Question Paper
Finanical Management (CFA540): January 2009

- Answer all 75 questions.
- Marks are indicated against each question.

Total Marks : 100

<Answer>

1. The market price of a share is Rs.150, the rate of return is12%, cost of equity capital is 11% and earnings per share is Rs.15. According to Gordon's Capitalization model, the retention ratio of the firm is

(a) 20%
(b) 30%
(c) 40%
(d) 50%
(e) 60%. **(1 mark)**

<Answer>

2. Banks borrow in call money market to

I. Meet the Cash Reserve Ratio (CRR) requirements which they should maintain with RBI.
II. Meet the Statutory Liquidity Ratio (SLR) requirements which they should maintain in liquid assets.
III. Meet sudden demands for funds, which may arise due to large payments and remittances.
IV. Meet the short term lending requirements.

(a) Only (I) above
(b) Both (I) and (II) above
(c) Both (I) and (III) above
(d) Both (II) and (IV) above
(e) (I), (III) and (IV) above. **(1 mark)**

<Answer>

3. Only few financial institutions are allowed to both borrow and lend in call money market. Which of the following financial institutions **cannot** do both the activities?

(a) Securities Trading Corporation of India Limited
(b) UTI Mutual Fund
(c) Bank of Rajasthan
(d) Discount and Finance House of India
(e) State Bank of India. **(1 mark)**

<Answer>

4. Which of the following statements is **not true** regarding Commercial Papers (CPs)?

(a) They are negotiable by endorsement and delivery and hence are highly flexible instruments
(b) They are issued in multiples of Rs.5 lakh, with the minimum investment of 5 lakh
(c) The maturity varies from 30 days to a year
(d) They normally have a buy-back facility
(e) No prior approval of RBI is needed for CP issues. **(1 mark)**

<Answer>

5. The Heckscher-Ohlin Model explores the possibility of two nations benefit by trading with each other. Which of the following statements is **not true** with respect to the assumptions of this Model?

(a) There are no trade controls and transportation costs
(b) Both commodity and factor markets are perfectly competitive
(c) There are constant or increasing returns to scale
(d) Both the countries have the same technology
(e) Labor and capital are perfectly immobile for inter-company transfers. **(1 mark)**

<Answer>

6. A transaction which increases the external purchasing power of the country is recorded as credit item. Which of the following items is **not** a credit item?

(a) Merchandise exports
(b) Travel
(c) Insurance
(d) Borrowing abroad
(e) Increase in foreign exchange reserves and gold reserves of the monetary authority. **(1 mark)**

<Answer>

7. Which of the following statements are **true** with respect to Crawling peg System?

I. It is a hybrid of fixed and flexible exchange rate systems.
II. While the value of a currency is fixed in terms of reference currency, this peg itself keeps changing in accordance with the underlying economic fundamentals.
III. The currency never becomes undervalued or overvalued at any time.
IV. The Central Bank occasionally enters the market in order to smoothen the transition from one rate to another, while allowing the market to follow its own trend.

(a) Both (I) and (II) above
(b) Both (I) and (III) above
(c) Both (I) and (IV) above
(d) (I), (II) and (III) above
(e) (I), (II) and (IV) above. **(1 mark)**

<Answer>

8. According to the Quantity Theory of Money,

(a) With the increase in money supply, export competitiveness of its goods increases
(b) With an increase in the money supply, the same amount of goods are chased by more money, hence the price of the goods decreases
(c) Change in price level is directly proportional to the change in money supply
(d) Change in price level is inversely proportional to the change in money demand
(e) Change in price level is inversely proportional to the change in both money supply and money demand. **(1 mark)**

<Answer>

9. Which of the following statements is/are **true** regarding Foreign Exchange Exposure?

I. Domestic assets and liabilities are directly exposed to exchange rate movements, as no conversion from a foreign currency to the domestic currency is involved.
II. When the slope of the exposure is negative, the exposure appears with a positive sign.
III. Exposure measures the sensitivity of changes in real domestic currency value of assets, liabilities and operating income.
IV. Exposures measure the responses only to the unexpected changes in the exchange rate.

(a) Only (I) above
(b) Both (I) and (II) above
(c) Both (I) and (III) above
(d) Both (II) and (IV) above
(e) Both (III) and (IV) above. **(1 mark)**

<Answer>

10. Which of the following statements is **true** regarding Split-off?

(a) It results in the complete break up of a company into two or more new companies
(b) A new legal entity is created to takeover the operations of an particular division or unit of the company and the shares of the new unit is distributed pro rata among the existing shareholders
(c) It involves conversion of an existing division or unit into a wholly owned subsidiary
(d) A new company is created to takeover the operations of a existing division or unit and a portion of the shares of the parent company are exchanged for the shares of the new company
(e) It involves outright sale of a portion of the firm to outsiders. **(1 mark)**

<Answer>

11. Which of the following is a function of the Controller?

(a) Management of liquid assets including cash
(b) Establishes relationship with the bankers and investors
(c) Overall management of the credit function of the firm
(d) Acts as a planning director
(e) Establishes the company policy with respect to the decision on trade discounts and vendor payment aging. **(1 mark)**

<Answer>

12.Voluntary export restraint is

(a) A limit on the number of units that can be exported or the market share that can be held by the domestic producers
(b) A situation when export from a particular country are totally banned
(c) A limit on the number of units that can be exported or the market share that can be held by the foreign producers
(d) Governments may directly or indirectly subsidize local production in an effort to make it more competitive in the domestic and foreign market
(e) A country facing a huge trade deficit against another country may pressurize it to adhere to a self imposed limit on the exports to the deficit facing country. **(1 mark)**

<Answer>

13.Zoya Limited is considering 4 projects – A, B, C and D with the following characteristics:

Projects	Initial Investment	Annual net Cash Flow (Year 1 to 5)
A	(20)	8.5
B	(4.5)	2.5
C	(7)	3.5
D	(8)	4.5

The funds available are limited to Rs.20 lakh and the cost of funds to the firm is 14%. According to Benefit Cost Ratio (BCR), the rank of the projects are

(a) A, B, C and D
(b) A, D, C and B
(c) B, C, A and D
(d) C, B, A and D
(e) D, B, C and A. **(2marks)**

<Answer>

14. Which of the following statements is **true** with respect to the domestic currency?

(a) An appreciation of the domestic currency results in making the imported goods and services cheaper in terms of domestic currency, hence increasing their demand
(b) An depreciation of the domestic currency results in making the imported goods and services cheaper in terms of domestic currency, hence increasing their demand
(c) An appreciation of the domestic currency results in making the exported goods and services cheaper in terms of domestic currency, hence increasing their demand
(d) An depreciation of the domestic currency results in making the exported goods and services cheaper in terms of domestic currency, hence increasing their demand
(e) An appreciation of the domestic currency results in making the imported goods and services costlier in terms of domestic currency, hence increasing their demand. **(1 mark)**

<Answer>

15.Which of the following statements is **true**?

(a) An increase in the level of domestic income increases the demand for all goods and services, including imports, which results in an increased demand of domestic currency
(b) An increase in the level of domestic income increases the demand for all goods and services, including imports, which results in an increased supply of domestic currency
(c) An increase in the level of domestic income increases the demand for all goods and services, including imports, which results in an increased supply of foreign currency
(d) An increase in the level of domestic income increases the demand for all goods and services, including imports, which results in decreased supply of domestic currency
(e) An increase in the level of domestic income decreases the demand for all goods and services, including imports, which results in an increased supply of domestic currency. **(1 mark)**

<Answer>

16.Anil Enterprises Limited (AEL) has placed two orders to Sunil Enterprises limited (SEL) in order to purchase machines from them. Each machine is sold at a price of Rs.5,00,000 at a profit margin of 20%. It is estimated that the probability of default is 10% for the first order and 5% for the second order. What is the expected profit to SEL from granting the second credit to AEL, assuming that the first order has been paid?

(a) Rs.67,500
(b) Rs.75,000
(c) Rs.85,000
(d) Rs.90,000
(e) Rs.95,000. **(1 mark)**

<Answer>

17. Which of the following statements is **not true** with respect to Law of One Price?

(a) It assumes that there is no restriction on the movement of goods between counties
(b) It would hold perfectly if, there were no transaction costs
(c) The price level in different countries determine the exchange rates of these countries' currencies
(d) It assumes no transaction costs
(e) Absence of tariffs distorts the Law of One Price. **(1 mark)**

<Answer>

18. While calculating the weighted average cost of capital, market value of weights are preferred because

(a) Book value of weights are historical in nature
(b) It is very difficult to estimate book value weights at the time of calculating the weighted average cost
(c) This in conformity with the definition of cost of capital as the investor's minimum required rate of return
(d) Book value of weights fluctuates violently
(e) Market values weights are fairly consistent over a period of time. **(1 mark)**

<Answer>

19. Which of the following statements is **not true** with respect to bankruptcy costs?

(a) Capital market when perfect, has no costs associated with bankruptcy
(b) Assets of a bankrupt firm can be sold at their economic values
(c) The probability of bankruptcy increases at an increasing rate as the debt-equity ratio increases
(d) Legal and administrative costs associated with bankruptcy are high
(e) Investors expect a lower rate of return from a firm which is faced with the prospect of bankruptcy. **(1 mark)**

<Answer>

20. Which of the following statements is **not true** with respect to under-trading?

(a) It arises in a company, when the volume of sales is much less than the amount of assets employed
(b) It results in lower turnover of working capital
(c) The company is under capitalized compared to the volume of sales
(d) As a precautionary measure, the company tries to reduce the debt equity ratio
(e) If a company faces the problem of under-trading, the company tries to reduce the inventory levels to reasonable levels. **(1 mark)**

<Answer>

21. Ashish Traders Ltd. has furnished the following details for the year ended 2008:

Owners' equity	Rs.10,00,000
Current debt to total debt	0.40
Total debt to owners' equity	0.60
Fixed assets to total debt	0.8
Total assets turnover	2 times
Inventory turnover	8 times

The inventory to current assets ratio is

(a) 0.357
(b) 0.375
(c) 0.537
(d) 0.573
(e) 0.753. **(3marks)**

<Answer>

22. Which of the following statements is **not true** with respect to Exchange Rate Quotations?

(a) An American Quote is the number of dollars expressed per unit of any other currency
(b) Merchant Quote is the quote given by the bank to its retail investors
(c) An European Quote is the number of dollars expressed per unit of any other currency
(d) A Quote given by a bank to another is bank is known as interbank quote
(e) A European Quote is the number of units of any other currency expressed in dollars. **(1 mark)**

<Answer>

23. Which of the following statements is/are **true** with respect to Swap?

I. A currency swap is a combination of one spot and one forward transaction.
II. A swap transaction whereby the foreign currency is bought in the first leg and sold in the second leg against the local currency is called a swap-in.
III. A swap transaction whereby the local currency is bought in the first leg and sold in the second leg against the foreign currency is called a swap-in.
IV. A swap transaction whereby the foreign currency is sold in the first leg and bought in the second leg against the local currency is called a swap-in.

(a) Only (I) above
(b) Only (II) above
(c) Both (I) and (II) above
(d) Both (I) and (III) above
(e) Both (I) and (IV) above. **(1 mark)**

<Answer>

24. Which of the following statements is **not true**?

(a) A Mortgage-backed security is a synthetic instrument for securization of debt
(b) Debt-equity swap is an offer from an issuer of debt to swap it for common stock
(c) Detachable Equity Warrants are issuable with Convertible debentures or other debt or equity instruments
(d) Participating Preference Shares is an quasi instrument to bolster net worth without loss of management control
(e) Participating Debentures are unsecured corporate debt securities which participate in the profits of the company. **(1 mark)**

<Answer>

25. Which of the following statements is **not true** with respect to Right Issues?

(a) The firm has to first offer right shares to the existing shareholders on a pro-rata basis
(b) The right offer has to be kept open for a period of 90 days
(c) The shareholder can renounce their right in favor of any other person at market determined rate
(d) The cost of issuing public issue will be comparatively less than the public issue
(e) The right issue will be priced lower than the public issue. **(1 mark)**

<Answer>

26. Which of the following statements are **true** with respect to Secured Premium Notes (SPNs)?

I. This is a kind of Convertible Debenture with an attached warrant.
II. Interest does not accrue on the instrument during the first 3 years of allotment.
III. The warrant attached to the SPN gives the holder the right to apply for and get allotment of one equity share for Rs.100 through cheque payment.
IV. The right on the warrant, attached to the SPN, has to be exercised between one and one-and-half year after allotment, by which time the SPN would be fully paid.

(a) Both (I) and (II) above
(b) Both (II) and (IV) above
(c) (I), (III) and (IV) above
(d) (II), (III) and (IV) above
(e) All (I), (II), (III) and (IV) above. **(1 mark)**

<Answer>

27. Which of the following merger waves, is marked by large number of mega-mergers and cross-border mergers?

(a) First Wave
(b) Second Wave
(c) Third Wave
(d) Fourth Wave
(e) Fifth Wave. **(1 mark)**

<Answer>

28. The operating exposure of a firm can be reduced by

(a) Covering through forward market
(b) Covering through futures market
(c) Covering through money market
(d) Covering through options market
(e) Altering the firm's operations. **(1 mark)**

<Answer>

29. Which of the following statements is/are **true** with respect to merger?

I. It is a process of acquiring control over the management of a firm by acquiring a substantial portion of its equity.
II. In a reverse subsidiary merger, the target firm becomes a subsidiary or is merged with the subsidiary of the acquirer.
III. In a subsidiary merger, a subsidiary firm of the acquirer is merged into target firm.
IV. A merger takes place when the firms involved in the combination are of unequal size.

(a) Only (II) above
(b) Only (IV) above
(c) Both (I) and (II) above
(d) Both (II) and (III) above
(e) (I), (III) and (IV) above. **(1 mark)**

<Answer>

30. Which of the following statements is **not true** with respect to the assumptions of Capital structure theories?

(a) Without incurring transaction costs, a firm can change its capital structure
(b) There is no income tax
(c) The firm has a policy of paying its earnings as dividend
(d) The net operating income is expected to grow or decline over time
(e) Investors have identical subjective probability distributions of net operating income for each company. **(1 mark)**

<Answer>

31. The following information regarding the equity shares of Dodd Ltd. is given:

Market Price	=	Rs.68
Dividend per share	=	Rs.4.00
Multiplier	=	5

According to the traditional approach to the dividend policy, the EPS for Dodd Ltd., is approximately

(a) Rs. 8.80
(b) Rs.10.80
(c) Rs.18.80
(d) Rs.28.80
(e) Rs.36.00. **(1 mark)**

<Answer>

32. The capitalization rate of A Ltd. is 15%. The company has 50,000 outstanding shares selling at the rate of Rs.150 each. It is anticipating a net income of Rs.5,00,000 for the current financial year and plans to declare a dividend of Rs.4.50 per share. The company also has a new project, the investment requirement for which is Rs.15,00,000. The additional number of shares to be issued under MM Model to maintain the current value of the firm, when dividend is paid, is approximately

(a) 5292 shares
(b) 6272 shares
(c) 7229 shares
(d) 7292 shares
(e) 7672 shares. **(2marks)**

<Answer>

33. Which of the following statements is **not true** with respect to factors affecting the composition of working capital?

(a) Purely trading organizations have finished goods inventory, accounts receivable and cash as current assets and accounts payable as current liabilities
(b) The nature of major raw material used in manufacture of finished goods will greatly influence the quantum of raw material inventory
(c) In capital goods manufacturing company, the demand of whose product is growing over time, the tendency will be to have high inventory of raw materials and components
(d) Unlike Travel Agency firms, manufacturing and trading companies mainly has accounts receivable and some amount of cash as current assets
(e) Capital goods manufacturing and trading companies will have a high proportion of current assets in the form of inventory of raw materials components and work-in-progress. **(1 mark)**

<Answer>

34. Which of the following statements is **not true** with respect to overdraft?

(a) It is similar to cash credit arrangement
(b) Interest is charged on the amount overdrawn subject to some minimum charges
(c) The customer is allowed to overdraw up to a pre-specified limit
(d) Overdraft account operates against security in the form of pledge of shares and securities, assignment of life insurance and sometimes even mortgage of fixed assets
(e) Overdraft account operates against security of inventory and account receivables in the form of hypothecation/pledge. **(1 mark)**

<Answer>

35. Which of the following statements is **not true** with respect to Public Deposits?

(a) The maximum maturity period allowed for it is 3 years while the minimum period is six months
(b) A company cannot raise more than 10% of its paid up capital and free reserves
(c) Capital redemption reserve can be treated as a part of free reserve
(d) Share premium account is treated as a part of reserves
(e) Government companies can accept deposits up to 35% of their paid up capital and free reserves. **(1 mark)**

<Answer>

36. In which of the following anti take-over measures, the target company makes a counter tender offer response to the raider's bid?

(a) White Squire
(b) Crown Jewels
(c) Greenmail
(d) Golden parachute
(e) White knight. **(1 mark)**

<Answer>

37. Which of the following statements are **true** with respect to Working Capital Turnover?

I. It is also known as working capital to sales ratio.
II. Very high and very low turnover values indicate the symptoms of under-trading and over-trading.
III. Given the profit margins, sales and net fixed assets, the lower the turnover the higher will be the rate of return on net operating capital employed.
IV. Higher the turnover, the better for the company.

(a) Both (I) and (II) above
(b) Both (II) and (III) above
(c) Both (II) and (IV) above
(d) (I), (II) and (IV) above
(e) (II), (III) and (IV) above. **(1 mark)**

<Answer>

38. Which of the following statements are **true** with respect to Factoring?

I. Under Invoice discounting, sales ledger administration and collection of receivables are carried out by the client.
II. Under Maturity factoring, short-term finance is provided by the factor to the client.
III. Under Non-Recourse factoring, credit protection is provided by the factor to the client.
IV. Factoring is related only to a specific transaction. It is not a continuous agreement between the Factor and the Seller of goods and services.

(a) Both (I) and (II) above
(b) Both (I) and (III) above
(c) Both (II) and (IV) above
(d) Both (III) and (IV) above
(e) (II), (III) and (IV) above. **(1 mark)**

<Answer>

39. What is the cash conversion cycle for a firm with a receivable period of 45 days, a payables period of 50 days and an inventory period of 65 days?

(a) 30 days
(b) 35 days
(c) 45 days
(d) 60 days
(e) 65 days. **(1 mark)**

<Answer>

40. Which of the following is **not** a current account item in India's balance of payment?

(a) Release of foreign exchange by Authorized Dealers to company executives on business visits abroad
(b) Freight charges collected and remitted by foreign shipping vessels
(c) Payments received by Indian musicians for the concerts rendered abroad
(d) Payments received on account of GDRs issued by Indian companies
(e) Dividends received on portfolio investments placed in New York by Indian mutual funds. **(1 mark)**

<Answer>

41. Which of the following statements is **not true** with respect to price elasticity of demand under Foreign Exchange Exposure?

(a) Lower the competition faced by a firm, higher the price flexibility
(b) Higher the product differentiation, the more price flexibility the firm enjoys
(c) Higher the competition faced by a firm, higher the price flexibility
(d) A large number of players restrict the flexibility prices enjoyed by a firm
(e) A firm's product being unique and different in some way from its competitors' products, help it charge a premium on it. **(1 mark)**

<Answer>

42. Calculate the Accounting Rate of Return (ARR) from the following table:

(Amount in Rs.)

Year	0	1	2	3
Investment	(1,00,000)			
Sales Revenue		1,30,000	1,00,000	90,000
Operating expenses (excluding depreciation)		64,000	50,000	50,000
Depreciation		30,000	40,000	20,000
Annual income		36,000	10,000	20,000

(a) 44%
(b) 45%
(c) 50%
(d) 54%
(e) 55%. **(1 mark)**

<Answer>

43. A supplier is offering credit term of 2/15, net 30. Calculate the implicit cost of not availing the discount.

(a) 38.56%
(b) 39.96%
(c) 44.98%
(d) 48.98%
(e) 58.45%. **(1 mark)**

<Answer>

44. Which of the following statements is **not true** with respect to Forward Exchange Contracts?

(a) It can be booked where there is exposure to exchange risk
(b) It can be booked for speculative purposes
(c) Value of the forward cover should not exceed the value of the goods contracted for
(d) It cannot be booked for anticipated transactions
(e) It can be booked only for firm exposure. **(1 mark)**

<Answer>

45. Ms. Rekha has taken a car loan for Rs.2,00,000 to be repaid in 60 equal monthly installments at the end of every month. If the loan carries an interest rate of 10% p.a. compounded quarterly, calculate the amount of each installment?

(a) Rs.4,150
(b) Rs.4,241
(c) Rs.4,465
(d) Rs.4,618
(e) Rs.4,763. **(2marks)**

<Answer>

46. The following information pertains to the balance of payments of a country for the year 2008:

Particulars	Rs.
Merchandize imports	2,80,480
Merchandize exports	2,32,640
Services rendered to foreigners	4,60,020
Services rendered by foreigners to residents	2,50,468
Foreign Portfolio Investment	2,00,000
Foreign direct investment	4,00,000

Given the above information, the capital account balance is

(a) Rs. 4,00,000
(b) Rs. 6,00,000
(c) Rs.13,10,488
(d) Rs.15,46,128
(e) Rs.18,23,608. **(1 mark)**

<Answer>

47. The following spot rates are quoted in the market:

$/£ : 1.7036/41
C$/$: 1.0067/73

The C$/£ spot rate should be

(a) 1.7165/1.7177
(b) 1.7150/1.7158
(c) 1.7160/1.7165
(d) 1.7150/1.7165
(e) 1.7155/1.7164. **(1 mark)**

<Answer>

48. Which of the following sets of spot quotations given by two banks C and D, give scope for arbitrage?

	Quotation	Bank C	Bank D
I.	$/£	1.9936/40	1.9945/50
II.	Euro/£	1.5031/33	1.5032/34
III.	HK$/$	7.7904/08	7.7900/02

(a) Only (I) above
(b) Only (II) above
(c) Both (I) and (II) above
(d) Both (I) and (III) above
(e) Both (II) and (III) above. **(2marks)**

<Answer>

49. The following data pertains to Hemant Ltd.:

Opening balance of Finished goods	Rs. 537.92
Closing balance of Finished goods	Rs. 1,132.74
Annual Cost of production	Rs.11,413.66
Customs and Excise duties	Rs. 35,025.56
Selling, Administration and financial expenses	Rs. 4,577.48

The Finished Goods Storage Period is

(a) 3 days
(b) 4 days
(c) 5 days
(d) 6 days
(e) 7 days. **(2marks)**

<Answer>

50. Radha company's existing sales are Rs.180 lakh. It is currently extending a credit period of "net 30 days" to its customers .The company's contribution to sales ratio is 20% and cost of funds is 15%.The company is contemplating to increase its sales by Rs.16 lakh to be achieved by means of lengthening the existing period to "net 45 days". If the bad debt losses on additional sales are expected to be 5%, the net additional benefit is approximately

(a) 1.035 lakh
(b) 1.135 lakh
(c) 1.175 lakh
(d) 1.258 lakh
(e) 1.350 lakh. **(2marks)**

<Answer>

51. If the spot dollar price of one Swiss franc is \$ 0.9879, the expected price of Swiss franc is \$ 1.002 and the interest on U.S. bonds is 4%. What should be the interest on Swiss franc bonds for the interest rate parity condition to hold good?

(a) 2.34%
(b) 2.44%
(c) 2.54%
(d) 2.64%
(e) 2.74%. **(1 mark)**

<Answer>

52. Giga Limited has got Rs.100 lakh of retained earnings and Rs.150 lakh of external equity through a fresh issue in its capital structure. The equity investors expect a rate of return of 16% and the cost of issuing external equity is 5%. The cost of external equity raised by the company is

(a) 11.84%
(b) 16.64%
(c) 16.84%
(d) 18.64%
(e) 18.84%. **(1 mark)**

<Answer>

53. The present value of Aarti Ltd. and Bharti Ltd. are Rs.2,000 crore and Rs.1,200 crore respectively .The present value of cost savings expected from the merger is Rs.400 crore. Aarti Ltd. pays Rs.1,250 crore to acquire Bharti Ltd. The expenses incurred towards the merger are Rs.150 crore. The value of synergy is

(a) Rs. 50 crore
(b) Rs.100 crore
(c) Rs.200 crore
(d) Rs.250 crore
(e) Rs.300 crore. **(2marks)**

<Answer>

54. Which of the following statements is **not true** with respect to Acquisition Finance?

(a) Acquisition may be paid either in cash, securities or a combination of cash and securities
(b) The securities offered may be in equity, preference shares or debentures
(c) The cash may be raised from internal accruals
(d) Acquisition cannot be financed by private placement of debt and equity shares
(e) The investment banker often arranges for a bridge loan against subsequent refinancing. **(1 mark)**

<Answer>

55. The inter-bank market rates are as under:

Euro/\$	Spot	0.6394/0.6398
	1 month	0.6375/0.6380
	2 months	0.6250/0.6254
	3 months	0.6155/0.6158

The forward margin included in the rate quoted to a bank that wants to purchase Euro for option to be delivered over third month is

(a) 0.0119
(b) 0.0239
(c) 0.0258
(d) 0.0262
(e) 0.0278. **(1 mark)**

<Answer>

56. The particulars of firms Sigma and Delta are as follows:

Particulars	Sigma	Delta
Profit (Rs. in cr.)	100	75
No. of shares (cr.)	20	25
EPS (Rs.)	5	3
P/E Multiple	30	10
Market Price (Rs.)	150	30

Sigma proposes to acquire Delta and give its shares in exchange of the shares of Delta. The maximum exchange ratio when the P/E of the combined firm is 35 is

(a) 0.23
(b) 0.38
(c) 0.45
(d) 0.52
(e) 0.83. **(2marks)**

<Answer>

57. Which of the following statements is/are **true** with respect to Blocked Funds?

I. A company may have funds blocked in another country due to restrictions on their being remitted.
II. If these funds can be activated and be invested in a new project, the initial outlay for the new project stands reduced accordingly.
III. If the funds are blocked completely and could not be repatriated at all, a partial amount of the activated funds are deducted from the amount of initial investment.
IV. If it is possible to recover a part of the blocked funds after paying withholding taxes, that part of the funds which can be recovered will be treated as activated funds and deducted from the initial investment.

(a) Only (I) above
(b) Only (III) above
(c) Both (I) and (II) above
(d) Both (II) and (IV) above
(e) (I), (III) and (IV) above. **(1 mark)**

<Answer>

58. Rajen & Company Ltd., recently issued 1 right share for every 5 shares held. If the price of the stock at the time of the issue was Rs.70 per share and the price after the rights issue was Rs.68 per share, the subscription price of each right share was

(a) Rs.50
(b) Rs.60
(c) Rs.58
(d) Rs.68
(e) Rs.86. **(2marks)**

<Answer>

59. The money invested in Kisan Vikas Patra today doubles in eight years and six months. What is the approximate rate of interest per annum as per “Rule of 69”?

(a) 8.47%
(b) 8.74%
(c) 9.47%
(d) 9.74%
(e) 10.74%. **(2marks)**

<Answer>

60. Which of the following statements are **true** with respect to purpose of receivables?

I. It increases total sales because, when a company sells goods on credit, it will be in a position to sell more goods than if it insists on immediate cash payments.
II. It increases profits as, it results in an increase in sales not only in volume, but also because companies charge higher margin of profit on cash sales as compared to credit sales.
III. It meets the increasing competition and for this the company may have to grant better credit facilities than those offered by its competitors.
IV. The purpose of receivables is indirectly connected with company's objectives of making credit sales.

(a) Both (I) and (II) above
(b) Both (I) and (III) above
(c) (I), (II) and (III) above
(d) (I), (III) and (IV) above
(e) (II), (III) and (IV) above. **(1 mark)**

<Answer>

61. Which of the following statements are **not true** with respect to Global Depository Receipts (GDRs)?

(a) It is a negotiable instrument
(b) It represents publicly traded foreign-currency equity share
(c) It is an instrument in the form of Depository Receipt or certificate created by the Overseas Bank outside India
(d) GDRs may be at the request of the investors converted into equity shares by cancellation of GDRs through intermediation of the depository and the sale of underlying shares in the domestic market through local custodian
(e) The voting rights of the shares are exercised by the Depository as per the understanding between the issuing company and the GDR holders. **(1 mark)**

<Answer>

62. The following details pertain to Suman Paints Ltd.:

Particulars	Amount (Rs. In lakh)
Opening Balance of	
a. raw materials, stores and spares etc.	3,454.84
b. work in progress	76.15
c. finished goods	637.92
d. accounts receivable	746.45
e. accounts payable	2,504.18
Closing Balance of	
a. raw materials, stores and spares etc.	4,295.14
b. work in progress	72.50
c. finished goods	1,032.74
d. accounts receivable	1,166.32
e. accounts payable	3,087.47
Purchases of raw materials, stores and spares etc.	12,676.10

Assuming 360 days a year, the raw material storage period is

(a) 108 days
(b) 112 days
(c) 115 days
(d) 118 days
(e) 181 days. **(3marks)**

<Answer>

63. Mr. Sharma purchased a 365 day T- Bill at a price of Rs.95.46.The face value of the T-Bill is Rs.100, maturing after 364 days. The yield of the T-Bill is

(a) 2.71%
(b) 3.53%
(c) 4.01%
(d) 4.77%
(e) 5.26%. **(1 mark)**

64. Mr. Ashish borrowed an amount of Rs.10,00,000 from M/s. Paywell Finance Ltd. As per the loan agreement, he has to repay Rs.8 lakhs at the end of 7th year, Rs.10 lakhs at the end of 8th year, Rs.5 lakhs at the end of 9th year and Rs.4 lakh at the end of 10th year from now. In order to meet these payments, he wants to deposit money in a bank scheme that offers an interest rate of 10% p.a. The approximate amount that Mr. Ashish should invest at the end of every year for a period of 6 years, so that he can repay the loan as per the agreement is <Answer>

(a) Rs.1,50,253
(b) Rs.1,80,500
(c) Rs.2,85,525
(d) Rs.3,45,000
(e) Rs.3,55,425. **(3marks)**

65. Consider the following data: <Answer>

Net operating cycle	55 days
Raw-material storage period	44 days
Conversion period	2 days
Finished goods storage period	10 days
Average payment period	20 days

The average collection period is

(a) 9 days
(b) 19 days
(c) 29 days
(d) 39 days
(e) 59 days. **(1 mark)**

66. Which of the following orders is **not** limited by a fixed price and time? <Answer>

(a) Limited Discretionary Order
(b) Best Rate Order
(c) Limit Orders
(d) Stop Loss Order
(e) Open Order. **(1 mark)**

67. Mrs. Reddy is 60 years old and she is expecting that she will live for another twelve years. Her total savings are Rs.2,00,000, which she has deposited in a bank. She wants to spend her savings equally over these twelve years. If the interest earned on the deposit is 10% per annum, the withdrawal made at the end of every year from her deposit over the defined period is <Answer>

(a) Rs.19,458.363
(b) Rs.20,119.063
(c) Rs.25,258.363
(d) Rs.29,352.663
(e) Rs.39,352.063. **(2marks)**

68. Which of the following statements are **true**? <Answer>

I. Tin parachute covers the layers of management immediately below the top level management.
II. Silver parachutes cover a larger cross section of the employees.
III. Golden parachutes are agreements that provide for payment of huge severance packages to the senior management executives.
IV. The word "Golden" signifies the lucrative nature of the compensation payment.

(a) Both (I) and (II) above
(b) Both (II) and (III) above
(c) Both (III) and (IV) above
(d) (I), (III) and (IV) above
(e) (II), (III) and (IV) above. **(1 mark)**

<Answer>

69. Consider the following information about Yamuna Crafts Ltd., for the year 2008-09:

Sales	Rs.7,00,000
Gross profit margin	38%
Current Ratio	1.5
Total assets turnover ratio	2.5
Inventory turnover ratio	8
Fixed assets: Current assets	5:3

The quick ratio is

(a) 0.2570
(b) 0.2750
(c) 0.5270
(d) 0.7250
(e) 0.7520. **(2marks)**

<Answer>

70. The market price of a share is Rs.109.375, the capitalization rate is 12%, earnings per share is Rs.15 and the return on investment is 10%. As per Walter's Model, the dividend per share is

(a) Rs.2.75
(b) Rs.3.00
(c) Rs.3.57
(d) Rs.3.75
(e) Rs.3.95. **(1 mark)**

<Answer>

71. The face value of the equity share of Sea Pearl Ltd. is Rs.100 and the current market price of the share is Rs.80. The company is expected to declare a dividend of 20% during the current year. If the dividends are expected to decline at the rate of 10% p.a., the expected rate of return on the shares is

(a) 9.0%
(b) 12.5%
(c) 22.5%
(d) 25.5%
(e) 32.5%. **(2marks)**

<Answer>

72. The following information relates to the sources of long term finance used by Prerna Industries Ltd.:

Source	Book value (Rs. in lakh)	Market value (Rs. in lakh)
Paid-up equity share capital	300	800
Reserves and surplus	400	–
Preference shares	125	145
Debentures	250	245

Cost of equity share capital = 20%
Cost of preference share capital = 15%
Post tax cost of debenture capital = 8%

The difference between the weighted average cost using book value weights and market value weights would be

(a) –0.35%
(b) –0.33%
(c) –0.30%
(d) 0.34%
(e) 0.45%. **(2marks)**

<Answer>

73. Akhila Enterprises Ltd. furnished the following information for the current financial year:

Sales	Rs.8,10,000
Net working capital	Rs. 90,000
Current ratio	1.5
Quick ratio	0.9
Gross profit margin	20%

The inventory turnover ratio for the company is

(a) 2 times
(b) 4 times
(c) 6 times
(d) 8 times
(e) 9 times. **(3marks)**

<Answer>

74. A Foreign Institutional Investor borrowed Euro 2 million at 3% p.a. for 6 months and invested in India at 6% p.a. for 6 months. The current spot rate is Rs.51 per Euro. In order to get a positive spread, the six months Rs./Euro forward rate should be

(a) $>$ Rs.51.75
(b) $<$ Rs.51.75
(c) $>$ Rs.51.85
(d) $\geq$ Rs.51.85
(e) $>$ Rs. 61.25. **(2marks)**

<Answer>

75. Consider the following data of M/s. Globus InfoTech Ltd.:

Market Value of Debt	Rs.6,00,000
Interest	Rs. 45,000
Net Operating income	Rs.1,50,000
Cost of Equity Capital	12%

If debt-equity ratio changes to 4:5, the revised equity capitalization rate according to net operating income approach is

(a) 10.15%
(b) 11.25%
(c) 12.31%
(d) 14.35%
(e) 15.45%. **(3marks)**

END OF QUESTION PAPER

Suggested Answers
Finanical Management (CFA540): January 2009

Section A : Basic Concepts

Answer **Reason**

1. D According to Gordon's dividend capitalization model ≤

$$P = \frac{E(1-b)}{k_e - br}$$

Where P = share price

E = EPS

b = retention ratio

ke = cost of equity capital

br = growth rate

$$150 = \frac{15(1-b)}{0.11 - b*0.12}$$

Or,b = 0.50 or 50%

2. C Banks borrow in the call money market to meet the CRR requirements which they should maintain with RBI and to meet the sudden demand for funds, which may arise due to large payments and remittances. ≤

3. B RBI, intermediaries like DFHI and SHCI and commercial banks are allowed to both borrow and lend in call money market.UTI Mutual Fund is only allowed to lend in the call money market. ≤

4. C The maturity period of Commercial Papers varies from 15 days to a year. Hence (c) is a false statement ≤

5. C The assumptions of Heckscher-Ohlin Model , which explores the possibility of two nations benefit by trading with each other ,are ≤

- There are no trade controls and transportation costs
- Both commodity and factor markets are perfectly competitive
- There are constant or decreasing returns to scale
- Both the countries have the same technology
- Labor and capital are perfectly immobile for inter- company transfers.

Hence (c) is the answer.

6. E Increase in foreign exchange reserves and gold reserves of the monetary authority is a debit item. ≤

Hence (e) is the answer.

7. E Over a period of time, due to market forces, the currency may diverge from the official rate.In such a ≤

situation the peg is fixed at a new level. Hence the statement that the currency never becomes undervalued or overvalued at any time , is a false statement.

8. C According to the Quantity Theory of Money, ≤

Change in price level is directly proportional to the change in money supply. With an increase in the money supply, the same amount goods are chased by more money, hence the price of the goods increases. This reduces the export competitiveness of its goods. This results in reduction of exports and increase of imports.

Hence(c) is the answer.

9. E Foreign Exchange Exposure measures the sensitivity of changes in real domestic currency value ≤

of assets, liabilities and operating income. Exposures measure the responses only to the unexpected changes in the exchange rate as the expected changes are already discounted by the market. Domestic assets and liabilities are not directly exposed to exchange rate movements, as no conversion from a foreign currency to the domestic currency is involved.When the slope of the exposure is negative, the exposure appears with a negative sign.

Hence (e) is the answer.

10. D **Spin-off**: A new legal entity is created to takeover the operations of a particular division or unit of the company and the shares of the new entity is distributed pro rata among the existing shareholders. ≤

Split-up: results in a complete break up of a company into two or more new companies.

Split-off: a new company is created to takeover the operations of an existing division or unit and a portion of the shares of the parent company are exchanged for the shares of the new company

Equity Carveouts: involves conversion of an existing division or unit into a wholly owned subsidiary

Divestitures: involves outright sale of a portion of the firm to outsiders.

Hence (d) is the answer.

11. D The Controller acts as Planning Director. Hence (d) is the correct option. ≤

- Management of liquid assets including cash
- Establishes relationship with the bankers and investors
- Overall management of the credit function of the firm
- Establishes the company policy with respect to the decision on trade discounts and
- Vendor payment aging, are the functions performed by the Treasurer.

12. E A **Quota** is a limit on the number of units that can be imported or the market share that can be held by the foreign producers. ≤

An **Embargo** arises when imports from a particular country are totally banned.

Subsidies to Local goods means when Governments directly or indirectly subsidize local production in an effort to make it more competitive in the domestic and foreign market.

Voluntary Export Restraint arises when a country facing a huge trade deficit against another country may pressurize it to adhere to a self imposed limit on the exports to the deficit facing country.

Hence (e) is the answer.

13. E The NPV of the 4 projects are: ≤

Project	Present value of future cash flows(Rs.in lakh)	BCR(PV/I)	RANK
A	8.5 PVIFA(14%,5)=29.18	29.18/20=1.459	IV
B	2.5 PVIFA(14%,5)=8.583	8.583/4.5=1.907	II
C	3.5 PVIFA(14%,5)=12.016	12.016/7=1.717	III
D	4.5 PVIFA(14%,5)=15.449	15.449/8=1.931	I

14. A An appreciation of the domestic currency results in making the imported goods and services cheaper in terms of domestic currency, hence increasing their demand. ≤

15. B An increase in the level of domestic income increases the demand for all goods and services, including imports, which results in an increased supply of domestic currency ≤

16. A The expected profit from granting the second credit to AEL,asssuming the payment for the first order has been made by AEL,is ≤

0.90{0.95*100000-0.05*400000}=Rs.67,500

17. E The presence of Tariff distorts the Law of One Price. ≤

18. C While calculating the weighted average cost of capital, market value of weights are preferred because, this in conformity with the definition of cost of capital as the investor's minimum required rate of return. ≤

19. E Investors expect a higher rate of return from a firm which is faced with the prospect of bankruptcy. Hence (e) is the answer. ≤

20. C In case of under trading the company is overcapitalized compared to the volume of sales. Hence (c) is the answer. ≤

21. A ≤

Total debt to owners' equity	=	0.6
Therefore, Total debt	=	0.6 x Owners' equity = 0.6 x 10,00,000 = Rs.6,00,000
Current debt to Total debt	=	0.40
= Current debt = 0.4 x Total debt	=	0.4 x 6,00,000 = Rs.2,40,000.
Fixed assets to Total debt = 0.8		
= Fixed assets = 0.8 x Total debt	=	0.8 x 6,00,000 = Rs.4,80,000.
Total assets = Total liabilities	=	Owners' equity + Total debt = Rs.10,00,000 + 6,00,000
	=	Rs.16,00,000

Current assets = Total assets – Fixed assets = 16,00,000 – 4,80,000 = Rs.11,20,000.

Assets turnover = $\frac{\text{Sales}}{\text{Assets}} = 2$

Sales = 2 x Assets = 2 x 16,00,000 = Rs.32,00,000

Inventory turnover = $\frac{\text{Sales}}{\text{Inventory}} = 8$

Inventory = Sales/8 = 32,00,000/8 = Rs.4,00,000

Inventory to current assets ratio = 4,00,000/11,20,000 = 0.357.

22. C
- An American Quote is the number of dollars expressed per unit of any other currency ≤
- Merchant Quote is the quote given by the bank to its retail investors
- A quote given by a bank to another is bank is known as Interbank quote
- A European Quote is the number of units of any other currency expressed per dollars.

23. C A currency swap is a combination of one spot and one forward. A swap transaction whereby the foreign currency is bought in the first leg and sold in the second leg against the local currency is called a swap-in or buy-sell swap. A swap transaction whereby the foreign currency is sold in the first leg and bought in the second leg against the local currency is called a swap-out or a sell-buy swap. ≤

24. C Detachable Equity Warrants are issuable with NonConvertible debentures or other debt or equity instruments. ≤

Hence (c) is the answer.

25. B The right offer is kept open for a period of 60 days. Hence statement (b) is a false statement. ≤

26. B Secured Premium Notes is a kind of Non-Convertible Debenture with an attached warrant. No interest will accrue on the instrument during the first 3 years of allotment. The warrant attached to the SPN gives the holder the right to apply for and get allotment of one equity share for Rs. 100 through cash payment. This right on SPN has to be exercised between one and one-and-half year after allotment. ≤

27. E The first wave (1897–1904) is known for its role in creating large monopolies. ≤

The second wave (1916–1929) resulted in an oligopolistic industry structure rather than monopolies.

The third wave (1965–1969) is known as a conglomerate merger period, as small or medium sized firms adopted a diversification strategy into business activities outside there traditional areas of interest.

In the fourth wave (1981–1989) hostile mergers played a significant role. This wave was the period of mega mergers..

Fifth wave (1992–Till date) is marked by large number of mega-mergers and cross-border mergers.

Hence (e) is the answer.

28. E Operating exposure is a result of economic consequences of exchange rate movements on the value of the firm. It cannot be managed by the traditional techniques due to unpredictability of the changes in the cash flows. Hence it can be reduced by altering the firm’s operations.. ≤

29. B
I. Merger refers to a business combination of two or more firms in which only one firm survives and the other firm(s) go out existence. ≤
II. In a reverse subsidiary merger, a subsidiary firm of the acquirer is merged into target firm.
III. In a subsidiary merger, the target firm becomes a subsidiary or is merged with the subsidiary of the acquirer.
IV. A merger takes place when the firms involved in the combination are of unequal size.

Hence (b) is the answer.

30. D The assumptions of Capital Structure theories are ≤

- Without incurring transaction costs, a firm can change its capital structure
- There is no income tax
- The firm has a policy of paying its earnings as dividend
- The net operating income is not expected to grow or decline over time
- Investors have identical subjective probability distributions of net operating income for each company.

31. D According to the traditional approach ≤

$$P = m\left(D + \frac{E}{3}\right)$$

$$68 = 5\left(4 + \frac{E}{3}\right)$$

or, $4 + \frac{E}{3} = 13.60$

or, $\frac{E}{3} = 9.60$

or, $E = 28.80$.

32. D In order to calculate the additional number of shares to be issued to maintain the current value of the firm, when dividend is paid, we have to first calculate the price per share at the end of year 1 ≤

The price per share next year can be computed as:

$$P_0 = \frac{1}{(1+k_e)}(D_1 + P_1)$$

Where, P_0 is the prevailing market price of the share

P_1 is the price next year

D_1 is the dividend per share next year

k_e is the capitalization rate.

$$150 = \frac{1}{(1+0.15)}(4.50 + P_1)$$

Solving for P_1, we get P_1 = Rs.168

Amount to be raised by issue of new shares

$n_1P_1 = I-(E-nD_1)$

where, n_1 in the additional number of shares to be issued

I is the total investment required

E is the earnings of the firm during the period

n_1P_1 = 15,00,000-(500000-50000*4.5)

= Rs.12,25,000

The additional number of shares to be issued

$$n_1 = \frac{1225000}{168}$$

= 7292 shares approximately.

Hence (d) is the answer.

33. D Travel agency firms will have mainly accounts receivable and some amount of cash as current assets unlike manufacturing and trading companies. ≤

Hence (d) is the answer.

34. E Cash credit account operates against security of inventory and account receivables in the form of hypothecation/pledge. ≤

Hence (e) is the answer.

35. D Share premium account is treated as a part of paid up share capital. ≤

Hence (d) is the answer.

36. E White Squire-this strategy entails the target company issuing a large block of shares and convertibles preference shares to a friendly party. This is done to dilute the stake of the hostile acquirer in the company by increasing the number of shares. ≤

Crown Jewels-this strategy involves creating mechanism to ensure that a raider, in the event of a hostile takeover, is denied access to the "jewels" of the company.

Greenmail-it refers to the repurchase of a block of shares from a specific shareholder, at a substantial premium, to prevent a hostile tender offer on the company.

Golden parachute-are agreements that provide for payments of huge severence packages to the senior management executives in case of takeover of the firm.

White knight-this strategy involves selecting of a "lesser evil".the target firm may invite another firm, called as the White Knight to make a counter offer for its shares.

Hence (e) is the answer.

37. C The following statements are true with respect to Working Capital Turnover ≤

I. It is reciprocal of working capital to sales ratio.

II. Very high and very low turnover values indicate the symptoms of under-trading and over-trading.

III. Given the profit margins, sales and net fixed assets, the higher the turnover the higher will be the rate of return on net operating capital employed.

IV. Higher the turnover, the better for the company.

Hence (c) is the answer.

38. B I. Under Invoice discounting, sales ledger administration and collection of receivables are carried out by the client. ≤

II. Under Maturity factoring, short-term finance is not provided by the factor to the client.

III. Under Non-Recourse factoring, credit protection is provided by the factor to the client.

IV. Factoring is a continuous agreement between the Factor and the Seller of goods and services and not related to a specific transaction.

Hence (b) is the correct answer.

39. D Cash Conversion cycle = receivables period+ inventory period-payment period ≤

= 45days+65days-50days

= 60days.

40. D Loans include concessional loans received by the government or public sector bodies, long-term and medium term borrowings from commercial capital in the form of loans, bond issues, etc. are a capital nature in Balance of Payment account. ≤

41. C The following statements are true with respect to price elasticity of demand under Foreign Exchange Exposure ≤

- Lower the competition faced by a firm, higher the price flexibility.
- Higher the product differentiation the more price flexibility the firm enjoys.
- A large number of players restrict the flexibility of prices enjoyed by a firm.
- A firm's product being unique and different in some way from its competitors' products, help it charge a premium on it.

Hence (c) is the answer.

42. A Accounting rate of Return = Average profit after tax/average book value of investment ≤

Average annual income = $\frac{36,000+10,000+20,000}{3}$ = 22,000

Average net book value of investment = (1,00,000+0)/2 = 50,000

Accounting Rate of return = (22,000)/(50,000)*100=44%.

43. D The implicit cost is (rate of discount÷(1- rate of discount))*(number of days in a year÷(credit period-discount period)) ≤

$\frac{0.02}{(1-0.02)} * \frac{360}{(30-15)} =$ 48.98% approximately.

44. B Forward Exchange Contracts cannot be booked for speculative purposes. ≤

45. B ≤

Effective interest rate = $\left(1+\frac{0.10}{4}\right)^4$ -1 = 10.38%

Effective monthly rate = $(1 + 0.1038)^{1/12} - 1 = 0.00826$

Therefore monthly installment = $\frac{2,00,000}{\text{PVIFA }(0.826\%,60)} =$ Rs.4,241.

Hence (b) is the correct answer.

46. B Capital account balance = Foreign direct investment i.e. Rs.6,00,000. ≤

47. D $(C\$ / £)_{bid}$: $(C\$ / \$)_{bid}$ x $(\$ / £)_{bid}$ ≤

1.0067 x 1.7036

1.7150

$(C\$ / £)_{ask}$: $(C\$ / \$)_{ask}$ x $(\$ / £)_{ask}$

1.0073x 1.7041

1.7165

C$ / £ : 1.7150/1.7165.

48. D The bid rate of $ / £ of Bank D is more than the ask rate of $ / £ of Bank C. Hence there is scope for arbitrage. ≤

The ask rate of HK $/ $ of Bank D is less than the bid rate of HK $ / $ of Bank C. Hence there is scope for arbitrage.

49. D **Finished Goods Storage Period** ≤

Average inventory of finished goods = (537.92+1132.74)/2 =835.33

Annual Cost of Sales = Opening stock of finished goods +cost production+ Selling, Administration and financial expenses+ Customs and Excise duties- Closing balance of Finished goods.

= 537.92+11413.66+4577.48+35025.56-1132.74

= 50421.88

Average daily cost of sales = 50421.88/360 = 140.06078

Finished goods storage period = 835.33/140.06078 = 6 days approximately.

50. A ΔI = $(ACP_N - ACP_O)[S_O/360] + V(ACP_N) * \Delta S/360$ ≤

ΔI = increase in investment

ACP_N = new average credit period

ACP_O = old average credit period

ΔS = increase in sales

V = ratio of variable cost to sales

ΔI = (45-30)[180/360]+0.8*45*16/360

= 7.5 + 106 = 9.1 lakh

ΔP = $\Delta S(1-V) - k\,\Delta I - b_n\,\Delta S$

= 16*0.2-0.15*9.1-0.05*16

= 3.2-1.365-0.8

= 1.035 lakh.

51. C According to interest rate parity ≤

$$\frac{1+0.04}{1+r_f} = \frac{1.002}{0.9879}$$

r_f = 2.54%

52. C Cost of retained earnings (k_r) = k_e i.e.,16% ≤

Cost of external equity raised by the company(k_{e1}) = $\frac{k_e}{1-f}$

$= \frac{0.16}{1-0.05} = 16.84\%.$

53. C The PV of Aarti after the merger is expected to be: ≤

Rs. 2000cr. + Rs. 1200 cr. + Rs.400 cr. = Rs. 3600cr.

The premium paid to acquire Bharti is

Rs.1250cr.- Rs. 1200 cr. = Rs.50 cr.

Therefore Net Acquisition value(NAV) is = $PV_{ab} - (PV_a + PV_b) - P - E$

Where, PV_{ab} is the present value of the merged entity

PV_a is the present value of firm Aarti

PV_b is the present value of firm Bharti

P is the premium paid by Aarti to acquire Bharti

E is the expenses in the merger.

NAV = Rs.3600cr. -(Rs.2000cr. + Rs.1200cr.) - Rs.50 cr. - Rs.150 cr.

= Rs.200cr.

54. D Acquisition can be financed by private placement of debt or equity. Hence statement (d) is a false statement. ≤

55. B The forward margin included in the rate quoted to a bank that wants to purchase Euro for option to be delivered over third month ≤

= Euro/$(0.6394-0.6155)

= Euro/$ 0.0239

Hence (b) is the answer.

56. E Exchange Ratio(ER) = $(-S_1 \div S_2) + ((E_1 + E_2)*PE_{12} \div P_1S_2$ ≤

Where, S_1 is number of issued shares by Sigma

S_2 is the number of issued shares by Delta

E_1 is the profit of Sigma

E_2 is the profit of Delta

P_1 is the Price per share of Sigma

PE_{12} is the Price to earnings Multiple of the combined/merged firm.

$$ER = \frac{-20cr.}{25cr.} + \frac{(100cr. + 75cr.) * PE_{12}}{150 * 25cr.}$$

$= -0.8 + (7 \div 150*PE_{12})$

Hence, the maximum exchange ratio when PE_{12} is 35

$= -0.8 + (7 \div 150*35)$

$= 0.83.$

57. C The following statement are true with respect to Blocked Funds ≤

I. A company may have funds blocked in another country due to restrictions on their being remitted.

II. If these funds can be activated and be invested in a new project, the initial outlay for the new project stands reduced accordingly.

III. If the funds are blocked completely and could not be repatriated at all, then the full amounts of the activated funds are deducted from the amount of initial investment.

IV. If it is possible to recover a part of the blocked funds, after paying withholding taxes, then that part of the funds which cannot be recovered will be treated as activated funds and deducted from the initial investment.

Hence (c) is the answer.

58. C ≤

Ex-rights value of share $= \dfrac{NP_0 + S}{N+1}$

Given: N = 5

P_o = Rs. 70 per share

Ex-rights price = Rs. 68 per share

$\therefore \quad 68 = \dfrac{5(70)+S}{5+1}$

or S = 68 (6) – 70 (5)

or S = Rs. 58 per share.

59. A Eight years and six months is 8.5 months ≤

Doubling Period $= 0 \; .35 + \dfrac{69}{Interest\ rate}$

Or, 8.50 $= 0 \; .35 + \dfrac{69}{Interest\ rate}$

Or, Interest rate = 69 ÷ 8.15 = 8.4663% ˜8.47%.

60. B The following statements are true with respect to purpose of receivables: ≤

I. It increase total sales, because when a company sells goods on credit , it will be in a position to sell more goods than if it insists on immediate cash payments .

II. It increases profits; because this results in an increase in sales not only in volume , but also because companies charge higher margin of profit on credit sales as compared to cash sales.

III. It meets the increasing competition; and for this the company may have to grant better credit facilities than those offered by its competitors.

IV. The purpose of receivables is directly connected with company's objectives of making credit sales.

Hence (b) is the answer.

61. B Global Depository Receipts represents publicly traded local-currency equity share. ≤

Hence (b) is the answer.

62. D The calculations of different segments of the operating cycle are shown below: ≤

Raw material storage period

1. Average stock of raw materials

$$= \frac{3454.84 + 4295.14}{2}$$

= 3874.99

2. Annual consumption of raw materials

= opening stock + purchases-closing stock

= 3454.84+12676.10-4295.14

= 11835.80

3. Annual daily consumption of raw materials

= 11835.80÷360

= 32.88

4. Raw material storage period

= 3874.99÷32.88

= 118 days.

63. D ≤

$$K= \frac{F-P}{P} * \frac{365}{d} *100$$

K = Yield

F = Face value

P = price

D = Maturity period in days

$$K= \frac{100-95.46}{95.46} \times \frac{365}{364} \times 100 = 4.77\%$$ approx.

64. C At the end of 6 years, the future value of the amount that Ashish deposits each year for a period of 6 years, should be equal to the present value of the payments that he has to make under the loan agreement in the 7th, 8th, 9th and 10th years. ≤

The discounted value of the payments to be made at the end of 7th, 8th, 9th and 10th years, as at the end of the 6th year $= \frac{8}{1.10} + \frac{10}{(1.10)^2} + \frac{5}{(1.10)^3} + \frac{4}{(1.10)^4} =$ Rs.22.03 lakh

Future value of the deposits made at the end of every year, for a period of 6 years =

X. FVIFA(10%, 6 years) (where X is the amount to be invested at the end of every period till 6 years).

$X. FVIFA(10\%, 6 \text{ years}) = \text{Rs. } 22.03 \text{ lakh}$

$$X = \frac{22.03 \text{ lakh}}{FVIFA_{(10\%,6 \text{ years})}} = \frac{22.03 \text{ lakh}}{7.7156} = \text{Rs.}2,85,525$$

Hence Ashish has to deposit Rs.2,85,525 at the end of every period for 6 years so as to be able to make the payments under the loan agreement.

65. B Average collection period = Net operating cycle + Average payment period – (RM storage period + Conversion period+ FG storage period) ≤

= 55 + 20 – (44 + 2 + 10) = 19 days.

66. E The orders can be classified into: ≤

- Limit Orders: Order limited by a fixed price. It may or may not include brokerage.
- Best Rate Order: To execute the buy/sell order at the best possible price.
- Immediate or Cancel Order: Order shall get cancelled if not executed immediately at the quoted price.
- Limited Discretionary Order: To provide discretion to the broker to execute order at a price, which is almost, approximate to the price fixed by client.
- Stop Loss Order: A particular limit is given for sustenance of loss. If the price falls below that, the broker is authorized to sell immediately to stop further occurrence of losses.
- Open Order: When client does not fix any time or price limit for execution of order

Hence (e) is the answer.

67. D Equated annual withdrawal × PVIFA(12 yr, 10%) = Rs.2,00,000 ≤

Equated annual withdrawal × 6.8137 = 2,00,000

Equated annual withdrawal = 2,00,000/6.8137 = Rs29,352.663

68. C I. Silver parachute covers the layers of management immediately below the top level management. ≤

II. Tin parachutes covers a larger cross section of the employees.

III. Golden parachutes are agreements that provide for payment of huge severance packages to the senior management executives.

IV. The word “Golden” signifies the lucrative nature of the compensation payment.

Hence (c) is the answer.

69. D ≤

$$\text{Quick ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

Inventory turnover ratio = 8

Given sales=Rs.7,00,000 and GPM=38%,

Therefore, COGS = 7,00,000*(1-34) = Rs.4,34,000

$$\text{Inventory} = \frac{\text{COGS}}{\text{Inventory turnover ratio}} = \frac{434000}{8} = \text{Rs.}54,250$$

$$\text{Total assets} = \frac{\text{Sales}}{\text{Total assets turnover}} = 7,00,000 / 2.5 = \text{Rs.}2,80,000$$

Given FA : CA = 5 : 3

$$CA = \frac{3 \times 2,80,000}{8} = \text{Rs.}1,05,000$$

CR = 1.5

$\therefore$ CL $= \dfrac{CA}{1.5} =$ Rs.70,000

QA $= \dfrac{1,05,000- 54250}{70000} = 0.7250.$

70. D According to Walter's Model [≤]

$$P = \frac{D + r/k_e(E-D)}{k_e}$$

Where, P = market price per share

E = Earnings per share

D = dividend per share

r = rate of return

k_e = cost of capital

$$109.375 = \frac{D + 0.10/0.12(15-D)}{0.12}$$

D = 3.750.

71. B [≤]

We know, $P_0 = \dfrac{D_1}{k_e - g}$

Where,

P_0 = Current market price

k_e = Expected rate of return

g = Growth rate in dividends

D_1 = Dividend at the end of one year.

The above equation can be rewritten as:

$$k_e = \frac{D_1}{P_0} + g$$

Putting the values for the variables we get:

$$k_e = \frac{(100 \times 0.20)(1-0.10)}{80} + (-0.10)$$

$$= \frac{20(0.90)}{80} - 0.10 = 0.125 \text{ i.e., } 12.5\%.$$

72. C Weighted Average Cost of Capital (WACC) using book value weights [≤]

Sum of book values of all sources of capital used is 300 + 400 + 125 + 250 = 1075

$\therefore$ Weight for equity capital (w_e) = 0.279

Weight for reserves and surplus (w_r) = 0.372

Weight for preference capital (w_p) = 0.116

Weight for debenture capital (w_d) = 0.233

$\therefore$ WACC $= w_e k_e + w_r k_r + w_p k_p + w_d k_d$

= 0.279 × 20% + 0..372 × 20% + 0.116 × 15% + 0.233 × 8.00%

= 16.62% (approx.)

Weighted average cost of capital (WACC) using market value weights

Sum of market values of all sources of capital used =800 + 145 + 245 =1190

Weight of equity capital = 0.672

Weight of preference capital = 0.122

Weight of debenture capital = 0.206

$\therefore$ WAC = 0.672 × 20 + 0.122 × 15 + 0.206 × 8.00

= 16.92% (approx.)

The difference between the WACC using book value weights and market value weights = (16.62-16.92)% = -0.30%

73. C Current assets – Current liabilities = 90,000 ≤

$$\frac{\text{Current assets}}{\text{Current liabilities}} = 1.5$$

Current assets = 1.5 Current liabilities

1.5 Current liabilities - Current liabilities = 90,000

Current liabilities = Rs.1,80,000

Current assets = 1.5 x Current liabilities = 1.5 x 1,80,000 = Rs.2,70,000

Now, Quick ratio = $\frac{\text{Quick assets}}{\text{Current liabilities}} = \frac{\text{Current assets - Inventory}}{\text{Current liabilities}} = 0.9$

Quick assets = 0.9 x Current liabilities = 0.9 x 1,80,000 = Rs.1,62,000

Inventory = Current assets – Quick assets = 2,70,000 – 1,62,000 = RS.1,08,000.

Gross profit margin = 20% = 0.2

Gross profit = 0.2 x Sales

COGS = Sales – Gross profit = 0.8 Sales

= 0.8 x 8,10,000 = Rs.6,48,000

Inventory turnover = $\frac{\text{COGS}}{\text{Inventory}} = \frac{6,48,000}{1,08,000} = 6$ times.

74. B ≤

Repayment of Euro two million with interest = $2\left(1+\frac{0.03}{2}\right)$

Investment of Euro two million in Rupees = $2 \times 51\left(1+\frac{0.06}{2}\right)$

6 months forward rate = $\frac{2 \times 51 \times \left(1+\frac{0.06}{2}\right)}{2\left(1+\frac{0.03}{2}\right)}$ =Rs.51.75

Hence for FII, the forward rate should be less than Rs.51.75 per Euro to give a positive spread.

75. C As per Net Operating Income Approach ≤

$k_e = \frac{\text{NOI} - \text{INT}}{\text{S}}$

where symbols are in their standard use

$\therefore \text{S} = \frac{1,50,000 - 45,000}{0.12} = \text{Rs.}8,75,000$

Market value of Debt = Rs.6,00,000 (given)

$\therefore$ Value of the firm = Rs.14,75,000

Overall cost of capital $k_o = \frac{\text{NOI}}{\text{V}} = \frac{1,50,000}{14,75,000} \times 100 = 10.17\%$

$K_d = \frac{45,000}{6,00,000} \times 100 = 7.5\%$

As per NOI approach, overall cost of capital will remain constant even if the debt-equity ratio changes.

$k_e = k_o + (k_o - k_d) \; D/E$

$$\therefore k_e = 0.1017 + (0.1017 - 0.075)\ 4/5$$

= 0.1017 +0.02136 = 0.12306 = 12.306%~12.31%.

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