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Code No. : 5779 **Sub. Code : HKCM 22/ HKAM 22**

M.Com. (CBCS) DEGREE EXAMINATION,
APRIL 2014.

Second Semester

Commerce/Commerce with Computer Application

FINANCIAL MANAGEMENT

(For those who joined in July 2012 onwards)

Time : Three hours Maximum : 75 marks

PART A — (10 × 1 = 10 marks)

Answer ALL questions.

Choose the correct answer :

1. The word finance comes from the Latin was

   (a) Finis (b) Finan

   (c) Finans (d) Finas

2. He is a person who is responsible in a significant way to carry out the finance functions

(a) Treasurer

(b) Controller

(c) Financial manager

(d) Cashier

3. The return after pay off period is not considered in case of

(a) Pay back method (b) ARR method

(c) IRR method (d) NPV method

4. The decision rule under Net Present Value method is

(a) NPV > 0 accept (b) NPV < 0 reject

(c) Both (a) and (b) (d) NPV = 0 accept

5. The cost of capital can be

(a) Explicit (b) Implicit

(c) Both (a) and (b) (d) None of these

6. When a firm has high operating leverage then it is a

(a) Very risky situation

(b) No risky situation

(c) Less risky situation

(d) Moderate risky situation

7. According to MM theory, the firm can be classified into ———— risk classes

(a) Homogeneous (b) Heterogeneous

(c) Financial (d) Operating

8. MM approach is similar to ———— approach

(a) Traditional (b) NOI

(c) NI (d) Income approach

9. Walter's model is based on the relationship between

(a) 'r' and 'k' (b) 'r' > 'k'

(c) 'r' = 'k' (d) 'r' < 'k'

10. Distribution of earnings of a company among its shareholders is

(a) Dividend (b) Profit

(c) Capital (d) Interest

PART B — (5 × 5 = 25 marks)

Answer ALL questions choosing either (a) or (b).

Each answer should not exceed 250 words.

11. (a) Explain about wealth maximization.

Or

(b) State the objectives of finical management.

12. (a) ABC Ltd. considering two projects. Each requires an investment of Rs. 10,000. The net cash inflows from investment in the two projects X and Y are as follows :

Years	X	Y
1	5000	1000
2	4000	2000
3	3000	3000
4	1000	4000
5	–	5000
6	–	6000

The company has fixed three years pay-back period as the cut-off point. Find the pay-back period.

Or

(b) A project is acceptable unless the yield is 10%. Cash inflows of the project along with cash out flows are given below :

Years	Outflows	Inflows	PV factor @ 10%
0	1,50,000	–	1.000
1	30,000	20,000	0.909
2	–	30,000	0.826
3	–	60,000	0.751
4	–	80,000	0.683
5	–	30,000	0.621

The salvage value at the end of the 5th year is Rs. 40,000. Calculate the net present value.

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

Or

(b) The following information relate to two companies :

Company	Sales Rs.	Variable cost Rs.	Fixed cost Rs.	Interest Rs.
P Ltd	5,00,000	2,00,000	1,50,000	50,000
Q Ltd	10,00,000	3,00,000	4,00,000	1,00,000

You are required to calculate the various leverages and comment upon it.

14. (a) Two firm L and U are identical in all respects except for the debt equity mix. Firm L has issued 12% debentures of Rs. 15,00,000. Firm U has no debt. Both L and U earn 30% before interest and taxes on their total assets of Rs. 20,00,000.

The tax rate is 50% and equity capitalization rate is 20%. Compute the value of the two firms using Net Income Approach.

Or

(b) Calculate Return on Equity capital and Return on Net worth ratio form the following data :

	Rs.
10,000 Equity shares of Rs. 10 each	1,00,000
10% 5,000 preference shares of Rs. 10 each	50,000
10% Debentures	50,000
Reserves and Surplus	1,50,000
Current liabilities	1,00,000
Profit before interest and tax	2,00,000
Tax liability at 50%	

15. (a) The following information is available in respect of the rate of return on investment (r) the capitalization rate (Ke) and earning per share (E) of hypothetical Ltd

(i) r = 12% (ii) r = 11% (iii) r = 10% (Ke) = 11% E= Rs. 20.

Determine the value of its shares, assuming the following.

D/P ratio (1-b) = 10% Retention ratio (b) =90%.

Or

(b) The Apex company which earns Rs. 5 per share, is capitalized at 105 and has a return on investment of 12%. Using Walter's dividend policy model, determine

(i) the optimum payout and

(ii) the price of share at this payout.

PART C — (5 × 8 = 40 marks)

Answer ALL questions choosing either (a) or (b).

Each answer should not exceed 600 words.

16. (a) Examine the traditional role of financial manager and elucidate his present role.

Or

(b) State the objectives of financial management.

17. (a) From the following information suggest which of the two projects should accept on the basis of Net Present Value method.

	Project A (Rs.)	Project B (Rs.)
Initial outlay	10,000	20,000
Cash inflows after taxes and depreciation : year 1	8,000	8,000
2	7,000	9,000
3	Nil	7,000
4	Nil	6,000
Service life	2 years	4 years
Required rate of return	10%	10%

Or

(b) The project cost of an investment is Rs. 50,000. the facility has a life expectancy of five years and no salvage value. The company's tax rate is 55%. The firm uses straight line depreciation. The estimated cash flow before tax and depreciation is as follows.

Year	1	2	3	4	5
CFBT	10,000	11,000	14,000	15,000	25,000

Compute the following

(i) Pay back period.

(ii) Average rate of return.

18. (a) A company issues 10% irredeemable debentures of Rs. 2,00,000. The company is in the 50% tax bracket. Calculate the cost of debt (before as well as after tax) if the debentures are issued at (i) par (ii) 10% discount and (iii) 10% premium.

Or

(b) From the following capital structure of a company. Calculate the overall cost of capital, using (i) book value weights and (ii) market value weights.

Source	Book value Rs.	Market value Rs.
Equity share capital (Rs. 10 per share)	45,000	90,000
Retained earnings	15,000	Nil
Preference share capital	10,000	10,000
Debentures	30,000	30,000

The after – tax cost of different sources of finance is as follows :

19. (a) Give the critical appraisal of the M-M approach to the problems of capital structure.

Or

(b) Company X and company Y are in the same risk class and identical expect that A uses debt while B use equity only. The levered firm A has 10% debentures of Rs. 9,00,000.

Both the firms earn 20% on their total assets of Rs. 15,00,000. The corporate rate of tax is 40 % and the rate of return on equity is 15% for an all equity company.

Compute the value of companies X and Y under Net Income Approach and M-M approach.

20. (a) What are the different types of dividend polity?

Or

(b) The following is the capital structure of A Ltd.

	Rs.
Equity share capital (Rs. 10 per share)	2,00,000
Share premium	3,00,000
Reserves and surplus	1,50.000
Total net worth	6,50,000

The company issues bonus shares to its existing equity shareholders in the ratio of 1 for every 10 at the market price of Rs. 15 per share.

You are required to show :

(i) The new capitalization of the company and

(ii) Earnings per share both before and after the bonus issue presuming the net earnings as Rs. 22,000.