(ALL CA INTERMEDIATE BATCHES)

DATE: 19.10.2020 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 company belongs to a risk-class for which the appropriate capitalization rate is 10%. It currently has outstanding 25,000 shares selling at Rs. 100 each. The firm is contemplating the declaration of dividend of Rs. 6 per share at the end of the current financial year. The company expects to have a net income Rs. 3.5 lacs and a proposal for making new investments of Rs. 6 lacs.
Show that under the MM assumptions, the payment of dividend does not affect the value of the firm.

(5 Marks)

(b) The selected financial date for A, B and C Companies for the year ended Dec., 2020 are as follows :

	A	B	C
Variable expenses as a % sales	66.67	75	50
Interest	200	300	1,000
Degree of operating leverage	5:1	6:1	2:1
Degree of financial leverage	3:1	4:1	2:1
Income tax rate	50%	50%	50%

Prepare Income Statement for A, B and C Companies.

(5 Marks)

(c) ABC Ltd. with EBIT of Rs. 3,00,000 is evaluating a number of possible capital structures, given below. Which of the capital structure will you recommed, and why?

Capital Structure	Debt (Rs.)	K_d %	K_e %
I	3,00,000	10.0	12.0
II	4,00,000	10.0	12.5
III	5,00,000	11.0	13.5
IV	6,00,000	12.0	15.0
V	7,00,000	14.0	18.0

(5 Marks)

(d) Growell Corporation has decided to change its capital structure. The firm currently has one crore fully paid-up shares. The share commands a price of Rs. 50 in the market and is likely to remain the same even after proposed capital restructuring. The restructuring involves increasing the firm's existing debt of Rs. 9 crore 10% debt to Rs. 14 crore. The proceeds will be used to retire the equity. The interest rate on debt is not expected to change as the debt investors do not perceive the firm to become more risky as a result of proposed debt. Company is in 40% tax bracket. Keeping in mind EPS – EBIT relationship in the context of capital structure, calculate the minimum level of EBIT that the firm must earn so that EPS does not change.

(5 Marks)

Question 2:

XYZ Ltd. is considering the introduction of a new product. It is estimated that profits before depreciation would increase by Rs. 1,20,000 each year for first four years and Rs. 60,000 each for the remaining period. An advertisement cost of Rs. 20,000 is expected to be incurred in the first year, which is not included in the above estimate of profits. The cost will be allowed for tax purpose in the first year.

A new plant costing Rs. 2,00,000 will be installed for the production of the new product. The salvage value of the plant after its life of 10 years is estimated to be Rs. 40,000. A working capital investment of Rs. 20,000 will be required in the year of installing the plant and a further Rs. 15,000 in the following year. The company's tax rate is 50% and it claims written down value depreciation at 33.33%. If the company's required rate of return is 20%, should the company introduce the new product? Ignore tax effect on Profit/Loss on sale of asset.

(10 Marks)

Question 3:

A Limited has the following capital

Equity share capital (2,00,000 shares)	Rs. 40,00,000
6% Preference shares	10,00,000
8% Debentures	30,00,000
	80,00,000

The market price of the company's equity share is Rs. 20 it is expected that company will pay a dividend of Rs. 2 per share at the end of current year, which will grow at 7 percent forever. The tax rate may be presumed at 50 percent. You are required to compute the following :

(a) A weighted average cost of capital based on existing capital structure.

(b) the new weighted average cost of capital if the company rasises an additional Rs. 20,00,000 debt by issuing 10 per cent debentures. This would result in increasing the expected dividend to Rs. 3 and leave the growth rate unchanged but the price of share will fall to Rs. 15 per share.

(c) The cost of capital if in (b) above, growth rate increases to 10 percent.

(10 Marks)

Question 4:

X Ltd. sells goods at a gross profit of 20%. It includes depreciation as part of cost of production. The following figures for the 12 months ending 31st Dec, 2005 are given to enable you to ascertain the requirement of working capital of the company on a cash cost basis.

In your working, you are required to assume that:

i. safety margin of 15% will be maintained;

ii. cash is to be held to the extent of 50% of current liabilities;

iii. there will be no work-in-progress;

iv. Tax is to be ignored.

Stocks of raw materials and finished goods are kept at one month's requirements. All working notes are to form part of your answer.

Sales at 2 months credit	Rs. 27,00,000
Materials consumed (suppliers credit is for 2 months)	6,75,000
Total wages (paid 1 month in arrear)	5,40,000
Manufacturing expenses outstanding at the end of the year	60,000

(These expenses are paid one month in arrears)	
Total administrative expenses (paid as above)	1,80,000
Sales promotion expenses paid quarterly and in advanced	90,000

(10 Marks)

Question 5:

Following is the abridged Balance Sheet of Alpha Ltd. :- (31.3.16)

Liabilities	Rs.	Assets	Rs.	Rs.
Share Capital	1,00,000	Land and Buildings		80,000
Profit and Loss Account	17,000	Plant and Machineries	50,000	
Current Liabilities	40,000	Less: Depreciation	15,000	35,000
				1,15,000
		Stock	21,000	
		Receivables	20,000	
		Bank	1,000	42,000
Total	1,57,000	Total		1,57,000

With the help of the additional information furnished below, you are required to prepare Trading and Profit & Loss Account and a Balance Sheet as at 31st March, 2017:

(i) The company went in for reorganisation of capital structure, with share capital remaining the same as follows:

Share capital	50%
Other Shareholders' funds	15%
5% Debentures	10%
Payables	25%

Debentures were issued on 1st April, interest being paid annually on 31st March.

(ii) Land and Buildings remained unchanged. Additional plant and machinery has been bought and a further Rs. 5,000 depreciation written off.
(The total fixed assets then constituted 60% of total fixed and current assets.)

(iii) Working capital ratio was 8 : 5.

(iv) Quick assets ratio was 1 : 1.

(v) The receivables (four-fifth of the quick assets) to sales ratio revealed a credit period of 2 months. There were no cash sales.

(vi) Return on net worth was 10%.

(vii) Gross profit was at the rate of 15% of selling price.

(viii) Stock turnover was eight times for the year.

Ignore Taxation.

(10 Marks)

Question 6:

(i) "The profit maximization is not an operationally feasible criterion. DISCUSS

(3 Marks)

(ii) EXPLAIN the followings:

(a) Bridge Finance
(b) Floating Rate Bonds
(c) Packing Credit.

(4 Marks)

(iii) "Financial Leverage is a double-edged sword" DISCUSS

(3 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) Describe the different determinants of money supply in a country.

(5 Marks)

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

(3 Marks)

(c) 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.

(2 Marks)

Question 8:

(a) Define the concept of market failure. Describe the different sources of market failure.

(5 Marks)

(b) Analyse what should be the tax policy during recession and depression?

(3 Marks)

(c) What role does Market Stabilization Scheme (MSS) play in our economy?

(2 Marks)

Question 9:

(a) 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.

(5 Marks)

(b) Define National Income. Draw the basis of distinction between GDP at current and constant prices.

(3 Marks)

(c) Explain the term quasi-public goods.

(2 Marks)

Question 10:

(a) Examine what types of fiscal policy measures are useful for redistribution of income in an economy?

(5 Marks)

(b) Explain the nature of changes in exchange rates and their impact on real economy?

(3 Marks)

(c) Describe the term 'Tragedy of Commons'

(2 Marks)

Question 11:

(a) What are the major functions of the WTO? What do you understand by the term 'Most-favored-nation' (MFN)?

(5 Marks)

(b) Write a note on Cash Reserve Ratio (CRR). Explain the operation of CRR.

(3 Marks)

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

(2 Marks)

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