CA INTERMEDIATE

SUBJECT-FM AND ECONOMICS

Test Code – CIM 8729

(Date :)

(Marks - 100)

PART A : FINANCIAL MANAGEMENT 60 MARKS

QUESTION 1 IS COMPULSORY. ATTEMPT ANY FOUR OUT OF REMAINING FIVE QUESTIONS.

WORKING NOTES SHOULD FORM PART OF YOUR ANSWER.

QUESTION 1(a) (5 MARKS)

Following figures and ratios are related to a company Q Ltd.:

(i) Sales for the year (all credit)	Rs. 30,00,000
(ii) Gross Profitratio	25 per cent
(iii) Fixed assets turnover (based on cost of goods sold)	1.5
(iv) Stock turnover (based on cost of goods sold)	6
(v) Liquidratio	1 : 1
(vi) Current ratio	1. 5 : 1
(vii) Receivables (Debtors) collection period	2 months
(viii) Reserves and surplus to share capital	0.6 : 1
(ix) Capital gearing ratio	0.5
(x) Fixed assets to networth	1.20 : 1

<u>You are required to calculate :</u>

Closing stock, Fixed Assets, Current Assets, Debtors and Net worth.

QUESTION 1(b) (5 MARKS)

ABC Ltd. wishes to raise additional finance of Rs. 20 lakhs for meeting its investments plan. The company has Rs. 4,00,000 in the form of retained earnings available for investment purposes. The following are the further details:

- Debt equity ratio 25 : 75.
- Cost of debt at the rate of 10% (before tax) uptoRs. 2,00,000 and 13% (before tax) beyond that.
- Earnings per share Rs. 12.
- Dividend payout 50% of earnings.
- Expected growth rate in dividend 10%.
- Current market price per share, Rs. 60.
- Company's tax rate is 30%.

<u>Required:</u>

(i) Calculate the post-tax average cost of additional debt.

(ii) Calculate the cost of retained earnings and cost of equity.

(iii) Calculate the overall weighted average (after tax) cost of additional finance.

QUESTION 1(c) **(5 MARKS)**

FollowingfiguresandinformationwereextractedfromthecompanyALtd.

Earnings of the company	Rs. 10,00,000
Dividend paid	Rs. 6,00,000
No. of shares outstanding	2,00,000
Price Earnings Ratio	10
Rate of return on investment	20%

<u>You are required to calculate</u>:

(i) Current Market price of theshare

(ii) Capitalisationrate of its riskclass

(iii) What should be the optimum pay-outratio?

(iv) What should be the market price per share at optimal pay-out ratio? (use Walter's Model)

QUESTION 1(d) **(5 MARKS)**

A company has Rs. 1,00,000 available for investment and has identified the following four investments in which toinvest.

Project	Investment (Rs.)	NPV (Rs.)
C	40,000	20,000
D	1,00,000	35,000
E	50,000	24,000
F	60,000	18,000

<u>You are required to optimize the returns from a package of projects within the capital spending limit if-</u>

(i) The projects are independent of each other and aredivisible.
(ii) The projects arenotdivisible.

QUESTION 2 **(10 MARKS)**

The capital structure of the Shiva Ltd. consists of equity share capital of Rs. 20,00,000 (Share of Rs. 100 per value) and Rs. 20,00,000 of 10% Debentures, sales increased by 20% from 2,00,000 units to 2,40,000 units, the selling price is Rs. 10 per unit; variable costs amount to Rs. 6 per unit and fixed expenses amount to Rs. 4,00,000. The income tax rate is assumed to be50%.

(a) **<u>You are required to calculate</u>** thefollowing:

(i) The percentage increase in earnings pershare;

(ii) Financial leverage at 2,00,000 units and 2,40,000units.

(iii) Operating leverage at 2,00,000 units and 2,40,000units.

(b) **<u>Comment</u>** on the behaviour of operating and Financial leverages in relation to increase in production from 2,00,000 units to2,40,000units.

QUESTION 3 **(10 MARKS)**

A company needs Rs. 31,25,000 for the construction of a new plant. The following three plans are feasible :

I. The company may issue 3,12,500 equity shares at Rs. 10 per share.

II. The company may issue 1,56,250 equity shares at Rs. 10 per share and 15,625 debentures of Rs. 100 denomination bearing a 8% rate of interest.

III. The company may issue 1,56,250 equity shares at Rs. 10 per share and 15,625 cumulative preference shares at Rs. 100 per share bearing a 8% rate of dividend.

(a) If the company's earnings before interest and taxes are Rs. 62,500, Rs. 1,25,000, Rs. 2,50,000, Rs. 3,75,000 and Rs. 6,25,000, **DETERMINE** earnings per share under each of three financial plans ? Assume a corporate income tax rate of 40%.

(b) **IDENTIFY** which alternative would you recommend and why ?

(c) **DETERMINE** the EBIT – EPS indifference points by formulae between Financing Plan I and Plan II and Plan I and Plan III.

QUESTION 4 **(10 MARKS)**

Data regarding two mutually exclusive projects have been compiled and given below:

Projects S		Project T	
Initial Investment Rs. 30 Lakhs		Initial Investment Rs. 50 Lakhs	
NPV Estimate	Probability	NPV Estimate	Probability
3	0.1	5	0.2
6	0.4	9	0.3
12	0.4	18	0.3
15	0.1	25	0.2

You are required to compute - (a) NPV and PI of each Project, (b) Risk attached to each Project by Co-efficient of Variation.

QUESTION 5 **(10 MARKS)**

Day Ltd., a newly formed company has applied to the Private Bank for the first time for financing it's Working Capital Requirements. The following information is available about the projections for the currentyear:

Estimated Level of Activity	Completed Units of Production 31,200 plus unit of work in progress 12,000
Raw Material Cost	Rs.40 per unit
Direct Wages Cost	Rs.15 per unit
Overhead	Rs.40 per unit (inclusive of Depreciation Rs.10 per unit)
Selling Price	Rs.130 per unit
Raw Material in Stock	Average 30 days consumption
Work in Progress Stock	Material 100% and Conversion Cost 50%
Finished Goods Stock	24,000 Units
Credit Allowed by the supplier	30 days
Credit Allowed to Purchasers	60 days
Direct Wages (Lag in payment)	15 days
Expected Cash Balance	Rs.2,00,000

Assume that production is carried on evenly throughout the year (360 days) and wages and overheads accrue similarly. All sales are on the credit basis. You are required to **CALCULATE the Net Working Capital Requirement onCash Cost Basis**.

QUESTION 6(a) **(4 MARKS)**

Write short notes on Over - Capitalisation.

QUESTION 6(b) **(4 MARKS)**

What do you mean by Financial Management? Explain its basic aspects.
Explain the two basic functions of Financial Management.

QUESTION 6(c) **(2 MARKS)**

Explain any two steps involved in DecisiontreeAnalysis.

OR

QUESTION 6(c) **(2 MARKS)**

Give any twolimitationsofleasing.

PART B : ECONOMICS 40 MARKS

QUESTION 7 IS COMPULSORY. ATTEMPT ANY THREE OUT OF REMAINING FOUR QUESTIONS.

QUESTION 7(a) **(2 MARKS)**

What is meantbyCrowdingout?

QUESTION 7(b) **(2 MARKS)**

Explain the leakages and injections inthe circular flowofIncome.

QUESTION 7(c) **(3 MARKS)**

Compute M1 supply of money from the data givenbelow:

Currency with public	2,13,279.8 Crores
Time deposits with bank	3,45,000.7 Crores
Demand deposits with bank	1,62,374.5 Crores
Post office savings deposit	382.9Crores
Other deposits of RBI	765.1Crores

QUESTION 7(d) **(3 MARKS)**

How does international trade Increase economic efficiency?Explain.

QUESTION 8(a) **(5 MARKS)**

In a two sector model Economy, the business sector produces 7500 units at an average price of Rs.7.

(i) What is the money value ofoutput?

(ii) What is the money income ofHouseholds?

(iii) If households spend 75 of their Income, what is the total consumerexpenditure?

(iv) What is the total money revenue received by the businesssector?

(v) What should happen tothe levelofoutput?

QUESTION 8(b)(i) **(3 MARKS)**

Describe thelimitations offiscalpolicy.

QUESTION 8(b)(ii) **(2 MARKS)**

What is meant by open market operations?

QUESTION 9(a)(i) **(3 MARKS)**

Distinguish between 'non tariffmeasures' and 'nontariffbarriers'

QUESTION 9(a)(ii) **(2 MARKS)**

What is allocation function of Fiscal-Policy?

QUESTION 9(b)(i) **(3 MARKS)**

Define Foreign Direct Investment (FDI). Mention two arguments made in favor of FDI to developing economieslikeIndia?

QUESTION 9(b)(ii) **(2 MARKS)**

Calculate the Marginal Propensity to Consume (MPC) and Marginal Propensity to Save (MPS) from the followingdata:

Income (Y)	Consumption (C)	Level
Rs. 8,000	Rs. 6,000	Initial level
Rs. 12,000	Rs. 9,000	Changed level

QUESTION 10(a)(i) **(3 MARKS)**

DefineInformationFailure.

QUESTION 10(a)(ii) **(2 MARKS)**

Explain theconcept of DemandforMoney.

QUESTION 10(b)(i) **(3 MARKS)**

How do Governments correct market failure resulting from demeritGoods?

QUESTION 10(b)(ii) **(2 MARKS)**

The Nominal Exchange rate of India is Rs. 56/1 $, Price Index in India is116andPrice Index in USA is 112. What will be the Real Exchange Rate of India?

QUESTION 11(a)(i) **(3 MARKS)**

Explain the role of Monetary Policy Committee (MPC)inIndia.

QUESTION 11(a)(ii) **(2 MARKS)**

Why is the central bank referred to as a"banker's bank"?

QUESTION 11(b)(i) **(3 MARKS)**

Calculate National Income by Value Added Method with the help of following data-

Particulars	Rs. (incrore)
Sales	700
Openingstock	500
IntermediateConsumption	350
ClosingStock	400
Net Factor Income fromAbroad	30
Depreciation	150
ExciseTax	110
Subsidies	50

QUESTION 11(b)(ii) **(2 MARKS)**

Define Social Good? What is the similarity and dissimilarity between Social Goods and Common Pool Resources?

OR

QUESTION 11(b)(ii) **(2 MARKS)**

"World Trade Organisation (WTO) has a three-tier systemofdecision making."Explain.