CA INTERMEDIATE M'19

SUBJECT- F.M. AND ECONOMICS

Test Code – PIN 5073

(Date :)

(Marks - 100)

SECTION – A (60 MARKS)

QUESTION NO.1 is compulsory and attempt any four out of remaining five questions.

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

A. A Ltd. and B Ltd. are identical in every respect except capital structure. A Ltd. does not employ debt in its capital structure, whereas B Ltd. employs 12% debentures amounting to Rs. 10 lakh. Assuming that -

(i) All assumptions of MM model are met

(ii) The income tax rate is 30%

(iii) EBIT is Rs. 2,50,000 and

(iv) The equity capitalization rate of A Ltd. is 20%.

CALCULATE the average Value of both the companies.

B. A company had paid dividend of Rs. 2 per share last year. The estimated growth of the dividends from the company is estimated to be 5% p.a. DETERMINE the estimated market price of the equity share if the estimated growth rate of dividends (i) rises to 8%, and (ii) falls to 3%. Also **COMPUTE the present market price of the share, given that the required rate of return of the equity investors is 15.5%.**

C. ABC Ltd. is examining the question of relaxing its credit policy. It sells at present 20,000 units at a price of Rs. 100 per unit, the variable cost per unit is Rs. 88 and average cost per unit at the current sales volume is Rs. 92. All the sales are on credit, the average collection period being 36 days.

A relaxed credit policy is expected to increase sales by 10% and the average age of receivables to 60 days. Assuming 15% return, should the firm relax its credit policy ?

D. Determine the risk adjusted net present value of the following projects*:*

	X	Y	Z
Net cash outlays (Rs.)	2,10,00 0	1,20,00 0	1,00,000
Project life	5 years	5 years	5 years
Annual Cash inflow (Rs.)	70,000	42,000	30,000
Coefficient of variation	1.2	0.8	0.4

The Company selects the risk-adjusted rate of discount on the basis of the coefficient of variation:

Coefficient of Variation	Risk-Adjusted Rate of Return	P.V. Factor 1 to 5 years At risk adjusted rate of discount
0.0	10%	3.791
0.4	12%	3.605
0.8	14%	3.433
1.2	16%	3.274
1.6	18%	3.127
2.0	22%	2.864
More than 2.0	25%	2.689

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

M/s. Navya Corporation has a capital structure of 40% debt and 60% equity. The company is presently considering several alternative investment proposals costing less than Rs. 20 lakhs. The corporation always raises the required funds without disturbing its present debt equity ratio.

The cost of raising the debt and equity are as under :

Project cost	Cost of debt	Cost of equity
Upto Rs. 2 lakhs	10%	12%
Above Rs. 2 lakhs & upto to Rs. 5 lakhs	11%	13%
Above Rs. 5 lakhs & upto Rs. 10 lakhs	12%	14%
Above Rs. 10 lakhs & upto Rs. 20 lakhs	13%	14.5%

Assuming the tax rate at 50%, **CALCULATE :**

(i) Cost of Capital to two projects X and Y whose fund requirements are Rs. 6.5 lakhs and Rs. 14 lakhs respectively.

(ii) If a project is expected to give after tax return of 10%, DETERMINE under what conditions it would be acceptable ?

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

X Ltd. is considering to select a machine out of two mutually exclusive machines. The company's cost of capital is 15 per cent and corporate tax rate is 30 per cent. Other information relating to both machines is as follows:

	Machine – I	Machine – II
Cost of Machine	Rs. 30,00,000	Rs. 40,00,000

Expected Life	10 years.	10 years
Annual Income		
(Before Tax and Depreciation)	Rs. 12,50,000	Rs. 17,50,000

Depreciation is to be charged on straight line basis:

You are required to CALCULATE:

(i) Discounted Pay Back Period

(ii) Net Present Value

(iii) Profitability Index

The present value factors of Re.1 @ 15% are as follows:

Year	01	02	03	04	05
PV factor @ 15%	0.870	0.756	0.658	0.572	0.497

QUESTION NO.4 **(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. in crore)

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.

(Rs. in crore)

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%

<u>You are required to CALCULATE the following:</u>

(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' equity.

(c) Current ratio.

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

Following is the Balance Sheet of Soni Ltd. as on 31st March, 2018 :

Liabilities	Amount in Rs.
Shareholder's Fund	
Equity Share Capital (Rs. 10 each)	25,00,000
Reserve and Surplus	5,00,000
Non-Current Liabilities (12 Debentures)	50,00,000
Current Liabilities	20,00,000
Total	**1,00,00,000**
Assets	**Amount in Rs.**
Non-Current Assets	60,00,000
Current Assets	40,00,000
Total	**1,00,00,000**

Additional Information:

(i) Variable Cost is 60% of Sales.

(ii) Fixed Cost p.a. excluding interest Rs. 20,00,000.

(iii) Total Asset Turnover Ratio is 5 times.

(iv) Income Tax Rate 25%

You are required to:

(1) Prepare Income Statement

(2) Calculate the following and comment:

(a) Operating Leverage

(b) Financial Leverage

(c) Combined Leverage

QUESTION NO.6

A. EXPLAIN Financial Distress and explain its relationship with Insolvency. **(4 MARKS)**

B. DISCUSS the limitations of financial ratios. **(4 MARKS)**

C. DISCUSS the dividend-price approach to estimate cost of equity capital. **(2 MARKS)**

SECTION – B (40 MARKS)

QUESTION NO.7 is compulsory and attempt any three out of remaining four questions.

QUESTION NO.7

A. **Find GDPMP and GNPMP from the following data** (in Crores of Rs.) using Income method. Show that it is the same as that obtained by Expenditure method.

Personal Consumption	7314
Depreciation	800
Wages	6508
Indirect Business Taxes	1000
Interest	1060
Domestic Investment	1442
Government Expenditures	2196
Rental Income	34
Corporate Profits	682
Exports	1346
Net Factor Income from Abroad	40
Mixed Income	806
Imports	1408

(3 MARKS)

B. Define Foreign Direct Investment (FDI). Mention two arguments made in favor of FDI to developing economies like India? **(5 MARKS)**

C. What are the major components of Monetary Policy ? **(2 MARKS)**

QUESTION NO.8

A. Explain the significance of "Public Debt" as an Instrument of Fiscal Policy. **(5 MARKS)**

B. Please refer to the table below. **(3 MARKS)**

a. Which of the three exporters engage on anticompetitive act in the international market while pricing its export of goods X to Country D?

b. What would be effect of such pricing on domestic producers of Good X? Advise remedy available for country D?

Good X	Country A (In $)	Good X (In $)	Country B (In $)
Average Cost	30.5	29.4	30.9
Price per unit for domestic sales	31.2	31.1	30.9
Price Charged in Country D	31.9	30.6	30.6

C. Explain the concept of Disposable Income [DI] and its relationship with Personal Income. **(2 MARKS)**

QUESTION NO.9

A. For an Economy with the following specifications **(5 MARKS)**

Consumption, C = 50+0.75 Y_d

Investment, I = 100

Government Expenditure, G = 200

Transfer Payments, R= 110

Income Tax = 0.2Y

a. Find out the equilibrium of income and the value of expenditure multiplier.

b. If autonomous taxes worth Rs. 25 Crores are added. Find out equilibrium level of Income.

c. If the economy is opened up with exports X = 25 and imports M = 5+0.25Y Calculate the new level of Income and balance of Trade (Assume that there are no autonomous Taxes.)

B. Explain the functioning of SLR? **(2 MARKS)**

C. What are the principles governing application of sanitary and phytosanitary measures? **(3 MARKS)**

QUESTION NO.10

A. Explain the concept of "Crowding Out", by which Fiscal Policy is rendered ineffective.

(2 MARKS)

B. Can the “Arbitrage” concept apply to the Foreign Exchange Market ? Explain.

(5 MARKS)

C. Explain the concept of adverse selection. What are the possible consequences of adverse selection? **(3 MARKS)**

QUESTION NO.11

A. Define aggregate demand. How do you derive the Keynesian aggregate demand schedule? **(3 MARKS)**

B. Explain the term quasi-public goods. **(2 MARKS)**

C. Explain the concepts of Market Stabilisation Scheme (MSS) & Open Market Operations (OMO). **(3 MARKS)**

D. Distinguish between Depreciation of Currency and Devaluation of Currency.

(2 MARKS)