MOCK TEST PAPER – 2

FINAL COURSE: GROUP – I

PAPER – 2 : STRATEGIC FINANCIAL MANAGEMENT (NEW)

*Question No. **1** is compulsory. Attempt any **four** questions from the remaining **five** questions. Working notes should form part of the answer.*

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) Capital structure of Sun Ltd., as at 31.3.2003 was as under:

	(Rs. in lakhs)
Equity share capital	80
8% Preference share capital	40
12% Debentures	64
Reserves	32

Sun Ltd., earns a profit of Rs. 32 lakhs annually on an average before deduction of income-tax, which works out to 35%, and interest on debentures. Sun Ltd. has been regularly paying equity dividend of 8%.

Normal return on equity shares of companies similarly placed is 9.6% provided:

(i) Profit after tax covers fixed interest and fixed dividends at least 3 times.

(ii) Capital gearing ratio is 0.75.

(iii) Yield on share is calculated at 50% of profits distributed and at 5% on undistributed profits.

ANALYZE the value per equity share of the company assuming the risk premium as:

(A) 1% for every one time of difference for Interest and Fixed Dividend Coverage.

(B) 2% for every one time of difference for Capital Gearing Ratio. ***(10 Marks)***

(b) Cinderella Mutual Fund has the following assets in Scheme Rudolf at the close of business on 31st March,2014.

Company	No. of Shares	Market Price Per Share
Nairobi Ltd.	25000	Rs. 20
Dakar Ltd.	35000	Rs. 300
Senegal Ltd.	29000	Rs. 380
Cairo Ltd.	40000	Rs. 500

The total number of units of Scheme Rudol are 10 lacs. The Scheme Rudolf has accrued expenses of Rs. 2,50,000 and other liabilities of Rs. 2,00,000.

CALCULATE the NAV per unit of the Scheme Rudolf. ***(5 Marks)***

(c) EXPLAIN Dow Jones theory. ***(5 Marks)***

2. (a) Mr. Tamarind intends to invest in equity shares of a company the value of which depends upon various parameters as mentioned below:

Factor	Beta	Expected value in %	Actual value in %
GNP	1.20	7.70	7.70
Inflation	1.75	5.50	7.00
Interest rate	1.30	7.75	9.00
Stock market index	1.70	10.00	12.00
Industrial production	1.00	7.00	7.50

The risk-free rate of interest be 9.25%,

CALCULATE the return of the share as per Arbitrage Pricing Theory. ***(6 Marks)***

(b) A multinational company is planning to set up a subsidiary company in India (where hitherto it was exporting) in view of growing demand for its product and competition from other MNCs. The initial project cost (consisting of Plant and Machinery including installation) is estimated to be US$ 500 million. The net working capital requirements are estimated at US$ 50 million. The company follows straight line method of depreciation. Presently, the company is exporting two million units every year at a unit price of US$ 80, its variable cost per unit being US$ 40.

The Chief Financial Officer has estimated the following operating cost and other data in respect of proposed project:

(i) Variable operating cost will be US $ 20 per unit of production;

(ii) Additional cash fixed cost will be US $ 30 million p.a. and project's share of allocated fixed cost will be US $ 3 million p.a. based on principle of ability to share;

(iii) Production capacity of the proposed project in India will be 5 million units;

(iv) Expected useful life of the proposed plant is five years with no salvage value;

(v) Existing working capital investment for production & sale of two million units through exports was US $ 15 million;

(vi) Export of the product in the coming year will decrease to 1.5 million units in case the company does not open subsidiary company in India, in view of the presence of competing MNCs that are in the process of setting up their subsidiaries in India;

(vii) Applicable Corporate Income Tax rate is 35%, and

(viii) Required rate of return for such project is 12%.

ADVICE X Inc. to establish the proposed project in India.

Note: 1. There will be no variation in the exchange rate of two currencies and all profits will be repatriated, as there will be no withholding tax.

2. Present Value Interest Factors (PVIF) @ 12% for five years are as below:

Year	1	2	3	4	5
PVIF	0.8929	0.7972	0.7118	0.6355	0.5674

(8 Marks)

(c) EXPLAIN briefly the concept of Credit Rating. ***(6 Marks)***

3. (a) The closing value of Sensex for the month of October, 2017 is given below:

Date Closing	Sensex Value
1.10.17	2800
3.10.17	2780
4.10.17	2795
5.10.17	2830
8.10.17	2760
9.10.17	2790
10.10.17	2880
11.10.17	2960
12.10.17	2990
15.10.17	3200
16.10.17	3300
17.10.17	3450
19.10.17	3360
22.10.17	3290
23.10.17	3360
24.10.17	3340
25.10.17	3290
29.10.17	3240
30.10.17	3140
31.10.17	3260

ANALYZE the weak form of efficient market hypothesis by applying the run test at 5% and 10% level of significance using 18 Degrees of Freedom.

Note:

Value of t at 5% is 2.101 at 18 Degrees of Freedom

Value of t at 10% is 1.734 at 18 Degrees of Freedom ***(10 Marks)***

(b) The current market price of an equity share of Penchant Ltd is Rs. 420. Within a period of 3 months, the maximum and minimum price of it is expected to be Rs. 500 and Rs. 400 respectively. The risk-free rate of interest be 8% p.a.

ESTIMATE the value of a 3 months Call option using "Risk Neutral" method at the strike rate of Rs. 450.

Given $e^{0.02} = 1.0202$ ***(6 Marks)***

(c) "The Financial Risk can be viewed from different perspective". Explain this statement.

(4 Marks)

4. (a) XYZ Inc. issues a £ 10 million floating rate loan on July 1, 2013 with resetting of coupon rate every 6 months equal to LIBOR + 50 bp. XYZ is interested in a collar strategy by selling a Floor and buying a Cap. XYZ buys the 3 years Cap and sell 3 years Floor as per the following details on July 1, 2013:

Notional Principal Amount	\$ 10 million
Reference Rate	6 months LIBOR

Strike Rate 4% for Floor and 7% for Cap

Premium 0*

The actual LIBOR happened to at each reset date was as follows:

Reset Date	LIBOR (%)
31-12-2013	6.00
30-06-2014	7.50
31-12-2014	5.00
30-06-2015	4.00
31-12-2015	3.75
30-06-2016	4.25

Determine:

(i) Effective interest paid out at each of above reset date,

(ii) The average overall effective rate of interest p.a.

*Since Premium paid for Cap = Premium received for Floor ***(8 Marks)***

(b) Mr. Tempest has the following portfolio of four shares:

Name	Beta	Investment Rs. Lac.
Oxy Rin Ltd.	0.45	0.80
Boxed Ltd.	0.35	1.50
Square Ltd.	1.15	2.25
Ellipse Ltd.	1.85	4.50

The risk-free rate of return is 7% and the market rate of return is 14%.

CALCULATE

(i) Portfolio return.

(ii) Calculate the portfolio Beta ***(8 Marks)***

(c) Explain briefly the concept of Cluster Financing. ***(4 Marks)***

5. (a) On 1 October 2015 Mr. X an exporter enters into a forward contract with a BNP Bank to sell US$ 1,00,000 on 31 December 2015 at Rs. 65.40/$. However, due to the request of the importer, Mr. X received amount on 28 November 2015. Mr. X requested the bank the take delivery of the remittance on 30 November 2015 i.e. before due date. The inter-banking rates on 28 November 2015 was as follows:

Spot Rs. 65.22/65.27

One Month Premium 10/15

ANALYZE the position of Mr. X, if bank agrees to take early delivery then what will be net inflow to Mr. X assuming that the prevailing prime lending rate is 18%. ***(8 Marks)***

(b) T Ltd. and E Ltd. are in the same industry. The former is in negotiation for acquisition of the latter. Important information about the two companies as per their latest financial statements is given below:

	T Ltd.	E Ltd.
Rs. 10 Equity shares outstanding	12 Lakhs	6 Lakhs
Debt:		

10% Debentures (Rs. Lakhs)	580	--
12.5% Institutional Loan (Rs. Lakhs)	--	240
Earning before interest, depreciation and tax (EBIDAT) (Rs. Lakhs)	400.86	115.71
Market Price/share (Rs.)	220.00	110.00

T Ltd. plans to offer a price for E Ltd., business as a whole which will be 7 times EBIDAT reduced by outstanding debt, to be discharged by own shares at market price.

E Ltd. is planning to seek one share in T Ltd. for every 2 shares in E Ltd. based on the market price. Tax rate for the two companies may be assumed as 30%.

ANALYZE the following under both alternatives i.e. as per T Ltd.'s offer and E Ltd.'s plan:

(i) Net consideration payable.

(ii) No. of shares to be issued by T Ltd.

(iii) EPS of T Ltd. after acquisition.

(iv) Expected market price *per share of T Ltd. after acquisition.*

Note: Calculations (except EPS) may be rounded off to 2 decimals in lakhs. ***(8 Marks)***

(c) DIFFERENTIATE between PTS and PTC.

OR

EXPLAIN securitisation in India. ***(4 Marks)***

6. (a) Mr. X, who has established the following spread on the Delta Corporation's stock :

(i) Purchased one 3-month call option with a premium of Rs. 30 and an exercise price of Rs. 550.

(ii) Purchased one 3-month put option with a premium of Rs. 5 and an exercise price of Rs. 450.

Delta Corporation's stock is currently selling at Rs. 500. ADVICE Mr. X about profit or loss, if the price of Delta Corporation's :

(i) remains at Rs.500 after 3 months.

(ii) falls at Rs.350 after 3 months.

(iii) rises to Rs.600.

Note: Assume the size option is 100 shares of Delta Corporation. ***(8 Marks)***

(b) An Indian exporting firm, Rohit and Bros., would be covering itself against a likely depreciation of pound sterling. The following data is given:

Receivables of Rohit and Bros	:	£500,000
Spot rate	:	Rs. 56.00/£
Payment date	:	3-months
3 months interest rate	:	India : 12 per cent per annum
	:	UK : 5 per cent per annum

ADVICE what should the exporter do? ***(6 Marks)***

(c) DESCRIBE the term Pitch Presentation in context of Start-up Business? ***(6 Marks)***