

**M.Com. DEGREE (C.S.S.) EXAMINATION, FEBRUARY 2016****First Semester****Faculty of Commerce****FMO 1C 03 – FINANCIAL MANAGEMENT PRINCIPLES****(2012 Admission onwards)****Time : Three Hours****Maximum Weight : 30****Section A***Answer any five questions.**Each question carries 1 weight.*

1. What is meant by optimum capital structure?
2. Name various theories of capital structure.
3. Write a very short note on cost of retained earnings.
4. Which capital budgeting methods take into consideration the concept of time value of money?
5. A company has sales of Rs. 5,00,00, variable cost of Rs. 3,00,000, fixed cost of Rs. 1,00,000. Calculate the operating leverage.
6. Define financial leverage.
7. What is financial planning?
8. Explain the following :
  - (a) Trading on Equity.
  - (b) Financial risk and business risk.

**(5 × 1 = 5)****Section B***Answer any five questions.**Each question carries 2 weight.*

9. Explain the principles governing a sound financial plan.
10. The Payback period of a project does not indicate its profitability. Comment.
11. Are the retained earnings less expensive than the new issue of ordinary shares? Give your views.
12. Explain EBIT -EPS approach for determining capital structure of a company.



13. What is meant by capital structure? Explain the factors determining capital structure of a firm.
14. Explain as to how the wealth maximisation objective is superior to profit maximisation objective.
15. Distinguish between Operating Leverage and Financial Leverage with appropriate illustrations.
16. A 7 Year Rs. 100 debenture of a firm can be sold for a net price of Rs. 97.75. The coupon rate of interest is 15% per year and bond will be redeemed at 5% premium on maturity. The firm's tax rate is 35%. Compute the after tax cost of debenture.

(5 × 2 = 10)

### Section C

Answer any **three** questions.

Each question carries 5 weight.

17. What is the relevance of cost of capital in capital budgeting and capital structure planning decisions?
18. Give a critical appraisal of the traditional approach and the Modigliani-Millers approach to the problem of capital structure.
19. Discuss in detail the various types of decisions which are to be taken by a Finance Manager in the emerging business scenario.
20. Company X and Company Y is in the same risk class and identical in all respects except that Company X uses debt while Company Y does not. Levered Company has Rs. 9 lakhs debentures carrying 10% rate of interest. Both companies earn 20% before interest and taxes on their total assets of Rs. 15 lakhs. Assume perfect capital markets, tax rate of 50% and capitalisation rate of 15% for all equity company.
  - (a) Compute the value of both the companies using Net Income approach.
  - (b) Compute the value of both the companies using Net Operating Income approach.
21. Expert Ltd is considering buying one of the following two mutually exclusive investment projects :

Project A : Buy a machine that requires an initial investment outlay of Rs. 1, 00,000 and will generate the cash flows after tax of Rs. 30,000 per year for 5 years.

Project B : Buy a machine that requires an initial investment outlay of Rs. 1,25,000 and will generate cash flows after tax of Rs. 27,000 per year for 8 years.

Which project should be undertaken? The company uses 10% cost of capital to evaluate the projects.

Present value of Re.1 for 8 years @10%--0.9091, 0.8264, 0.7513, 0.6830, 0.6209, 0.5645, 0.5132 and 0.4665.



22. The following details of A Ltd. for the year ended 31-3-2013 are furnished :

Operating Leverage	- 3 : 1.
Financial Leverage	- 2 : 1.
Interest charges per annum	- Rs. 20 Lakhs.
Corporate tax rate	- 50%.
Variable cost as percentage of sales	- 60%.

Prepare the Income Statement of the Company.

(3 × 5 = 15)