# MOCK TEST PAPER – 1 FINAL COURSE: GROUP – I PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT SUGGESTED ANSWERS/HINTS

(a)	(i)	SWAP ratio based on c	urrent market	prices:				
		EPS before acquisition	:					
		Mani Ltd. : Rs.2,000 la	khs / 200 lakhs	:	Rs.10			
		Ratnam Ltd.: Rs.4,000	lakhs / 1,000 l	akhs:	Rs. 4			
		Market price before acc	quisition:					
		Mani Ltd.: Rs.10 × 10			Rs.100			
		Ratnam Ltd.: Rs.4 × 5			Rs. 20			
		SWAP ratio: 20/100 or	1/5 i.e.		0.20			
	(ii)	EPS after acquisition:						
		Rs. (2,000 + 4,000)	Lakhs	_	Do 15 (	0		
		(200 + 200) Lakh	IS	-	KS.15.0	JU		
	(iii)	Market Price after acqu	isition:					
		EPS after acquisition :			Rs.15.0	00		
		P/E ratio after acquisiti	on 10 × 0.9			9		
		Market price of share (	Rs. 15 X 9)		Rs.135.0	0		
	(iv)	Market value of the me	rged Co.:					
		Rs.135 × 400 lakhs sha	ares		Rs. 540	0.00 Crores		
					or Rs.	54,000 Lakhs	5	
	(v)	Gain/loss per share:						Rs. Crore
						Mani	Ltd.	Ratnam Ltd.
		Total value before Acqu	isition				200	200
		Value after acquisition					<u>270</u>	<u>270</u>
		Gain (Total)				-	70	<u>    70    </u>
		No. of shares (pre-merg	er) (lakhs)			2	200	1,000
		Gain per share (Rs.)					35	7
(b)	If fo	reign exchange risk is	hedged					
								Total (Rs.)
-	~			1104	4 00 000	E 07	- 000	

				Total (Rs.)
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	Rs.225/-	395	510	
Variable cost	Rs. 27,00,000	Rs. 39,50,000	Rs. 40,80,000	Rs. 1,07,30,000

1

Three months forward rate for selling	2.427	0.0216	0.0178	
Rupee value of receipts	Rs.32,13,844	Rs. 47,36,111	Rs. 53,88,764	Rs. 1,33,38,719
Contribution	Rs.5,13,844	Rs. 7,86,111	Rs. 13,08,764	Rs. 26,08,719
Average contribution to sale ratio				19.56%
If risk is not hedged				
Rupee value of receipt	Rs.31,72,021	Rs. 47,44,898	Rs. 53,58,659	Rs. 1,32,75,578
Total contribution				Rs. 25,45,578
Average contribution to sale ratio				19.17%

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

- (c) Key elements of a well-functioning financial system are explained as below:
  - (i) A strong legal and regulatory environment Capital market is regulated by SEBI which acts a watchdog of the securities market. This has been ensured through the passing of SEBI Act, Securities Contract Regulation Act and numerous SEBI rules, regulations and guidelines. Likewise money market and foreign exchange market is regulated by RBI and this has been ensured through various provisions of the RBI Act, Foreign Exchange Management Act etc. Thus, a strong legal system protects the rights and interests of investors and acts as a most important element of a sound financial system.
  - (ii) Stable money Money is an important part of an economy. Frequent fluctuations and depreciations in the value of money lead to financial crises and restrict the economic growth.
  - (iii) Sound public finances and public debt management Sound public finances means setting and controlling public expenditures and increase revenues to fund these expenditures efficiently. Public debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding. It also includes developing and maintaining an efficient market for government securities.
  - (iv) A central bank A central bank supervises and regulates the operations of the banking system. It acts as a banker to the banks and government, manager of money market and foreign exchange market and also lender of the last resort. The monetary policy of the Central Bank is used to keep the pace of economic growth on a higher path.
  - (v) Sound banking system A well-functioning financial system must have large variety of banks both in the private and public sector having both domestic and international operations with an ability to withstand adverse national and international events. They perform varied functions such as operating the payment and clearing system, and foreign exchange market. Banks also undertake credit risk analysis and assess the expected risk and return of a project before giving any loan for a proposed project.
  - (vi) Information System All the participants in the financial system requires information at some stage or the other. Proper information disclosure practices form basis of a sound financial system for e.g. the corporates has to disclose their financial performance in the financial statements. Similarly, at the time of initial public offering, the companies have to disclose a host of information disclosing their financial health and efficiency.

- (vii) Well functioning securities market A securities market facilitates the issuance of both equity and debt. An efficient securities market helps in the deployment of funds raised through the capital market to the required sections of the economy, lowering the cost of capital for the firms, enhancing liquidity and attracting foreign investment.
- 2. (a) (i) Portfolio Beta

0.20 x 0.40 + 0.50 x 0.50 + 0.30 x 1.10 = 0.66

(ii) Residual Variance

To determine Residual Variance first of all we shall compute the Systematic Risk as follows:

 $\beta_A^2 \times \sigma_M^2 = (0.40)^2 (0.01) = 0.0016$ 

 $\beta_B^2 \times \sigma_M^2 = (0.50)^2 (0.01) = 0.0025$ 

 $\beta_{\rm C}^2 \times \sigma_{\rm M}^2 = (1.10)^2 (0.01) = 0.0121$ 

**Residual Variance** 

A 0.015 - 0.0016 = 0.0134

B 0.025 - 0.0025 = 0.0225

- C 0.100 0.0121 = 0.0879
- (iii) Portfolio variance using Sharpe Index Model

Systematic Variance of Portfolio =  $(0.10)^2 \times (0.66)^2 = 0.004356$ 

Unsystematic Variance of Portfolio =  $0.0134 \times (0.20)^2 + 0.0225 \times (0.50)^2 + 0.0879 \times (0.30)^2 = 0.014072$ 

Total Variance = 0.004356 + 0.014072 = 0.018428

(iv) Portfolio variance on the basis of Markowitz Theory

$$= (w_A \times w_A \times \sigma_A^2) + (w_A \times w_B \times Cov_{AB}) + (w_A \times w_C \times Cov_{AC}) + (w_B \times w_A \times Cov_{AB}) + (w_B \times w_B \times \sigma_B^2) + (w_B \times w_C \times Cov_{BC}) + (w_C \times w_A \times Cov_{CA}) + (w_C \times w_B \times Cov_{CB}) + (w_C \times w_C \times \sigma_C^2)$$

2

=  $(0.20 \times 0.20 \times 0.015) + (0.20 \times 0.50 \times 0.030) + (0.20 \times 0.30 \times 0.020) + (0.20 \times 0.50 \times 0.030) + (0.50 \times 0.50 \times 0.025) + (0.50 \times 0.30 \times 0.040) + (0.30 \times 0.20 \times 0.020) + (0.30 \times 0.50 \times 0.040) + (0.30 \times 0.30 \times 0.10)$ 

= 0.0006 + 0.0030 + 0.0012 + 0.0030 + 0.00625 + 0.0060 + 0.0012 + 0.0060 + 0.0090 = 0.0363

(b) Duration of Bond X

Year	Cash flow	P.V. @ 10%		Proportion of bond value	Proportion of	bond
					value x time (yea	irs)
1	1070	.909	972.63	1.000	1.000	

Duration of the Bond is 1 year

# **Duration of Bond Y**

Year	Cash flow	<i>P.V.</i>	@ 10%	Proportion value	of	bond	Proportion value x time	of (vear	bond ˈs)	
1	80	.909	72.72	0.077		0.0	)77	-/		
2	80	.826	66.08	0.071		0.071		0.1	42	

3	80	.751	60.08	0.064	0.192
4	1080	.683	<u>737.64</u>	<u>0.788</u>	<u>3.152</u>
			<u>936.52</u>	<u>1.000</u>	<u>3.563</u>

Duration of the Bond is 3.563 years

Let  $x_1$  be the investment in Bond X and therefore investment in Bond Y shall be  $(1 - x_1)$ . Since the required duration is 2 year the proportion of investment in each of these two securities shall be computed as follows:

 $2 = x_1 + (1 - x_1) 3.563$ 

x<sub>1</sub> = 0.61

Accordingly, the proportion of investment shall be 61% in Bond X and 39% in Bond Y respectively.

Amount of investment

Bond X	Bond Y
PV of Rs. 1,00,000 for 2 years @ 10% x 61%	PV of Rs. 1,00,000 for 2 years @ 10% x 39%
= Rs. 1,00,000 (0.826) x 61%	= Rs. 1,00,000 (0.826) x 39%
= Rs. 50,386	= Rs. 32,214
No. of Bonds to be purchased	No. of Bonds to be purchased
= Rs. 50,386/Rs. 972.73 = 51.79 i.e. approx.	= Rs. 32,214/Rs. 936.52 = 34.40 i.e. approx. 34
52 bonds	bonds

**Note:** The investor has to keep the money invested for two years. Therefore, the investor can invest in both the bonds with the assumption that Bond X will be reinvested for another one year on same returns.

(c) The concept of sustainable growth can be helpful for planning healthy corporate growth. This concept forces managers to consider the financial consequences of sales increases and to set sales growth goals that are consistent with the operating and financial policies of the firm. Often, a conflict can arise if growth objectives are not consistent with the value of the organization's sustainable growth. Question concerning right distribution of resources may take a difficult shape if we take into consideration the rightness not for the current stakeholders but for the future stakeholders also. To take an illustration, let us refer to fuel industry where resources are limited in quantity and a judicial use of resources is needed to cater to the need of the future customers along with the need of the present customers. One may have noticed the save fuel campaign, a demarketing campaign that deviates from the usual approach of sales growth strategy and preaches for conservation of fuel for their use across generation. This is an example of stable growth strategy adopted by the oil industry as a whole under resource constraints and the long run objective of survival over years. Incremental growth strategy, profit strategy and pause strategy are other variants of stable growth strategy.

Sustainable growth is important to enterprise long-term development. Too fast or too slow growth will go against enterprise growth and development, so financial should play important role in enterprise development, adopt suitable financial policy initiative to make sure enterprise growth speed close to sustainable growth ratio and have sustainable healthy development.

The sustainable growth rate (SGR), concept by Robert C. Higgins, of a firm is the maximum rate of growth in sales that can be achieved, given the firm's profitability, asset utilization, and desired dividend payout and debt (financial leverage) ratios. The sustainable growth rate is a measure of how much a firm can grow without borrowing more money. After the firm has passed this rate, it must borrow funds from another source to facilitate growth. Variables typically include the net

profit margin on new and existing revenues; the asset turnover ratio, which is the ratio of sales revenues to total assets; the assets to beginning of period equity ratio; and the retention rate, which is defined as the fraction of earnings retained in the business.

SGR = ROE x (1- Dividend payment ratio)

Sustainable growth models assume that the business wants to: 1) maintain a target capital structure without issuing new equity; 2) maintain a target dividend payment ratio; and 3) increase sales as rapidly as market conditions allow. Since the asset to beginning of period equity ratio is constant and the firm's only source of new equity is retained earnings, sales and assets cannot grow any faster than the retained earnings plus the additional debt that the retained earnings can support. The sustainable growth rate is consistent with the observed evidence that most corporations are reluctant to issue new equity. If, however, the firm is willing to issue additional equity, there is in principle no financial constraint on its growth rate.

3. (a)

Total value

Business Segment	Capital-to-Sales	Segment Sales	Theoretical Values
Wholesale	0.85	€225000	€191250
Retail	1.2	€720000	€864000
General	0.8	€2500000	€2000000
Total value			<u>€3055250</u>
Business Segment	Capital-to-Assets	Segment Assets	Theoretical Values
Wholesale	0.7	€600000	€420000
Retail	0.7	€500000	€350000
General	0.7	€4000000	€2800000

Business Segment	Capital-to- Operating Income	Operating Income	Theoretical Values
Wholesale	9	€75000	€675000
Retail	8	€150000	€1200000
General	4	€700000	€2800000
Total value			€4675000

€3570000

Average theoretical value =  $\frac{3055250 + 3570000 + 4675000}{3} = 3766750$ 

Average theoretical value of Cranberry Ltd. = €3766750

# (b) Calculation of Income available for Distribution

	Units (Lakh)	Per Unit (Rs.)	Total (Rs. In lakh)
Income from April	300	0.0765	22.9500
Add: Dividend equalization collected on issue	6	0.0765	0.4590
	306	0.0765	23.4090
Add: Income from May		0.1125	34.4250
	306	0.1890	57.8340
Less: Dividend equalization paid on repurchase	3	0.1890	(0.5670)
	303	0.1890	57.2670

Add: Income from June		0.1500	45.4500
	303	0.3390	102.7170
Less: Dividend Paid		0.2373	(71.9019)
	303	0.1017	30.8151

## Calculation of Issue Price at the end of April

	Rs.
Opening NAV	18.750
Add: Entry Load 2% of Rs. 18.750	(0.375)
	19.125
Add: Dividend Equalization paid on Issue Price	0.0765
	19.2015

### Calculation of Repurchase Price at the end of May

	Rs.
Opening NAV	18.750
Less: Exit Load 2% of Rs. 18.750	(0.375)
	18.375
Add: Dividend Equalization paid on Issue Price	0.1890
	18.564

# **Closing NAV**

		Rs. (Lakh)
Opening Net Asset Value (Rs. 18.75 × 300)		5625.0000
Portfolio Value Appreciation		425.4700
Issue of Fresh Units (6 × 19.2015)		115.2090
Income Received (22.950 + 34.425 + 45.450)		102.8250
		6268.504
Less: Units repurchased (3 × 18.564)	-55.692	
Income Distributed	-71.9019	(-127.5939)
Closing Net Asset Value		6140.9101
Closing Units (300 + 6 – 3) lakh		303 lakh
∴ Closing NAV as on 30 <sup>th</sup> June		Rs. 20.2670

- (c) There are two types of commodity swaps: fixed-floating or commodity-for-interest.
  - (a) Fixed-Floating Swaps: They are just like the fixed-floating swaps in the interest rate swap market with the exception that both indices are commodity based indices.

General market indices in the international commodities market with which many people would be familiar include the S&P Goldman Sachs Commodities Index (S&PGSCI) and the Commodities Research Board Index (CRB). These two indices place different weights on the various commodities so they will be used according to the swap agent's requirements.

(b) Commodity-for-Interest Swaps: They are similar to the equity swap in which a total return on the commodity in question is exchanged for some money market rate (plus or minus a spread).

# 4. (a) Impact of Financial Restructuring

- (i) Benefits to Grape Fruit Ltd.
  - (a) Reduction of liabilities payable

		Rs. in lakhs
	Reduction in equity share capital (6 lakh shares x Rs.75 per share)	450
	Reduction in preference share capital (2 lakh shares x Rs.50 per share)	100
	Waiver of outstanding debenture Interest	26
	Waiver from trade creditors (Rs.340 lakhs x 0.25)	<u>85</u>
		<u>661</u>
(b)	Revaluation of Assets	
	Appreciation of Land and Building (Rs.450 lakhs - Rs.200 lakhs)	<u>250</u>
	Total (A)	<u>911</u>

Amount of Rs.911 lakhs utilized to write off losses, fictious assets and over- valued assets.

Writing off profit and loss account	525
Cost of issue of debentures	5
Preliminary expenses	10
Provision for bad and doubtful debts	15
Revaluation of Plant and Machinery	120
(Rs.300 lakhs – Rs.180 lakhs)	
Total (B)	<u>675</u>
Capital Reserve (A) – (B)	236

(ii) Balance sheet of Grape Fruit Ltd as at 31<sup>st</sup> March 2011 (after re-construction)

(Rs. in lakhs)

Liabilities	Amount	Assets		Amount
12 lakhs equity shares of	300	Land & Building		450
10% Preference shares of Rs. 50/- each	100	Plant & Machinery		180
Capital Reserve	236	Furnitures & Fixtures		50
9% debentures	200	Inventory		150
Loan from Bank	74	Sundry debtors	70	
Trade Creditors	255	Prov. for Doubtful Debts	<u>-15</u>	55
		Cash-at-Bank (Balancing figure)*		280
	1165			1165

\*Opening Balance of Rs.130/- lakhs + Sale proceeds from issue of new equity shares Rs.150/- lakhs.

**(b)** 
$$p = \frac{e^{rt} - d}{u - d}$$

 $e^{rt} = e^{0.036}$ 

d = 411/421 = 0.976

$$p = \frac{e^{0.036} - 0.976}{1.406 - 0.976} = \frac{1.037 - 0.976}{0.43} = \frac{0.061}{0.43} = 0.1418$$

Thus, probability of rise in price 0.1418

- (c) There are four asset allocation strategies:
  - (a) Integrated Asset Allocation: Under this strategy, capital market conditions and investor objectives and constraints are examined and the allocation that best serves the investor's needs while incorporating the capital market forecast is determined.
  - (b) Strategic Asset Allocation: Under this strategy, optimal portfolio mixes based on returns, risk, and co-variances is generated using historical information and adjusted periodically to restore target allocation within the context of the investor's objectives and constraints.
  - (c) Tactical Asset Allocation: Under this strategy, investor's risk tolerance is assumed constant and the asset allocation is changed based on expectations about capital market conditions.
  - (d) Insured Asset Allocation: Under this strategy, risk exposure for changing portfolio values (wealth) is adjusted; more value means more ability to take risk.
- (d) Although there are many constituents for IFC but some of the important constituent are as follows:
  - Highly developed Infrastructure: A leading edge infrastructure is prerequisite for creating a platform to offer internationally completive financial services.
  - (ii) Stable Political Environment: Destabilized political environment brings country risk investment by foreign nationals. Hence, to accelerate foreign participation in growth of financial center, stable political environment is prerequisite.
  - (iii) Strategic Location: The geographical location of the finance center should be strategic such as near to airport, seaport and should have friendly weather.
  - (iv) Quality Life: The quality of life at the center showed be good as center retains highly paid professional from own country as well from outside.
  - (v) Rationale Regulatory Framework: Rationale legal regulatory framework is another prerequisite of international finance center as it should be fair and transparent.
  - (vi) Sustainable Economy: The economy should be sustainable and should possess capacity to absorb all the shocks as it will boost investors' confidence.

#### 5. (a) (i) Straight Value of Bond

Rs. 85 x 0.9132 + Rs. 85 x 0.8340 + Rs. 1085 x 0.7617 = Rs. 974.96

(ii) Conversion Value

Conversion Ration x Market Price of Equity Share

= Rs. 45 x 25 = Rs. 1,125

(iii) Conversion Premium

Conversion Premium = Market Conversion Price - Market Price of Equity Share

50

$$= \frac{\text{Rs.}1,175}{25} - \text{Rs.} 45 = \text{Rs.} 2$$
  
or = Rs. 1,175 - Rs. 45 x 25 = Rs.  
or  $\frac{\text{Rs.}1,175 - \text{Rs.}1,125}{\text{Rs.}1,125} = 4.47\%$ 

(iv) Percentage of Downside Risk

$$= \frac{\text{Rs.}1,175 - \text{Rs.}974.96}{\text{Rs.}974.96} \times 100 = 20.52\% \text{ or } \frac{\text{Rs.}1,175 - \text{Rs.}974.96}{\text{Rs.}1,175} = 17.02\%$$

(v) Conversion Parity Price

**Bond Price** 

No. of Share on Conversion

$$=\frac{\text{Rs.1,175}}{25}$$
 = Rs. 47

(b) First of all we shall calculate premium payable to bank as follows:

$$P = \frac{rp}{\left[ (1 \div i) - \frac{1}{i \times (1 + i)^{t}} \right]} X A \text{ or } \frac{rp}{PVAF(3.5\%,4)} \times A$$

Where

P = Premium

A = Principal Amount

rp = Rate of Premium

i = Fixed Rate of Interest

t = Time

$$= \frac{0.01}{\left[(1/0.035) - \frac{1}{0.035 \times 1.035^4}\right]} \times \pounds 15,000,000 \text{ or } \frac{0.01}{(0.966 + 0.933 + 0.901 + 0.871)} \times \pounds 15,000,000$$
$$= \frac{0.01}{\left[(28.5714) - \frac{1}{0.04016}\right]} \times \pounds 15,000,000 \text{ or } \frac{\pounds 150,000}{3.671} = \pounds 40,861$$

Please note above solution has been worked out on the basis of four decimal points at each stage.

Now we see tl	ne net pa	yment rece	eived fror	m bank
---------------	-----------	------------	------------	--------

Reset Period	Additional interest due to rise in interest rate	Amount received from bank	Premium paid to bank	Net Amt. received from bank
1	£ 75,000	£ 75,000	£ 40,861	£34,139
2	£ 112,500	£ 112,500	£ 40,861	£71,639
3	£ 150,000	£ 150,000	£ 40,861	£109,139
TOTAL	£ 337,500	£ 337,500	£122,583	£ 214,917

Thus, from above it can be seen that interest rate risk amount of £ 337,500 reduced by £ 214,917 by using of Cap option.

Note: It may be possible that student may compute upto three decimal points or may use different basis. In such case their answer is likely to be different.

#### (c) Stages of Venture Capital Funding

- 1. Seed Money: Low level financing needed to prove a new idea.
- 2. Start-up: Early stage firms that need funding for expenses associated with marketing and product development.
- 3. First-Round: Early sales and manufacturing funds.
- 4. Second-Round: Working capital for early stage companies that are selling product, but not yet turning in a profit.
- 5. Third Round: Also called Mezzanine financing, this is expansion money for a newly profitable company.
- Fourth-Round: Also called bridge financing, it is intended to finance the "going public" process.

#### 6. (a) Calculation of NPV

Year	0	1	2	3
Inflation factor in India	1.00	1.10	1.21	1.331
Inflation factor in Africa	1.00	1.40	1.96	2.744
Exchange Rate (as per IRP)	6.00	7.6364	9.7190	12.3696
Cash Flows in Rs.'000				
Real	-50000	-1500	-2000	-2500
Nominal (1)	-50000	-1650	-2420	-3327.50
Cash Flows in African Rand '000				
Real	-200000	50000	70000	90000
Nominal	-200000	70000	137200	246960
In Indian ₹ '000 (2)	-33333	9167	14117	19965
Net Cash Flow in Rs. '000 (1)+(2)	-83333	7517	11697	16637
PVF@20%	1	0.833	0.694	0.579
PV	-83333	6262	8118	9633

NPV of 3 years = -59320 (Rs. '000)

NPV of Terminal Value =  $\frac{16637}{0.20} \times 0.579 = 48164$  (Rs.'000)

Total NPV of the Project = -59320 (Rs. '000) + 48164 (Rs.'000) = -11156 (Rs.'000)

- (b) Following are main features of VAR
  - (i) Components of Calculations: VAR calculation is based on following three components :
    - (a) Time Period
    - (b) Confidence Level Generally 95% and 99%
    - (c) Loss in percentage or in amount
  - (ii) Statistical Method: It is a type of statistical tool based on Standard Deviation.
  - (iii) Time Horizon: VAR can be applied for different time horizons say one day, one week, one month and so on.
  - Probability: Assuming the values are normally attributed, probability of maximum loss can be predicted.

- (v) Control Risk: Risk can be controlled by selling limits for maximum loss.
- (vi) Z Score: Z Score indicates how many standard Deviations is away from Mean value of a population. When it is multiplied with Standard Deviation it provides VAR.
- (c) Primary Participants are main parties to this process. The primary participants in the process of securitization are as follows:
  - (i) Originator: It is the initiator of deal or can be termed as securitizer. It is an entity which sells the assets lying in its books and receives the funds generated through the sale of such assets. The originator transfers both legal as well as beneficial interest to the Special Purpose Vehicle (discussed later).
  - (ii) Special Purpose Vehicle: Also, called SPV is created for the purpose of executing the deal. Since issuer originator transfers all rights in assets to SPV, it holds the legal title of these assets. It is created especially for the purpose of securitization only and normally could be in form of a company, a firm, a society or a trust.

The main objective of creating SPV to remove the asset from the Balance Sheet of Originator. Since, SPV makes an upfront payment to the originator, it holds the key position in the overall process of securitization. Further, it also issues the securities (called Asset Based Securities or Mortgage Based Securities) to the investors.

(iii) The Investors: Investors are the buyers of securitized papers which may be an individual, an institutional investor such as mutual funds, provident funds, insurance companies, mutual funds, Financial Institutions etc.

Since, they acquire a participating in the total pool of assets/receivable, they receive their money back in the form of interest and principal as per the terms agree.

## Or

The securitization has the following features:

- Creation of Financial Instruments The process of securities can be viewed as process of creation of additional financial product of securities in market backed by collaterals.
- (ii) Bundling and Unbundling When all the assets are combined in one pool it is bundling and when these are broken into instruments of fixed denomination it is unbundling.
- (iii) Tool of Risk Management In case of assets are securitized on non-recourse basis, then securitization process acts as risk management as the risk of default is shifted.
- (iv) Structured Finance In the process of securitization, financial instruments are tailor structured to meet the risk return trade of profile of investor, and hence, these securitized instruments are considered as best examples of structured finance.
- (v) Trenching Portfolio of different receivable or loan or asset are split into several parts based on risk and return they carry called 'Trenche'. Each Trench carries a different level of risk and return.
- (vi) Homogeneity Under each trenche the securities are issued of homogenous nature and even meant for small investors the who can afford to invest in small amounts.

(d) No. of Shares = 
$$\frac{\text{Rs. }1,300 \text{ crores}}{\text{Rs. }40}$$
 = 32.5 Crores  
EPS =  $\frac{\text{PAT}}{\text{No.of shares}}$   
EPS =  $\frac{₹ 290 \text{ crores}}{32.5 \text{ crores}}$  = Rs. 8.923  
FCFE = Net income - [(1-b) (capex - dep) + (1-b) ( $\Delta$ WC)]  
FCFE = 8.923 - [(1-0.27) (47-39) + (1-0.27) (3.45)]  
= 8.923 - [5.84 + 2.5185] = 0.5645  
Cost of Equity = R<sub>f</sub> + ß (R<sub>m</sub> - R<sub>f</sub>)  
= 8.7 + 0.1 (10.3 - 8.7) = 8.86%  
Po =  $\frac{\text{FCFE}(1+g)}{K_e - g} = \frac{0.5645(1.08)}{0.0886 - .08} = \frac{0.60966}{0.0086} = \text{Rs. }70.89$