K.J. Somaiya Institute of Management Studies & Research
Course: PGDM (FS) – II Tri. End Term Exam
Sub: Financial Management

Date of Exam: 2nd Jan., 2017 Time: 3 Hours Marks: 50 Marks

Note: 1. Attempt any Five Question Each of 10 Marks
2. Use of scientific calculator is allowed but not mobile phones or financial calculators.

Question No.1

The MNC Company Limited has decided to increase its productive capacity to meet an anticipated increase in demand for its products. The extent of this increase in capacity is still to be determined and a management meeting has been called to decide which of the following two mutually exclusive Proposals-I and II should be undertaken. On the basis of the following information given below you are required to:

(a) Evaluate the profitability (ignoring taxation) and
(b) Advise management in deciding between Proposal I and Proposal II on the assumption of cost of capital of 8%. (Calculate NPV, BCR and Payback Period)
(c) State the matters to be taken into consideration while deciding between Proposal I and Proposal II.

Particulars	Proposal I	Proposal II
Buildings	50000	100000
Plant	200000	300000
Installation	10000	15000
Working capital (note iii)	50000	65000
Net income:		
Annual pre-depreciation profits (note i)	70000	95000
Other relevant income/expenditure including sales promotion (note ii)	---	15000
Plant scrap value	10000	15000
Building disposable value	30000	60000

Notes:

i. The investment life is 10 years.
ii. An exceptional amount of expenditure on sales promotion of Rs.15000 will be spent in year 2 on proposal II. This has not been taken into account in calculation pre-depreciation profits.
iii. Working capital is recovered at book value

Question No.2

X Limited has credit sales of Rs.360 lakhs and its average collection period is 30 days. The financial controller estimates that the bad debts losses are around 2% of credit sales. The firm spends Rs.140000 annually on debtors' administration. This cost comprises of telephonic and fax bills along with salaries of staff members. These are the avoidable costs. A factoring firm has offered to buy the firms receivables. The factor will charge 1% commission and will pay and advance against receivables on an interest @15% p.a. after withholding 10% as reserve.

Required: Should company engage factor? (Assume 360 days in a year).

Question No.3

Determine the weighted average cost of capital based on the following information:

Capital Structure	Amount
Debentures (Rs.100 per debenture)	Rs.800000
Preference shares (Rs.100 per share)	Rs.200000
Equity shares (Rs.10 per share)	Rs.1000000
Total	Rs.2000000

Recent market price of all these securities are: Debentures Rs.110 per debenture; Preference shares: Rs.120 per share; and equity shares: Rs.22 per share.

External financing opportunities are:

i. Rs.100 per Debenture redeemable at par, 10 year maturity, 13% interest rate, 4% flotation cost and sales price Rs.100;
ii. Rs.100 per Preference share redeemable at par, 10 year maturity, 14% dividend rate, 5% flotation cost and sales price Rs.100; and
iii. Equity shares- Rs.2 per share and sale price Rs.22.

Dividend expected on equity shares at the end of the year is Rs.2 per share; anticipated growth rate in dividend is 7%. Company pays all its earnings in the form of dividends. Corporate tax rate is 30%.

Question No. 4

Calculate the amount of working capital requirement for SRDD Limited from the following information:

	Rs. Per Unit
Raw material	160
Direct labour	60
Overheads	120
Total cost	340
Profit	60
Selling Price	400

Raw materials are held in stock on an average for one month. Materials are in progress on an average for half-a-month. Finished goods are in stock on an average for one month.

Credit allowed by suppliers is one month and credit allowed to debtors is two months. Time lag in payment of wages is 1 ½ weeks. Time lag in payment of overheads expenses is one month. ¼ of the sales are made on cash basis.

Cash in hand and at the bank is expected to be Rs.50000. Expected level of production is 104000 units for a year of 52 weeks.

Note: Show all calculations in weeks.

Question No.5

The purchase manager of an organization has collected the following data for one of the A class items.

Interest on the locked up capital	20%
Order processing cost for each order	Rs.100
Inspection cost per lot	Rs.50
Follow up cost for each order	Rs.80
Pilferage while holding inventory	5%
Other holding cost	15%
Other procurement cost for each order	Rs.170
Annual demand	1000 units
Cost per item	Rs.10
Discount for a minimum order quantity of 500 items	10%

Calculate

1. EOQ
2. Total cost at EOQ and at 500 items quantity.

Question No. 6

Sales and working capital of Glaxo Ltd. for a period of 3 years are given below:

Year	Sales Turnover (Rs. in Cr.)	Net Current Assets (Rs. in Cr.)
2000	858.34	70.75
2001	992.14	118.12
2002	870.53	116.15

Estimate the working capital requirement for the year 2003 by regression analysis, if an anticipated sale is Rs.950 Cr.

Question No.7

A company currently has an annual turnover of Rs.1000000 and an average collection period of 45 days. The company wants to experiment with more liberal credit policy on the ground that increase in collection will generate additional sales.

From the following information, kindly indicate which of the policies you would like the company to adopt:

Credit policy	Increase in credit period	Increase in sales	% of Default
I	15 days	Rs.50000	2%
II	30 days	Rs.80000	3%
III	40 days	Rs.100000	4%
IV	60 days	Rs.125000	6%

The selling price of the product is Rs.5, and the variable cost per unit is Rs.3. The current bad debts loss is 1% and the required rate of return on investment is 20%. A year can be taken to comprise of 360 days.

Question No. 8

(I) Mr. Prasad is considering to purchase a commercial complex that will generate a net cash flow of Rs.400000 at the end of one year. The future cash flows are expected to grow at the rate of 4% p.a. Mr. Prasad's required rate of return is 12%. Mr. Prasad would be willing to pay the amount of ------------------ for the complex if he wishes to sell it at the end of four years at Rs.40 lakh, net of transaction costs.

a. Rs.4958921
b. Rs.3826958
c. Rs.15613927
d. Rs.16151256
e. Rs.18277509

(II) At the time of retirement Mr. Swamy is given a choice between two alternatives.

i. An annual pension of Rs.20000 as long as he lives.
ii. A lump sum payment of Rs.150000. if Mr. Swamy expects to live for 15 years and rate of interest is 15%, which alternative should he select.

(Note: PVFA @ 15%, 15 Years = 5.847)

Question 9

Short Notes (Any Two)

1. ABC Analysis
2. Factoring Process
3. Drawbacks of IRR

PV Table

	PVF		
Year	**12%**	**8%**	**15%**
1	0.893	0.926	0.870
2	0.797	0.857	0.756
3	0.712	0.794	0.658
4	0.636	0.735	0.572
5	0.567	0.681	0.497
6	0.507	0.630	0.432
7	0.452	0.583	0.376
8	0.404	0.540	0.327