Test Series: October, 2018

MOCK TEST PAPER – 2

INTERMEDIATE (NEW): GROUP – II

PAPER – 8: FINANCIAL MANAGEMENT& ECONOMICS FOR FINANCE

Time Allowed – 3 Hours **Maximum Marks – 100**

PAPER 8A : FINANICAL MANAGEMENT (60 Marks)

Answers are to be given only in English except in the case of the candidates who have opted for Hindi medium. If a candidate has not opted for Hindi medium his/ her answers in Hindi will not be valued.

*Question No. **1** is compulsory.*

*Attempt any **four** questions from the remaining **five** questions.*

Working notes should form part of the answer.

1. Answer the following:

(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 share capital	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) NSG Ltd. has a sale of Rs.75,00,000, variable cost of Rs.42,00,000 and fixed cost of Rs.6,00,000. The Present capital structure of NSG is as follows:

Equity Shares	Rs. 55,00,000
Debt (12%)	Rs. 45,00,000
Total	Rs. 1,00,00,000

(i) DETERMINE the ROCE of NSG Ltd.

(ii) Does NSG have a favourable financial leverage? ANALYSE.

(iii) If the industry average of asset turnover is 3, does it have a high or low asset leverage? DETERMINE

(iv) COMPUTE the leverages of NSG?

(v) DETERMINE, at what level of sales, will the EBT be zero?

(c) Following information relate to a concern:

Debtors Velocity	3 months
Credits Velocity	2 months
Stock Turnover Ratio	1.5
Gross Profit Ratio	25%

Bills Receivables	Rs. 25,000
Bills Payables	Rs. 10,000
Gross Profit	Rs. 4,00,000
Fixed Assets to turnover Ratio	4

Closing stock of the period is Rs. 10,000 above the opening stock.

CALCULATE

(i) Sales and cost of goods sold

(ii) Sundry Debtors

(iii) Sundry Creditors

(iv) Closing Stock

(v) Fixed Assets

(d) RST Ltd. has a capital of Rs. 10,00,000 in equity shares of Rs. 100 each. The shares are currently quoted at par. The company proposes to declare a dividend of Rs. 10 per share at the end of the current financial year. The capitalization rate for the risk class of which the company belongs is 12%. COMPUTE the market price of the share at the end of the year, if

(i) a dividend is not declared?

(ii) a dividend is declared?

(iii) assuming that the company pays the dividend and has net profits of Rs.5,00,000 and makes new investments of Rs.10,00,000 during the period, how many new shares must be issued? Use the MM model. **(4 × 5 Marks = 20 Marks)**

2. JKL Ltd. has the following book-value capital structure as on March 31, 20X8.

	(Rs.)
Equity share capital (2,00,000 shares)	40,00,000
11.5% Preference shares	10,00,000
10% Debentures	30,00,000
	80,00,000

The equity shares of the company are sold at Rs. 20. It is expected that the company will pay next year a dividend of Rs. 2 per equity share, which is expected to grow by 5% p.a. forever. Assume a 35% corporate tax rate.

Required:

(i) COMPUTE weighted average cost of capital (WACC) of the company based on the existing capital structure.

(ii) COMPUTE the new WACC, if the company raises an additional Rs. 20 lakhs debt by issuing 12% debentures. This would result in increasing the expected equity dividend to Rs. 2.40 and leave the growth rate unchanged, but the price of equity share will fall to Rs.16 per share. **(10 Marks)**

3. RST Limited is considering relaxing its present credit policy and is in the process of evaluating two proposed polices. Currently, the firm has annual credit sales of Rs 225 lakhs and accounts receivable turnover ratio of 5 times a year. The current level of loss due to bad debts is Rs.7,50,000. The firm is required to give a return of 20% on the investment in new accounts receivables. The company's variable costs are 60% of the selling price. Given the following information, DETERMINE which is a better option?

(Amount in lakhs)

	Present Policy	Policy Option I	Policy Option II
Annual credit sales (Rs)	225	275	350
Accounts receivable turnover ratio	5	4	3
Bad debt losses (Rs)	7.5	22.5	47.5

(10 Marks)

4. The management of Z Company Ltd. wants to raise its funds from market to meet out the financial demands of its long-term projects. The company has various combinations of proposals to raise its funds. You are given the following proposals of the company:

Proposal	Equity shares (%)	Debts (%)	Preference shares (%)
P	100	-	-
Q	50	50	-
R	50	-	50

(i) Cost of debt and preference shares is 10% each.

(ii) Tax rate – 50%

(iii) Equity shares of the face value of Rs. 10 each will be issued at a premium of Rs. 10 per share.

(iv) Total investment to be raised Rs. 40,00,000.

(iv) Expected earnings before interest and tax Rs. 18,00,000.

From the above proposals the management wants to take advice from you for appropriate plan after computing the following:

- Earnings per share
- Financial break-even-point

COMPUTE the EBIT range among the plans for indifference. Also indicate if any of the plans dominate.

(10 Marks)

5. X Limited is considering to purchase of new plant worth Rs. 80,00,000. The expected net cash flows after taxes and before depreciation are as follows:

Year	Net Cash Flows (Rs.)
1	14,00,000
2	14,00,000
3	14,00,000
4	14,00,000
5	14,00,000
6	16,00,000
7	20,00,000
8	30,00,000
9	20,00,000
10	8,00,000

The rate of cost of capital is 10%.

You are required to CALCULATE

(i) Pay-back period

(ii) Net present value at 10 discount factor

(iii) Profitability index at 10 discount factor

(iv) Internal rate of return with the help of 10% and 15% discount factor

The following present value table is given for you:

Year	Present value of Rs. 1 at 10% discount rate	Present value of Rs. 1 at 15% discount rate
1	.909	.870
2	.826	.756
3	.751	.658
4	.683	.572
5	.621	.497
6	.564	.432
7	.513	.376
8	.467	.327
9	.424	.284
10	.386	.247

(10 Marks)

6. (a) DISCUSS the three major decisions taken by a finance manager to maximize the wealth of shareholders.

(b) STATE the disadvantages of the Certainty equivalent Method. EXPLAIN its differences with Risk Adjusted discount rate.

(c) STATE the advantages of Stock-Splits. **(4 + 4 + 2 =10 Marks)**

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SECTION B: ECONOMICS FOR FINANCE

*Question No.**7** is compulsory. Answer any **three** from rest.*

Marks: 40

In case, any candidate answers extra question(s) / Sub -question(s) over and above the required number, then only the requisite number of questions first answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.

Working Notes should from part of the respective questions.

7 (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) Explain the effects of monetary policy through the exchange rate channel? **(3 Marks)**

(c) Define information failure **(3 Marks)**

(d) What' s meant by devaluation? **(2 Marks)**

8. (a) (i) Define CRR. How is CRR used as a policy instrument. **(3 Marks)**

(ii) What should the market price reflect for achieving economic efficiency? **(3 Marks)**

(b) (i) Explain the leakages and injections in the circular flow of income **(2 Marks)**

(ii) Define 'moral hazard' **(2 Marks)**

9. (a) (i) Explain the function of money as a unit of account? **(3 Marks)**

(ii) What is the rationale for government intervention in allocation of resources? **(2 Marks)**

(b) Suppose an economy:

Consumption Function (C)	= 200+ 0.6 Y_d, where Y_d = Y-T
Autonomous Investment (I)	= Rs. 600 crores
Government Expenditure G	= Rs. 900 crores
Taxes (T)	= Rs.100 crores
Exports (X)	= Rs.200 crores
Import Function (M)	= 50 + 0.3 Y

Where Y and Y_d National Income and Personal Disposable Income respectively. All the figures are in Rupees.

Find Out:

(i) Equilibrium level of GDP

(ii) Disposable Income

(iii) Net Exports at Equilibrium GDP **(5 Marks)**

10. (a) (i) Explain how Reserve Bank of India acts as a 'lender of last resort 'to commercial banks? **(3 Marks)**

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

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

11. (a) (i) What is meant by free trade policy? **(3 Marks)**

(ii) What is meant by 'safeguard measures' under WTO? **(2 Marks)**

(b) (i) Explain the concept of adverse selection. What are the possible consequences of adverse selection? **(3 Marks)**

(ii) Mention the types of Transactions in the forex market? **(2 Marks)**

OR

What is the role of Liquidity Adjustment Facility? **(2 Marks)**