Audit Committee :

Audit Committee has been empowered to discuss the performance of the company both from the point of view of interest of shareholders and efficiency. This Committee also discussed in detail quarterly performances taking care for proper disclosures and transparency. The annual report included a report on a corporate Governance, Corporate Social responsibility and Management discussions on future plans.

Shareholders Grievance Committee:

The interests of the shareholders regarding dividend payments, changes of addresses, any grievance against the company were discussed and disposed of every quarter and the status is indicated in the quarterly report.

Remuneration Committee:

Remuneration of whole time Managing Directors was recommended after application of mind as well as the relevant sections of the companies Act approval in the General Meetings of the Share holders.

Share transfer Committee :

With dematerialization, transfer of shares have become more transparent. However, the Committee looks into the aspects of insider trading and any possibilities and malpractices.

Answer to Question No. 8(b)

Evaluating the going concern uncertainties

In order to evaluate various going concern uncertainties an Auditor needs to follow certain procedures which may include

1) Analyze and discuss cash flow, profit and other relevant forecasts with management
2) Review events occurring after the balance sheet date for items affecting the entity's ability to continue as a going concern
3) Analyze and discuss the entity's latest available interim financial statements
4) Review the terms of debentures and loan agreements and determine whether any have been breached
5) Read minutes of the meeting of shareholders, the board of directors and important committees for reference to financing difficulties.
6) Review the status of matters under litigation and claims
7) Confirm the existence legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assess the financial ability of such parties to provide additional funds.
8) Considering the entity's position concerning unfilled orders.

Answer to Question No. 8(c)

RECOMMENDATION: PERCENTAGE OF INDEPENDENT DIRECTORS.

No less than 50 percent of the board of director of any listed company, as well as unlisted public limited companies with a paid up share capital and free reserves of Rs. 10 crores and above, or turnover of 50 crores and above, should consist of independent directors — independence being defined in earlier recommendation.

However this will not apply to

(1) Unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, bank or financial institution, as long as they do not change their character.
(2) Unlisted subsidiaries of listed companies.

Nominee directors will be excluded both from the denominator.

FINAL EXAMINATION – GROUP-III (SYLLABUS - 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2010

PAPER – F-P12 : FINANCIAL MANAGEMENT AND INTERNATIONAL FINANCE

Suggested Solution

Part - A (Compulsory)

Q.1. (a) In each of the cases given below, one out of four answers is correct. Indicate the correct answer and give workings/reasons briefly in support of your answer :

(i) LEENZA LTD. currently pays a dividend of Rs. 4 per share that is expected to grow at a rate of 10% for the next year, after which it is expected to grow at a rate of 7% forever. What value would you place on the stock of this company if a 15% rate of return is required? (Round off your answer to the nearest integer). [Given PVIF (15% 1 year) = 0-8696.]

A. Rs. 53.05

B. Rs. 55.00

C. Rs. 58.10

D. None of the above

(ii) The Degree of Operating Leverage (DOL) and the Degree of Financial Leverage of ALANTA LTD. are 3 and 1.67 respectively. If the management of the company targets to increase the EPS by 10 per cent, by how much percentage should sales volume be increased? (Round off your answer to the nearest value).

A. 5.00%

B. 3.00%

C. 2.00%

D. Insufficient data

(iii) ANGEL LTD., an export customer who relied on the inter bank rate of Rs./$ 46.50/10 requested his banker to purchase a bill for USD 80,000. What is the rate to be quoted to ANGEL LTD., if the banker wants a margin of 0.08%?

A. Rs. 46.40

B. Rs. 46.46.

C. Rs. 46.60

D. None of the above

(iv) The total asset-turnover ratio and total asset to net-worth of ZENITH LTD. are 1.75 and 2 respectively. If the net profit margin of the company is 8 per cent, what will be its Return on Equity (ROE)?

A. 28.0%

B. 25.5%

C. 20.0%

D. Insufficient information

(v) The current price of a share of VETA LTD. is Rs. 120. The company is planning to go for rights issue. The subscription price for one rights share is proposed to be Rs. 104. If the company targets that ex-rights value of a share shall not fall below Rs. 116, the number of existing shares required for one rights share will be

A. 1

B. 2

C. 3

D. None of the above

(vi) Consider the following:
One year euro interest rate is 3% (compounded quarterly).
One year Rupee interest rate is 6% (compounded quarterly).
The forward six months exchange rate is Rs. 58-82/euro.
According to interest rate parity, the spot exchange rate is

A. Rs. 57.96

B. Rs. 58.10

C. Rs. 58.60

D. None of the above

(vii) The dividend payout ratio of ASKITA LTD. is 40%. If the company follows traditional approach to dividend policy with a multiplier of 9, the P/E of ASKITA LTD. will be

A. 4.4

B. 6.6

C. 7.1

D. 7.7

Answer 1.(a) :

i) B : Rs.55. The Present value of dividend stream to an investor is given as :

Rs. 4 (1.10) x 0.8696 = Rs. 3.826

D_2 = Rs.4 x 1.10 x 1.07 = Rs. 4.708

Price Share = $\frac{4.708}{0.15-0.07}$ x 0.8696 + Rs.3.826

= Rs.55.00

ii) C : 2.00%

DTL = DOL x DFL = 3 x 1.67 = 5.01

Therefore, as per the concept of DTL, in order to increase the EPS by 10% the sales volume will be increased by 10 ÷ 5.01 = 2%

iii) B : Rs.46.46.

Profit margin of 0.08% is to be deducted from the bid rate.

That is 46.50 x 0.0008 = Rs.0.04

Spot bid rate = 46.50 – 0.04 = Rs.46.46

iv) A : 28%

The Return on Equity (ROE) :

PAT / Sales x (SALES / TA x TA / Net work)

= 0.08 x 1.75 x 2.00 = 28% (0.28).

v) C : 3

Ex-rights price of a share = $\frac{nPo + s}{n + 1}$

on substituting the value,

$116 = \frac{120n + 104}{n+1}$ or, 116n + 116 = 120n + 104

or, $n = \frac{12}{4} = 3$

vi) A : Rs.57.96

$(1 + \frac{0.06}{4})^2 = \frac{1}{S}(1 + \frac{0.03}{4})^2 \times 58.82$

or, $1.0302 = \frac{1}{S}(59.7056)$

∴ S = Rs.57.96 Thus, Spot exchange rate = Rs.57.96

vii) B : 6.6 :

According to traditional Approach

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

Substituting the value, we get.

$$P = 9\left(0.40E + \frac{E}{3}\right) = E\,(3.6 + 3) = 6.6E$$

P/E = 6.6

Q.1.(b) Choose the most appropriate one from the stated options and write it down [only indicate A, B, C, D as you think correct]:

(i) Short-term portfolio investments are recorded in which head of Balance of Payment (BOP) account?

A. Investment Income

B. Current Accounts

C. Capital Account

D. Reserves

(ii) If the acceptance of one project is dependent on the acceptance of the other project, then they are said to be

A. Complementary

B. Mutual exclusive

C. Contingent

D. Economically dependent

(iii) The internal rate of return can be said to be based on the assumption that the intermediate cash flows are

A. Perfectly certain

B. Highly variable

C. Re-invested at a rate equal to the internal rate of return of the firm.

D. Re-invested at the cost of capital of the firm

(iv) Which of the following institutions has international monetary co-operation as its primary concern ?

A. World Bank

B. Bank for international settlement

C. IMF

D. IDA

(v) Cash transaction means settlement on

A. T+0

B. T+1

C. T+2

D. T+3

(vi) Which of the following statements about Venture Capital is correct?

A. It will not be appropriate to finance a management buy out.

B. It will provide both loan and equity finance to a company.

C. It will provide secured medium term-loan.

D. It will be available to companies listed in stock exchange.

Answer 1.(b) :

i) C

ii) D

iii) C

iv) C.

v) A

vi) B.

Q.1(c) Mention whether the following statements are True (T) or False (F):

(i) CVP analysis assumes a linear revenue function and a linear cost function.

(ii) The key issue of the theory of capital structure is to examine whether a business can change its value and cost of capital by changing its capital structure.

(iii) In case of projects which are divisible, capital rationing is done by ranking the projects on the basis of Net Present Value (NPV).

(iv) Leading and netting are internal hedging techniques whereas swap is an external technique for hedging.

(v) If a forward currency is FLAT, it means that the expected spot rate is equal to the forward rate

Answer 1(c) :

i) True

ii) True

iii) False

iv) True

v) False.

PART - B

Q.2. (a) Explain the relevancy of EBIT-EPS analysis in capital structure decisions of management.

Answer 2(a) :

EBIT - EPS Analysis :

This is an important tool to analyze the impact of alternative methods of financing on the Earnings Per Share (EPS) of the firm. This tool captures the sensitivity of the EPS to any changes in the Earnings Before Interest and Tax (EBIT). It gives an insight into the risk-return trade-off that governs valuation.

The relation between EBIT and EPS is as follows :

$$EPS = \frac{(EBIT - I)(1 - t)}{n}$$

Where,

I is the annual interest payment

t is the tax rate of the firm

n is the number of shares.

The EBIT Indifference Point is the level at which the EPS of the firm is same for two different capital structures. The EBIT - EPS indifference point can be mathematically represented as follows :

$$\frac{(EBIT - I_1)(1 - T)}{n_1} = \frac{(EBIT - I_2)(1 - t)}{n_2}$$

The EBIT-EPS analysis helps in understanding the impact on the earnings per share under alternative methods of financing. In case of the indifference point being lower than the expectred level of EBIT, the use of debt financing is supported. The case for equity financing is stronger, if the indifference point being highrer than the expected level of EBIT.

Q.2.(b) The following particulars pertain to PREETI LTD.:

Income Statement for the year ended 31st March, 2010

(Amount in Rs. thousand)

Sales Revenue		3,200
Less: Cost of Goods sold		2,000
		1,200
Add: Government Compensation for loss in riots		50
		1,250
Less:		
Operating Expenses	790	
Interest on Debentures	15	

Depreciation on Fixed Assets	210	
Cost of issue of Debentures written off	1	1,016
Profit before Tax		234
Less: Tax Provision		92
Profit after Tax		142

	As on 31st March, 2009	As on 31st March, 2010
	(Amount in Rs. thousand)	
Inventories	180	220
Debtors	40	38
Bills receivable	30	55
Cash in hand and at Bank	102	248
Creditors	78	95
Bills payable	20	15
Outstanding expenses	31	44

You are also informed that the following important transactions have taken place during the year ended 31st March, 2010:

(i) Fully paid equity shares of the face value of Rs. 2,00,000 were allotted at a premium of 20%.

(ii) 10% Debentures for Rs. 3,00,000 were redeemed at a premium of 2%.

(iii) Land was purchased for Rs. 1,50,000 and the consideration was discharged by the allotment to the vendor of zero per cent convertible Debentures for the amount.

(iv) Tax paid during the year totalled Rs. 95,000.

(v) Dividend for the year ended 3 1 st March, 2009 amounting to Rs. 1,00,000 was paid.

Required :

Prepare CASH FLOW statement for the year ended 31lst March, 2010, using Indirect Method.

Answer 2.(b) :

PREETI LTD.

CASH FLOW STATEMENT FOR THE YEAR ENDED MARCH 31, 2010

(INDIRECT METHOD)

(Amount in Rs.THOUSAND)

(A) CASH FLOWS from Operting Activities :		
Net profit before tax and extra ordinary item : (234 – 50)	184	
Adjustments for :		
Interest on Debentures :	15	
Depreciatrion on fixed Assets :	210	
Cost of issue of Debentures amortized :	1	
Operating Profit before working Capital changes :	410	
Adjustments for :		
Increase in Inventories :	(40)	
Decrease in Debtors :	2	
Increase in Bills Receivables	(25)	
Increase in Creditors :	17	
Decrease in bills payable :	(5)	
Increase in Outstanding expenses :	13	
CASH GENERATED FROM Operation :	372	
Income Tax Paid :	(95)	
	277	
Cash flow from extraordinary item :		
Government Compensation for loss in riot :	50	
NET CASH from Operating Activities :		327
B. CASH FLOWS from Investing Activities :		NIL
C. CASH FLOWS FROM Financing Activities :		
Issue of Equity Share Capital at a premium :	240	
Redemption of 10% debentures at a Premium	(306)	
Debenture - Interest paid :	(15)	

Dividend Paid :	(100)	
NET CASH Used in Financing Activities :		(181)
Net increase in Cash and Cash Equivalents :		146
CASH and CASH Equivalents in the beginning :		102
CASH AND CASH Equivalents at the end (31.03.2010) :		248

SIGNIFICANT NON-CASH TRANSACTION :

Land was purchased by issuing at par, ZERO percent Convertible Debentures of Rs.1,50,000.

Q. 3. AMTEK LTD. which specializes in manufacturing garments is planning for expansion to handle a new contract which it expects to obtain.

An investment bank have approached the company and asked whether the company had considered Venture Capital financing.

In 2006, the company borrowed Rs. 150 lakh on which interest is paid at 10%p.a.

The company shares are unquoted and it has decided to take your ADVICE in regard to the CALCULATION OF VALUE of the COMPANY that could be used in negotiations, using the following available Information and Forecast.

Company's Forecast Turnover for the year ending 31st March, 2010 is Rs. 3,000 lakh which is mainly dependent on the ability of the company to obtain the new contract, the chances for which is 60%.

Turnover for the following year is dependent to some extent on the outcome of the year ending 31st March, 2010:

Following are the estimated turnovers and probabilities:

Year 2010	
Turnover (Rs. in lakh)	Probability (Rs. in lakh)
3,000	0.60
2,250	0.30
1,800	0.10

Year 2011	
Turnover (Rs. in lakh)	Probability (Rs. in lakh)
3,750	0.70
4,500	0.30
3,000	0.50
2,700	0.50
2,250	0.60
1,800	0.40

Operating costs, inclusive of depreciation, are expected to be 40% and 35% of turnover respectively, for the years ending 31st March, 20 10 and 2011.

Corporate tax is to be paid at 30%.

It is assumed that profits after interest and Taxes are FREE CASH FLOWS.

Growth in earnings is expected to be 40% for the years ending 31st March, 2012, 2013 and 2014 which will fall to 10% each year after that.

Industry Average Cost of equity (net of tax) is 15%.

Note: Extracted from the table of PV.

PVIF at 15% for 0 to 5 years: 1.000, 0.870, 0.756, 0.658, 0.572, 0.497.

Answer 3 :

AMTEX LTD.

ESTIMATION OF EARNINGS FOR THE YEAR ENDED

MARCH 31, 2010 & 2011

Year 2010 (Rs. in Lakh)

Probability	Turnover	Expected Turnover
0.60	3000	1800
0.30	2250	675
0.10	1800	180
Total		**2655**

Year 2011 (Rs. in Lakh)

Probability (Jointly)	Turnover	Expected Turnover
0.6x0.7=0.42	3750	1575
0.6x0.3=0.18	4500	810
0.3x0.5=0.15	3000	450
0.3x0.5=0.15	2700	405
0.1x0.6=0.06	2250	135
0.1x0.4=0.04	1800	72
Total		**3447**

(Rs. in Lakh)

	2010	2011
Sales	2655.0	3447.0
Operating Cost (40%/35%)	(1062.0)	(1206.4)
Interest (150x0.10)	(15.0)	(15.0)
Profit after Interest	1578.0	2225.6
Tax (30%)	(473.4)	(667.9)
Earnings / CASH Flows :	1104.6	1557.9

Estimated CASH FLOWS (Assuming FCF) for the year ending

March 31, 2012, 2013 & 2014

(Rs. in Lakh)

2012	:	1557.9	x	1.40	=	2181.10
2013	:	2181.1	x	1.40	=	3053.5
2014	:	3053.5	x	1.40	=	4274.9

DISCOUNTED CASH FLOWS (Assuming FCF) for the year 2010 – 2014

Year Ending March 31	Cash Flows (Assuming FCF) (Rs. in Lakh)	DCF at 15%	Present Value (PV) (Rs. in Lakh)
2010	1104.60	0.870	961.00
2011	1557.90	0.756	1177.77
2012	2181.10	0.658	1435.16
2013	3053.50	0.572	1746.60
2014	4274.90	0.497	2124.63
		Total :	7445.16

ESTIMATES OF VALUE OF CASH FLOWS FROM YEAR ENDING

MARCH 31, TO INFINITY

(Rs. in Lakh)

Earnings in 2015	=	4274.90 x 1.10	=	4702.39
In To-day's Money	=	4702.39 x 0.497	=	2337.09
$P_0 = D_1 / (Ke - g)$	=	2337.09 / (0.15–0.10)	=	Rs.46741.76 Lakh.

Present Value of All Future Estimated Cash Flows :

(Rs. in Lakh)

Year Ending March 31	
2010 to 2014 :	7445.16
2014 Onwards :	46741.76
	54186.92

Therefore the Value of Ametk Ltd. is Rs.54186.92 Lakh.

Q.4. (a) A company is currently facing working capital crunch. You are required to discuss the various areas that you would like to took into and suggest the ways by which the company can overcome the problem.

Answer 4.(a) :

The following aspects are to be considered to over come the problem (facing working Capital Crunch).

i) Proper estimate of working capital requirement.

ii) Preparation of cash flow statement and Cash Budgets on a monthly basis.

iii) Introduction of a proper and scientific Inventory and stock management system.

iv) Introduction and monitoring of a proper credit management policy.

v) Analysis of fund flow, analysis of WIP.

vi) All the above steps should be taken on a collective manner.

(b) ATUL COMPANY LTD. earned an EBIT of Rs. 3 crore for the year just ended. The company has 10 lakh equity shares outstanding with a face value of Rs. 10 each and an outstanding debt of Rs. 2 crore, which carries interest at 12%. The company also has. free reserves to the extent of Rs. 5 crore, which can be capitalized. The company is planning a bonus issue to utilize the entire free reserves and later a stock split to make the face value of the shares Rs. 2.

After the bonus issue and stock split are complete, the company plans to raise funds to the extent of Rs. 5 crore to finance additional investments. The required funds may be raised either as debt at an interest of 14% or equity, which can be issued at the par value of Rs. 2. The company expects the standard deviation of total EBIT after the investments are made is Rs. 1.8 crore. Assume the income tax rate of the company is 30%.

You are required to calculate the minimum level of EBIT at which the debt issue is better than the equity from the point of view of EPS by at least 95%.

Answer 4.(b) :

Number of share after bonus issue = [10 + (500/10)] = 60 lakh

Number of shares after stock split = 60 x 5 = 300 lakh

The expresion for EPS, if funds are raised through equity is as follows :

= {(Total EBIT – Interest on existing debt) (1 - tax rate)} / Total number of shares

= {(total EBIT x 24) (1-0.30)] /300 + 500/2)]

= (total EBIT x 0.70 – 16.80) / 550

The expression for EPS will be as follows, if funds are raised through debt :

(Total EBIT – 24 – 70) [(1-0.30)/300)]

= {Total EBIT x 0.70 – 65.80}/300

The EBIT – EPS indifference point can be calculated by equating the two :

∴ {(Total EBIT 0.70 - 16.80) / 550} = {(Total EBIT x 0.70 – 65.80)/300}

or, 210 x Total EBIT – 5040 = 385 x Total EBIT - 36190

or, (385 - 210) Total EBIT = 36190 – 5040

Total EBIT = Rs. 178 lakh.

The minimum level of EBIT that is expected (given indifference EBIT) at which debt is better than equity by 95% can be found as follows :

$$\frac{X - \mu}{b} = Z$$

$$\frac{\text{EBIT} - \text{EBIT (expected)}}{b\ \text{EBIT}} = Z$$

{[1.78 – EBIT (expected)]/ 1.8} = –1.65

(Z value found out from the normal distribution table)

EBIT (expected) = 2.97 + 1.78 = Rs.4.75 Cr.

Q. 5. (a) What are needs for a range of various performance measures in an organization ? What are the various categories of performance indicators?

Answer 5.(a) :

The needs for a range of performances measures are as under :

a) to know current status, degree of achievement and how far to go to achieve the ultimate goal

b) for strategic allignments to communicate and reinforce messages to employees on company focus, direction and targets

c) for strategic learning to know what works and what does not.

As to the selection of a range of performance measures which are appropriate to a particular company, this selection will have to be made taking into account company's strategic intentions.

Performance indicators can be catgegorised as under competitive advantage

financial performance

quality of service

flexibility

resource utilisation

innovation.

Q. 5.(b) The Manager (Accounts) of MULTSOFT LTD. has studied his varying monthly Cash Flows and has arrived at the probabilities of Cash Inflows and outgo as detailed below:

Cash Inflow (Rs.)	Probabilities	Cash Outgo (Rs.)	Probabilities
1,40,000	0.35	1,10,000	0.15
1,50,000	0.20	1,20,000	0.25
1,60,000	0.15	1,30,000	0.30
1,70,000	0.14	1,40,000	0.15
1,80,000	0.11	1,50,000	0.11
1,90,000	0.05	1,70,000	0.04

The Manager (Accounts) at the beginning (April) of the year has Rs. 20,000 in Bank. The Manager (Accounts) can avail of temporary overdraft facilities to cover any cash shortage.

Required:

(i) Simulate the process to compute sales (cash inflow) and expenses (cash outgo) of the company over a financial year (April to March) using the following two series of random numbers:

Series 1: 34, 84, 38, 82, 36, 92, 73, 91, 63, 29, 27, 26

Series 2: 96, 57, 99, 84, 51, 29, 41, 11, 66, 30, 41, 80

(ii) How much money does the Manager (Accounts) has at the end (March) of the year ?

Answer 5.(b) :

MULTISOFT LTD.

(i) & (ii) First of all, Random number 00 - 99 are allocated in proportion to the probabilities associated with Cash Inflows and CashOutgo as given under :

Cash Inflows (Rs.)	Probabilities	Cumulative Probabilities	Random numbers assigned
140000	0.35	0.35	00 - 34
150000	0.20	0.55	35 - 54
160000	0.15	0.70	55 - 69
170000	0.14	0.84	70 - 83
180000	0.11	0.95	84 - 94
190000	0.05	1.00	95 - 99

Cash Outgo (Rs.)	Probabilities	Cumulative Probabilities	Random numbers assigned
110000	0.15	0.15	00 - 14
120000	0.25	0.40	15 - 39
130000	0.30	0.70	40 - 69
140000	0.15	0.85	70 - 84
150000	0.11	0.96	85 - 95
170000	0.04	1.00	96 - 99

Now using the Random Numbers of Series 1 for CASH INFLOWS and Series - 2 for CASH OUTGO, let us simulate the Sales (CASH INFLOWS) and expenses (CASH OUTGO) as under :

Month	Random Numbers	Cash Inflow (Rs.)	Random Number	Cash Outgo (Rs.)	Net Inflow (Rs.)	Opening Balance (Rs.)	Closing Balance (Rs.)
April	34	140000	96	170000	(30000)	20000	(10000) (overdraft)
May	84	180000	57	130000	50000	(10000)	40000
June	38	150000	99	170000	(20000)	40000	20000
July	82	170000	84	140000	30000	20000	50000

Month	Random Numbers	Cash Inflow (Rs.)	Random Number	Cash Outgo (Rs.)	Net Inflow (Rs.)	Opening Balance (Rs.)	Closing Balance (Rs.)
August	36	150000	51	130000	20000	50000	70000
Sept.	92	180000	29	120000	60000	70000	130000
October	73	170000	41	130000	40000	130000	170000
Novem	91	180000	11	110000	70000	170000	240000
Decem.	63	160000	66	130000	30000	240000	270000
January	29	140000	30	120000	20000	270000	290000
February	27	140000	41	130000	10000	290000	300000
March	26	140000	80	140000	0	300000	300000

ii) The MANAGER (Accounts) has got Rs.300000 at the end (MARCH) of year as stated on the table.

Question :

6. (a) Explain briefly the factors that attract the flow of Foreign Direct Investments (FDI) in India.

Answer 6.(a) :

The factors that attract the Flow of Foreign Direct Investments in India are enumerated below :

1) India has a well developed network of banking and financial institutions and an organized capital market open to foreign institutional investors that attracts them to undertake investments.
2) India has vast potential of young entrepreneurs in the private sector. In India skills and competence is used as a base for carrying out production activities and export to neighbour countries.
3) For the last few years there has been political stability in the country.
4) India enjoys good reputation among other countries as to honouring of its commitments about repayment obligations, remittance of dividends etc.
5) India has vast potential of unskilled labour available at cheap rates as compared to other countries and vast natural resources that attract foreign Investors.

Q.6.(b) VEDIKA TRADERS LTD. exports edible oils to Middle-East and African countries. In June the company exported an consignment worth $ 5 million to Zambia. The payment for the same is expected to realize during the month of September. The company has entered into a option forward contract for delivery of $ 5 million over the month of September.

The market quotes on June 30 at the time of entering into the contract were as follows:

June 30, Spot	Rs./$	47.05/08
Forward	1 month	23/25 paise
	2 month	47/49 paise
	3 month	70/72 paise

On September '01, the company approached the bank for extension of the contract by another two months, that is for delivery during the month of November.

The market quotes on September '01 were as follows :

Spot	Rs./$	47.58/60
Forward	1 month	18/20 paise
	2 month	37/39 paise
	3 month	55/57 paise

On November '0 1, the company approached the bank to cancel the forward contract. The exchange rates as on November '01, were as follows:

Spot	Rs./$	47.97/99
Forward	1 month	16/18 paise
	2 month	33/35 paise

You are required to calculate:

(i) The forward rate to be quoted on June 30.

(iii) The exchange rate to be quoted by the bank on September '01 for the extension of the contract.

(iii) The amount of cash flows due to extension of the contract.

(iv) The exchange rate at which the forward contract to be cancelled on November '01.

(v) The amount of cash flows due to cancellation of the contract.
(Ignore FEDAI margin for merchant quotes.)

Answer 6.(b) :

VEDIKA LTD. (V.T. LTD.)

i) The company obtained a forward cover for its receivable of US $5 Million on June 30, for delivery in September.

The Forward rate to be quoted is :	Rs. 47.05
Add : 2 months premium since	Rs. 0.47
The Dollar is at premium	Rs. 47.52

ii) The exchange rate to be quoted on September for delivery November is Rs. (47.58 + 0.37) : Rs. 47.95.

iii) On September 01, the Company approach for extension by 3 month. The request of the company is considered by canceling at one month forward selling rate, that is Rs.47.80 (47.60 + .20).

The amount of Cash Flow due to extension of the Contract is as follows :

Bank buys Dollars under original contract at :	Rs. 47.52
Bank sells under cancellation at :	Rs. 47.80
Difference payable by the Party is per $	Rs. 0.28

Amount of CASH FLOW due to extension of the contract is :

Rs. 0.28 x 5000000 = Rs. 14.00 lakh.

i) The Company approached for cancellation on November '01 which means only cancellation by one month. The contract would be cancelled at one month forward selling rate prevailing on the date of cancellation.

That is Rs.47.99 + Premium Rs.0.18 = Rs.48.17

ii) The amount of CASH FLOW due to cancellation of Forward Contract is as follows :

Bank buys under original contract at	Rs. 47.95
Bank Sells on cancellation :	Rs. 48.17
Amount payable by the company is per $	Rs. 0.22

Total cash flow due to cancellation is Rs. 11.00 lakh.
(5000000 x 0.22)

Question :

7. (a) Venture Capital is considered to be a high risk capital. Do you agree? Enumerate the main features of Venture Capital.

Answer 7.(a) :

Venture capital is a significant innovation. It is generally considered as a synonym of "high risk capital". It is often thought of as "the early stage financing of new and young enterprises seeking to grow rapidly".

Venture capital financing is generally the first capital to be invested by sources outside the firm and the last to exit. In the parlance of the market, it is the front money or funds that are normally subordinated to all other financial commitments of the enterprise. Aside from common stock financing, the common forms of alternative equity investments issued in venture capital investments are convertible debentures, warrants and letter stock options.

The Main features of Venture Capital are enumerated below :

- The Venture Capitalist is included to assume a high degree of risk in the expectation of earning a high rate of return.
- Venture Capital is basically equity finance in relatively new Companies when it is to early to go to the Capital market to raise fund.

- It is a long term investment in growth-oriented small/medium firms.
- There is a substantial degree of active involvement of the venture Capital Institutions with the promoters of the venture Capital undertakings.
- Venture Capital financing involves high risk-return spectrum.
- Venture Capital is not technology finance though technology finance may form a sub-set of venture capital financing.
- Providing Capital to person having managerial skills.
- Expecting a high return in the form of capital gain.

Q.7 (b) ANKRIT LTD. is considering two mutually exclusive project M and project N.

The Finance Director thinks that the project with the higher NPV should be chosen whereas the Managing Director thinks that the one with the higher IRR should be undertaken especially as both projects have the same initial outlay and length of life. The company anticipates a cost of capital of 10% and the net after-tax cash flows of the projects are as follows:

Year	0	1	2	3	4	5
Cash Flows:						
Project M	(200000)	35000	80000	90000	75000	20000
Project N	(200000)	218000	10000	10000	4000	3000

Required:

(1) Calculate the NPV and IRR of each project.

(2) State with reasons, which project you would recommend.

(3) Explain the inconsistency in the ranking of the two projects.

Present Value Table is given :

Year	0	1	2	3	4	5
PVIF at 10%	1.000	0.909	0.826	0.751	0.683	0.621
PVIF at 20%	1.00	0.833	0.694	0.579	0.482	0.402

Answer 7.(b) :

ANKRIT LTD.

i) CALCULATION OF THE NPV AND IRR OF PROJECT-M PROJECT-N

NPV OF PROJECT-M.

Year	Cash Flows (Rs.)	Discounted Factor @ 10%	Discounted Values (Rs.)	Discounted Factor @ 20%	Discounted Values (Rs.)
0	(200000)	1.000	(200000)	1.000	(200000)
1	35000	0.909	31815	0.833	29155
2	80000	0.826	66080	0.694	55520
3	90000	0.751	67590	0.579	52110
4	75000	0.683	51225	0.482	36150
5	20000	0.621	12420	0.402	8040
	NPV		29130		(19025)

IRR OF PROJECT - M :

At 20% NPV is (–) 19025 and at 10% NPV is 29130

$$IRR = 10 + \frac{29130}{29130+19025} \times 10 = 10 + \frac{29130}{48155} \times 10$$

$$= 16.05\%$$

NPV OF PROJECT - N

Year	Cash Flows (Rs.)	Discounted Factor @ 10%	Discounted Values (Rs.)	Discounted Factor @ 20%	Discounted Values (Rs.)
0	(200000)	1.000	(200000)	1.000	(200000)
1	218000	0.909	198162	0.833	181594
2	10000	0.826	8260	0.694	6940
3	10000	0.751	7510	0.579	5790
4	4000	0.683	2732	0.482	1928
5	3000	0.621	1863	0.402	1206
	NPV		18527		(2542)

IRR OF PROJECT – N

At 20% NPV is (–) 2542

At 10% NPV is 18527

$$IRR = 10 + \frac{18527}{18527 + 2542} \times 10 = 10 + \frac{18527}{21069} \times 10$$

$$= 18.79\%$$

ii) Both the projects are acceptable because they generate Positive NPV at the company's cost of capital at 10%. However, the Company will have to select project – M because it has a higher NPV. If the company follows IRR method, then Project – N should be selected because of higher internal rate of Return (IRR). But when NPV and IRR give contradictory results, a poroject with higher NPV is generally preferred because of higher return in absolute terms. Hence PROJECT – M should be selected.

iii) The inconsistency in the ranking of the projects arises because of the difference in the pattern of CASH FLOWS. Project – M's major cash flows occur mainly in the middle three years whereas Project – N generates the major CASH FLOWS in the first itself.

Q.8. Write short notes on any three out of the following :

(a) Bill of Lading;
(b) Stack hedging and Strip hedging;
(c) Commercial paper as a source of Financing;
(d) Limitation of Financial Planning.

Answer 8. :

a) BILL OF LADING :

The Bill of Lading is an important document issued by a common carrier, namely, the shipping company or Airways, stating that the goods mentioned therein have been received for shipment or airlift and that it has undertaken to deliver the goods at a named destination on payment of freight or for which freight has already been paid (c.i.f. or c.f.). The Bill of Lading is a document of title to goods, transferable by endorsement and is a receipt from the shipping company regarding the number of packages with a particular weight and markings and a contract for the transportation of the same to a part of destination mentioned therein. The shipping company is governed by the carriage of goods by the Sea Act which provides protection to shippers and obligations on the shipping companies.

A Bill of Lading stating "Received for Shipment" is not adequate if the sales terms are "on board". The bill should specify that goods have been "on board" or "shipped" to satisfy the terms of c.i., or c.i.f.

Bills of Lading are the following types :

a) Freight paid or freight payable. In the case of c.i.f. or c.f., the freight should be paid by the shipper and in case of f.o.b., it may be payable by the consignee or importer or his agent. The bill of lading "Freight collect" is, therefore, not proper tender for c.i.f. terms of sale;

b) Clean or claused bill. In the case of any adverse remarks such as "damaged bags" or "bill torn" or "Drums dirty or old", such bill are called "claused" or dirty bills as against clean bills which do not mention anything adverse on the condition of packages.

c) Stale bill of lading. If the bills are kept for too long with the shipper and by that time goods might have reached the destination port, the importer has to pay demurrages for non-acceptance of the goods which is due to delay in the receipt of shipping documents. Such delayed bills of lading are called "Stale Bills".

(b) STACK HEDGING AND STRIP HEDGING :

For longer – term hedging programmes like two year loan with provision for three monthly rollover – complicated strategies like 'stack – hedging' and 'strip hedging' can be employed.

In a stack hedge the total number of contract needed to hedge the loan are purchased for the month of the first roll over date. At that date, the remaining number of contracts necessary are purchased for the next roll over date. The process will continue.

In the case of a strip hedge each three month segments of the loan are considered as separate entities. Future contracts are purchased for each rollover date at the very outset of the loan.

(c) COMMERCIAL PAPER AS A SOURCE OF FINANCE :

Commercial paper (CP) is an unsecured promissory note issued by a firm to raise funds for a short period, generally, varying from a few days to a few months.

- CP is sold on an unsecured basis and does not contain any restrictive conditions :
- Maturing CP can be repaid by selling new CP and thus can provide a continuous source of funds.
- Maturity of CP can be tailored to suit the requirement of the issuing firm.
- CP can be issued as a source of fund even when money market is tight.
- Generally, the cost of CP to the issuing firm is lower than the cost of commercial bank loans.

CP is advantageous both to the issuer as well as to the investor. The issuer can raise short-term funds at lower costs and the investor as a short term outlet of funds. CP provides liquidity as they can be transferred.

(d) LIMITATION OF FINANCIAL PLANNING :

Plans are decisions and decisions require facts, but facts about the future are non-existent, consequently assumptions concerning the future must be substituted.

- Since, future conditions can not be forecasted accurately, the adaptability of plan is seriously limited. This is true for plans which cover several years in advance, since reliability of forecasting decreases with time.
- The difficulty in planning is the reluctance or inability of the management to change a plan once it has been made.

There are several reasons for this :

- Plans relating to capital expenditure often involve colossal expenditure and commitments for funds are made months in advance and such plans can not be readily changed.
- Management personnel are psychologically against change, which creates rigidity.
  - Financial Planning is limited when there is lack of co-ordination among the personal.