,000	4,000

The riskless discount rate is 5%. Project A is less risky than project B. The management considers the risk premium rate of 5% for project A and 10% for project B. Evaluate the projects.

16. A Ltd. has a present sale of `  50, 00,000 to two customers with no risk at all. It plans to two customers with no risk at all. It plans to extend credit to customers who are in risk category. Such a policy would increase sales by ` 10,00,000 on which the firm expects bad debts loss of 8%.

The P.V. Ratio is 15%. The average collection period is 60 days and the cost of funds is 20% should the company relaxe its credit standard?

17. Anbu Ltd has an equity capital consisting of 5,000 Equity shares of `  100 each. It plans to raise ` 3,00,000 for the financial expansion programme and identify four options for raising funds.1)Issue Equity shares of `  100 each.2)Issue 1,000 Equity shares of ` 100 each and 2,000 8% Preference shares of ` 100 each. 3) Borrow of ` 3, 00,000 at 10% interest p.a. 4) Issue 1,000 Equity shares of ` 100 each and ` 2, 00,000, 10% debentures. This company has an EBIT of ` 1, 50,000 of its expansion. Tax rate is 50%. Suggest the source in which funds should be raised.

PART – C

Answer any Two Questions **2 x 20 = 40**

18. Xavier ltd has to make a choice between debt issue and equity issue for its expansion programme. Its current position as follows-

The capital structure consists of 5% Debentures `  20,000: Equity. Share Capital (`.10) ` 50,000 and Reserves ` . 30,000. Its income statement is as follows

Sales	3, 00,000
Less:- Total Cost	2,69,000
EBIT	31,000
Less: Interest	1,000
EBT	30,000
Less: Tax	10,500
EAT	19,500

The Expansion programme is expected to cost ` . 50,000. This is financed through debt and the rate of interest will be 7% and the PE ratio will be 6. If the expansion is financed through equity the new shares are sold `.25 each and the PE ratio will be 7.The expansion will increase the sales by 50% with the return of 10% on the new sales before interest and taxes so advice the company.

19. A ltd. wishes to raise an additional allotment of ` . 10 lakhs for meeting its investment plans. It has Rs. 2, 10,000 in the form of retained earnings available for investment. The following are further details:-

a) Debt Equity Ratio = 3:7
b) Cost of debt (Kd)

a. Upto ` . 1,80,000 = 10%
b. Over ` 1,80,000 = 16%

c) EPS = ` . 4
d) Dividend Payout ratio = 50%
e) Expected growth rate of dividend = 10%
f) Current market price per share = ` . 44
g) Tax rate = 35%

1. You are required to determine the pattern for raising additional finance assuming the company intends to maintain its existing Debt – Equity ratio.
2. Determine the cost of additional debt
3. Determine the cost of equity capital and retained earnings
4. Compute the W. A Cost for additional finance using book value as weights.

20. A project requires investment of ` .1, 00,000 and the working capital of ` . 20,000 at the end of the first year. The project has a life of 5 years and the scrap value of ` 20, 000.

The projects yields the following profits before tax:

Year	Profit before Tax (PBT) `
1	20,000
2	40,000
3	60,000
4	50,000
5	30,000

Calculate

(i) Pay back period (PBP).(ii) Average Rate of Return (ARR).(iii) Net Present Value (NPV) (iv) Profitability Index PI. (v) Discounted pay back period. Assume cost of capital is 10% and tax @ 50%.

21. ABC Ltd. is considering the following credit policy alternatives.

	Options I	Options II	Options III
Credit period (days)	30	40	60
Sales (` . in lakhs)	10	11	12
Bad debts (% of sales)	5%	3%	6%
Cost of credit administration (` . in lakhs)i.e. administration expenses	.2	.22	.25
Average collection period (days)	45	50	70

The PV Ratio is 40%. The firm requires 20% of Return on Investment.

Suggest a suitable credit policy for the firm.

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