Total number of printed pages–8

25 (2) FIMN 203

2014

FINANCIAL MANAGEMENT

Paper : 203

Full Marks : 70

Time : Three hours

The figures in the margin indicate full marks for the questions.

Section-'A' is Compulsory. Answer any four questions from Section-'B'.

SECTION-A

1. Answer the following : *(any 14)* 14×1=14

(a) Two mutually exclusive projects (A and B) have been evaluated. Project A has NPV of Rs. 8 lakhs and IRR of 16% ; Project B has NPV of Rs. 7 lakhs but has IRR of 18%. Since Project B has higher internal rate of return, it should be selected. *(TRUE/FALSE)*

(b) Two competing projects (X and Y) respectively have IRRs of 14% and 12%. Which project should be selected ? (indicate the correct option) :

(i) Project X *(ii)* Project Y *(iii)* Can't say.

Contd.

(c) A project requires an initial investment of Rs. 10,00,000. The estimated cash inflows from the project are as follows : Rs. 3 lakhs (year 1), Rs. 1 lakh (year 2), Rs. 3 lakhs (year 3), Rs. 6 lakhs (year 4), and Rs. 4 lakhs (year 5). The pay-back period of the project is ________ years. *(Fill in the blank)*

(d) A project requires an investment of Rs. 20 lakhs. The estimated profit after tax for years 1–5 are : Rs. 3 lakhs, Rs. 3 lakhs, Rs. 3 lakhs, Rs. 6 lakhs and Rs. 8 lakhs respectively. The accounting ratio of return is 21 per cent. *(TRUE/FALSE)*

(e) In the case of an investment project, if the NPV of the project is zero, IRR is equal to cost of capital. *(TRUE/FALSE)*

(f) What would be the profitability index if the internal rate of return equals the cost of capital of the firm ?

(g) A firm's after tax cost of capital of the specific sources is as follows : Cost of debt — 8%, Cost of preference shares — 14%, Cost of equity — 17%. Its capital structure is, Debt — Rs. 3,00,000, Preference capital — Rs. 2,00,000, Equity capital — Rs. 5,00,000. What is its weighted average cost of capital (K_o) using book-value weights ?

(h) A firm has made credit sales of Rs. 2,40,000 during the year. The outstanding amount of debtors at the beginning and at the end of the year respectively are Rs. 27,500 and Rs. 32,500. Calculate its average collection period.

(i) A firm has Net Profit ratio of 10% and total assets turnover — 2 times. Calculate its rate of return on assets.

(j) The current ratio of firm is 2·2 : 1 and its net working capital is Rs. 2,40,000. Calculate its current Assets and current Liabilities.

(k) If the EPS of a company is Rs. 11·50 and its EYR (Earnings Yield Ratio) is 28·75%, find its PE Ratio.

(l) Given — G.P. Ratio = 25%, cost of goods sold Rs. 6,00,000. Find sales.

(m) A company's expected annual net operating income (EBIT) is Rs. 50,000. The company has Rs. 2,00,000, 10% debentures. The equity capitalisation rate (K_e) of the company is 12·5%. Calculate the value of the firm ignoring taxes.

(n) A company's expected EBIT is Rs. 50,000. The company has Rs. 2,00,000, 10% debentures. If its overall capitalisation rate is 12·5% find its equity capitalisation rate.

(o) A customer purchases goods worth Rs. 2,00,000 on credit on 1st February 2014, the credit term being '2/10 net 30'. He makes the payment on 9th February. Calculate the amount payable by him.

SECTION-B 14×4=56

2. H Ltd. has at present annual sales level of 10,000 units at Rs. 300 per unit. The variable cost is Rs. 200 per unit and fixed cost 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 period to 2 months and 3 months and has made the following estimates :

	Existing	Proposed	
Credit period (month)	1	2	3
Increase in sales (per cent)	—	15	30
Bad Debts (per cent)	1	3	5

There will be increase in fixed cost by Rs.50,000 on account of increase in sales beyond 25 per cent of present level. The company plans a pre-tax return of 20 per cent on investment in receivables.

You are required to calculate the most paying credit policy for the company.

3. A project costing Rs. 5,60,000 is expected to produce annual net cash benefits (CFAT) of Rs. 80,000 over a period of 15 years. Estimate the payback period and IRR of the project. Also compute the NPV of the project if the firm's cost of capital is 10% per annum.

4. From the following Balance Sheets of Aruna Sugars Ltd., you are required to prepare a statement of cash flow —

	2010	2011		2010	2011
Equity Share Capital	2,00,000	3,00,000	Goodwill	90,000	60,000
			Land & Building	90,000	1,70,000
Retained Earnings	40,000	60,000	Long Term Investments	40,000	65,000
Public Deposits	50,000	95,000	Short Term Investments	10,000	15,000
Creditors	75,000	90,000	Inventory	50,000	90,000
Outstanding Expenses	25,000	35,000	Debtors	50,000	1,20,000
			Prepaid Expenses	10,000	7,000
			Preliminary Exp.	15,000	7,000
			Cash	15,000	13,000
			Bank	20,000	32,000
	3,90,000	5,80,000		3,90,000	5,80,000

Interest paid on public deposits amounted Rs. 9,000.

5. X & Y Ltd. is desirous to purchase a business and has consulted you and one point on which you are asked to advise then is the average amount of working capital which will be required in the first year's working.

You are given the following estimates and are instructed to add 10% to your computed figure to allow for contingencies.

PARTICULARS		AMOUNT FOR THE YEAR
(i) Average amount for stocks :		
Stock of finished product	—	Rs. 5,000
Stock of stores & materials	—	8,000
(ii) Average credit given :		
Inland sales, 6 weeks' credit	—	3,12,000
Export sales, 1·5 weeks' credit	—	78,000
(iii) Average time lag in payment of wages and other outgoings :		
Wages 1·5 weeks	—	2,60,000
Stocks & materials, 1·5 months	—	48,000
Rent & royalties, 6 months	—	10,000
Clerical staff, 0·5 month	—	62,400
Manager, 0·5 month	—	4,800
Miscellaneous expenses 1·5 months	—	48,000
(iv) Payment in advance :		
Sundry expenses (paid quarterly in advance)	—	8,000

Set up your calculations for the average amount of working capital required.

6. 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. 3 lakhs 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 of 10% debentures.

Plan 2 : Issue of 10% debentures for 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 2014

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

Income Statement for the Year Ending 31st March 2014

Sales	—	Rs. 19,00,000
Operating Costs	—	16,00,000
EBIT		300,000
Interest	—	24,000
Earnings after Interests		2,76,000
Taxes	—	96,600
EAT	—	1,79,400
EPS		4·48

(a) Determine the number of equity shares that will be issued if financial plan 3 is adopted.

(b) Assume that the price-earnings ratio is expected to remain unchanged at 8 if plan 3 is adopted, but is likely to drop to 6 if either plan 1 or 2 is used to finance the expansion. Determine the expected market price of the shares in each of the situations.

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

(a) Intermediate approach to optimum capital structure

(b) Managerial finance functions

(c) NPV *vs.* IRR.