

**PAPER 2- MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS
NOVEMBER, 2004**

Answer any five questions

Question No.1 is compulsory. Answer any four questions from the rest. Figures in the margin indicate marks allotted to each question.

Working notes should form part of the answer.

Question 1

You own an unused Gold mine that will cost Rs.10,00,000 to reopen. If you open the mine, you expect to be able to extract 1,000 ounces of Gold a year for each of three years. After that the deposit will be exhausted. The gold price is currently Rs.5,000 an ounce, and each year the price is equally likely to rise or fall by Rs.500 from its level at the start of year. The extraction cost is Rs.4,600 an ounce and the discount rate is 1 per cent.

Required :

- (a) Calculate economic value added (EVA) with the help of the following information of Hypothetical Limited: **(6 Marks)**

Financial leverage	1.4 times
Capital structure	Equity capital Rs.170 lakh; Reserve and surplus Rs.130 lakh; 10% Debentures Rs.400 lakh
Cost of Equity	17.5%
Income tax rate	30%

- (b) A has invested in three Mutual Fund Schemes as per details below:

	MF A	MF B	MF C
Date of investment	01.12.03	01.01.04	01.03.04
Amount of investment	Rs.50,000	Rs.1,00,000	Rs.50,000
Net Asset Value (NAV) at entry date	Rs.10.50	Rs.10	Rs.10
Dividend received upto 31.03.04	Rs.950	Rs.1,500	Nil
NAV as at 31.03.04	Rs.10.40	Rs.10.10	Rs.9.80

Required:

- (a) What is the effective yield on per annum basis in respect of each of the three schemes to Mr.A upto 31.03.04? **(6 Marks)**
- (b) Explain the term “Exposure Netting”, with an example. **(5 Marks)**
- (c) Distinguish between Money Market and Capital Market **(3 Marks)**

Question 3

- (a) ABC Limited's share are currently selling at Rs.13 per share. There are 10,00,000 shares outstanding. The firm is planning to raise Rs.20 lakhs to finance a new project.

Required :

What is the ex-right price of shares and the value of a right, if

- (i) The firm offers one right share for every two shares held.
 - (ii) The firm offers one right share for every four shares held.
 - (iii) How does the shareholders' wealth change from (i) to (ii)? How does right issue increases shareholders' wealth?
- (b) Fair finance, a leasing company, has been approached by a prospective customer intending to acquire a machine whose Cash Down price is Rs.3 crores. The customer, in order to leverage his tax position, has requested to quote for a three year lease with rentals payable at the end of each year but in a diminishing manner such that they are in the ratio of 3:2:1. **(8 Marks)**

Depreciation can be assumed to be an straight line basis and Fair Finance's marginal tax rate is 35%. The target rate of return for Fair Finance on the transaction is 10%.

Required:

Calculate the lease rents to be quoted for the lease for three years.

- (c) Explain briefly about net asset value (NAV) of a Mutual Fund Scheme. **(6 Marks)**

Question 4

- (a) Which position on the index future gives a speculator, a complete hedge against the following transactions: **(6 Marks)**

- The share of Right Limited is going to raise. He has a long position on the cash market of Rs.50 lakh on the Right Limited. The beta of the Right Limited is 1.25.
- The share of Wrong Limited is going to depreciate. He has a short position on the cash market of Rs.25 lakh on the Wrong Limited. The beta of the Wrong Limited is 0.90.
- The share of Fair Limited is going to stagnant. He has a short position on the cash market of Rs.20 lakh of the Fair Limited. The beta of the Fair Limited is 0.75.

- (b) Mr.A is contemplating purchase of 1,000 equity shares of a company. His expectation of return is 10% before tax by way of dividend with an annual growth of 5%. The company's last dividend was Rs.2 per share. Even as he is contemplating, Mr.A suddenly finds, due to a budget announcement dividends have been exemption from tax in the hands of the recipients. But the imposition of dividend Distribution tax on the Company is likely to a fall in dividend of 20 paise per share. A's marginal tax rate is 30%.

(6 Marks)

Required :

Calculate what should be Mr.A's estimates of the price per share before and after the Budget announcement ?

- (c) Excel Exporters are holding an Export bill in United States Dollar (USD) 1,00,000, due 60 days hence. They are worried about the falling USD value which is currently at Rs.45.60 per USD. The concerned Export Consignment has been priced on an Exchange rate of Rs.45.50 per USD. The Firm's Bankers have quoted a 60-day forward rate of 45.20. **(4 Marks)**

Calculate :

- Rate of discount quoted by the Bank
- The probable loss of operating profit if the forward sales is agreed to.

- (d) Distinguish between Forfeiting and Factoring. **(4 Marks)**

Question 5

- (a) Given below is information of market rates of Returns and Data from two Companies A and B:

	Year 2002	Year 2003	Year 2004
Market (%)	12.0	11.0	9.0
Company A (%)	13.0	11.5	9.8
Company B (%)	11.0	10.5	9.5

Required :

- Determine the beta coefficients of the Shares of Company A and Company B. **(6 Marks)**
- Distinguish between "Systematic risk" and "Unsystematic risk". **(2 Marks)**

- (b) The following information is provided related to the acquiring Firm Mark Limited and the target Firm Mask Limited: **(8Marks)**

	Firm Mark Limited	Firm Mask Limited
Earnings after tax (Rs.)	2,000 lakh	400 lakh
Number of shares outstanding	200 lakh	100 lakh
P/E ratio (times)	10	5

Required :

- What is the Swap Ratio based on current market prices?
 - What is EPS of Mark Limited after acquisition?
 - What is the expected market price per share of Mark Limited after acquisition, assuming P/E. ratio of Mark Limited remain unchanged?
 - Determine the market value of the merged firm.
 - Calculate gain / loss for shareholders of the two independent companies after acquisition.
- (c) Explain the terms “Intrinsic value of an option” and the “Time value of an option”. **(4 Marks)**

Question 6

- (a) Briefly explain “Buy Back of Securities” and give the management objectives of buying Back Securities. **(5 Marks)**
- (b) Explain the term “Insider Trading” and why Insider Trading is punishable. **(5 Marks)**
- (c) Write a brief note on the tax issues relating to Foreign Collaboration Agreements. **(6 Marks)**
- (d) A customer with whom the Bank had entered into 3 months forward purchase contract for Swiss Franks 1,00,000 at the rate of Rs.36.25 comes to the Bank after two months and requests cancellation of the contract. On that date, the rates are:

Spot	CHF 1 = Rs.36.30	36.35
One month forward	36.45	36.52

Determine the amount of Profit and Loss to the customer due to cancellation of the contract.