5. A company plans to sell 30,000 units next year. The expected cost of goods sold is as follows :

	Rs. per unit
Raw material	100
Manufacturing expenses	30
Selling, administration & Financial expenses	20
Selling price	200

The duration at various stages of the operating cycle is expected to be as follows :

Raw materials stage	2 months
Work in process stage (50% completion)	1 month
Finished goods stage	½ month
Debtor's stage	1 month

Assuming the monthly sales level of 2500 units :

(i) Calculate the investment in various current assets, and

(ii) Estimate the gross working capital requirement if the desired cash balance is 5% of the gross working capital requirements.

6. Elaborating the major financial management decisions that a business firm makes, throw light on the scope of Financial Management.

7. Write notes on (any *two*) :

(a) Traditional approach in capital structure theories

(b) Financial Leverage

(c) NPV Vs IRR as techniques for project appraisal.

2007

FINANCIAL MANAGEMENT

Paper : 204

Full Marks – 70

Time – Three hours

The questions are of equal value.

Answer any *five* questions.

1. (a) H. Ltd. has a present annual sales level of 10,000 units at Rs. 300 per unit. The variable cost is Rs. 200 per unit and the fixed costs amount to Rs. 3,00,000 per annum. The present credit period allowed by the company is 1 month. The company is considering a proposal to increase the credit periods to 2 months and 3 months and has made the following estimates :

	Credit Policy		
	Existing 1 month	Proposed 2 months	Proposed 3 months
Increase in sales		15%	30%
Bad Debts	1%	3%	5%

There will be increase in fixed cost by Rs. 50,000 on account of increase of sales beyond 25% of present level.

The company plans on a pre-tax return of 20% on investment in receivables.

Suggest the most paying credit policy for the company.

2. A company's capital structure consists of the following :

	(Rs. in lakhs)
Equity shares of Rs. 100 each	20
Retained Earnings	10
9% Preference Shares	12
7% Debentures	8
Total	50

Its earning before interest and taxes is 12% which is likely to remain unchanged after expansion. The expansion involves additional finances of Rs. 25 lakhs for which following alternatives are available to it.

(i) Issue of 20,000 equity shares at a premium of Rs. 25 per share.

(ii) Issue of 10% preference shares.

(iii) Issue of 8% debentures.

It is estimated that P/E ratio in the case of above financing alternatives would be 21.4, 17 and 15.7 respectively.

Which of these alternatives of financing would you recommend ? The income tax rate is 50%.

3. A company is considering a Rs. 30,000 outlay on an air-cooling system designed to produce a more congenial working environment for those who work on a fairly

tedious assembly line. It is expected that such a system would increase efficiency, which means it will reduce costs. In fact, over the ten year life of the system, cost reductions are expected to be 2% of the current cost of Rs. 6,00,000 per year to operate this line. The other revenues and non-depreciation expenses will remain unaffected. The air-cooling system will be depreciated to zero on a straight line basis. The company's tax rate is 55%. A 20% investment allowance (tax credit on amount invested) is available on this investment. The cost of capital is 12%.

Should the proposal of the air-cooling system be adopted ?

4. A company having a net working capital of Rs. 2.8 lakhs as on 30.6.2001 indicates the following financial ratios and performance figures :

Current ratio	2.4
Liquidity ratio	1.6
Inventory turnover (on cost of sales)	8
Gross profit on sales	20%
Credit allowed (months)	1.5

The company's fixed assets is equivalent to 90% of its net worth (share capital plus reserves) while reserves amounted to 40% of share capital.

Prepare the Balance Sheet of the company as on 30.6.2001 showing step by step calculations.