

~~ASS0228~~
Section A : Basic Concepts (30 Marks)

- This section consists of questions with serial number 1 - 30.
- Answer all questions.
- Each question carries one mark.
- Maximum time for answering Section A is 30 Minutes.

1. A short-term usance promissory note issued mostly by large corporations with high credit rating is referred to as
 - (a) Participation certificate
 - (b) Certificate of deposit
 - (c) Gilt edged securities
 - (d) Letter of credit
 - ☒ (e) Commercial paper.
2. The phrase 'price specie flow mechanism' is associated with which monetary system?
 - (a) Currency board
 - (b) Crawling peg
 - (c) Gold standard
 - (d) Bretton Wood
 - (e) Floating exchange rate.
3. Identify from the following, the suitable strategy to hedge economic exposure.
 - (a) Leading and lagging
 - (b) Netting the exposure
 - (c) Product strategy
 - (d) Forward and futures
 - (e) Currency swap.
4. The ₹100 face value bond issued by Athlon Ltd. is selling at a discount of 5% in the market. If the bond carries a coupon rate of 10% p.a. paid annually, the current yield of the above bond is
 - (a) 10.00%
 - ☒ (b) 10.53%
 - (c) 11.07%
 - (d) 11.14%
 - (e) 11.65%.
5. Financial forecasting is done primarily to support
 - (a) Investing
 - (b) Organizing
 - (c) Planning
 - (d) Controlling
 - (e) Staffing.

6. Which of the following statements is **true** if the Net Present Value (NPV) of a project is positive?
- (a) Internal Rate of Return (IRR) is more than the cost of capital
 - (b) The pay-back period of the project is less than one year
 - (c) The discount rate is equal to the risk free rate of return
 - (d) Benefit cost ratio is less than unity
 - (e) Accepting the project has an indeterminate effect on shareholders.
7. Which of the following statements is/are **true** with respect to Factoring?
- I. Under Invoice factoring, sales ledger administration and collection of receivables are carried out by the client.
 - II. Under Recourse factoring, credit protection 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) Only (I) above
 - (b) Only (II) above
 - (c) Both (I) and (III) above
 - (d) Both (II) and (IV) above
 - (e) Both (III) and (IV) above.
8. Which of the following is **not** an assumption underlying the Modigliani and Miller approach to capital structure?
- (a) Information is freely available to investors ✓
 - (b) The transaction cost is constant, irrespective of the value of the transactions in securities ✓
 - (c) Firms can be divided into classes in such a way that all the firms falling within one class have the same degree of business risk ✓
 - (d) There is no corporate or personal income tax ✓
 - (e) Investors make rational investment decisions.
9. If the Argentina Peso is devalued by 20% against the US dollar, the percentage of appreciation of the US dollar against the Peso is
- $100 - 20 = 80$
- (a) 20.00%
 - (b) 25.00%
 - (c) 27.33%
 - (d) 33.67%
 - (e) 42.86%.
10. Which of the following is/are **true** about determination of exchange rates?
- I. Under a flexible exchange rate system, the exchange rate of a currency is determined by the demand and supply of the currency.
 - II. Under a fixed exchange rate system, the central bank/regulatory authority ensures an official demand in order to maintain the exchange rate at equilibrium.
 - III. Under a fixed exchange rate system the central bank/regulatory authority ensures an official demand or supply in order to maintain the exchange rate at equilibrium.
- (a) Only (I) above
 - (b) Both (I) and (II) above
 - (c) Both (I) and (III) above
 - (d) Both (II) and (III) above
 - (e) All (I), (II) and (III) above.

11. Assume that inflation in Australia is 2.5% and in U.S.A is 1.2%. According to the approximate form of PPP condition, dollar

- (a) Appreciates by 1.28%
(b) Depreciates by 1.28%
(c) Appreciates by 1.30%
(d) Depreciates by 1.30%
(e) Depreciates by 1.17%.

$$\begin{array}{r} 2.5 + 1.2 = 3.7 \\ 3.7 - 2.5 = 1.2 \\ \hline 1.3 \end{array}$$

12. Mr. Suresh wrote a European call option on a stock. The premium was ₹ 3 per share and the market price and exercise price of the share were ₹ 39 and ₹ 45 respectively. If on expiry date, the price of the share was ₹ 42, the profit/loss to Mr. Suresh was

- (a) ₹ 1
(b) -₹ 2
(c) -₹ 3
(d) ₹ 2
(e) ₹ 3.

$$\begin{array}{r} 42 \\ - 45 \\ \hline -3 + 3 = 0 \end{array}$$

$$45 + 3 = 48$$

$$48 - 42 = 6$$

13. If the current ratio is 1.5 and the quick ratio is 0.75, the proportion of inventory to total current assets is

- (a) 25%
(b) 50%
(c) 67%
(d) 75%
(e) 100%.

14. Miranda Ltd. and Pine Ltd. are two companies identical in all respect except that Pine Ltd. is a levered company. The Profit after tax of both companies are ₹ 16 lakh and the required return on equity of Miranda Ltd. is 16%. If the market value of Pine Ltd. is ₹ 120 lakh, the tax shield available to the company is

- (a) ₹ 16 lakh
(b) ₹ 20 lakh
(c) ₹ 100 lakh
(d) ₹ 120 lakh
(e) ₹ 350 lakh.

15. Consider the following information relating to Duracell Ltd.:

EBIT	₹ 20 crore
Depreciation	₹ 3 crore
Interest on debt	₹ 3 crore
Annual loan installment	₹ 2 crore
Tax rate	35%

The fixed charges coverage ratio of the company is

- (a) 2.50
(b) 3.03
(c) 3.78
(d) 4.04
(e) 4.59.

16. The face value of the equity share of Red Star Ltd., is ₹ 100 and the current market price of the share is ₹ 80. The company is expected to declare a dividend of 20% during the current year. If the dividends are expected to grow at the rate of 10% p.a., the expected rate of return on the share is
- 8.0%
 - 12.5%
 - 17.5%
 - 32.0%
 - 37.5%
17. Nimit borrowed ₹ 25,000 from a bank at an effective interest rate of 12 percent per annum. The amount has to be repaid with interest in five equal annual installments. Each installment is payable at the end of every year. What will be the amount of each installment?
- ₹ 6,935
 - ₹ 7,014
 - ₹ 7,125
 - ₹ 7,397
 - ₹ 7,611.
18. If the debt-equity ratio increases, then the degree of operating leverage
- Increases
 - Decreases
 - Becomes zero
 - Changes unpredictably
 - Remains unchanged.
19. If the 3-months ₹/\$ forward rate is 46.80/46.85 and the 3-months swap points are 10/07, then the spot rate is
- 46.70/46.92
 - 46.80/46.85
 - 46.83/46.88
 - 46.87/46.95
 - 46.90/46.92.
20. Which is the **most** important source of information for the compilation of India's Balance of Payment (BoP)?
- World Bank
 - Government Agencies located abroad
 - R>Returns filed by authorized dealers
 - Specific surveys conducted for the purpose
 - Dept. of Economic Affairs under Ministry of Finance.
21. The face value of a 91 day T-Bill is ₹ 100. Mr. Rupesh kumar purchased the bill after 15 days of issue for ₹ 98.35. Assume 365 days a year, the yield on the above T-bill is approximately
- 1.65%
 - 6.73%
 - 7.92%
 - 8.06%
 - 8.65%.

22. Consider efficiencies of countries as reflected by labor hours used in the following table

Country	Labor-hours required	
	1 unit of color TV	1 unit of computer
Green Land	5	10
Rose Islands	15	20

If both the countries have 300 units of labor-hours, then the opportunity cost of producing color TV for Rose Islands is

- (a) 0.5
(b) 1.33
(c) 0.75
(d) 3.00
(e) 0.33.

23. The following are the exchange rates quoted in Hong Kong:

HK\$ / \$ 7.7690 / 7.7692
SFr / \$ 1.0739 / 1.0741

The synthetic quotes of HK\$ per SFr are

- (a) HK\$/SFr 8.3431/8.3449
(b) HK\$/SFr 0.1382/0.1383
(c) HK\$/SFr 6.6949/6.6953
(d) HK\$/SFr 7.7073/7.7074
(e) HK\$/SFr 7.2330/7.2346.

24. Which of the following is **false** about a forward contract in foreign exchange?

- (a) The price of the currency is fixed at the time of contract
(b) The terms of delivery and payments are also fixed at the time of contract
(c) The future date should be beyond one month from the date of contract
(d) A forward contract can be either outright forward or option forward
(e) It is an agreement where the parties agree to buy or sell a currency at a future date.

25. The return earned by an investor in bond, if he holds it till maturity is called

- (a) Current yield
(b) Holding period return
(c) Yield to maturity
(d) Realized yield
(e) Expected return.

26. Which of the following statements is **true**, in case of a direct quote?

- (a) Exchange margin is to be added to the bid rate only
(b) Exchange margin is to be added to the bid rate and deducted from the ask rate
(c) Exchange margin is to be deducted from the bid rate and the ask rate
(d) Exchange margin is to be added to the bid rate and ask rate
(e) Exchange margin is to be deducted from the bid rate and added to the ask rate.

27. Consider the following information about Tide Ltd.:

Particulars	₹
Annual consumption of raw material	20,000
Annual cost of production	25,000
Annual cost of sales	1,00,000
Average stock of raw materials	7,500
Average work-in-process	2,000

Assuming 360 days in a year, the average conversion period of the company is

- (a) 7.2 days
 (b) 16.0 days
 (c) 28.8 days
 (d) 32.4 days
 (e) 34.2 days.
28. Consider the following data regarding a deep discount bond issued by Pathan Mills Ltd.:
- Issue price : ₹ 14,010
 Time period of redemption : 15 years
 Yield to maturity : 14% p.a.
- The face value of the bond is
- (a) ₹ 70,000
 (b) ₹ 95,000
 (c) ₹ 1,00,000
 (d) ₹ 1,10,000
 (e) ₹ 1,50,000.
29. Which of the following statements is **not true** regarding the Degree of Financial Leverage (DFL)?
- (a) It measures the financial risk of the firm
 (b) It is zero at financial break even point
 (c) DFL will be positive for all values of EBIT that are above financial break-even point
 (d) As EBIT increases above the financial break-even point, the DFL will start declining and will reach a limit of 1
 (e) For a DFL of 2, to increase EBIT by 20%, sales should increase by 10%.
30. Which of the following statements is **true** with respect to Present Value Interest Factor of an Annuity (PVIFA)?
- (a) The cash flow is assumed to occur at the beginning of the period under consideration
 (b) It is a reciprocal to sinking fund factor
 (c) It is the inverse of Future Value Interest Factor of an Annuity (FVIFA)
 (d) It is the capital recovery factor
 (e) It represents the present value of a regular annuity of ₹ 1 for the given values of 'k' and 'n'.

END OF SECTION A

Section B : Problems/Caselets (50 Marks)

- This section consists of questions with serial number 1 – 6.
- Answer all questions.
- Marks are indicated against each question.
- Detailed workings/explanations should form part of your answer.
- Do not spend more than 110 - 120 minutes on Section B.

1. An Indian importer has a payable of £2 million. The seller has given the Indian importer the following two options.

- i. Pay immediately with a cash discount of 1% on the payable.
- ii. Pay after 3 months with interest at 5% p.a.

The borrowing rate for the importer in rupees is 9% p.a. The following are the exchange rates as on July 11, 2010.

₹/£	Spot	67.87/89 .
	3 months forward	20/22 paise

Which of the above two options is advisable for the importer?

(8 marks)

2. The dividends on the equity shares of Sudershan Industries Ltd., (SIL) have been experiencing a growth rate of 15% per annum in the recent years, which is considered to be above normal. The above normal growth rate in dividends is expected to continue for four years after which the growth rate will reduce to 8% per annum which will continue indefinitely. The company has recently announced a dividend of ₹ 2.5 per share. The required rate of return on the equity shares is 15%.

You are **required** to find out the value of the equity share of SIL.

(9 marks)

3. Jai Ram Industries Ltd., has three divisions viz, paper, edible oil and agrotech. The paper division is financed by ₹ 3 crores of non-convertible debentures (NCD), the edible oil division is financed by ₹ 2 crores of preference shares, and the agrotech division is financed by ₹ 1.5 crores of long term debt. The NCDs have a face value of ₹ 100 and a coupon rate of 10%, and were issued at a discount of 5%. Further, on redemption of the NCDs a premium of 5% will be paid. The maturity period of the NCDs is 10 years. The preference shares were issued at face value ₹ 100 without any discount and carry a dividend of 12%, and are redeemable after 15 years at a premium of 10%. The corporate tax rate applicable is 40%. The interest rate on the long term debt is 14%.

You are **required** to calculate the cost of financing for each division individually and also the weighted average cost of capital for the entire company.

(8 marks)

4. Blackrock Leasing Company is offering leasing on its bull dozer on the following terms:

Period of lease	–	6 years
Lease rentals (annual)	–	₹ 3,00,000 for the first 3 years and ₹ 3,50,000 for the next 3 years
Rentals payable	–	At the end of every year

If the present value of the bull dozer is ₹ 12,00,000 and the salvage value on the expiry of the lease period is ₹ 2,00,000, what is the annual return earned by the leasing company on the above asset? (Ignore tax aspect).

(8 marks)

Caselet

Answer the following questions based on the given Caselet:

5. As per the caselet, the People's Bank of China has decided to proceed further with reform of the renminbi exchange rate regime and to enhance the renminbi exchange rate flexibility. In this context, discuss the reasons behind the demand for Yuan revaluation? (8 marks)
6. Discuss the implications of Yuan revaluation on China and India. (9 marks)

The People's Bank of China, issued a statement on its website, didn't announce any specific changes to the exchange-rate regime. But it was seen as a clear signal that China will let the yuan resume a gradual rise against the U.S. currency, after nearly two years of being effectively pegged around 6.83 yuan per dollar. The move came a week ahead of the Group of 20 summit at which China's exchange-rate policy was expected to be discussed. "In view of the recent economic situation and financial market developments at home and abroad, and the balance of payments situation in China, the People's Bank of China has decided to proceed further with reform of the renminbi exchange rate regime and to enhance the renminbi exchange rate flexibility," the central bank said in the statement, referring to the Chinese currency by its official name. China's government fixed the yuan against the dollar in mid-2008, when the global recession was intensifying, as part of several measures to stabilize its economy. But international reaction to the policy has grown increasingly negative in recent months, with many of China's trading partners saying the currency is undervalued and thus gives Chinese-made goods an unfair edge. By abandoning the much-criticized peg, China may be able to defuse a potential political crisis and aid the long-term prospects of its economy, officials and economists said. How much China allows the yuan to actually appreciate won't be apparent, and is likely to depend on the government's assessment of how well the global economy is performing. With the debt crisis in Europe worrying Chinese officials, the movement may not be fast. "The basis for large-scale appreciation of the renminbi exchange rate does not exist," the central bank said in the English-language version of its statement. China's announcement was timed just ahead of the summit of the G-20 in Toronto, where Chinese President Hu Jintao met U.S. President Barack Obama and the leaders of the world's other major economies. China wanted to avoid its currency policies from becoming a focus of international criticism at the summit. Emerging markets like Brazil and India had become increasingly unhappy with the effects of China's pegged currency, and the U.S. political calendar was also starting to heat up. Many analysts felt the prospects for an early move on the currency had dimmed after the European debt crisis and the prospect of weaker global growth. And China didn't announce either a one-time appreciation of the currency or a widening of the yuan's daily trading band, measures that some economists had speculated would be included in any reform package. That may indicate that China's appetite for significant change in the currency is limited. As of last week, currency derivative markets were pricing in an appreciation of a little more than 1% against the U.S. dollar over the next 12 months. On the other hand, China's consumer price inflation went over 3% in May for the first time in a year and a half, which may have increased the pressure on authorities to use a stronger currency to tame higher prices. When China last followed what it called a managed float with reference to a

basket of currencies, it resulted in a 21% gain against the dollar from 2005 to mid-2008, with the fastest appreciation coming in periods of high inflation. But because of the strength of the dollar this year, China's peg has actually resulted in a sharp appreciation of the yuan against a basket of other currencies. The euro's recent plunge against the dollar means that its value has risen 15% this year against the currency of Europe, China's largest trading partner. So China can legitimately argue that its currency is already much stronger than it was just a few months ago.

END OF CASELET

END OF SECTION B

Section C : Applied Theory (20 Marks)

- This section consists of questions with serial number 7 - 8.
- Answer all questions.
- Marks are indicated against each question.
- Do not spend more than 25 -30 minutes on Section C.

7. If the forward premium deviates substantially from the interest rate differential, covered interest arbitrage is possible, says the Interest Rate Parity theorem. Briefly discuss why the Interest Rate Parity may not hold good in reality. (10marks)
8. There are various techniques of managing foreign exchange exposure so as to reduce or eliminate foreign exchange risk. These techniques can be broadly classified as internal and external hedging techniques. How do you differentiate between internal and external hedging techniques? Also describe briefly the different internal and external hedging techniques. (10marks)

END OF SECTION C

END OF QUESTION PAPER