M.Com. 2nd Semester Examination, 2010

FINANCIAL MANAGEMENT

PAPER —CM-1201

Full Marks : 50

Time : 2 hours

The figures in the right-hand margin indicate marks

Candidates are required to give their answers in their own words as far as practicable

Illustrate the answers wherever necessary

UNIT—I

1. Answer any *two* questions from the following : 5x2

(*a*) Basic finance function of a company is to collect fund. Critically discuss the above statement. 5

(*b*) "Business risk is independent of capital structure while the genesis of financial risk lies in it." Explain. 5

(*c*) State the importance of cost of capital in capital budgeting and capital structure decisions. 5

(*d*) Describe, in brief, the basic theme of Shareholders' Wealth Maximization (SWM) concept as the objective of financial management. Suggest the revision in the concept after incorporation of the agency problems. 5

2. Answer any *one* question from the following : 10×1

(*a*) Following is the excerpt of the balance sheet of a company as on 31st March, 2010 :

	Rs.
50,000 equity shares of Rs. 10 each fully paid-up :	5,00,000
[Market price (ex-dividend)— as on 31.3.2010 : Rs. 55] Expected market price — as on 31.3.2015 : Rs. 90]	
1,00,000, 12% preference shares of Rs. 2 each fully paid-up	2,00,000
[Issue date : 31.3.09, Redemption date : 31.3.2013, Dividends are paid annually at the end of each year]	

	Rs.
14% debentures of Rs. 100 each : [Issue date : 31.3.10, Redemption date : 31.3.2014]	2,00,000
General reserve	1,00,000

Preference shares and debentures are issued at par but redeemed at a premium of 10%. Corporate tax rate is 40%. Interest on debentures is also paid annually on due basis. If cost of equity share capital is calculated on the basis of an average holding of 5 years by an investor and the expected dividend rates for the 5 years are as follows :

Year-end	Dividend rate (in % age)
2011	11
2012	13
2013	13·5
2014	14
2015	14·5

Calculate overall cost of capital on the basis of book-value weights. 10

(b) (i) What is an indifference point in the EBIT-EPS analysis ?

(ii) A plastic manufacturing company is planning to expand its assets by 50%. All financing for this expansion will come from external sources. The expansion will generate additional sales of Rs. 4 lakh with a return of 25% on sales before interest and taxes. The finance department of the company has submitted the following plans for the consideration of the board :

Plan 1 : Issue 10% debentures.

Plan 2 : Issue 10% debentures of half the required amount and balance in equity shares to be issued at 25% premium.

Plan 3 : Issue of equity shares at 25% premium.

Balance Sheet of the company as on 31st March

Liabilities	Amount (in Rs.)	*Assets*	Amount (in Rs.)
Equity share capital		Total Assets	12,00,000
(Rs. 10 per share)	4,00,000		
8 % Debentures	3,00,000		
Retained earnings	2,00,000		
Current liabilities	3,00,000		
	12,00,000		12,00,000

Income Statement for the year ending on 31st March

	Rs.
Sales	19,00,000
Operating cost	- 16,00,000
EBIT	3,00,000
Interest	- 24,000
Earnings after interest	2,76,000
Taxes at 50 %	1,38,000
	1,38,000
Eps.	3·45

Which financial plan should be a adopted by the company ?

(*iii*) Compute the indifference point between plan 1 and plan 2. 3 + 5 + 2

UNIT—II

3. Answer any *two* questions : 5×2

(*a*) Find out Cash Requirement for Working Capital : 5

Creditors	Rs. 3,75,000
Debtor	Rs. 4,00,000 [2 months sale]
Stock	Rs. 1 month sale
Cash	Rs. 5,000
Fixed Asset	Rs. 6,00,000

Depreciation rate @ 10% p.a.
Gross Profit rate 20%.

(*b*) What is the importance of Working Capital Management? 5

(*c*) From the following information supplied to you, determine the market value of equity shares of Rahul Ltd. as per Gordon's model :

Earnings of the company	Rs. 500,000
Dividend paid	Rs. 300,000
Number of shares outstanding	100,000
Price earning ratio	8
Rate of return on investment	0·15

Are you satisfied with the current dividend policy of the company? 3 + 2

(*d*) State the objectives of holding cash. 5

4. Answer any *one* from the following : 10 x 1

(*a*) (*i*) ABC Ltd. has annual demand of cash to the extent of Rs. 15,00,000. Interest rate earned per planning period is 4%. Conversion cost per conversion is Rs. 500. Find out optimum cost of cash.

(*ii*) Find out maximum permissible bank finance according to Tandon Committees recommendation from the following information :

Stock Rs. 50,000
Debtor Rs. 45,000
Cash Rs. 4,000
Prepaid Exp. Rs. 2,500
Bank loan for working capital Rs. 8,000
Creditors Rs. 12,000
Permanent current assets in 40%. 6 + 4

(*b*) Enumerate the factors which have a bearing on the dividend policy of company. 10

[*Internal Assessment* — 10 Marks]