(ALL BATCHES)

DATE: 16.10.2018 **MAXIMUM MARKS:100** **TIMING: 3¼Hours**

FINANCIAL MANAGEMENT & ECONOMICS FOR FINANCE

SECTION - A

Q. No. 1 is compulsory.

Candidates are also required to answer any four questions from the remaining five questions.

In case, any candidate answers extra question(s)/sub-question(s) over and above the required number, then only the requisite number of equestions first answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.

Working Notes should form part of the respective answer.

Question: 1

(a) A firm's details are as under:

Sales (@100 per unit)	Rs. 24,00,000
Variable Cost	50%
Fixed Cost	Rs. 10,00,000

It has borrowed Rs. 10,00,000 @ 10% p.a. and its equity share capital is Rs. 10,00,000 (Rs. 100 each) Calculate:

(i) Operating Leverage
(ii) Financial Leverage
(iii) Combined Leverage
(iv) Return on Investment
(v) If the sales increases by Rs. 6,00,000; what will the new EBIT?

(5 Marks)

(b) The capital structure of Beta Limited is as follows:

Equity share capital of Rs. 10 each	8,00,000
9% preference share capital of Rs. 10 each	3,00,000
	11,00,000

Additional information: Profit (after tax at 35 per cent), Rs. 2,70,000; Depreciation, Rs. 60,000; Equity dividend paid, 20 per cent; Market price of equity shares, Rs. 40.

You are required to compute the following, showing the necessary workings:

(i) Dividend yield on the equity shares
(ii) Cover for the preference and equity dividends
(iii) Earnings per shares
(iv) Price-earnings ratio.

(5 Marks)

(c) There are two company N Ltd. and M Ltd., having same earnings before interest and taxes i.e. EBIT of Rs. 20,000. M Ltd. is a levered company having a debt of Rs.1,00,000 @ 7% rate of interest. The cost of equity of N Ltd. is 10% and of M Ltd. is 11.50%.

Find out how arbitrage process will be carried on?

(5 Marks)

(d) Ganesha Limited is setting up a project with a capital outlay of Rs. 60,00,000. It has two alternatives in financing the project cost.

Alternative-I : 100% equity finance by issuing equity shares of Rs. 10 each

Alternative-II : Debt-equity ratio 2:1 (issuing equity shares of Rs. 10 each)

The rate of interest payable on the debts is 18% p.a. The corporate tax rate is 40%. Calculate the indifference point between the two alternative methods of financing.

(5 Marks)

Question: 2

(a) The following information is available in respect of Saitrading company:

(i) On an average, debtors are collected after 45 days; inventories have an average holding period of 75 days and creditor's payment period on an average is 30 days.
(ii) The firm spends a total of Rs. 120 lakhs annually at a constant rate.
(iii) It can earn 10 per cent on investments.

From the above information, you are required to calculate:

(a) The cash cycle and cash turnover,
(b) Minimum amounts of cash to be maintained to meet payments as they become due,
(c) Savings by reducing the average inventory holding period by 30 days.

(5 Marks)

(e) The following information relates to Navya Ltd:

Earnings of the company	Rs. 20,00,000
Dividend pay-out ratio	60%
No. of Shares outstanding	4,00,000
Rate of return on investment	15%
Equity capitalization rate	12%

Required:
(i) DETERMINE what would be the market value per share as per Walter's model.
(ii) COMPUTE optimum dividend pay-out ratio according to Walter's model and the market value of company's share at that pay-out ratio.

(5 Marks)

Question: 3

ABC Ltd. has the following capital structure which is considered to be optimum as on 31st March, 2017.

	(Rs.)
14% Debentures	30,000
11% Preference shares	10,000
Equity Shares (10,000 shares)	1,60,000
	2,00,000

The company share has a market price of Rs. 23.60. Next year dividend per share is 50% of year 2017 EPS. The following is the trend of EPS for the preceding 10 years which is expected to continue in future.

Year	**EPS (Rs.)**	**Year**	**EPS (Rs.)**
2008	1.00	2013	1.61
2009	1.10	2014	1.77
2010	1.21	2015	1.95
2011	1.33	2016	2.15
2012	1.46	2017	2.36

The company issued new debentures carrying 16% rate of interest and the current market price of debenture is Rs. 96.

Preference share Rs. 9.20 (with annual dividend of Rs. 1.1 per share) were also issued. The company is in 50% tax bracket.

(A) Calculate after tax:
  (i) Cost of new debt
  (ii) Cost of new preference shares
  (iii) New equity share (consuming new equity from retained earnings)
(B) Calculate marginal cost of capital when no new shares are issued.
(C) How much can be spent for capital investment before new ordinary shares must

be sold. Assuming that retained earnings for next year's investment are 50 percent of 2017.

(D) What will the marginal cost of capital when the funds exceeds the amount calculated in (C), assuming new equity is issued at Rs. 20 per share?

(10 Marks)

Question: 4

PQ Ltd., a company newly commencing business in 2017 has the following projected Profit and Loss Account:

	(Rs.)	(Rs.)
Sales		2,10,000
Cost of goods sold		1,53,000
Gross Profit		57,000
Administrative Expenses	14,000	
Selling Expenses	13,000	27,000
Profit before tax		30,000
Provision for taxation		10,000
Profit after tax		20,000
The cost of goods sold has been arrived at as under:		
Materials used	84,000	
Wages and manufacturing Expenses	62,500	
Depreciation	23,500	
	1,70,000	
Less: Stock of Finished goods (10% of goods produced not yet sold)	17,000	
	1,53,000	

The figure given above relate only to finished goods and not to work-in-progress. Goods equal to 15% of the year's production (in terms of physical units) will be in process on the average requiring full materials but only 40% of the other expenses. The company believes in keeping materials equal to two months' consumption in stock.

All expenses will be paid one month in advance. Suppliers of materials will extend 1-1/2 months credit. Sales will be 20% for cash and the rest at two months' credit. 70% of the Income tax will be paid in advance in quarterly instalments. The company wishes to keep Rs. 8,000 in cash. 10% has to be added to the estimated figure for unforeseen contingencies.

Prepare an estimate of working capital.

Note: All workings should form part of the answer.

(10 Marks)

Question: 5

A company is considering its working capital investment and financial policies for the next year. Estimated fixed assets and current liabilities for the next year are Rs. 2.60 crores and Rs. 2.34 crores respectively. Estimated Sales and EBIT depend on current assets investment, particularly inventories and book-debts. The financial controller of the company is examining the following alternative Working Capital Policies:

(Rs. Crores)

Working Capital Policy	Investment in Current Assets	Estimated Sales	EBIT
Conservative	4.50	12.30	1.23
Moderate	3.90	11.50	1.15
Aggressive	2.60	10.00	1.00

After evaluating the working capital policy, the Financial Controller has advised the adoption of the moderate working capital policy. The company is now examining the use of long-term and short-term borrowings for financing its assets. The company will use Rs. 2.50 crores of the equity funds. The corporate tax rate is 35%. The company is considering the following debt alternatives.

(Rs. Crores)

Financing Policy	Short-term Debt	Long-term Debt
Conservative	0.54	1.12
Moderate	1.00	0.66
Aggressive	1.50	0.16
Interest rate-Average	12%	16%

You are required to CALCULATE the following:

(i) Working Capital Investment for each policy:
- (a) Net Working Capital position
- (b) Rate of Return
- (c) Current ratio

(ii) Financing for each policy:
- (a) Net Working Capital position.
- (b) Rate of Return on Shareholders' equity.
- (c) Current ratio.

(10 Marks)

Question: 6 : Write Short notes:

(a) Global depository Bonds (GDRs) **(2½ Marks)**
(b) Indian depository Bonds (IDRs) **(2½ Marks)**
(c) Venture Capital Financing **(2½ Marks)**
(d) Plain Vanilla Bonds **(2½ Marks)**

SECTION - B
Q. No. 7 is compulsory.
Answer any three from the rest.
In case, any candidate answers extra question(s)/sub-question(s) over and above the required number, then only the requisite number of equestions first answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.
Working Notes should form part of the respective answer.

Question: 7

(a) Find the value of the multiplier when
(i) MPC is 0.2
(ii) MPC is 0.5
(iii) MPC is 0.8 **(3 Marks)**

(b) You are given the following data on an economy in millions:

Consumer Expenditure (inclusive of indirect taxes)	110 m
Investment	20 m
Government Expenditure (inclusive of transfer payments)	70 m
Exports	20 m
Imports	50 m
Net Property Income from abroad	10 m
Transfer payments	20 m
Indirect taxes	30 m
Population	0.5 m

(i) Calculate the Gross Domestic Product at market prices.
(ii) Calculate the Gross National Income at market prices.
(iii) Calculate the Gross Domestic Product at factor cost.
(iv) Calculate the per capita Gross National Income at factor cost. **(4 Marks)**

(c) What is the major aim of the agreement on Technical Barriers to Trade (TBT) serve? **(3 Marks)**

Question: 8

(a) Explain the term recessionary gap'. **(2 Marks)**
(b) What is meant by crowding out? **(3 Marks)**
(c) Define credit multiplier. How is it calculated? **(3 Marks)**
(d) What is the distinction between direct and indirect instruments of monetary policy? **(2 Marks)**

Question: 9

(a) Compute Reserve Money from the following data published by RBI

Components	(In billions of Rs.) As on 7 July 2017
Currency in Circulation	15428.40
Bankers' Deposits with RBI	4596.18
'Other' Deposits with RBI	183.30

(2 Marks)

(b) Find GDPMP and GNP MP from the following data (in Crores of Rs) using income method. Show that it is the same as that obtained by expenditure method.

Personal Consumption	7,314
Depreciation	800
Wages	6,508
Indirect Business Taxes	1,000
Interest	1,060
Domestic Investment	1,482
Government Expenditures	2,196
Rental Income	34
Corporate Profits	682
Exports	1,346
Net Factor Income from Abroad	40
Mixed Income	806
Imports	1,408

(3 Marks)

(c) Describe, using examples, common access resources. **(5 Marks)**

Question: 10

(a) (i) What is the crux of Heckscher-Ohlin theory of international trade? **(3 Marks)**

(ii) What are the major arguments against liberal trade? **(2 Marks)**

(b) Identify the market outcomes for each of the following situations
(i) A few youngsters play loud music at night. Neighbours may not be able to sleep.
(ii) Ram buys a large SUV which is very heavy
(iii) X smokes in a public place
(iv) Rural school students given vaccination against measles
(v) Traffic congestion making travel very uncomfortable
(vi) Piracy of computer programs

(vii) Some species of fish are now getting extinct because they have been caught indiscriminately.
(viii) The municipality provides sirens four times a day
(ix) Burglar alarms are installed by many in your locality
(x) Global warming increases due to emissions of fossil fuels

(5 Marks)

Question: 11

(a) Distinguish between direct quote and indirect quote?

(3 Marks)

(b) What is the purpose of SPS measures?

(2 Marks)

(c) Do you agree with the argument that FDI is likely to reduce employment?

(3 Marks)

(d) Outline the main goals of tariffs?

(2 Marks)

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