NOV 2018

Roll No. ....

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

Total No. of Questions – 11

Time Allowed – 3 Hours

Total No. of Printed Pages – 24

Maximum Marks – 100

VFYK–H

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.

1. (a) Y Limited requires ₹ 50,00,000 for a new project. This project is expected to yield earnings before interest and taxes of ₹ 10,00,000. While deciding about the financial plan, the company considers the objective of maximizing earnings per share. It has two alternatives to finance the project – by raising debt ₹ 5,00,000 or ₹ 20,00,000 and the balance, in each case, by issuing Equity Shares. The company's share is currently selling at ₹ 300, but is expected to decline to ₹ 250 in case the funds are borrowed in excess of ₹ 20,00,000. The funds can be borrowed at the rate of 12 percent upto ₹ 5,00,000 and at 10 percent over ₹ 5,00,000. The tax rate applicable to the company is 25 percent. **5**

Which form of financing should the company choose ?

Marks

(b) Following information relating to Jee Ltd. are given : 5

Particulars	
Profit after tax	₹ 10,00,000
Dividend payout ratio	50%
Number of Equity Shares	50,000
Cost of Equity	10%
Rate of Return on Investment	12%

(i) What would be the market value per share as per Walter's Model ?

(ii) What is the optimum dividend payout ratio according to Walter's Model and Market value of equity share at that payout ratio ?

(c) The following is the information of XML Ltd. relate to the year ended 31-03-2018 : 5

Gross Profit	20% of Sales
Net Profit	10% of Sales
Inventory Holding period	3 months
Receivable collection period	3 months
Non-Current Assets to Sales	1 : 4
Non-Current Assets to Current Assets	1 : 2
Current Ratio	2 : 1
Non-Current Liabilities to Current Liabilities	1 : 1
Share Capital to Reserve and Surplus	4 : 1
Non-current Assets as on 31st March, 2017	₹ 50,00,000

Marks

Assume that :

(i) No change in Non-Current Assets during the year 2017-18

(ii) No depreciation charged on Non-Current Assets during the year 2017-18.

(iii) Ignoring Tax

You are required to Calculate cost of goods sold, Net profit, Inventory, Receivables and Cash for the year ended on 31st March, 2018 **5**

(d) From the following details relating to a project, analyse the sensitivity of the project to changes in the Initial Project Cost, Annual Cash Inflow and Cost of Capital :

Particulars	
Initial Project Cost	₹ 2,00,00,000
Annual Cash Inflow	₹ 60,00,000
Project Life	5 years
Cost of Capital	10%

To which of the 3 factors, the project is most sensitive if the variable is adversely affected by 10% ?

Cumulative Present Value Factor for 5 years for 10% is 3.791 and for 11% is 3.696.

P.T.O.

Marks

2. Following is the Balance Sheet of Soni Ltd. as on 31st March, 2018 : 10

Liabilities	Amount in ₹
Shareholder's Fund	
Equity Share Capital (₹ 10 each)	25,00,000
Reserve and Surplus	5,00,000
Non-Current Liabilities (12% Debenture)	50,00,000
Current Liabilities	20,00,000
Total	**1,00,00,000**

Assets	Amount in ₹
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 ₹ 20,00,000.

(iii) Total Asset Turnover Ratio is 5 times.

(iv) Income Tax Rate 25%

Marks

You are required to :

(1) Prepare Income Statement

(2) Calculate the following and comment :

(a) Operating Leverage

(b) Financial Leverage

(c) Combined Leverage

3. PD Ltd. an existing company, is planning to introduce a new product with projected life of 8 years. Project cost will be ₹ 2,40,00,000. At the end of 8 years no residual value will be realized. Working capital of ₹ 30,00,000 will be needed. The 100% capacity of the project is 2,00,000 units p.a. but the Production and Sales Volume is expected are as under : 10

Year	Number of Units
1	60,000 units
2	80,000 units
3 – 5	1,40,000 units
6 – 8	1,20,000 units

Marks

Other Information :

(i) Selling price per unit ₹ 200

(ii) Variable cost is 40% of sales.

(iii) Fixed cost p.a. ₹ 30,00,000.

(iv) In addition to these advertisement expenditure will have to be incurred as under :

Year	1	2	3 – 5	6 – 8
Expenditure (₹)	50,00,000	25,00,000	10,00,000	5,00,000

(v) Income Tax is 25%.

(vi) Straight line method of depreciation is permissible for tax purpose.

(vii) Cost of capital is 10%.

(viii) Assume that loss cannot be carried forward.

Present Value Table

Year	1	2	3	4	5	6	7	8
PVF @ 10%	0.909	0.826	0.751	0.683	0.621	0.564	0.513	0.467

Advise about the project acceptability.

Marks

4. MN Ltd. has a current turnover of ₹ 30,00,000 p.a. Cost of Sale is 80% of turnover and Bad Debts are 2% of turnover, Cost of Sales includes 70% variable cost and 30% Fixed Cost, while company's required rate of return is 15%. MN Ltd. currently allows 15 days credit to its customer, but it is considering increase this to 45 days credit in order to increase turnover. **10**

It has been estimated that this change in policy will increase turnover by 20%, while Bad Debts will increase by 1%. It is not expected that the policy change will result in an increase in fixed cost and creditors and stock will be unchanged.

Should MN Ltd. introduce the proposed policy ? (Assume a 360 days year)

5. The following data relate to two companies belonging to the same risk class : **10**

Particulars	A Ltd.	B Ltd.
Expected Net Operating Income	₹ 18,00,000	₹ 18,00,000
12% Debt	₹ 54,00,000	–
Equity Capitalization Rate	–	18%

Marks

Required :

(a) Determine the total market value, Equity capitalization rate and weighted average cost of capital for each company assuming no taxes as per M.M. Approach.

(b) Determine the total market value, Equity capitalization rate and weighted average cost of capital for each company assuming 40% taxes as per M.M. Approach.

6. Answer the following :

(a) Explain in brief following Financial Instruments : 1×4 =4

(i) Euro Bonds

(ii) Floating Rate Notes

(iii) Euro Commercial paper

(iv) Fully Hedged Bond

(b) Discuss the Advantages of Leasing. 4

(c) Write two main objectives of Financial Management. 2

OR

Write two main reasons for considering risk in Capital Budgeting decisions.

SECTION – B

Marks : 40

Question No. **7** is compulsory.

Answer any **three** from the rest.

Working notes should form part of the respective answers.

Marks

7. (a) How the Government intervenes to ensure stability in price level ? **2**

(b) Explain the Concept of Gross National Product at market price (GNPmp). **2**

(c) The RBI Published the following data as on 31st March, 2018. You are required to compute M_4 : **3**

	(₹ in crores)
Currency with the public	1,12,206.6
Demand Deposits with Banks	1,93,300.4
Net Time Deposits with Banks	2,67,310.2
Other Deposits of RBI	614.8
Post Office Savings Deposits	277.5
Post Office National Savings Certificates (NSCs)	110.5

Marks

(d) The table given below shows the number of labour hours required to produce Sugar and Rice in two countries X and Y : 3

Commodity	Country X	Country Y
1 unit of Sugar	2.0	5.0
1 unit of Rice	4.0	2.5

(i) Compute the Productivity of labour in both countries in respect of both commodities.

(ii) Which country has absolute advantage in production of Sugar ?

(iii) Which country has absolute advantage in production of Rice ?

8. (a) In a two sector model Economy, the business sector produces 7500 units at an average price of ₹ 7. 5

(i) What is the money value of output ?

(ii) What is the money income of Households ?

(iii) If households spend 75% of their income, what is the total consumer expenditure ?

(iv) What is the total money revenue received by the business sector ?

(v) What should happen to the level of output ?

Marks

(b) (i) Define the Contractionary Fiscal Policy. What measures under this policy are to be adopted to eliminate the inflationary gap ? 3

(ii) Explain the role of Monetary Policy Committee (MPC) in India. 2

9. (a) (i) Explain with example how Ad Valorem Tariff is levied. 3

(ii) What is allocation function of Fiscal Policy ? 2

(b) (i) What are the modes of Foreign Direct Investment (FDI) ? 3

(ii) Calculate the Average Propensity to Consume (APC) and Average Propensity to Save (APS) from the following data : 2

Income	**Consumption**
₹ 4,000	₹ 3,000

10. (a) (i) Define the market failure. Why do markets fail ? 3

(ii) Mention the general characteristics of Money. 2

(b) (i) How do Governments correct market failure resulting from demerit Goods ? 3

(ii) The Nominal Exchange rate of India is ₹ 56 / 1 \$, Price Index in India is 116 and Price Index in USA is 112. What will be the Real Exchange Rate of India ? 2

11. (a) (i) Explain the different mechanism of monetary policy which influences the price-level and national income. 3

(ii) Explain the Monetary Policy Framework Agreement. 2

(b) (i) Distinguish between Personal Income and Disposable Personal Income. 3

(ii) "World Trade Organisation (WTO) has a three-tier system of decision making." Explain. 2

OR

Explain the concept of Social Costs.
