Roll No. ....

IPCE (New Syllabus)
Paper - 8
Financial Management and Economics for Finance

MAY 2019

Total No. of Questions – **11**

Total No. of Printed Pages – **10**

Time Allowed – **3** Hours

Maximum Marks – **100**

PFG2

Answers to questions are to be given only in English except in the case of 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.

SECTION – A

Marks : 60

Question No. **1** is compulsory.

Candidates are also required to answer any **four** questions from the remaining **five** questions.

Working notes should form part of the respective answers.

Marks

1. (a) Following figures and ratios are related to a company Q Ltd. : **5**

(i)	Sales for the year (all credit)	₹ 30,00,000
(ii)	Gross Profit ratio	25 per cent
(iii)	Fixed assets turnover (based on cost of goods sold)	1.5
(iv)	Stock turnover (based on cost of goods sold)	6
(v)	Liquid ratio	1:1
(vi)	Current ratio	1.5:1
(vii)	Receivables (Debtors) collection period	2 months
(viii)	Reserves and surplus to share capital	0.6:1
(ix)	Capital gearing ratio	0.5
(x)	Fixed assets to net worth	1.20:1

You are required to calculate :

Closing stock, Fixed Assets, Current Assets, Debtors and Net worth.

Marks

(b) Alpha Ltd. has furnished the following information : **5**

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

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

(c) Kanoria Enterprises wishes to evaluate two mutually exclusive projects X and Y. **5**

The particulars are as under :

	Project X (₹)	Project Y (₹)
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

Marks

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.

(d) The following information is supplied to you : 5

Total Earning	₹ 40 Lakhs
No. of Equity Shares (of ₹ 100 each)	4,00,000
Dividend Per Share	₹ 4
Cost of Capital	16%
Internal rate of return on investment	20%
Retention ratio	60%

Calculate the market price of a share of a company by using :

(i) Walter's Formula

(ii) Gordon's Formula

Marks

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

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

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

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

If RM Steels Limited's earnings before interest and taxes are ₹ 20,000; ₹ 40,000; ₹ 80,000; ₹ 1,20,000 and ₹ 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%.

3. AT Limited is considering three projects A, B and C. The cash flows associated with the projects are given below : 10

Cash flows associated with the Three Projects (₹)

Project	C_0	C_1	C_2	C_3	C_4
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

Marks

You are required to :

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

(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

4. The capital structure of the Shiva Ltd. consists of equity share capital of ₹ 20,00,000 (Share of ₹ 100 per value) and ₹ 20,00,000 of 10 % Debentures, sales increased by 20% from 2,00,000 units to 2,40,000 units, the selling price is ₹ 10 per unit; variable costs amount to ₹ 6 per unit and fixed expenses amount to ₹ 4,00,000. The income tax rate is assumed to be 50%. **10**

(a) You are required to calculate the following :

(i) The percentage increase in earnings per share;

(ii) Financial leverage at 2,00,000 units and 2,40,000 units.

(iii) Operating leverage at 2,00,000 units and 2,40,000 units.

 Marks

(b) Comment on the behaviour of operating and Financial leverages in relation to increase in production from 2,00,000 units to 2,40,000 units.

5. Bita Limited manufactures used in the steel industry. The following information regarding the company is given for your consideration : **10**

(i) Expected level of production 9000 units per annum.

(ii) Raw materials are expected to remain in store for an average of two months before issue to production.

(iii) Work-in-progress (50 percent complete as to conversion cost) will approximate to 1/2 month's production.

(iv) Finished goods remain in warehouse on an average for one month.

(v) Credit allowed by suppliers is one month.

(vi) Two month's credit is normally allowed to debtors.

(vii) A minimum cash balance of ₹ 67,500 is expected to be maintained.

(viii) Cash sales are 75 percent less than the credit sales.

(ix) Safety margin of 20 percent to cover unforeseen contingencies.

(x) The production pattern is assumed to be even during the year.

(xi) The cost structure for Bita Limited's product is as follows :

	₹
Raw Materials	80 per unit
Direct Labour	20 per unit
Overheads (including depreciation ₹ 20)	80 per unit
Total Cost	180 per unit
Profit	20 per unit
Selling Price	200 per unit

You are required to estimate the working capital requirement of Bita limited.

6. (a) Explain the steps of Sensitivity Analysis. 4

(b) What is the process of Debt Securitisation ? 4

(c) Explain any two steps involved in Decision tree Analysis. 2

OR

Give any two limitations of leasing. 2

SECTION – B

Marks : 40

Question No. 7 is compulsory.

Answer any **three** questions from the rest.

Working notes should form part of the respective answers.

Marks

7. (a) Given Consumption function C = 300 + 0.75Y; 3

Investment = ₹ 800; Net Imports = ₹ 100

Calculate equilibrium level of output.

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

(c) Compute M1 supply of money from the data given below : 3

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

(d) Define 'Market power'. What is its disadvantage ? 2

Marks

8. (a) Compute GNP at factor cost and NDP at market price using expenditure method from the following data : 5

	(₹ 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

(b) (i) Why is there a need for the government to resort to resource allocation ? 3

(ii) Why is the central bank referred to as a "banker's bank" ? 2

9. (a) (i) Explain the classical theory of Comparative Advantage as given by David Ricardo. 3

(ii) What will be the total credit created by the commercial banking system for an initial deposit of ₹ 3000 at a Required Reserve Ratio (RRR) of 0.05 and 0.08 respectively ? Also compute credit multiplier. 2

(b) (i) Describe the limitations of fiscal policy. 3

(ii) What are the conceptual difficulties in the measurement of national income ? 2

Marks

10. (a) (i) How does international trade increase economic efficiency ? Explain. **3**

(ii) What is meant by expansionary fiscal policy ? Under what circumstances do government pursue expansionary policy ? **2**

(b) (i) "Money has four functions : a medium, a measure, a standard and a store." Elucidate. **3**

(ii) When investment in an economy increases from ₹ 10,000 crores to ₹ 14,000 crores and as a result of this national income rises from ₹ 80,000 crores to ₹ 92,000 crores, compute investment multiplier. **2**

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

(ii) What is meant by 'Mixed tariffs' ? **2**

(b) (i) Using suitable diagram, explain, how the nominal exchange rate between two countries is determined ? **3**

(ii) What is meant by quasi public goods ? **2**

OR

Distinguish between Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). **2**
