

Test Series: November, 2021

MOCK TEST PAPER - 2

INTERMEDIATE (NEW): GROUP – II

PAPER – 8: FINANCIAL MANAGEMENT & ECONOMICS FOR FINANCE

PAPER 8A: FINANCIAL MANAGEMENT

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.

Time Allowed – 3 Hours (Total time for 8A and 8B)

Maximum Marks – 60

1. Answer the following:

- (a) XYZ Company's equity share is quoted in the market at ₹ 25 per share currently. The company pays a dividend of ₹ 5 per share and the investor's market expects a growth rate of 5% per year.

You are required to:

- (i) CALCULATE the company's cost of equity capital.
- (ii) If the company issues 12% debentures of face value of ₹ 100 each and realises ₹ 95 per debenture while the debentures are redeemable after 10 years at a premium of 12%, CALCULATE cost of debenture using YTM?

Assume tax rate to be 30%.

- (b) ABC Limited is setting up a project with a capital outlay of ₹ 90,00,000. It has two alternatives in financing the project cost.

Alternative-I: 100% equity finance by issuing equity shares of ₹ 10 each

Alternative-II: Debt-equity ratio 2:1 (issuing equity shares of ₹ 10 each)

The rate of interest payable on the debts is 18% p.a. The corporate tax rate is 30%. CALCULATE the indifference point between the two alternative methods of financing.

- (c) The capital structure of PS Ltd. for the year ended 31st March, 2021 consisted as follows:

Particulars	Amount in ₹
Equity share capital (face value ₹ 10 each)	10,000
10% debentures (₹ 100 each)	1,00,000

During the year 2020-21, sales decreased to 10,000 units as compared to 12,000 units in the previous year. However, the selling price stood at ₹ 12 per unit and variable cost at ₹ 8 per unit for both the years. The fixed expenses were at ₹ 20,000 p.a. and the income tax rate is 30%.

You are required to CALCULATE the following:

- (i) The degree of financial leverage at 12,000 units and 10,000 units.
- (ii) The degree of operating leverage at 12,000 units and 10,000 units.

- (iii) The percentage change in EPS due to change in units sold.
- (d) The following information is supplied to you:

Particulars	₹
Total Earnings	5,00,000
Equity shares (of ₹ 100 each)	50,00,000
Dividend paid	3,75,000
Price/ Earnings ratio	12.5

Applying Walter's Model:

- (i) ANALYSE whether the company is following an optimal dividend policy.
- (ii) COMPUTE P/E ratio at which the dividend policy will have no effect on the value of the share.
- (iii) Will your decision change, if the P/E ratio is 8 instead of 12.5? ANALYSE.

[4 × 5 Marks = 20 Marks]

2. Jensen and spencer pharmaceutical is in the business of manufacturing pharmaceutical drugs including the newly invented Covid vaccine. Due to increase in demand of Covid vaccines, the production had increased at all time high level and the company urgently needs a loan to meet the cash and investment requirements. It had already submitted a detailed loan proposal and project report to Expo-Impo bank, along with the financial statements of previous three years as follows:

Statement of Profit and Loss

(In ₹ '000)

	2018-19	2019-20	2020-21
Sales			
Cash	400	960	1,600
Credit	3,600	8,640	14,400
Total sales	4,000	9,600	16,000
Cost of goods sold	2,480	5,664	9,600
Gross profit	1,520	3,936	6,400
Operating expenses:			
General, administration, and selling expenses	160	900	2,000
Depreciation	200	800	1,320
Interest expenses (on borrowings)	120	316	680
Profit before tax (PBT)	1,040	1,920	2,400
Tax @ 30%	312	576	720
Profit after tax (PAT)	728	1,344	1,680

BALANCE SHEET

(In ₹ '000)

	2018-19	2019-20	2020-21
Assets			
Non-Current Assets			
Fixed assets (net of depreciation)	3,800	5,000	9,400
Current Assets			
Cash and cash equivalents	80	200	212
Accounts receivable	600	3,000	4,200
Inventories	640	3,000	4,500
Total	5,120	11,200	18,312
Equity & Liabilities			
Equity share capital (shares of ₹10 each)	2,400	3,200	4,000
Other Equity	728	2,072	3,752
Non-Current borrowings	1,472	2,472	5,000
Current liabilities	520	3,456	5,560
Total	5,120	11,200	18,312

INDUSTRY AVERAGE OF KEY RATIOS

Ratio	Sector Average
Current ratio	2.30:1
Acid test ratio (quick ratio)	1.20:1
Receivable turnover ratio	7 times
Inventory turnover ratio	4.85 times
Long-term debt to total debt	24%
Debt-to-equity ratio	35%
Net profit ratio	18%
Return on total assets	10%
Interest coverage ratio (times interest earned)	10

As a loan officer of Expo-Impo Bank, you are REQUIRED to apprise the loan proposal on the basis of comparison with industry average of key ratios considering closing balance for accounts receivable of ₹ 6,00,000 and inventories of ₹ 6,40,000 respectively as on 31st March, 2018. **[10 Marks]**

- Superb Ltd. constructs customized parts for satellites to be launched by USA and Canada. The parts are constructed in eight locations (including the central headquarter) around the world. The Finance Director, Ms. Kuthrapali, chooses to implement video conferencing to speed up the budget process and save travel costs. She finds that, in earlier years, the company sent two officers from each location to the central headquarter to discuss the budget twice a year. The average travel cost per

person, including air fare, hotels and meals, is ₹ 27,000 per trip. The cost of using video conferencing is ₹ 8,25,000 to set up a system at each location plus ₹ 300 per hour average cost of telephone time to transmit signals. A total 48 hours of transmission time will be needed to complete the budget each year. The company depreciates this type of equipment over five years by using straight line method. An alternative approach is to travel to local rented video conferencing facilities, which can be rented for ₹ 1,500 per hour plus ₹ 400 per hour average cost for telephone charges. You are Senior Officer of Finance Department. You have been asked by Ms. Kuthrapali to EVALUATE the proposal and SUGGEST if it would be worthwhile for the company to implement video conferencing. **[10 Marks]**

4. On 01st April, 2020, the Board of Director of ABC Ltd. wish to know the amount of working capital that will be required to meet the programme they have planned for the year. From the following information, PREPARE a working capital requirement forecast and a forecast profit and loss account and balance sheet:

Issued share capital	₹ 6,00,000
10% Debentures	₹ 1,00,000
Fixed Assets	₹ 4,50,000

Production during the previous year was 1,20,000 units; it is planned that this level of activity should be maintained during the present year.

The expected ratios of cost to selling price are: raw materials 60%, direct wages 10% overheads 20%

Raw materials are expected to remain in store for an average of two months before issue to production. Each unit of production is expected to be in process for one month. The time lag in wage payment is one month.

Finished goods will stay in the warehouse awaiting dispatch to customers for approximately three months.

Credit allowed by creditors is two months from the date of delivery of raw materials. Credit given to debtors is three months from the date of dispatch.

Selling price is ₹ 5 per unit.

There is a regular production and sales cycle and wages and overheads accrue evenly. **[10 Marks]**

5. (a) PQR Ltd. has under its consideration a project with an initial investment of ₹ 2,25,00,000. Three probable cash inflow scenarios with their probabilities of occurrence have been estimated as below:

Annual cash inflow (₹)	50,00,000	75,00,000	1,00,00,000
Probability	0.2	0.7	0.1

The project life is 5 years and the desired rate of return is 12%. The estimated terminal values for the project assets under the three probability alternatives are ₹ 0, ₹ 50,00,000 and ₹ 75,00,000 respectively.

You are required to:

- CALCULATE the probable NPV;
- CALCULATE the worst-case NPV and the best-case NPV; and
- STATE the probability occurrence of the worst case, if the cash flows are perfectly positively correlated over time. **[8 Marks]**

- (b) 'Pecking order theory' suggests manager to use various sources for raising of fund in certain order. BRIEF out that order. **[2 Marks]**
6. (a) BRIEF out any four types of Preference shares along with its feature. **[4 Marks]**
- (b) EXPLAIN any four types of Packing Credit. **[4 Marks]**
- (c) EXPLAIN: Callable bonds and Puttable bonds.

Or

Briefly DESCRIBE bridge finance. **[2 Marks]**

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Time Allowed – 3 Hours (Total time for 8A and 8B)

Maximum Marks – 60

1. (a) What is the distinction between taxes on production and product taxes? (Marks 2)
(b) Describe the relevance of Circular flow of income in the measurement of National Income (Marks 3)
(c) What are the factors behind the concept of multiplier? (Marks 3)
(d) Suppose the Consumption function of the economy is given by: (Marks 2)
 $C = 40 + 0.8 Y$
and Investment Function is given by
 $I = 30 + 0.4 Y$
What will be the equilibrium level of national Income?
2. (a) What is the role of the government in the management of the fiscal parameters of the economy? (Marks 3)
(b) What is the rationale of measuring money supply?. (Marks 2)
(c) Calculate GDP and National Income from the Following data: (Marks 5)

Item	Rs. In crore
Depreciation	400
Exports	1200
Imports	900
Net Factor income from rest of the world	600
Change in business inventories	200
Gross private domestic fixed Investment	400
Indirect Taxes	7000
Subsidies	500

State government consumption and investment expenditure	700
Central government consumption and investment expenditure	800
Private Consumption Expenditure	5000

3. (a) What are the Operating Procedures and Instruments of Monetary Policy? **(Marks 3)**
(b) What is the Process of determination of Nominal Exchange Rate ? **(Marks 2)**
(c) What are the Factors that leads to market Failure? **(Marks 3)**
(d) What are the advantage of Foreign Portfolio Investment? **(Marks 2)**

- 4 (a) What is countervailing duty and how does it effect trade policy? **(Marks 3)**
(b) How is economy effected by crowding out effect? **(Marks 2)**
(c). Elaborate the reason why tragedy of the commons occurs? **(Marks 3)**
(d) What is the usefulness of the National Income Account? **(Marks 2)**

5. (a) What is the effect of New Trade Policy on Industries? **(Marks 3)**
(b) Why is government intervention required in case of demerit good? **(Marks 2)**
(c) What are the limitation of Fiscal Policy? **(Marks 3)**
(d). What are the export related measures as an instrument of Trade Policy? **(Marks 2)**