J.K. SHAH TEST SERIES
Evaluate Learn Succeed

CA FINAL – Nov. 19

SUBJECT- SFM

Test Code – FNJ 7059

(Date :)

(Marks - 100)

Question 1 is compulsory and attempt any 4 out of remaining 5

Question 1:

(A)

BRS Inc deals in computer and IT hardwares and peripherals. The expected revenue for the next 8 years is as follows:

Years	Sales Revenue ($ Million)
1	8
2	10
3	15
4	22
5	30
6	26
7	23
8	20

Summarized financial position as on 31 March 2012 was as follows:

$ Million

Liabilities	Amount	Assets	Amount
Equity Stocks	12	Fixed Assets (Net)	17
12% Bonds	8	Current Assets	3
	20		**20**

Additional Information:

(a) Its variable expenses is 40% of sales revenue and fixed operating expenses (cash) are estimated to be as follows:

Period	Amount ($ Million)
1- 4 years	1.6
5-8 years	2

(b) An additional advertisement and sales promotion campaign shall be launched requiring expenditure as per following details:

Period	Amount ($ Million)
1 year	0.50
2-3 years	1.50
4-6 years	3.00
7-8 years	1.00

(c) Fixed assets are subject to depreciation at 15% as per WDV method.

(d) The company has planned additional capital expenditures (in the beginning of each year) for the coming 8 years as follows:

Period	**Amount ($ Million)**
1	0.50
2	0.80
3	2.00
4	2.50
5	3.50
6	2.50
7	1.50
8	1.00

(e) Investment in Working Capital is estimated to be 20% of Revenue.

(f) Applicable tax rate for the company is 30%.

(g) Cost of Equity is estimated to be 16%.

(h) The Free Cash Flow of the firm is expected to grow at 5% per annum after 8 years.

CALCULATE:

(i) Value of Firm

(ii) Value of Equity **(12 marks)**

Question 1:(B)

Techniques used in Economic Analysis. Explain. **(4 marks)**

Question 1 (C)

Mr. A will need Rs. 1,00,000 after two years for which he wants to make one time necessary investment now. He has a choice of two types of bonds. Their details are as below:

	Bond X	**Bond Y**
Face value	Rs. 1,000	Rs. 1,000
Coupon	7% payable annually	8% payable annually
Years to maturity	1	4
Current price	Rs. 972.73	Rs. 936.52
Current yield	10%	10%

Advice Mr. A whether he should invest all his money in one type of bond or he should buy both the bonds and, if so, in which quantity? Assume that there will not be any call risk or default risk.

(4 marks)

Question 2:

(A)

Mr. A is interested to invest Rs. 1,00,000 in the securities market. He selected two securities B and D for this purpose. The risk return profile of these securities are as follows :

Security	Risk (σ)	Expected Return (ER)
B	10%	12%
D	18%	20%

Co-efficient of correlation between B and D is 0.15.

You are required to calculate the portfolio return of the following portfolios of B and D to be considered by A for his investment.

(i) 100 percent investment in B only;

(ii) 50 percent of the fund in B and the rest 50 percent in D;

(iii) 75 percent of the fund in B and the rest 25 percent in D; and

(iv) 100 percent investment in D only.

Also indicate that which portfolio is best for him from risk as well as return point of view? **(6 marks)**

Question 2:

(B)

Laxman buys 10,000 shares of X Ltd. at a price of Rs. 22 per share whose beta value is 1.5 and sells 5,000 shares of A Ltd. at a price of Rs. 40 per share having a beta value of 2. He obtains a complete hedge by Nifty futures at Rs. 1,000 each. He closes out his position at the closing price of the next day when the share of X Ltd. dropped by 2%, share of A Ltd. appreciated by 3% and Nifty futures dropped by 1.5%.

CALCULATE the overall profit/loss to Ram? **(5 marks)**

Question 2: (C)

Using the **chop-shop approach** (or Break-up value approach), assign a value for Cranberry Ltd. whose stock is currently trading at a total market price of €4 million. For Cranberry Ltd, the accounting data set forth three business segments: consumer wholesale, retail and general centers. Data for the firm's three segments are as follows:

Business Segment	Segment Sales	Segment Assets	Segment Operating Income
Wholesale	€225,000	€600,000	€75,000
Retail	€720,000	€500,000	€150,000
General	€ 2,500,000	€4,000,000	€700,000

Industry data for "pure-play" firms have been compiled and are summarized as follows:

Business Segment	Capitalization/Sales	Capitalization/Assets	Capitalization/Operating Income
Wholesale	0.85	0.7	9
Retail	1.2	0.7	8
General	0.8	0.7	4

(5 marks)

Question 2: (D)

Explain Asset Allocation Strategies. **(4 marks)**

Question 3: (A)

Electra space is consumer electronics wholesaler. The business of the firm is highly seasonal in nature. In 6 months of a year, firm has a huge cash deposits and especially near Christmas time and other 6 months firm cash crunch, leading to borrowing of money to cover up its exposures for running the business.

It is expected that firm shall borrow a sum of €50 million for the entire period of slack season in about 3 months.

A Bank has given the following quotations:

Spot	5.50% - 5.75%
3 × 6 FRA	5.59% - 5.82%
3 × 9 FRA	5.64% - 5.94%

3 month €50,000 future contract maturing in a period of 3 months is quoted at 94.15 (5.85%).

ADVISE:

(i) How a FRA, shall be useful if the actual interest rate after 3 months turnout to be:

(a) 4.5% (b) 6.5%

(ii) How 3 months Future contract shall be useful for company if interest rate turns out as mentioned in part (a) above. **(10 marks)**

Question 3: (B)

The Textile Manufacturing Company Ltd., is considering one of two mutually exclusive proposals, Projects M and N, which require cash outlays of Rs. 8,50,000 and Rs. 8,25,000 respectively. The certainty-equivalent (C.E) approach is used in incorporating risk in capital budgeting decisions. The current yield on government bonds is 6% and this is used as the risk free rate. The expected net cash flows and their certainty equivalents are as follows:

Project M			Project N	
Year-end	Cash Flow Rs.	C.E.	Cash Flow Rs.	C.E.
1	4,50,000	0.8	4,50,000	0.9
2	5,00,000	0.7	4,50,000	0.8
3	5,00,000	0.5	5,00,000	0.7

Present value factors of Rs. 1 discounted at 6% at the end of year 1, 2 and 3 are 0.943, 0.890 and 0.840 respectively.

Required:

(i) Which project should be accepted?

(ii) If risk adjusted discount rate method is used, which project would be appraised with a higher rate and why?

(10 marks)

Question 4:(A)

You, a foreign exchange dealer of your bank, are informed that your bank has sold a T.T. on Copenhagen for Danish Kroner 10,00,000 at the rate of Danish Kroner 1 = Rs. 6.5150. You are required to cover the transaction either in London or New York market. The rates on that date are as under:

Mumbai-London	Rs. 74.3000	Rs. 74.3200
Mumbai-New York	Rs. 49.2500	Rs. 49.2625
London-Copenhagen	DKK 11.4200	DKK 11.4350
New York-Copenhagen	DKK 07.5670	DKK 07.5840

In which market will you cover the transaction, London or New York, and what will be the exchange profit or loss on the transaction? Ignore brokerages.

(6 marks)

Question 4: (B)

Capital structure of Sun Ltd., as at 31.3.2003 was as under:

	(Rs. in lakhs)
Equity share capital	80
8% Preference share capital	40
12% Debentures	64
Reserves	32

Sun Ltd., earns a profit of Rs. 32 lakhs annually on an average before deduction of income-tax, which works out to 35%, and interest on debentures.

Normal return on equity shares of companies similarly placed is 9.6% provided:

(a) Profit after tax covers fixed interest and fixed dividends at least 3 times.

(b) Capital gearing ratio is 0.75.

(c) Yield on share is calculated at 50% of profits distributed and at 5% on undistributed profits.

Sun Ltd., has been regularly paying equity dividend of 8%.

Compute the value per equity share of the company. **(8 marks)**

Question 4:(C)

Explain cash settlement and physical settlement in derivative contracts and their relative advantages and disadvantages. **(6 marks)**

Question 5:(A)

The following is the Balance-sheet of Grape Fruit Company Ltd as at March 31st, 2011.

Liabilities	**(Rs. in lakhs)**	**Assets**	**(Rs. in lakhs)**
Equity shares of Rs. 100 each	600	Land and Building	200
14% preference shares of Rs. 100/- each	200	Plant and Machinery	300
13% Debentures	200	Furniture and Fixtures	50
Debenture interest accrued and payable	26	Inventory	150
Loan from bank	74	Sundry debtors	70
Trade creditors	340	Cash at bank	130
		Preliminary expenses	10
		Cost of issue of debentures	5
		Profit and Loss account	525
	1440		1440

The Company did not perform well and has suffered sizable losses during the last few years. However, it is felt that the company could be nursed back to health by proper financial restructuring. Consequently the following scheme of reconstruction has been drawn up :

(1) Equity shares are to be reduced to Rs. 25/- per share, fully paid up;

(2) Preference shares are to be reduced (with coupon rate of 10%) to equal number of shares of Rs. 50 each, fully paid up.

(3) Debenture holders have agreed to forgo the accrued interest due to them. In the future, the rate of interest on debentures is to be reduced to 9 percent.

(4) Trade creditors will forego 25 percent of the amount due to them.

(5) The company issues 6 lakh of equity shares at Rs. 25 each and the entire sum was to be paid on application. The entire amount was fully subscribed by promoters.

(6) Land and Building was to be revalued at Rs. 450 lakhs, Plant and Machinery was to be written down by Rs. 120 lakhs and a provision of Rs.15 lakhs had to be made for bad and doubtful debts.

Required:

(i) Show the impact of financial restructuring on the company's activities.

(ii) Prepare the fresh balance sheet after the reconstructions is completed on the basis of the above proposals. **(10 Marks)**

Question 5:(B)

Explain Mechanism of Securitization. **(5 marks)**

Question 5: (C)

Mr. Fed Up wants to invest an amount of Rs. 520 lakhs and had approached his Portfolio Manager. The Portfolio Manager had advised Mr. Fed Up to invest in the following manner:

Security	Moderate	Better	Good	Very Good	Best
Amount (in Rs. Lakhs)	60	80	100	120	160
Beta	0.5	1.00	0.80	1.20	1.50

Advise Mr. FedUp in regard to the following, using Capital Asset Pricing Methodology:

(i) Expected return on the portfolio, if the Government Securities are at 8% and the NIFTY is yielding 10%.

(ii) Replacing Security 'Better' with NIFTY. **(5 marks)**

Question 6:(A)

What is the definition of Startup under Startup India Initiative ? **(5 marks)**

Question 6: (B)

Sun Moon Mutual Fund (Approved Mutual Fund) sponsored open-ended equity oriented scheme "Chanakya Opportunity Fund". There were three plans viz. 'A' – Dividend Re-investment Plan, 'B' – Bonus Plan & 'C' – Growth Plan.

At the time of Initial Public Offer on 1.4.2009, Mr. Anand, Mr. Bacchan & Mrs. Charu, three investors invested Rs. 1,00,000 each & chosen 'B', 'C' & 'A' Plan respectively.

The History of the Fund is as follows:

Date	Dividend %	Bonus Ratio	Net Asset Value per Unit (F.V. Rs. 10)		
			Plan A	Plan B	Plan C
28.07.2013	20		30.70	31.40	33.42
31.03.2014	70	5 : 4	58.42	31.05	70.05
31.10.2017	40		42.18	25.02	56.15
15.03.2018	25		46.45	29.10	64.28
31.03.2018		1 : 3	42.18	20.05	60.12
24.03.2019	40	1 : 4	48.10	19.95	72.40
31.07.2019			53.75	22.98	82.07

On 31st July 2019 all three investors redeemed all the balance units.

CALCULATE:

(i) Annual rate of return of Mrs. Charu who has invested in 'A' – Dividend Re-investment Plan.

(ii) Annual rate of return of Mr. Anand who has invested in 'B' – Bonus Plan.

(iii) Annual rate of return of Mr. Bacchan who has invested 'C'– Growth Plan.

Assumptions:

1. Long-term Capital Gain is exempt from Income tax.
2. Short-term Capital Gain is subject to 10% Income tax.
3. Security Transaction Tax 0.2 per cent only on sale/redemption of units.
4. Ignore Education Cess **(10 marks)**

Question 6:

(C) Distinguish between Systematic Risk and Unsystematic Risk. **(5 marks)**