LOYOLA COLLEGE (AUTONOMOUS), CHENNAI – 600 034

M.Com. DEGREE EXAMINATION – COMMERCE

FIRST SEMESTER – NOVEMBER 2009

CO 1807 - FINANCIAL MANAGEMENT

Date & Time: 04/11/2009 / 1:00 - 4:00 Dept. No. Max. : 100 Marks

PART A

Answer all questions : **10 x 2 = 20**

1. Give the formula for operating leverage.
2. Mention the pattern of capital structure.
3. What do you mean by arbitrage process?
4. Write a note on operating cycle.
5. Explain the term Lock-box system.
6. Analyze the merits and demerits of pay back period.
7. Calculate K and V according to net income approach when ABC limited is expecting an annual EBIT of Rs. 2,00,000. The company has Rs. 8,00,000 in 10% debentures. The Ke is12.5%
8. Annual requirement = 10,000 units cost per unit = Rs. 5 ordering cost = Rs100per order rent, insurance etc per unit per annum Rs. 3 return on investment = 20% Calculate EOQ.
9. A company has 15%perpertual debt of Rs. 2,00,000 the tax rate is 35% debenture the Kd assuming the debt is issued at 10% discount.
10. Write the formula for Ke as per dividend plus growth approach.

PART – B

Answer any five questions : **5 x 8 = 40**

11. What are the significance of capital budgeting?
12. Explain the following capital structure approaches with assumptions
    a. Net income approach b. Net operating income approach
13. Discuss the internal factors affecting dividend policy.
14. Arun Ltd issued 12% preference shares of Rs. 1000 each at Rs. 950 repayable in two equal installments at the end of 10^{th} and11th year respectively Kp.

	Annuity table value for 10 yrs	PV factor for 10^{th} year	PV factor for 11^{th} year
12% P v Factor	5.65	.322	.287
15% P v Factor	5.019	.247	.215

15. X Ltd. currently provides 45 days credit to its customers. Existing sales are Rs1.5 crores. The cost of capital is 15% and variable cost is 80% of sales. The firm is considering extending the credit period to 60 days. This will increase sale by Rs. 15,00,000 on which 5% bad debts is expected should the company extent the credit period.
16. (a) Explain the traditional approach of capital structure.
    (b) In considering the most desirable capital structure for a company, the following estimates of the cost of debt and equity capital (after tax) has been made at various levels of debt-equity mix:

Debt as percentage of total capital employed	Cost of Debt (%)	Cost of Equity (%)
0	5.0	12.0
10	5.0	12.0
20	5.0	12.5
30	5.5	13.0
40	6.0	14.0
50	6.5	16.0
60	7.0	20.0

You are required to determine the optimal debt-equity mix for the company by calculating composite cost of capital.

17. National steel company is considering to invest in a project which cost Rs. 2,50,000 and will require an increase in the level of inventories and receivables (working capital) of Rs. 1,25,000 over its life. The project will generate additional sales of Rs. 2,50,000 and will require additional expenses of Rs. 75,000 every year. The project has 5 years life. The firm's cost of capital is 10% and is in the tax bracket of 50%.
    Assuming straight line method of depreciation should the project be accepted?
    Given: Present Value of an Annuity of Re. 1 at 10% for 5 years is 6.105.

18. A project having an initial investment of Rs. 6,000. It has the following cash flows with a respective probability.COC and discount rate is 15%. Ascertain the NPV.

Year 1		Year 2		Year 3	
Cash inflow	prob.	Cash inflow	prob.	Cash inflow	prob.
1,000	.1	2,000	.2	1,500	.1
1,500	.2	2,500	.3	2,200	.7
2,000	.4	2,700	.2	2,800	.1
2,500	.2	2,800	.3	3,500	.1
3,000	.1				

PART – C

Answer any two questions : **2 x 20 = 40**

19. Suriya Ltd. has the following book value of capital structure.

	Rs.
Equity capital (Rs.10 each)	100 lakhs
11% Preference share capital (Rs.100 each)	10 lakhs
Retained Earnings	120 lakhs
13.5% Debentures (Rs.100 each)	50 lakhs
12% Term loans	80 lakhs
	360 lakhs

(1) The next expected dividend per share is Rs 1.5. The dividend per share expected to grow at 7%. The market price per share is Rs.20.
(2) Preference shares are redeemed at par after 10 years is currently selling at Rs.75.
(3) Debentures are redeemable at par after 6 years is currently selling at Rs.80.
(4) The tax rate is 50%.
Calculate weighted average COC using book value and market value as weights.

20. A Ltd. produces 1,20,000 units per annum. Its percentage for cost to selling price are raw materials 60%, wages 10%, and Overheads 20%.
Selling price is Rs. 5 per unit.
1. Raw material is in stock 2 months
2. Work-in-progress in stock 1 months
3. Finished goods in stock 3 months
4. Creditors allowed 2 months credit and Debtors are given 3 months credit.
5. Wages and OHS are paid on the 1st of each month for the previous month.
6. Cash in hand Rs.40,000.
Calculate the cash cost of working capital.

21. Loyola college incurred the following expenses on its visiting faculty during the Previous Year.

	Rs.
Salary	2,50,000
Travel	1,50,000
Accommodation	6,00,000
Boarding	2,00,000

The accommodation expenses are expected to increase by Rs. 1,00,000 every year.

The college plans to construct a building to take care of the accommodation of such faculty. This building will save Rs. 80,000 in boarding charges and Rs.2,70,000 in cost of training which where either to conduct in a near by hotel every year to construct the building the college will use its existing land which was bought from some year bank at a cost of Rs. 8,00,000. The building will cost Rs. 16,00,000 and the annual maintenance is expected to be Rs. 1,00,000. The cost of construction will be written off equally over 5 years. The tax rate is 50% and the cost of capital is 15%. Should the college construct the building.

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