INTER CA – MAY 2018

PAPER 8 : FINANCIAL MANAGEMENT AND ECONOMICS FOR FINANCE

Branch: Multiple Date:

PART- A : FINANCIAL MANAGEMENT (60 marks)

Note: Question 1 is compulsory. Attempt any five from the rest.

Question 1 (5 marks each)

A) A Firm has the following data for the year ending 31st March - :

Particulars	`
Sales (1,00,000 units @ ` 20)	20,00,000
Earnings before Interest andx Taxes	2,00,000
Fixed Assets	5,00,000

The three possible Current assets holding of the Firm are ` 5,00,000, ` 4,00,000 and ` 3,00,000. It is assumed that Fixed Assets level is constant and Profits do not vary with Current Assets Levels.
For each of the three levels of Current Assets, compute – (a) ROA, (b) Current Assets to Fixed Assets. Explain your findings.

B) From the following data of Company A and Company B, prepzare their Income Statements.

Particulars	Company A	Company B
Variable Cost	` 56,000	60% of Sales
Fixed Cost	` 20,000	-
Interest Expenses	` 12,000	` 9,000
Financial Leverage	5:1	-
Operating Leverage	-	4:1
Inccome Tax Rate	30%	30%
Sales	-	` 1,05,000

C) SK Limited has obtained funds from the following sources, the specific cost are also given against them:

Source of Funds	Amount	Cost of Capital
Equity Shares	` 30,00,000	15%
Preference Shares	` 8,00,000	8%
Retained Earnings	` 12,00,000	11%
Debentures	` 10,00,000	9% (before tax)

You are required to calculate Weighted Average Cost of Capitak. Assume that Corporate Tax Rate is 30%.

D) Determine the risk adjusted Net Present Value of the following projects –

Particulars	X	Y	Z
Net Cash Outlays (`)	2,10,000	1,20,000	1,00,000
Project Life	5 years	5 years	5 years
Annual Cash Inflow (`)	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	0.0	0.4	0.8	1.2	1.6	2.0	Morethan2
Risk – Adjusted Rate of Return	10%	12%	14%	16%	18%	22%	25%
PV Factor 1 to 5 years at Risk Adjusted Rate of Discount	3.791	3.605	3.433	3.274	3.127	2.864	2.689

Question 2 (4 marks each)

A) Explain the inter – relationship between Investment, Financing and Dividend Decisions.

B) Shankar, an executive in an MNC, is 35 years old. He has decided it is time to plan seriously for his retirement. At the end of each year until he is 65, he will save ` 10,000 in a Retirement Account. If the account earns 10% per year, how much will Shankar have saved at the age of 65?

Question 3 (8 marks)

MN Limited gives you the following information related for the year ending 31st March. Calculate – (i) Quick Ratio, (ii) Fixed Assets Turnover Ratio, (iii) Proprietary Ratio, (iv) EPS , and (v) Price – Earnings Ratio.

Particulars		Particulars	
Current Ratio	2.5:1	Current Market Price per Equity Share	` 16
Debt-Equity Ratio	1:1.5	Net Working Capital	` 4,50,000
Return on Total Assets	15%	Fixed Assets	` 10,00,000
Total Assets Turnover Ratio	2	60,000 Equity Shares of ` 10 each	` 6,00,000
Gross Profit Ratio	20%	20,000 9% Preference Shares of ` 10 each	` 2,00,000
Stock Turnover Ratio	7	Opening Stock	` 3,80,000

Question 4 (4 marks each)

A) Write short notes on Venture Capital Financing?

B) A Company passes through three stages: Growth, Transition and Maturity Stage. The Growth Stage is expected to last for 2 years, while the Transition stage lasts for 3 years. During the Transition Stage, the Growth rate of dividends changes from 18% to 9%. What would be the rate of dividend at the end of the first year of the Transition Stage?

Question 5 (8 marks)

A Company has prepared the following projects for a year:

Sales	21,000 units
Selling Prices per unit	` 40
Variable Costs per unit	` 25
Total Costs per unit	` 35
Credit period allowed	One month

The Company proposes to increase the credit period allowed to its customers from one month to two months. It is envisaged that the change in the policy as above will increase Sales by 8%. The Company desires a return of 25% on its Investment.

You are required to answer the following questions –

1. What is the Incremental Contribution due to extension of Credit Period?
2. What is the Incremental Investment of Funds on – (a) Variable Cost basis, and (b) Total Cost basis, due to extension of Credit Period?
3. What is the Effective Return on Investment if credit is extended as above?
4. Advise whether the proposed Credit Policy should be implemented or not.

Question 6 (8 marks)

An industrial unit desires to acquire a Diesel Generating Set costing ` 20 Lakhs which has an economic life of ten years at the end of which the asset is not expected to have any residual value. The unit is considering the alternative choices of –

- Taking the Machinery on lease, or
- Purchasing the Asset outright by rasing a Loan.

Lease Payments are to be made in advance, and the Lessor requires the Asset to be completely amortized over its useful period and that the Asset will yield him a return of 10%

The Cost of Debt is worked at 16% per annum. Average Rate of Income Tax is 50%. It is expected that the operative costs would remain the same under either method. Straight Line Method of Depreciation may be adopted.

As a Financial Consultant, indicate what your advice will be. Workings are to form part of your answer. Would your advice change it the Annual Lease Rental is fixed at ` 3,50,000?

Question 7 (8 marks)

The following cash – flow streams need to be analysed –

Cash – Flow Stream	Year end 1	Year end 2	Year end 3	Year end 4	Year end 5
A	` 100	` 200	` 200	` 300	` 300
B	` 600				
C					` 1,200
D	` 200		` 500		` 300

1. Calculate the Terminal Value of each stream at the end of year 5 with an interest rate of 10%.
2. Compute the Present Value of each stream if the Discount Rate is 14% .
3. Compute the Internal Rate of Return of each stream, if the Initial investment at time 0 were ` 600.

PART – B: ECONOMICS FOR FINANCE (40 Marks)

Note: Question 1 is compulsory. Attempt any four from the rest.

Question 1 (4 marks each)

A) Write short notes on the Circular Flow of income.

B) What are the major components of Monetary Policy?

Question 2 (4 marks each)

A) List the shortcomings / limitations / difficulties in measurement of National Income?

B) Compute Credit Multiplier if the Required Reserve Ratio is 4%, 10% and 20%. For every 1,00,000 deposited in the Banking System, what will be the Total Credit Money created by the Banking system in each case?

Question 3 (4 marks each)

A) Explain Friedman's Theory of Demand for Money.

B) Write short notes on "Market Failure".

Question 4 (4 marks each)

A) What is Fiscal Policy? What are its Objective?

B) List three merits and three demerits of the Theory of Absolute Advantage in International Trade.

Question 5 (4 marks each)

A) Differentiate between NDP & NNP at Market Prices.

B) Distinguish between Appreciation of Currency and Revaluation of Currency.

Question 6 (4 marks each)

A) Write short notes on the World Trade Organization (WTO).

B) Write short notes on "Global Public Goods".

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