LOYOLA COLLEGE (AUTONOMOUS), CHENNAI – 600 034

M.Com. DEGREE EXAMINATION – COMMERCE

FIRST SEMESTER – NOVEMBER 2007

CO 1807 - FINANCIAL MANAGEMENT

AU 15

Date : 25/10/2007 Dept. No. Max. : 100 Marks
Time : 1:00 - 4:00

PART – A

(10 x 2 = 20 marks)

Answer ALL questions. Each question carries TWO marks.

1. What are the objectives of Financial Management?
2. Calculate the Compound value of Rs. 1000 when invested for 3 years and the interest on it is Compoundeded at 10% p.a. Semi-annually.
3. What would be the pattern of Capital Structure of a new company?
4. What is meant by Point of Indifference?
5. A company has the following capital structure:

Equity share capital………….	Rs.1,00,000
10% Preference share capital …	Rs.1,00,000
8% Debentures ………………	Rs.1,25,000

   The present EBIT is Rs.50,000. Calculate the financial leverage assuming that the company is in 50% tax bracket.
6. Define the Future cost and Historical cost of capital.
7. A company raised preference share capital of Rs.1,00,000 by issue of 10% preference shares of Rs.10 each. Calculate the cost of preference capital when they are issued at (i) 10% premium and (ii) at 10% discount.
8. What is meant by ‘Capital Rationing’?
9. Calculate the Net present value for a small sized project requiring an initial investment of Rs.20,000 and which provides a net cash inflow of Rs.6,000 each year for six years. Assume the cost of funds to be 8% p.a. and there is no scrap value.
10. What is ABC analysis?

PART – B

(5 x 8 = 40 marks)

Answer any FIVE of the following. Each questions carries EIGHT marks.

11. Discuss the causes and Consequences of overtrading.

12. The capital structure of the Progressive corporation consists of an ordinary share capital of Rs.10,00,000 (shares of Rs.100 per value) and Rs.10,00,000 units of 10% debentures. Sales increased by 20% from 1,00,000 units to 1,20,000 units. The selling price is Rs.10 per unit; Variable cost amounts to Rs.6 per unit and fixed expenses amount to Rs.2,00,000. The income tax rate is assumed to be 50%.

    You are required to calculate the following:

    i) The percentage increase in earning per share;
    ii) The degree of operating leverage at 1,00,000 units and 1,20,000 units.
    iii) The degree of operating leverage at 1,00,000 units and 1,20,000 units.

    Comment on the behaviour of operating and financial leverages in relation to increase in production.

13. What are the advantages to the Company and the Investors by issue of Bonus shares?

14. From the following capital structure of a company, calculate the over all cost of capital using (a) book value weights and (b) market value weights.

Source	Book Value	Market Value
Equity share capital (Rs.10 shares)	Rs. 45,000	Rs.90,000
Retained earnings	15,000	-
Preference share capital	10,000	10,000
Debentures	30,000	30,000

The after-Tax cost of different sources of finance is as follows:
Equity share capital : 14%; Retained earnings : 13%
Preference share capital: 10%; Debentures: 5%.

15. Alpha company is contemplating conversion of 500 14% convertible bonds of Rs.1,000 each. Market price of the bond is Rs.1080. Bond indenture provides that one bond will be exchanged for 10 shares. Price-earning ratio before redemption is 20:1 and anticipated price-earning ratio after redemption is 25:1. Number of shares outstanding prior to redemption are 10,000. EBIT amounts to Rs.2,00,000. The company is in the 35% tax bracket. Should the company convert bond into shares? Give reasons.

16. A firm can invest Rs.10,000 in a project with a life of three years. The projected cash inflow are: year I Rs.4000; year II Rs.5000; year III Rs.4000. Cost of capital is 10% p.a. Should the investment be made?

17. Calculate the operating cycle of a company which gives the following details relating to its operations:

	Rs.
Raw materials consumption per annum	…….. 8,42,000
Annual cost of production	…….. 14,25,000
Annual cost of sales	……. 15,30,000
Annual Sales	……. 19,50,000
Average value of current assets held:	
Raw materials	…….. 1,24,000
Work in Progress	…….. 72,000
Finished goods	…….. 1,22,000
Debtors	…….. 2,60,000

The company gets 30 days credit from its suppliers. All sales made by the firm are on credit only. You may take one year as equal to 365 days.

18. Explain the different types of leases.

PART – C

(2 x 20 = 40 marks)

Answer any TWO of the following. Each question carries TWENTYmarks.

19. A limited company is considering investing in a project requiring a capital outlay of Rs.2,00,000. Fore cost for annual income after depreciation but before tax is as follows:

year		Rs.
1	--------------------------	1,00,000
2	--------------------------	1,00,000
3	--------------------------	80,000
4	--------------------------	80,000
5	--------------------------	40,000

Depreciation may be taken as 20% on original cost and Taxation at 50% of net income.

You are required to evaluate the project according to the following methods:

a) Rate of return on original investment method
b) Discounted cash flow method taking cost of capital as 10%
c) Net present value index method
d) Internal rate of return method

20. The following are the details regarding the operation of a firm during a period of 12 months.

Sales	---------------------------	Rs. 12,00,000
Selling Price per unit	-------------------	Rs. 10
Variable cost price per unit	------------	Rs. 7
Total cost per unit	----------------------	Rs. 9

Credit period allowed to customers: One month

The firm is considering a proposal for a more liberal extension of credit which will result in increasing average collection period from one month to two months. This relaxation is expected to increase the sales by 25% from its existing level.

You are required to advise the firm regarding adoption of the new credit policy, presuming that if firm’s required return on investment is 25%.

21. Write notes on the following:

a) Factors determining capital structure of a company.
b) Kinds of capital Investment proposals.
c) Motives for holding cash.
d) Modigliani and Miller’s approach of Dividend.

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