LOYOLA COLLEGE (AUTONOMOUS), CHENNAI – 600 034

B.Com. DEGREE EXAMINATION – **COMMERCE**

SIXTH SEMESTER – **APRIL 2016**

CO 6604 – FINANCIAL MANAGEMENT

(UP TO 11 – BATCH)

Date: 15-04-2016 Dept. No. Max. : 100 Marks

Time: 09:00-12:00

PART – A

ANSWER **ALL** THE QUESTIONS: (10x2=20 marks)

1. Give the meaning of Business Finance.
2. Explain the meaning of Trading on Equity.
3. Define Pay-Back period.
4. Explain explicit cost of capital.
5. What is operating cycle of a business?
6. Calculate the net present value requiring an initial investment of ₹ 20,000 and which provides net cash inflow of ₹ 6,000 each year for six years. Assume the cost of funds to be 8% p.a. and that there is no scrap value.
7. A company has 10% redeemable preference shares of ₹ 1,00,000 redeemable at the end of the 10^{th} year from the year of their issue. The underwriting costs came to 2%. Calculate the effective cost of preference share capital.
8. Two firms A and B are identical in all respects except the degree of leverage. Firm A has 6% debt of ₹ 3.00 lakhs, while firm B has no debt. Both the firms earn an EBIT of ₹ 1,20,000 each. The equity capitalisation rate is 10% and the corporate tax is 60%. Calculate the value of unlevered firm.
9. Equipment requires an initial investment of ₹ 6,000. The annual cash flow is estimated at ₹ 2,000 for 5 years. Calculate Pay Back Period from the given information.
10. The installed capacity of a factory is 600 units. Actual capacity used is 400 units. Selling price per unit is ₹ 10; Variable cost is ₹ 6 per unit. Calculate operating leverage if fixed cost is ₹ 400.

PART – B

ANSWER ANY **FOUR** QUESTIONS: (4x10=40Marks)

11. State the importance of Financial Management.
12. Explain the limitations of MM Hypothesis of Capital Structure.

13. Payoff Ltd. is considering in replacing the old machine by new machine. There are two alternative models M and N of the new machine. Prepare a statement of profitability showing the pay-back period from the following information:

Particulars	Machine M	Machine N
Estimated Life of the machine	4 years	5 years
	₹	₹
Cost of the machine	9,000	18,000
Estimated saving in scrap	500	800
Estimated savings in direct wages	6,000	8,000
Additional cost of maintenance	800	1,000
Additional cost of supervision	1,200	1,800
Ignore Taxation		

14. X Ltd. is expected an annual EBIT of ₹ 2 Lakhs. The company has ₹ 8 lakh in 10% Debentures. The cost of Equity Capital or Capitalisation rate is 12.5%. You are required to calculate the total value of the firm under Net Income approach. Also state the overall cost of capital.

15. Calculate the Operating Leverage, Financial Leverage and Combined Leverage from the following data:

    Sales ₹ 8,00,000, Variable Cost ₹ 3,20,000, Fixed Costs ₹ 1,00,000, Interest ₹ 8,000, Income tax rate is 40%.

16. A company issues 10% irredeemable debentures of ₹ 1,00,000. The company is in 55% tax bracket. Calculate the cost of debt (before as well as after tax) if the debentures are issued at (a) par, (b) 10% discount , and (c) 10% premium.

17. What is Management of Working Capital? Why is it necessary?

PART – C

ANSWER ANY **TWO** QUESTIONS: (2x20=40 marks)

18. A company has a share capital of ₹ 1,00,000 divided into shares of ₹ 10 each. It has a major expansion programme requiring an investment of another ₹ 50,000. The management is considering the following alternatives for raising this amount:

    (i) Issue of 5,000 equity shares of ₹ 10 each.

    (ii) Issue of 5,000 12% preferences share of ₹ 10 each.

    (iii) Issue of 10% debentures of ₹ 50,000.

    The company's present EBIT are ₹ 40,000 p.a.

You are required to calculate the effect of each of the above modes of financing on the earning per share (EPS) presuming:

a) EBIT continues to be the same even after expansion b) Tax rate is 50%.

19. The Alpha Co, Ltd. is considering the purchase of a new machine. Two alternative machines (A and B) have been suggested, each having an initial cost of ₹ 4,00,000 and requiring ₹ 20,000 as additional working capital at the end of 1st year. Earnings after taxation are expected to be as follows:

	Cash Inflows	
Year	Machine A ₹	Machine B ₹
1	40,000	1,20,000
2	1,20,000	1,60,000
3	1,60,000	2,00,000
4	2,40,000	1,20,000
5	1,60,000	8,0000

The company has a target of return on capital of 10% and on this basis you are required to compare the profitability of the machine and state which alternative you consider financially preferable using NPV.

Note: The following table gives the present value of Re. 1 due in 'n' number of years:

1st year-0.91, 2nd year – 0.83, 3rd year – 0.75, 4th year – 0.68, 5th year – 0.62.

20. A and B who want to buy a business seek your advice about the average working capital requirements in the first year's trading. The following estimates are available and you are asked to add 10% to your computed figure to allow for contingencies:

	Figures for the year (₹)
a. Average amount locked up for the stocks:	
Stock of finished products	5,000
Stock of stores, materials, etc.	8,000
b. Average credit given:	
Inland sales- 2 weeks credit	78,000
Export sales- 6 weeks credit	3,12,000
c. Time available for payment:	
For purchases - 4 weeks	96,000
For wages – 2 weeks	2,60,000

Set up your calculation for the average amount of working capital required.

21. Explain the meaning of Financial Management and explain its objectives in detail.

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