CA INTERMEDIATE

SUBJECT- F.M. AND ECONOMICS

Test Code – PIN 5053

(Date :)

(100 Marks)

PART-I

FINANCIAL MANAGEMENT

Question No. 1 is compulsory.

Attempt any four questions from the remaining five questions.

QUESTION NO.1 (5 MARKS X 4 = 20 MARKS)

A. PQR Ltd. has the following capital structure on October 31, 20X8:

Sources of capital	(Rs.)
Equity Share Capital (2,00,000 Shares of Rs. 10 each)	20,00,000
Reserves & Surplus	20,00,000
12% Preference Shares	10,00,000
9% Debentures	30,00,000
	80,00,000

The market price of equity share is Rs. 30. It is expected that the company will pay next year a dividend of Rs. 3 per share, which will grow at 7% forever. Assume 40% income tax rate.

You are required to COMPUTE weighted average cost of capital using market value weights.

B. The accountant of Moon Ltd. has reported the following data:

Gross profit	Rs. 60,000
Gross Profit Margin	20 per cent
Total Assets Turnover	0.30:1
Net Worth to Total Assets	0.90:1
Current Ratio	1.5:1
Liquid Assets to Current Liability	1:1
Credit Sales to Total Sales	0.80:1
Average Collection Period	60 days

Assume 360 days in a year

You are required to complete the following:

Balance Sheet of Moon Ltd.

Liabilities	Rs.	Assets	Rs.
Net Worth		Fixed Assets	
Current Liabilities		Stock	
		Debtors	
		Cash	
Total Liabilities		Total Assets	

C. The earning per share of a company is Rs. 10 and the rate of capitalisation applicable to it is 10 per cent. The company has three options of paying dividend i.e. (i) 50%, (ii) 75% and (iii) 100%.

CALCULATE the market price of the share as per Walter's model if it can earn a return of (a) 15, (b) 10 and (c) 5 per cent on its retained earnings.

D. Sun Ltd. is considering two financing plans. Details of which are as under:

a. Fund Rs. requirement – Rs. 100 Lakhs
b. Financial Plan

Plan	Equity	Debt
I	100%	-
II	25%	75%

c. Cost of debt – 12% p.a.
d. Tax Rate – 30%
e. Equity Share Rs. 10 each, issued at a premium of Rs. 15 per share
f. Expected Earnings before Interest and Taxes (EBIT) Rs. 40 Lakhs

You are required to compute:

(i) EPS in each of the plan
(ii) The Financial Break Even Point
(iii) Indifference point between Plan I and II

QUESTION NO.2 **(10 MARKS)**

A company is considering the proposal of taking up a new project which requires an investment of Rs. 800 lakhs on machinery and other assets. The project is expected to yield the following earnings (before depreciation and taxes) over the next five years:

Year	Earnings (Rs. in lakhs)
1	320
2	320
3	360
4	360
5	300

The cost of raising the additional capital is 12% and assets have to be depreciated at 20% on written down value basis. The scrap value at the end of the five year period may be taken as zero. Income-tax applicable to the company is 40%.

<u>You are required to CALCULATE the net present value of the project and advise the management to take appropriate decision. Also CALCULATE the Internal Rate of Return of the Project.</u>

Note: Present values of Re. 1 at different rates of interest are as follows:

Year	10%	12%	14%	16%	20%
1	0.91	0.89	0.88	0.86	0.83
2	0.83	0.80	0.77	0.74	0.69
3	0.75	0.71	0.67	0.64	0.58
4	0.68	0.64	0.59	0.55	0.48
5	0.62	0.57	0.52	0.48	0.40

QUESTION NO.3 **(10 MARKS)**

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.

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's equity.

(c) Current Ratio.

QUESTION NO.4 **(10 MARKS)**

The following details of a company for the year ended 31st March, 2017 are given below:

Operating leverage	2:1
Combined leverage	2.5:1
Fixed Cost excluding interest	Rs. 3.4 lakhs
Sales	Rs. 50 lakhs
8% Debentures of Rs. 100 each	Rs. 30.25 lakhs
Equity Share Capital of Rs. 10 each	Rs. 34 lakhs
Income Tax Rate	30%

Required:

(i) Calculate Financial Leverage

(ii) Calculate P/V ratio and Earning per Share (EPS)

(iii) If the company belongs to an industry, whose assets turnover is 1.5 does it have a high or low assets turnover?

(iv) At what level of sales, the Earning before Tax (EBT) of the company will be equal to zero?

QUESTION NO.5 **(10 MARKS)**

A Company is considering a proposal of installing a drying equipment. The equipment would involve a Cash outlay of Rs. 6,00,000 and net Working Capital of Rs. 80,000. The expected life of the project is 5 years without any salvage value. Assume that the company is allowed to charge depreciation on straight-line basis for Income-tax purpose. The estimated before-tax cash inflows are given below:

	Before-tax Cash inflows (Rs. Rs.000)				
Year	1	2	3	4	5
	240	275	210	180	160

The applicable Income-tax rate to the Company is 35%. If the Company's opportunity Cost of Capital is 12%, **calculate the equipment's discounted payback period, payback period, net present value and internal rate of return.**

The PV factors at 12%, 14% and 15% are:

Year	1	2	3	4	5
PV factor at 12%	0.8929	0.7972	0.7118	0.6355	0.5674
PV factor at 14%	0.8772	0.7695	0.6750	0.5921	0.5194
PV factor at 15%	0.8696	0.7561	0.6575	0.5718	0.4972

QUESTION NO.6 **(5 MARKS X 2 = 10 MARKS)**

A. "Financial Leverage is a double-edged sword" DISCUSS

B. "The profit maximization is not an operationally feasible criterion." IDENTIFY.

PART – II

ECONOMICS FOR FINANCE

Question no. 7 is compulsory and attempt any three out of remaining four questions.

QUESTION NO. 7 :

(A)

You are given the following data on an economy	(Rs. in Crores) :
Investment expenditure (I) :	250
Government expenditure on goods and services (G) :	800
Exports (X) :	600

All tax revenues are derived from a uniform rate of income tax of 30% of income.

Consumption expenditure is given by : $C = 0.75\ Y_d$; Where : Y_d is disposable national income (i.e. income less taxes) and C is consumption expenditure

Import expenditure is given by : M = 0.15 Y Where : Y is national income and M is import expenditure

(i) Calculate the equilibrium value of National Income.

(ii) Calculate the Current Account Balance at the equilibrium value of National Income.

(iii) Calculate the Fiscal Surplus (+) or Deficit (-) at the equilibrium value of National Income

(5 Marks)

(B) How are the following transactions treated in national income calculation? What is the rationale in each case?

- Electricity sold to a steel plant.
- Electric power sold to a consumer household.
- A car manufacturer procuring parts and components from the market.
- A computer producer buys a robot produced in the same country and uses it in production of computers.

(2 Marks)

(C) Explain the impact of Government Intervention in case of merit Goods.

(3 Marks)

QUESTION : 8

(A) Calculate (a) GDP_{MP} and (b) NNP_{FC} from the following data :

Particulars	**(Rs.) In Crore**
Net indirect tax	208
Consumption of fixed capital	42
Net factor income from abroad	– 40
Rent	311
Profits	892
Interest	81
Royalty	6
Wages and Salary	489
Employer's contribution to Social Security Scheme	50

(3 Marks)

(B) Explain the concepts of Liquidity Adjustment Facility (LAF) & Marginal Standing Facility (MSF). **(3 Marks)**

(C) What is meant by 'Voluntary Export Restraints'? **(2 Marks)**

(D) Define Real Effective Exchange Rate (REER)? **(2 Marks)**

QUESTION : 9

(A) An increase of investment by Rs. 600 Crores resulted in an increase in national income by 2400 Crores. Find MPC and MPS? **(2 Marks)**

(B) Write short notes on the Speculative Demand for Money. **(3 Marks)**

(C) Many apprehensions have been raised in respect of the WTO and its ability to maintain and extend a system of liberal world trade. Comment. **(3 Marks)**

(D) Distinguish between 'pump priming' and 'compensatory spending' **(2 Marks)**

QUESTION : 10

(A) What are the purposes of Trade Barriers in International Trade ? **(5 Marks)**

(B) What are the different routes for securing FDI? **(2 Marks)**

(C) Describe the meaning and mechanism of 'crowding out' effect of public expenditure.

(3 Marks)

QUESTION : 11

(A) Write short notes on the impact of CDR on Money Supply & Money Multiplier.

(5 Marks)

(B) Define 'moral hazard'. **(2 Marks)**

(C) Distinguish between Depreciation of Currency and Devaluation of Currency.

(3 Marks)