Model Test Paper- Strategic Financial Management

Question No. 1 is compulsory. Attempt any five questions from the remaining six questions.

Working notes should form part of the answer.

Question 1

(a) A share of XYZ Ltd. is currently quoted at, a price earnings ratio of 7.5 times. The retained earnings per share being 37.5% is Rs. 3 per share. Compute:

(i) The company's cost of equity, if investors expect annual growth rate of 12%.

(ii) If anticipated growth rate is 13% p.a., calculate the indicated market price, with same cost of capital.

(iii) If the company's cost of capital is 18% and anticipated growth rate is 15% p.a., calculate the market price per share, assuming other conditions remain the same. (5 Marks)

(b) 3i Imports co., purchased USD 100,000 worth of machines from a firm in New York, USA. The value of the rupee in terms of the Dollar has been decreasing. The firm in New York offers 2/10, net 90 terms. The spot rate for the USD is Rs. 55; the 90 days forward rate is Rs. 56.

i. Compute the Rupee cost of paying the account within the 10 days.

ii. Compute the Rupee cost of buying a forward contract to liquidate the account in 10 days.

iii. The differential between part a and part b is the result of the time value of money (the discount for prepayment) and protection from currency value fluctuation. Determine the magnitude of each of these components. (5 Marks)

(c) ABC Ltd. is a toy manufacturer. The analyst's forecast of free cash flow is as follows:

(Rs in crores)

	Years							
	2008	2009	2010	2011	2012	2013	2014	2015
Sales	178.13	204.85	235.58	270.92	311.56	358.29	412.03	473.83
EBIT	16.33	17.25	17.19	19.58	22.17	24.95	27.89	30.95
NOPAT	10.61	11.21	11.17	12.73	14.41	16.22	18.13	20.12
+ Depreciation	3.14	2.13	2.68	2.82	2.96	3.11	3.26	3.42
Less :								
Capital exp.	0	0.63	2.36	1.79	1.88	1.97	2.07	2.17
Increase in working capital	0	6.44	4.12	6.10	9.45	11.67	12.97	14.32
Free cash flow	13.75	6.27	7.37	7.66	6.04	5.69	6.35	7.05

The cost of capital of the company is 15%. Assuming that the company will not make any operating improvements or change the capital structure and analyst expects a 10% forever after 2015, determine the Value of the company. (5 Marks)

(d) Compute the β Value and required returns for the following combination of investments.

Risk Free Investment (%)	100	70	30	0
Market Investment (%)	0	30	70	100

If Risk Free rate of return is 5% and Market Return is 13%. (5 Marks)

Question 2

(a) Mr. X approached Very Fair Finance, a leasing company, to acquire a machine whose Cash Down price is Rs. 3 crores. In order to leverage his tax position, Mr. X has requested quotation 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.

Assuming that depreciation is chargeable on a straight line basis and Very Fair Finance's marginal tax rate is 35% and target rate of return is 10%, calculate the lease rents to be quoted for the lease for three years. (8 Marks)

(b) ABC mutual fund raised Rs. 1.50 crore on 1 January 2013, by issue of 15 lakh units at Rs. 10 per unit. The fund invested in several capital market instruments to build a portfolio of Rs. 1.40 crore. Initial expense amounted to Rs. 8 lakhs. During the month of January, the fund sold certain securities costing Rs. 44.75 lakhs for Rs. 47 lakhs and purchased certain other securities for Rs. 41.6 lakhs. The fund management expenses for the month amounted to Rs. 6 lakhs of which Rs. 50,000 was in arrears. The dividend earned was Rs. 1.5 lakhs. 80% of the realized earnings were distributed. The market value of the portfolio on 31 January 2013 was Rs. 1.4785 crore.

An investor subscribed to 1 unit on 1 January 2013 and disposed it off at closing NAV on 31 January 2013. Determine his annual rate of earning. (8 Marks)

Question 3

(a) You as a dealer in foreign exchange have the following position in US$:

	US$
Balance in the Nostro A/c in Citi Bank NY (Overdraft)	10,000
Opening Position Overbought	2,500
Purchased a telegraphic transfer	25,000
Issued a DD on New York	10,000
Remitted by TT	12,500
Purchased Bill on New York	37,500
Forward Sale	37,500
Export Bill Realized	22,500

What steps would you take, if you are required to maintain a credit Balance of US$ 5,000 in Nostro A/c and square up the exchange position? (8 Marks)

(b) TMC Ltd. has a huge receivable and is considering engaging a factor, the following information is available:

(i) The current average collection period for the Company's debtors is 80 days and ½% of debtors default. The factor has agreed to pay money due after 60 days and will take the responsibility of any loss on account of bad debts.

(ii) The annual charge for the factoring is 2% of turnover payable annually in arrears. Administration cost saving is likely to be Rs.1,00,000 per annum.

(iii) Annual sales, all on credit, are Rs.1,00,00,000. Variable cost is 80% of sales price. The Company's cost of borrowing is 15% per annum. Assume the year is consisting of 365 days.

Should the Company enter into a factoring agreement? (8 Marks)

Question 4

(a) Nominal value of 10% bonds issued by a company is Rs.100. The bonds are redeemable at Rs.110 at the end of year 5.

Determine the value of the bond if required yield is (i) 5.1% and (ii) 10%. (6 Marks)

(b) The following data is related to 8.5% Fully Convertible (into Equity shares) Debentures issued by CJS Ltd. at Rs. 1000.

Market Price of Debenture	Rs. 900
Conversion Ratio	30
Straight Value of Debenture	Rs. 700
Market Price of Equity share on the date of Conversion	Rs. 25
Expected Dividend Per Share	Rs. 1

You are required to calculate:

(a) Conversion Value of Debenture

(b) Market Conversion Price

(c) Conversion Premium per share

(d) Ratio of Conversion Premium

(e) Premium over Straight Value of Debenture

(f) Favourable income differential per share

(g) Premium pay back period (10 Marks)

Question 5

(a) Suppose that there is a future contract on a share presently trading at Rs. 1000. The life of future contract is 90 days and during this time the company will pay dividends of Rs. 7.50 in 30 days, Rs. 8.50 in 60 days and Rs. 9.00 in 90 days.

Assuming that the Compounded Continuously Risk free Rate of Interest (CCRRI) is 12% p.a. you are required to find out:

(i) Fair Value of the contract if no arbitrage opportunity exists.

(ii) Value of Cost to Carry.

[Given $e^{-0.01} = 0.9905$, $e^{-0.02} = 0.9802$, $e^{-0.03} = 0.97045$ and $e^{0.03} = 1.03045$] (8 Marks)

(b) MT Fincorp has bought a 6X9 Rs. 10 crore Forward Rate Agreement (FRA) at 5.25%. On fixing date reference rate i.e. MIBOR turns out be as follows:

Period	Rate (%)
3 months	5.50
6 months	5.70
9 months	5.85

Assuming 360 days in a year you are required to determine:

(a) Profit/Loss to MT Fincorp. in terms of basis points.

(b) The settlement amount. (8 Marks)

Question 6

(a) BT Chemicals has received a notice from Pollution Control Board of their city to get installed wastage affluent plant to improve waste generation. The cost of installation of plant is \$5 million with a life span of 4 years. After 4 years the plant shall be disposed at 10% of its installation cost.

Due to installation of plant there will be an incremental cash flow, estimated at \$2 million p.a. for the four years.

The company has two options to acquire plant:

(a) Borrow funds at 10% (pre-tax) rate from a bank and acquire machine. The loan is repayable in 4 equal installments.

(b) Obtain a financial lease of \$2 million payable at the end of the year.

At present the company is ungeared with beta 3. If company takes the loan the D/E ratio of company would become 0.30. Company is in tax bracket of 40%. Depreciation is allowable @25% as per WDV method. Further risk free rate of return and market return are 6% and 8% respectively.

Ignoring the tax gain on the loss due to disposal of plant, you are required to calculate which option of acquiring the plant the company should go for. (8 Marks)

(b) The following information is available in respect of Security Y

Equilibrium Return	15%
Market Return	15%
7% Treasury Bond Trading at	€140
Covariance of Market Return and Security Return	225%
Coefficient of Correlation	0.75

You are required to determine the Standard Deviation of Market Return and Security Return. (8 Marks)

Question 7

Write a short note on any ***four*** of the following:

(a) Commercial Paper

(b) Foreign Currency Convertible Bonds

(c) Zero Coupon Bonds

(d) Takeover by reverse bid

(e) Zero date of a Project in project management (4 Marks X 4 = 16 Marks)

Student can solve the question paper at their own and send scanned copy at sfmclasses@gmail.com for evaluation purpose indicating their name, address, contact number and registration number.