Paper-12: FINANCIAL MANAGEMENT & INTERNATIONAL FINANCE

Time Allowed: 3 Hours **Full Marks: 100**

The figures in the margin on the right side indicate full marks.
Answer Question No. 1 from Part A which is compulsory and any five questions from Part B.
Working notes should form a part of the answer
"Wherever necessary, suitable assumptions should be made and indicated in answers by the candidates"

PART A (25 Marks)

Question 1.

(a) In each of the cases given below, one out of four answers is correct. Indicate the correct answer (= 1 mark) and give workings/reasons briefly in support of your answer (= 1 mark)
[2 × 9]

(i) XYZ Ltd. has a gearing of 30%. Its cost of equity is 21% and the cost of debt is 15%. The company's WACC is:
(A) 14.3%;
(B) 19.2%;
(C) 14.7%;
(D) 4.5%.

(ii) Dividend-Payers Ltd. has a stable income and stable dividend policy. The average annual dividend payout is ₹ 27 per share (Face Value = ₹ 100). You are required to find out Dividend payout in year 2, if the company were to have an expected market price of ₹ 160 per share at the existing cost of equity. [The market price in year 1 is ₹ 150]
(A) ₹ 28.88;
(B) ₹ 26.86;
(C) ₹ 28.80;
(D) ₹ 26.98.

(iii) The P/V ratio of a firm dealing in precision instruments is 50% and margin of safety is 40%. Calculate net profit, if the sales volume is ₹ 50,00,000.
(A) ₹ 10,00,000;
(B) ₹ 1,00,000;
(C) ₹ 5,00,000;
(D) ₹ 6,00,000.

(iv) What is the opportunity cost of not taking a discount, when the credit terms are 2/20 net 45? [Assume 1 year = 360 days]
(A) 24.9%;
(B) 29.4%;
(C) 22.9%;
(D) 29.2%.

(v) If the following rates are prevailing: Euro/$: 1.1916/1.1925 and $/£: 1.42/1.47, what will be the cross rate between Euro / Pound?
(A) 1.6921/1.7530;
(B) 1.7530/1.6921;
(C) 1.6921/1.1925;
(D) 1.7530/1.1916.

(vi) The dollar is currently trading at ₹ 40. If dollar appreciates by 10%, what will be the spot rate?
(A) ₹ 40.00;
(B) ₹ 0.0275;
(C) ₹ 0.0225;
(D) ₹ 44.00.

(vii) A firm has sales of ₹ 75,00,000 variable cost of ₹ 42,00,000 and fixed cost of ₹ 6,00,000.It has a debt of ₹ 45,00,000 at 9% interest and equity of ₹ 55,00,000. At what level of sales, the EBIT of the firm will be equal to zero?
(A) ₹ 28,48,500;
(B) ₹ 28,84,500;
(C) ₹ 22,84,500;
(D) ₹ 26,48,500.

(viii) Zoom Technologies Limited issued 1,00,000, 14% debentures of ₹ 100 each, redeemable after 5 years at ₹ 110 each. The commission payable to under writers and brokers is 10%. The after-tax cost of debt, assuming a tax rate of 45%, will be:
(A) 15.1%;
(B) 12.54%;
(C) 10%;
(D) 11.7%.

(ix) According to Gordon's dividend capitalisation model, if the share price of a firm is ₹ 43, its dividend pay-out ratio is 60%, cost of equity is 9%, ROI is 12% and the number of shares are12,000, what will be the net profit of the firm?
(A) ₹ 15,480
(B) ₹ 23,220
(C) ₹ 36,120
(D) ₹ 54,180

(b) State if each of the following sentences is true or false: [1×7]

(i) A call option is the right to sell, whereas a put option is a right to buy.
(ii) One of the demerits of ARR (Accounting Rate of Return) method is that time value of money is not considered here.
(iii) If the parties to the lease transaction are domiciled in different countries, it is known as domestic lease.
(iv) Gross Working Capital is the excess of current assets over current liabilities.
(v) The maturity period of commercial paper usually ranges from 90 days to 360 days.
(vi) In case of ABC Analysis for inventory control, 'A' class items means high percentage of the total items but having low values.
(vii) Fixed assets turnover ratio indicates the extent to which the investment in fixed assets has contributed towards sales.

PART B (75 MARKS)

Question 2.

(a) The turnover of Bengal Polymers Limited is ₹ 60 lakhs of which 80% is on credit. Debtors are allowed one month to clear off the dues. A factor is willing to advance 90% of the bills raised on credit for a fee of 2% per month plus a commission of 4% on the total amount of debts. The company, as a result of this arrangement, is likely to save ₹ 21,600 annually in management costs and avoid bad debts at 1% on the credit sales.

A scheduled bank has come forward to make an advance equal to 90% of the debts at interest rate of 18% per annum. However, its processing fee will be 2% on the debts.

Advise management of the company whether it should avail services of a factor or accept offer from the bank. **[10]**

(b) Explain the salient features of non-recourse project financing. **[5]**

Question 3.

(a) Saran Ltd. has achieved sales of ₹ 40 million and a net profit of ₹ 5 million in the year ended 31-3-2014. The following figures are extracted from the accompanying Balance Sheet (Extracts) as on 31-03-2014 of the company:

	₹ (million)
Paid up Equity Share Capital	5
Reserve and Surplus	3
Long-term Loans	8
Current Liabilities and Provisions	4

The company wants to increase the Return on Equity by 7.5 percent in the year ending 31-03-2015.

Required:
Assess the change needed in the Net Profit margin of the company to meet the desired increase in its ROE. Assume that the other ratios will not change. **[6]**

(b) List out the main official foreign sources of finance. **[5]**

(c) An Indian customer who has imported equipment from Germany has approached a bank for booking a forward Euro contract. The delivery is expected six months from now. The following rates are quoted:
($/Euro) spot 0.8453/0.8457
6m - Swap points 15/20
₹ / $ spot 46.47/46.57
6m - Swap points 20/30
What rate the bank will quote, if it needs a margin of 0.5%? **[4]**

Question 4.

(a) Precision Instruments Limited manufactures ball bearings. The company plans to add some more product lines and so, it has decided to acquire a machine costing ₹ 50 lakhs having a useful life 5 years, with salvage value of ₹ 10 lakhs. Consider short-term capital loss/gain for income tax. The full purchase value of the machine can be financed by bank loan at the rate of 10% interest per annum repayable in five equal instalments falling due at the end of each year. Alternatively, the machine can be procured on a 5 year lease, year-end lease rentals being ₹ 12.50 lakhs per annum. The company follows the written down value method of depreciation at the rate of 25 per cent. The company is in 30% tax bracket.

Required:
(i) What is the present value (PV) of cash outflow for each of these financing alternatives using the after-tax cost of debt?
(ii) Which of the two alternatives is preferable?

Note:

Extracts from the PV Table:
(i) PVIF at 7% for 0 to 5 years are:
1.000, 0.9346, 0.8734, 0.8163, 0.7629, 0.7130
(ii) PVIF at 10% for 0 to 5 years are:
1.000, 0.9091, 0.8264, 0.7513, 0.6830, 0.6209
(iii) PVIFA for 5 years at 10% = 3.7908
(iv) PVIFA for 5 years at 7% = 4.1002. **[10]**

(b) Find the direct cross quote of French Francs in India, given that —
₹ / USD = 44.04/44.08
USD / AUD = 18.05/18.08
GBP / AUD = 0.4119/0.4127
GBP / FRF = 0.0996/0.0999 **[5]**

Question 5.

(a) The following quotes are available:

Spot ($/Euro)	0.8385 / 0.8391
3 –m swap points	20/30
Spot ($ / Pound)	1.4548 / 1.4554
3-m swap points	35/25

Find the 3-m (€/£) outright forward rates. **[5]**

(b) Indicate the important accounting ratios that would be used by each of the following:
(i) A long–term creditor interested in determining whether his claim is adequately secured.
(ii) A bank who has been approached by a company for short-term loan / overdraft.
(iii) A Shareholder who is examining his portfolio and who is to decide whether he should hold or sell his shares in a company. **[3]**

(c) State the ratios which are commonly used in hotel industry. **[2]**

(d) From the following data, Using MM Approach, find out (i) the value of each firm and also (ii) Equity Capitalisation rate for each firm.

Particulars	Firm A	Firm B	Firm C
EBIT (₹)	12,00,000	12,00,000	12,00,000
No. of Equity Shares	3,00,000	2,50,000	2,00,000
10% debentures (₹)	—	9,00,000	10,00,000

Every firm expects 12% return on Investment. **[5]**

Question 6.

(a) M/s Circuit Manufacturing Corporation (CMC) furnishes the following information:
Total Sales: 1,45,000 units
Selling price per unit: ₹ 23
Fixed Cost: ₹ 2,80,000
Variable Cost: ₹ 17 per unit
Debt: ₹ 10,00,000 @11% interest rate
Equity: ₹ 20,00,000
Face Value of each share: ₹ 10
Tax rate applicable: 45%

You are required to work out the following:

(i) By what amount the firm's sales have to come down, so that the Earnings before Taxes (EBT) is equal to zero?
(ii) If Earnings before Interest & Taxes (EBIT) double, what is the new level of Earnings before Taxes (EBT)?
(iii) What will be the degree of operating, financial and combined leverage?
(iv) If the asset turnover of the industry is 0.75, does the firm have a high or low degree of asset turnover? **[3+2+3+2]**

(b) Describe the features of Venture Capital. **[5]**

Question 7.

(a) The selected financial data for Companies — A,B and C for the year ended March 31, 2014 are as follows:

Company	A	B	C
Financial leverage	3:1	4:1	2:1
Interest	₹ 200	₹ 300	₹ 1,000
Operating leverage	4:1	5:1	3:1
Variable cost as a % to sales	66.67%	75%	50%
Income tax rate	45%	45%	45%

(i) Prepare Income statement for the year ended 31st March, 2014 for each company.
(ii) Comment on the financial position and capital structure of these companies. **[7+3]**

(b) State the factors which affect the flow of foreign capital. **[5]**

Question 8.

Write Short Notes on any three of the following: **[5×3]**

(a) Sensitivity Analysis (SA)
(b) Stock Splits
(c) Foreign Currency Convertible Bonds (FCCBs)
(d) Economic Ordering Quantity (EOQ)