

**MOCK TEST PAPER – 2**  
**FINAL COURSE: GROUP – I**  
**PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT**  
**SUGGESTED ANSWERS/HINTS**

1. (a) In order to hedge itself the company would go short on future at current future price of ₹ 18.50. Thus company shall be sure of realizing price of ₹ 18.50 in 6 months.

|                                                  |           |
|--------------------------------------------------|-----------|
| Quantity to wheat to be hedged                   | 440000 kg |
| Size of Future Contract                          | 2000 kg   |
| No. of Future Contracts to be sold (440000/2000) | 220       |
| Future Price                                     | ₹ 18.50   |
| Exposure in Future (₹ 18.50X220X2000)            | ₹ 8140000 |

6 months later company would cancel its future position by buying Future contract and sell goods in Spot Market

|                                 |             |
|---------------------------------|-------------|
| Buying price of Future Contract | ₹ 17.55     |
| Amount Bought (440000x ₹ 17.55) | ₹ 77,22,000 |
| Gain/ Loss on Future Contracts  | ₹ 4,18,000  |
| Spot Price                      | ₹ 17.50     |
| Actual Selling                  | ₹ 77,00,000 |
| Effective Selling Amount        | ₹ 81,18,000 |
| Effective Selling Price         | ₹ 18.45     |

- (b) Price of Share:

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

Where  $D_1$  = Expected Dividend

$K_e$  = Expected Return

$g$  = Growth Rate

The expected price before budget announcement.

$$= \frac{3(1.075)}{0.15 - 0.075} = \frac{3.225}{0.075} = ₹ 43$$

Expected Price after Budget announcement

$$= \frac{2.70(1.075)}{0.105 - 0.075} = \frac{2.9025}{0.03} = ₹ 96.75$$

- (c) (i) €1000000(\$1.6590) = \$1659000 or €1000000/0.6028 = \$1658925 (Difference is due to rounding off)
- (ii) €1000000/0.6075 = \$1646091 or €1000000(\$1.6460) = \$1646000
- (iii) If the exchange rate is €0.50/\$, when the payment is due in 3 months, the €1000000 will cost:

$$€1000000/0.50 = \$2000000$$

Which is more than the Spot Price today and more than the purchasing a forward contract for 90 days.

- (d) First we shall compute the  $\beta$  of Security X.

$$\text{Risk Free Rate} = \frac{\text{Coupon Payment}}{\text{Current Market Price}} = \frac{6}{120} = 5\%$$

Assuming equilibrium return to equal to CAPM Return

$$20\% = R_f + \beta_A(R_m - R_f)$$

$$20\% = 5\% + \beta_A(15\% - 5\%)$$

$$\beta_A = 1.50$$

- (i) Computation of SD of Market Return

$$\beta_A = \frac{\text{Cov}_{A,m}}{\sigma_m^2} = 1.50$$

$$= \frac{294\%}{\sigma_m^2} = 1.50$$

$$\sigma_m^2 = 196\% \text{ i.e. } \sigma_m = 14\%$$

- (ii) Computation of SD of Security Return

$$\beta_A = \frac{\sigma_A}{\sigma_m} \times \sigma_{Am} = 1.50$$

$$\frac{\sigma_A}{14} \times 0.75 = 1.50$$

$$\sigma_A = 28\%$$

2. (a) Working Notes:

(i) Calculation of Cost of Equity

*Ungeared*

$$k_e = R_f + \beta(R_M - R_f)$$

$$= 6\% + 3(8\% - 6\%)$$

$$= 6\% + 6\% = 12\%$$

*Gear*

$$\beta_L = \beta_U[1 + (1 - T)D/L]$$

$$= 3(1 + 0.60 \times 0.30) = 3(1.18) = 3.54$$

$$k_e = 6\% + 3.54(8\% - 6\%) = 13.08\% \text{ say } 13\%.$$

(ii) Calculation of Annual Installment and Schedule of Debt Repayment under Loan Option

The loan amount is repayable together with the interest at the rate of 10% on loan amount and is repayable in equal installments at the end of each year. The PVAF at the rate of 10% for 4 years is 3.170, the amount payable will be

$$\text{Annual Payment} = \frac{50,00,000}{3.170} = \text{€ } 1577287 \text{ (rounded)}$$

**Schedule of Debt Repayment**

| End of Year | Total Payment<br>€ | Interest<br>€ | Principal<br>€ | Principal Amount<br>Outstanding<br>€ |
|-------------|--------------------|---------------|----------------|--------------------------------------|
| 1           | 1577287            | 500000        | 1077287        | 3922713                              |
| 2           | 1577287            | 392271        | 1185016        | 2737697                              |
| 3           | 1577287            | 273770        | 1303517        | 1434180                              |
| 4           | 1577287            | 143107*       | 1434180        | -----                                |

\* Balancing Figure

Now evaluation shall be made in three stages:

(i) Whether project is worthwhile or not by computing NPV of the machine using 12% as discounting rate.

| Particulars    | Year | PVF@12% | Cash<br>Flow € | PV €      |
|----------------|------|---------|----------------|-----------|
| Initial Outlay | 0    | 1       | (5000000)      | (5000000) |

|                         |   |       |         |         |
|-------------------------|---|-------|---------|---------|
| Incremental Cash Inflow | 1 | 0.893 | 2000000 | 1786000 |
| Incremental Cash Inflow | 2 | 0.797 | 2000000 | 1594000 |
| Incremental Cash Inflow | 3 | 0.712 | 2000000 | 1424000 |
| Incremental Cash Inflow | 4 | 0.636 | 2000000 | 1272000 |
| Salvage Value           | 4 | 0.636 | 500000  | 318000  |
| Total                   |   |       |         | 1394000 |

Since NPV of plant is positive it should be installed.

- (ii) Should the plant be leased: The relevant discount rate shall be cost of equity (ungeared) i.e. 12%. According the PV of cash flow under lease option shall be as follows:

|            |                  |
|------------|------------------|
| Lease Rent | €2000000         |
| Tax Shield | <u>(€800000)</u> |
| Outflow    | <u>€1200000</u>  |
|            | × 3.038          |
|            | €3645600         |

- (iii) Loan Option: When company will go for loan option, company shall become geared one and hence geared cost of equity shall be used for discounting.

#### Schedule of Cash Outflows: Debt Alternative

(Amount in €)

| (1)                       | (2)          | (3)      | (4)     | (3) + (4) | (5)                      | (6)                     | (7)        | (8)                            |
|---------------------------|--------------|----------|---------|-----------|--------------------------|-------------------------|------------|--------------------------------|
| End of year               | Debt Payment | Interest | Dep     |           | Tax Shield [(3)+(4)]0.40 | Cash outflows (2) – (5) | PV F @ 13% | PV                             |
| 1                         | 1577287      | 500000   | 1250000 | 1750000   | 700000                   | 877287                  | 0.885      | 776398                         |
| 2                         | 1577287      | 392271   | 937500  | 1329771   | 531908                   | 1045379                 | 0.783      | 818532                         |
| 3                         | 1577287      | 273770   | 703125  | 976895    | 390758                   | 1186529                 | 0.693      | 822265                         |
| 4                         | 1577287      | 143107   | 527344  | 670451    | 268180                   | 1309107                 | 0.613      | 802483                         |
| Less: PV of Salvage Value |              |          |         |           |                          |                         |            | 3219678<br>(306500)<br>2913178 |

Total present value of Outflows = €2913178

Since PV of outflows is lower in the Borrowing option, BidTown should avail of the loan and purchase the equipment.

Note: In above solution the cash flows under loan option has been discounted at 13% (geared). Since the difference between ungeared cost of equity (12%) and 13% is not significance if students have used 12% rate for discounting cash under both options (Lease and Loan) full marks should be awarded to them.

(b) Return of the stock under APT

| <b>Factor</b>       | <b>Actual value in %</b> | <b>Expected value in %</b> | <b>Difference</b> | <b>Beta</b> | <b>Diff. x Beta</b> |
|---------------------|--------------------------|----------------------------|-------------------|-------------|---------------------|
| GNP                 | 7.70                     | 7.70                       | 0.00              | 1.20        | 0.00                |
| Inflation           | 7.00                     | 5.50                       | 1.50              | 1.75        | 2.63                |
| Interest rate       | 9.00                     | 7.75                       | 1.25              | 1.30        | 1.63                |
| Stock index         | 12.00                    | 10.00                      | 2.00              | 1.70        | 3.40                |
| Ind. Production     | 7.50                     | 7.00                       | 0.50              | 1.00        | <u>0.50</u>         |
|                     |                          |                            |                   |             | 8.16                |
| Risk free rate in % |                          |                            |                   |             | <u>9.25</u>         |
| Return under APT    |                          |                            |                   |             | <u>17.41</u>        |

3. (a) If foreign exchange risk is hedged

|                                       |               |              |             | <i>Total<br/>(₹)</i> |
|---------------------------------------|---------------|--------------|-------------|----------------------|
| Sum due                               | Yen 78,00,000 | US\$1,02,300 | Euro 95,920 |                      |
| Unit input price                      | Yen 650       | US\$10.23    | Euro 11.99  |                      |
| Unit sold                             | 12000         | 10000        | 8000        |                      |
| Variable cost per unit                | ₹225/-        | 395          | 510         |                      |
| Variable cost                         | ₹27,00,000    | ₹39,50,000   | ₹40,80,000  | ₹1,07,30,000         |
| Three months forward rate for selling | 2.427         | 0.0216       | 0.0178      |                      |
| Rupee value of receipts               | ₹32,13,844    | ₹47,36,111   | ₹53,88,764  | ₹1,33,38,719         |
| Contribution                          | ₹5,13,844     | ₹7,86,111    | ₹13,08,764  | ₹26,08,719           |
| Average contribution to sale ratio    |               |              |             | 19.56%               |
| <b>If risk is not hedged</b>          |               |              |             |                      |
| Rupee value of receipt                | ₹31,72,021    | ₹47,44,898   | ₹53,58,659  | ₹1,32,75,578         |
| Total contribution                    |               |              |             | ₹25,45,578           |
| Average contribution to sale ratio    |               |              |             | 19.17%               |

AKC Ltd. Is advised to hedge its foreign currency exchange risk.

**(b) Plan – D**

| Date       | Units held                | Dividend          |         | Reinvestment | New    | Total         |
|------------|---------------------------|-------------------|---------|--------------|--------|---------------|
|            |                           | %                 | Amount  | Rate         | Units  | Units         |
| 01.04.2005 |                           |                   |         |              |        | 5235.60       |
| 30.09.2005 | 5235.60                   | 10                | 5235.60 | 39.10        | 133.90 | 5369.50       |
| 31.03.2007 | 5369.50                   | 15                | 8054.25 | 44.20        | 182.22 | 5551.72       |
| 15.09.2008 | 5551.72                   | 13                | 7217.24 | 45.05        | 160.20 | 5711.92       |
| 27.03.2009 | 5711.92                   | 16                | 9139.07 | 44.80        | 204    | 5915.92       |
| 31.03.2010 | Maturity Value            | ₹ 40.40 X 5915.92 |         |              |        | ₹ 2,39,003.17 |
|            | Less: Cost of Acquisition |                   |         |              |        | ₹ 2,00,000.00 |
|            | Total Gain                |                   |         |              |        | ₹ 39,003.17   |

$$\text{Unit acquired} = \frac{2,00,000}{38.20} = 5235.60$$

$$\therefore \text{Effective Yield} = \frac{₹ 39,003.17}{₹ 2,00,000} \times \frac{1}{5} \times 100 = 3.90\%$$

Alternatively, it can be computed by using the IRR method as follows:

$$\text{NPV at 4\%} = -2,00,000 + 1,96,443 = -3,557$$

$$\text{NPV at 2\%} = -2,00,000 + 2,16,473 = 16,473$$

$$\text{IRR} = \text{LR} + \frac{\text{NPV at LR}}{\text{NPV at LR} - \text{NPV at HR}} (\text{HR} - \text{LR}) = 2\% + \frac{16473}{16473 - (-3557)} (4\% - 2\%) = 3.645\%$$

**Plan – B**

|          |                  |                    | No. of Units   | NAV (₹)            |
|----------|------------------|--------------------|----------------|--------------------|
| 1.4.05   | Investment       | ₹2,00,000/35.60=   | 5617.98        | 35.60              |
| 30.6.06  | Bonus            | 5617.98/5 =        | <u>1123.60</u> | 36.25              |
|          |                  |                    | 6741.58        |                    |
| 30.10.08 | "                | 6741.58/8 =        | <u>842.70</u>  | 38.30              |
|          |                  |                    | 7584.28        |                    |
| 11.4.09  | "                | 7584.28/10 =       | <u>758.43</u>  | 38.90              |
|          |                  |                    | 8342.71        |                    |
| 31.3.10  | Maturity Value   | 8342.71 x ₹ 39.70= |                | 3,31,205.59        |
|          | Less: Investment |                    |                | <u>2,00,000.00</u> |
|          | Gain             |                    |                | <u>1,31,205.59</u> |

$$\therefore \text{Effective Yield} = \frac{1,31,205.59}{2,00,000} \times \frac{1}{5} \times 100 = 13.12\%$$

Alternatively, it can be computed by using the IRR method as follows:

$$\text{NPV at 13\%} = -2,00,000 + 1,79,765 = -20,235$$

$$\text{NPV at 8\%} = -2,00,000 + 2,25,413 = 25,413$$

$$\begin{aligned} \text{IRR} &= \text{LR} + \frac{\text{NPV at LR}}{\text{NPV at LR} - \text{NPV at HR}} (\text{HR} - \text{LR}) = 8\% + \frac{25413}{25413 - (-20235)} (13\% - 8\%) \\ &= 10.78\% \end{aligned}$$

4. (a)

|                                  | 12 Months                                                        | 24 months                                                          |
|----------------------------------|------------------------------------------------------------------|--------------------------------------------------------------------|
| 1. Total Annual Charges for Loan | $38000 \times 12 - 40000 = 5600$                                 | $(2140 \times 24 - 40000)/2 = 5680$                                |
| 2. Flat Rate of interest         | $\frac{5600}{40000} \times 100 = 0.14$                           | $\frac{5680}{40000} \times 100 = 0.142$                            |
| 3. Effective Interest Rate       | $\frac{n}{n+1} \times 2F$<br>$= \frac{12}{13} \times 28 = 25.85$ | $\frac{n}{n+1} \times 2F$<br>$= \frac{24}{25} \times 28.4 = 27.26$ |

- (b) (i) In order to find risk of portfolio of two shares, the covariance between the two is necessary here.

| Probability | (ABC-ABC) | (XYZ-XYZ) | 2X3      | 1X4            |
|-------------|-----------|-----------|----------|----------------|
| (1)         | (2)       | (3)       | (4)      | (5)            |
| 0.20        | -0.55     | 3.9       | -2.145   | -0.429         |
| 0.25        | 1.45      | -2.1      | -3.045   | -0.761         |
| 0.25        | -19.55    | 15.9      | -310.845 | -77.71         |
| 0.30        | 15.45     | -14.1     | -217.845 | <u>-65.35</u>  |
|             |           |           |          | <u>-144.25</u> |

$$\sigma^2_P = (0.5^2 \times 167.75) + (0.5^2 \times 126.98) + 2 \times (-144.25) \times 0.5 \times 0.5$$

$$\sigma^2_P = 41.9375 + 31.745 - 72.125$$

$$\sigma^2_P = 1.5575 \text{ or } 1.56(\%)$$

$$\sigma_P = \sqrt{1.56} = 1.25\%$$

$$E(R_P) = (0.5 \times 12.55) + (0.5 \times 12.1) = 12.325\%$$

Hence, the return is 12.325% with the risk of 1.25% for the portfolio. Thus the

portfolio results in the reduction of risk by the combination of two shares.

(ii) For constructing the minimum risk portfolio the condition to be satisfied is

$$X_{ABC} = \frac{\sigma_X^2 - r_{AX}\sigma_A\sigma_X}{\sigma_A^2 + \sigma_X^2 - 2r_{AX}\sigma_A\sigma_X} \text{ or}$$

$$= \frac{\sigma_X^2 - \text{Cov.}_{AX}}{\sigma_A^2 + \sigma_X^2 - 2\text{Cov.}_{AX}}$$

$\sigma_X$  = Std. Deviation of XYZ

$\sigma_A$  = Std. Deviation of ABC

$r_{AX}$  = Coefficient of Correlation between XYZ and ABC

$\text{Cov.}_{AX}$  = Covariance between XYZ and ABC.

Therefore,

$$\% \text{ ABC} = \frac{126.98 - (-144.25)}{126.98 + 167.75 - [2 \times (-144.25)]}$$

$$\frac{271.23}{583.23} = 0.46 \text{ or } 46\%$$

$$\% \text{ ABC} = 46\%, \text{ XYZ} = 54\% (1 - 0.46)$$

|       |              |                          |                         |
|-------|--------------|--------------------------|-------------------------|
| 5 (a) | Particulars  | Mark Ltd.                | Mask Ltd.               |
|       | EPS          | ₹ 2,000 Lakhs/ 200 lakhs | ₹ 400 lakhs / 100 lakhs |
|       |              | = ₹ 10                   | ₹ 4                     |
|       | Market Price | ₹ 10 × 10 = ₹ 100        | ₹ 4 × 5 = ₹ 20          |

(i) The Swap ratio based on current market price is

$$₹ 20 / ₹ 100 = 0.2 \text{ or } 1 \text{ share of Mark Ltd. for 5 shares of Mask Ltd.}$$

$$\text{No. of shares to be issued} = 100 \text{ lakh} \times 0.2 = 20 \text{ lakhs.}$$

(ii) EPS after merger

$$= \frac{₹ 2,000 \text{ lakhs} + ₹ 400 \text{ lakhs}}{200 \text{ lakhs} + 20 \text{ lakhs}} = ₹ 10.91$$

(iii) Expected market price after merger assuming P / E 10 times.

$$= ₹ 10.91 \times 10 = ₹ 109.10$$

(iv) Market value of merged firm

$$= ₹ 109.10 \text{ market price} \times 220 \text{ lakhs shares} = 240.02 \text{ crores}$$

(v) Gain from the merger

Post merger market value of the merged firm ₹ 240.02 crores

Less: Pre-merger market value

Mark Ltd. 200 Lakhs × ₹ 100 = 200 crores

Mask Ltd. 100 Lakhs × ₹ 20 = 20 crores ₹ 220.00 crores

Gain from merger ₹ 20.02 crores

Appropriation of gains from the merger among shareholders:

|                               | <i>Mark Ltd.</i> | <i>Mask Ltd.</i> |
|-------------------------------|------------------|------------------|
| Post merger value             | 218.20 crores    | 21.82 crores     |
| Less: Pre-merger market value | 200.00 crores    | 20.00 crores     |
| Gain to Shareholders          | 18.20 crores     | 1.82 crores      |

(b) Evaluation of project utilizes of Project A and Project B

|                     | Project A   |         |               |
|---------------------|-------------|---------|---------------|
| Cash flow<br>(in ₹) | Probability | Utility | Utility value |
| -15,000             | 0.10        | -100    | -10           |
| 10,000              | 0.20        | -60     | -12           |
| 15,000              | 0.40        | 40      | 16            |
| 10,000              | 0.20        | 30      | 6             |
| 5,000               | 0.10        | 20      | <u>2</u>      |
|                     |             |         | <u>2</u>      |

|                     | Project B   |         |               |
|---------------------|-------------|---------|---------------|
| Cash flow<br>(in ₹) | Probability | Utility | Utility value |
| -10,000             | 0.10        | -60     | -6            |
| -4,000              | 0.15        | -3      | -0.45         |
| 15,000              | 0.40        | 40      | 16            |
| 5,000               | 0.25        | 20      | 5             |
| 10,000              | 0.10        | 30      | <u>3</u>      |
|                     |             |         | <u>17.55</u>  |

Project B should be selected as its expected utility is more

6. (a) (i) Taxable income = Net Income / (1 - 0.40)

or, Taxable income = ₹ 15,00,000 / (1 - 0.40) = ₹ 25,00,000

Again, taxable income = EBIT – Interest

or, EBIT = Taxable Income + Interest

$$= ₹ 25,00,000 + ₹ 15,00,000 = ₹ 40,00,000$$

(ii)  $EVA = EBIT (1 - T) - (WACC \times \text{Invested capital})$

$$= ₹ 40,00,000 (1 - 0.40) - (0.126 \times ₹ 1,00,00,000)$$

$$= ₹ 24,00,000 - ₹ 12,60,000 = ₹ 11,40,000$$

(iii)  $EVA \text{ Dividend} = ₹ 11,40,000 / 2,50,000 = ₹ 4.56$

If Delta Ltd. does not pay a dividend, we would expect the value of the firm to increase because it will achieve higher growth, hence a higher level of EBIT. If EBIT is higher, then all else equal, the value of the firm will increase.

(b) (i) Current future price of the index  $= 5000 + 5000 (0.09 - 0.06) \frac{4}{12}$

$$= 5000 + 50 = 5,050$$

$$\therefore \text{Price of the future contract} = ₹ 50 \times 5,050 = ₹ 2,52,500$$

(ii) Hedge ratio  $= \frac{1010000}{252500} \times 1.5 = 6 \text{ contracts}$

Index after three months turns out to be 4500

$$\text{Future price will be} = 4500 + 4500 (0.09 - 0.06) \times \frac{1}{3} = 4,545$$

$$\begin{aligned} \text{Therefore, Gain from the short futures position is} &= 6 \times (5050 - 4545) \times 50 \\ &= ₹ 1,51,500 \end{aligned}$$

- 7 (a) Camel stands for Capital, Assets, Management, Earnings and Liquidity. The CAMEL model adopted by the rating agencies deserves special attention, it focuses on the following aspects-

- (i) *Capital*- Composition of external funds raised and retained earnings, fixed dividends component for preference shares and fluctuating dividends component for equity shares and adequacy of long term funds adjusted to gearing levels, ability of issuer to raise further borrowings.
- (ii) *Assets*- Revenue generating capacity of existing/proposed assets, fair values, technological/physical obsolescence, linkage of asset values to turnover, consistency, appropriation of methods of depreciation and adequacy of charge to revenues, size, ageing and recoverability of monetary assets like receivables and its linkage with turnover.

- (iii) *Management*- Extent of involvement of management personnel, team-work, authority, timeliness, effectiveness and appropriateness of decision making along with directing management to achieve corporate goals.
- (iv) *Earnings*- Absolute levels, trends, stability, adaptability to cyclical fluctuations, ability of the entity to service existing and additional debts proposed.
- (v) *Liquidity*- Effectiveness of working capital management, corporate policies for stock and creditors, management and the ability of the corporate to meet their commitment in the short run.

These five aspects form the five core bases for estimating credit worthiness of an issuer which leads to the rating of an instrument. Rating agencies determine the pre-dominance of positive/negative aspects under each of these five categories and these are factored in for making the overall rating decision.

- (b) The process of Debt Securitisation can be classified in the following three functions:
1. **The origination function** – A borrower seeks a loan from finance company, bank, housing company or a financial institution. On the basis of credit worthiness repayment schedule is structured over the life of the loan.
  2. **The pooling function** – Many similar loans or receivables are clubbed together to create an underlying pool of assets. This pool is transferred in favour of a SPV (Special Purpose Vehicle), which acts as a trustee for the investor. Once the assets are transferred they are held in the organizers portfolios.
  3. **The securitisation function** – It is the SPV's job to structure and issue the securities on the basis of asset pool. The securities carry coupon and an expected maturity, which can be asset base or mortgage based. These are generally sold to investors through merchant bankers. The investors interested in this type of securities are generally institutional investors like mutual fund, insurance companies etc. The originator usually keeps the spread available (i.e. difference) between yield from secured asset and interest paid to investors.

Generally the process of securitisation is without recourse i.e. the investor bears the credit risk of default and the issuer is under an obligation to pay to investors only if the cash flows are received by issuer from the collateral.

- (c) Take Over Strategies other than tender offer the acquiring companies are as follows:

**Street Sweep:** This refers to the technique where the acquiring company accumulates larger number of shares in a target before making an open offer. The advantage is that the target company is left with no choice but to agree to the proposal of acquirer for takeover.

**Bear Hug:** When the acquirer threatens the target to make an open offer, the board of target company agrees to a settlement with the acquirer for change of control.

**Strategic Alliance:** This involves disarming the acquirer by offering a partnership rather than a buyout. The acquirer should assert control from within and takeover the target company.

**Brand Power:** This refers to entering into an alliance with powerful brands to displace the target's brands and as a result, buyout the weakened company.

- (d) These are bonds issued by Indian companies in foreign market with the option to convert them into pre-determined number of equity shares of the company. Usually price of equity shares at the time of conversion will fetch premium. The Bonds carry fixed rate of interest.

The issue of bonds may carry two options:

*Call option:* Under this the issuer can call the bonds for redemption before the date of maturity. Where the issuer's share price has appreciated substantially, i.e., far in excess of the redemption value of bonds, the issuer company can exercise the option. This call option forces the investors to convert the bonds into equity. Usually, such a case arises when the share prices reach a stage near 130% to 150% of the conversion price.

*Put option:* It enables the buyer of the bond a right to sell his bonds to the issuer company at a pre-determined price and date. The payment of interest and the redemption of the bonds will be made by the issuer-company in US dollars.

- (e) The evaluation of sustainable growth strategy calls for interface of financial planning approach with strategic planning approach. Choice of the degree of sustainability approach for sustainability and modification in the sustainability principle must be based on financial evaluation of the alternative schemes in terms of financial and overall corporate objectives. There are two alternative methods for evaluation. They are:

- (i) **Valuation Method:** Valuation method depends on demand curve approach by either making use of expressed preferences or making use of revealed preferences.
- (ii) **Pricing Method:** Pricing method is a non-demand curve approach that takes into consideration either opportunity costs or alternative costs or shadow

projects or government payments or those response methods depending on the nature of the problem and environmental situation.

Valuation methods are in general more complex in implementation than pricing methods. But demand curve methods are more useful for cases where it seems likely that disparity between price and value is high.