(ALL CA INTERMEDIATE BATCHES)

DATE: 19.01.2021 MAXIMUM MARKS: 100 TIMING: 3¼ Hours

FINANCIAL MANAGEMENT

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 questions top 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 Sai Trading 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)

(b) 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 Limited has the following book value capital structure:

Equity Share Capital (150 million shares, Rs. 10 par)	Rs. 1,500 million
Reserves and Surplus	Rs. 2,250 million
10.5% Preference Share Capital (1 million shares, Rs. 100 par)	Rs. 100 million
9.5% Debentures (1.5 million debentures, Rs. 1,000 par)	Rs. 1,500 million
8.5% Term Loans from Financial Institutions	Rs. 500 million

The debentures of ABC Limited are redeemable after three years and are quoting at Rs. 981.05 per debenture. The applicable income tax rate for the company is 35%.

The current market price per equity share is Rs. 60. The prevailing default-risk free interest rate on 10- year GOI Treasury Bonds is 5.5%. The average market risk premium is 8%. The beta of the company is 1.1875.

The preferred stock of the company is redeemable after 5 years is currently selling at Rs. 98.15 per preference share.

Required:

(i) Calculate weighted average cost of capital of the company using market value weights.

(ii) Define the marginal cost of capital schedule for the firm if it raises Rs. 750 million for a new project. The firm plans to have a debt of 20% of the newly raised capital. The beta of new project is 1.4375. The debt capital will be raised through term loans, it will carry interest rate of 9.5% for the first Rs.100 million and 10% for the next Rs. 50 million.

(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:

C Ltd. is considering investing in a project. The expected original investment in the project will be Rs. 2,00,000, the life of project will be 5 year with no salvage value. The expected profit after depreciation but before tax during the life of the project will be as following:

Year	1	2	3	4	5
Rs.	85,000	1,00,000	80,000	80,000	40,000

The project will be depreciated at the rate of 20% on original cost. The company is subjected to 30% tax rate.

Required:

(i) Calculate payback period and average rate of return (ARR)

(ii) Calculate net present value and net present value index, if cost of capital is 10%.

(iii) Calculate internal rate of return.

Note: The P.V. factors are:

Year	P.V. at 10%	P.V. at 37%	P.V. at 38%	P.V. at 40%
1	.909	.730	.725	.714
2	.826	.533	.525	.510
3	.751	.389	.381	.364
4	.683	.284	.276	.260
5	.621	.207	.200	.186

(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)

ECONOMICS FOR FINANCE

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) Write a short note on Structure of the WTO.

(3 Marks)

(b) Explain Countervailing Duties.

(2 Marks)

(c) Explain Technical Measures as Trade Barriers.

(3 Marks)

(d) Explain The Mercantilists View of International Trade.

(2 Marks)

Question 8:

(a) Explain the Speculative Demand for Money.

(3 Marks)

(b) What should be the Fiscal Policy for Long-Run Economic Growth.

(2 Marks)

(c) Explain Automatic Stabilizers.

(3 Marks)

(d) Explain Pigouvian Taxes.

(2 Marks)

Question 9:

(a) What is local content requirement? How will it affect trade?

(3 Marks)

(b) Define 'dumping'? What is meant by an 'Anti-dumping' measure?

(3 Marks)

(c) Explain the term quasi-public goods.

(2 Marks)

(d) Explain how speculative motive for holding cash is related to market interest rate.

(2 Marks)

Question 10:

(a) In 1983 Australia decided to float its dollar. Assuming free trade, explain the effects of each of the following on the spot exchange rate between AUD and USD.

(i) There is a substantial increase demand in Australia for US exports of services. Since Australia manufactures were favoured over others, there is a proportionate increase in exports of Australian products to the US

(ii) Investors in Australia perceive that the returns on investments in the US would be much more lucrative than elsewhere. As a result there is a huge increase in demand for investments in US dollar denominated financial investments

(iii) Political uncertainties in the US due to presidential elections caused large scale shift of Australian financial investments back in to Australia.

(iv) An epidemic in some parts of Australia made the US evoke SPS measures and ban the entry of a number of food items to the US

(5 Marks)

(b) Mention the Main Advantages of a Fixed Rate Regime.

(3 Marks)

(c) Write a note on Overseas Direct Investment by Indian Companies.

(2 Marks)

Question 11:

(a) Using the information given in the following table calculate,

(i) Value added by firm A and firm B

(ii) Gross Domestic Product at Market Price

(iii) Net Domestic Product at Factor Cost.

	Particulars	**Rs. crore**
(i)	Sales by firm B to general government	300
(ii)	Sales by firm A	1500
(iii)	Sales by firm B to households	1350
(iv)	Change in stock of firm A	200
(v)	Closing stock of firm B	140
(vi)	Opening stock of firm B	130
(vii)	Purchases by firm A	270
(viii)	Indirect taxes paid by both the firms	375
(ix)	Consumption of fixed capital	720
(x)	Sales by firm A to B	300

(5 Marks)

(b) Classify each of the following goods based on their characteristics. Mention the rationale.

(i) Open-access Wi-Fi networks

(ii) Roads with toll booths

(iii) Parks

(3 Marks)

(c) Describe the term 'Tragedy of commons'.

(2 Marks)

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