J.K. SHAH TEST SERIES
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CA INTERMEDIATE N'19

SUBJECT- F.M. AND ECONOMICS

Test Code – CIM 8453

(Date :)

(Marks - 100)

SECTION - A

Question No. 1 is compulsory.

Attempt any four questions out of the remaining five questions.

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

A. Alpha Ltd. has furnished the following information :

- Earning Per Share (EPS)	Rs. 4
- Dividend payout ratio	25%
- Market price per share	Rs. 50
- Rate of tax	30%
- Growth rate of dividend	10%

The company wants to raise additional capital of Rs. 10 lakhs including debt of Rs. 4 lakhs. The cost of debt (before tax) is 10% up to Rs. 2 lakhs and 15% beyond that. **Compute the after tax cost of equity and debt and also weighted average cost of capital**.

B. Kanoria Enterprises wishes to evaluate two mutually exclusive projects X and Y. The particulars are as under :

	Project X (Rs.)	Project Y (Rs.)
Initial Investment	1,20,000	1,20,000
Estimated cash inflows (per annum for 8 years)		
Pessimistic	26,000	12,000
Most Likely	28,000	28,000
Optimistic	36,000	52,000

The cut off rate is 14%. The discount factor at 14% are :

Year	1	2	3	4	5	6	7	8	9
Discount factor	0.877	0.769	0.675	0.592	0.519	0.456	0.400	0.351	0.308

Advise management about the acceptability of projects X and Y.

C. The following summarises the percentage changes in operating income, percentage changes in revenues, and betas for four listed firms.

Firm	Change in revenue	Change in operating income	Beta
A Ltd.	35%	22%	1.00
B Ltd.	24%	35%	1.65
C Ltd.	29%	26%	1.15
D Ltd.	32%	30%	1.20

Required:

a. CALCULATE the degree of operating leverage for each of these firms. Comment also.

b. Use the operating leverage to EXPLAIN why these firms have different beta.

D. The following information pertains to SD Ltd.

Earnings of the Company	Rs. 50,00,000
Dividend Payout ratio	60%
No. of shares outstanding	10,00,000
Equity capitalization rate	12%
Rate of return on investment	15%

a. COMPUTE the market value per share as per Walter's model?

b. COMPUTE the optimum dividend payout ratio according to Walter's model and the market value of Company's share at that payout ratio?

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

RM Steels Limited requires Rs. 10,00,000 for construction of a new plant. It is considering three financial plans :

(i) The company may issue 1,00,000 ordinary shares at Rs. 10 per share;

(ii) The company may issue 50,000 ordinary shares at Rs. 10 per share and 5000 debentures of Rs. 100 denominations bearing a 8 per cent rate of interest; and

(iii) The company may issue 50,000 ordinary shares at Rs. 10 per share and 5,000 preference shares at Rs. 100 per share bearing a 8 per cent rate of dividend.

If RM Steels Limited's earnings before interest and taxes are Rs. 20,000; Rs. 40,000; Rs. 80,000; Rs. 1,20,000 and Rs. 2,00,000, you are required to compute the earnings per share under each of the three financial plans ?

Which alternative would you recommend for RM Steels and why? Tax rate is 50%.

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

A regular customer of your company has approached to you for extension of credit facility for purchasing of goods. On analysis of past performance and on the basis of information supplied, the following pattern of payment schedule emerges:

Pattern of Payment Schedule	
At the end of 30 days	20% of the bill
At the end of 60 days	30% of the bill.
At the end of 90 days	30% of the bill.
At the end of 100 days	18% of the bill.
Non-recovery	2% of the bill.

The customer wants to enter into a firm commitment for purchase of goods of Rs.30 lakhs in 2019, deliveries to be made in equal quantities on the first day of each quarter in the calendar year. The price per unit of commodity is Rs.300 on which a profit of Rs.10 per unit is expected to be made. It is anticipated that taking up of this contract would mean an extra recurring expenditure of Rs.10,000 per annum. If the opportunity cost is 18% per annum, would you as the finance manager of the company .**<u>RECOMMEND the grant of credit to the customer? Assume 1 year = 360 days.</u>**

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

AT Limited is considering three projects A, B and C. The cash flows associated with the projects are given below:

Cash flows associated with the Three Projects (Rs.)

Project	C0	C1	C2	C3	C4
A	(10,000)	2,000	2,000	6,000	0
B	(2,000)	0	2,000	4,000	6,000
C	(10,000)	2,000	2,000	6,000	10,000

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

(a) Calculate the payback period of each of the three projects.

(b) If the cut-off period is two years, then which projects should be accepted?

(c) Projects with positive NPVs if the opportunity cost of capital is 10 percent.

(d) "Payback gives too much weight to cash flows that occur after the cut-off date". True or false?

(e) "If a firm used a single cut-off period for all projects, it is likely to accept too many short lived projects." True or false?

P.V. Factor @ 10 %

Year	0	1	2	3	4	5
P.V.	1.000	0.909	0.826	0.751	0.683	0.621

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

The following is the Profit and loss account and Balance sheet of KLM LLP.

Trading and Profit & Loss Account

Particulars	**Amount (Rs.)**	**Particulars**	**Amount (Rs.)**
To Opening stock	12,46,000	By Sales	1,96,56,000
To Purchases	1,56,20,000	By Closing stock	14,28,000
To Gross profit c/d	42,18,000		
	2,10,84,000		2,10,84,000
		By Gross profit b/d	42,18,000
To Administrative expenses	18,40,000	By Interest on investment	24,600
To Selling & distribution expenses	7,56,000	By Dividend received	22,000
To Interest on loan	2,60,000		
To Net profit	14,08,600		
	42,64,600		42,64,600

Balance Sheet as on……….

Capital & Liabilities	**Amount (Rs.)**	**Assets**	**Amount (Rs.)**
Capital	20,00,000	Plant & machinery	24,00,000
Retained earnings	42,00,000	Building	42,00,000
General reserve	12,00,000	Furniture	12,00,000
Term loan from bank	26,00,000	Sundry receivables	13,50,000
Sundry Payables	7,20,000	Inventory	14,28,000
Other liabilities	2,80,000	Cash & Bank balance	4,22,000
	1,10,00,000		1,10,00,000

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

(i) Gross profit ratio (ii) Net profit ratio (iii) Operating cost ratio

(iv) Operating profit ratio (v) Inventory turnover ratio (vi) Current ratio

(vii) Quick ratio (viii) Interest coverage ratio (ix) Return on capital employed

(x) Debt to assets ratio.

QUESTION NO.6

A. Explain the steps of Sensitivity Analysis. **(4 MARKS)**

B. What is the process of Debt Securitisation ? **(4 MARKS)**

C. STATE the meaning of Payback Reciprocal. **(2 MARKS)**

SECTION – B

Question No. 7 is compulsory.

Answer any three from the rest.

QUESTION NO.7

A. Given Consumption function C = 300 + O.75Y;

Investment = Rs. 800; Net Imports = Rs. 100

Calculate equilibrium level of output. **(3 Marks)**

B. Explain 'depreciation' and 'appreciation' of home currency under floating exchange rate. **(2 Marks)**

C. **Compute M1 supply of money from the data given below**:

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	*382.9 Crores*	
Other deposits of RBI	*765.1 Crores*	***(3 Marks)***

D. Define 'Market power'. What is its disadvantage? **(2 Marks)**

QUESTION NO.8

A. How can the government influence the resource allocation in an economy? **(5 Marks)**

B. Is prohibition of import of poultry from countries affected by avian flu, meat and poultry processing standards to reduce pathogens, residue limits for pesticides in foods etc. an example of Sanitary and Phytosanitary (SPS) measure? How? **(3 Marks)**

C. Distinguish between horizontal and vertical Foreign Direct Investment. **(2 Marks)**

QUESTION NO.9

A. Compute GNP at factor cost and NDP at market price using expenditure method from the following data:

(Rs. in Crores)

Personal Consumption expenditure	2900
Imports	300
Gross public Investment	500
Consumption of fixed capital	60
Exports	200
Inventory Investment	170
Government purchases of goods & services	1100
Gross Residential construction Investment	450
Net factor Income from abroad	(-)30
Gross business fixed Investment	410
Subsidies	80

(5 Marks)

B. Why is the central bank referred to as a "banker's bank" ? **(3 Marks)**

C. Assume that Rs. 70 is needed to buy one US dollar in foreign exchange market (i.e. the nominal exchange rate is Rs. 70/ US $). Suppose that a price index of standardized basket of goods and services is Rs. 200 in India and US $ 100 in United States, find out the real exchange rate? (Treat India as a domestic country and United States as a foreign country). **(2 Marks)**

QUESTION NO.10

A. Why empirical analysis of money supply is important? **(3 Marks)**

B. Is cable television an example of impure public good? Verify your answer. **(2 Marks)**

C. Explain the classical theory of Comparative Advantage as given by David Ricardo.

(5 Marks)

QUESTION NO.11

A. Describe the determinants of demand for money as identified by Milton Friedman in his re-statement of Quantity Theory of demand for money. **(3 Marks)**

B. What is meant by 'Mixed tariffs'? **(2 Marks)**

C. Using suitable diagram, explain, how the nominal exchange rate between two countries is determined'? **(3 Marks)**

D. What is meant by quasi public goods? **(2 Marks)**