MOCK TEST PAPER –1

FINAL (NEW) COURSE: GROUP – I

PAPER – 2 : STRATEGIC FINANCIAL MANAGEMENT

*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) Following information is provided relating to the acquiring company Mani Ltd. and the target company Ratnam Ltd:

	Mani Ltd.	Ratnam Ltd.
Earnings after tax (Rs. lakhs)	2,000	4,000
No. of shares outstanding (lakhs)	200	1,000
P/E ratio (No. of times)	10	5

Required:

(i) What is the swap ratio based on current market prices?

(ii) What is the EPS of Mani Ltd. after the acquisition?

(iii) What is the expected market price per share of Mani Ltd. after the acquisition, assuming its P/E ratio is adversely affected by 10%?

(iv) Determine the market value of the merged Co.

(v) Calculate gain/loss for the shareholders of the two independent entities, due to the merger.

(8 Marks)

(b) Following information relates to AKC Ltd. which manufactures some parts of an electronics device which are exported to USA, Japan and Europe on 90 days credit terms.

Cost and Sales information:

	Japan	USA	Europe
Variable cost per unit	Rs.225	Rs.395	Rs.510
Export sale price per unit	Yen 650	US$10.23	Euro 11.99
Receipts from sale due in 90 days	Yen 78,00,000	US$1,02,300	Euro 95,920

Foreign exchange rate information:

	Yen/Rs.	US$/Rs.	Euro/Rs.
Spot market	2.417-2.437	0.0214-0.0217	0.0177-0.0180
3 months forward	2.397-2.427	0.0213-0.0216	0.0176-0.0178
3 months spot	2.423-2.459	0.02144-0.02156	0.0177-0.0179

Advice AKC Ltd. by calculating average contribution to sales ratio whether it should hedge it's foreign currency risk or not. ***(8 Marks)***

(c) Explain any four key elements for a well-functioning financial system. ***(4 Marks)***

2. (a) Following are the details of a portfolio consisting of three shares:

Share	Portfolio weight	Beta	Expected return in %	Total variance
A	0.20	0.40	14	0.015
B	0.50	0.50	15	0.025
C	0.30	1.10	21	0.100

Standard Deviation of Market Portfolio Returns = 10%

You are given the following additional data:

Covariance (A, B) = 0.030

Covariance (A, C) = 0.020

Covariance (B, C) = 0.040

Calculate the following:

(i) The Portfolio Beta

(ii) Residual variance of each of the three shares

(iii) Portfolio variance using Sharpe Index Model

(iv) Portfolio variance (on the basis of modern portfolio theory given by Markowitz) ***(10 Marks)***

(b) Mr. A will need Rs. 1,00,000 after two years for which he wants to make one time necessary investment now. He has a choice of two types of bonds. Their details are as below:

	Bond X	Bond Y
Face value	Rs. 1,000	Rs. 1,000
Coupon	7% payable annually	8% payable annually
Years to maturity	1	4
Current price	Rs. 972.73	Rs. 936.52
Current yield	10%	10%

Advice Mr. A whether he should invest all his money in one type of bond or he should buy both the bonds and, if so, in which quantity? Assume that there will not be any call risk or default risk.

(6 Marks)

(c) Explain Balancing Financial vis-à-vis Sustainable Growth. ***(4 Marks)***

3. (a) Using the chop-shop approach (or Break-up value approach), assign a value for Cranberry Ltd. whose stock is currently trading at a total market price of €4 million. For Cranberry Ltd, the accounting data set forth three business segments: consumer wholesale, retail and general centers. Data for the firm's three segments are as follows:

Business Segment	Segment Sales	Segment Assets	Segment Operating Income
Wholesale	€225,000	€600,000	€75,000
Retail	€720,000	€500,000	€150,000
General	€ 2,500,000	€4,000,000	€700,000

Industry data for "pure-play" firms have been compiled and are summarized as follows:

Business Segment	Capitalization/Sales	Capitalization/Assets	Capitalization/Operating Income
Wholesale	0.85	0.7	9
Retail	1.2	0.7	8
General	0.8	0.7	4

(5 Marks)

(b) On 1st April, an open ended scheme of mutual fund had 300 lakh units outstanding with Net Assets Value (NAV) of Rs. 18.75. At the end of April, it issued 6 lakh units at opening NAV plus 2% load, adjusted for dividend equalization. At the end of May, 3 Lakh units were repurchased at opening NAV less 2% exit load adjusted for dividend equalization. At the end of June, 70% of its available income was distributed.

In respect of April-June quarter, the following additional information are available:

	Rs. in lakh
Portfolio value appreciation	425.47
Income of April	22.950
Income for May	34.425
Income for June	45.450

You are required to calculate

(i) Income available for distribution;

(ii) Issue price at the end of April;

(iii) repurchase price at the end of May; and

(iv) net asset value (NAV) as on 30th June. ***(10 Marks)***

(c) Discuss the types of Commodity Swaps. ***(5 Marks)***

4. (a) The following is the Balance-sheet of Grape Fruit Company Ltd as at March 31st, 2011.

Liabilities	(Rs. in lakhs)	Assets	(Rs. in lakhs)
Equity shares of Rs. 100 each	600	Land and Building	200
14% preference shares of Rs. 100/- each	200	Plant and Machinery	300
13% Debentures	200	Furniture and Fixtures	50
Debenture interest accrued and payable	26	Inventory	150
Loan from bank	74	Sundry debtors	70
Trade creditors	340	Cash at bank	130
		Preliminary expenses	10
		Cost of issue of debentures	5
		Profit and Loss account	525
	1440		1440

The Company did not perform well and has suffered sizable losses during the last few years. However, it is felt that the company could be nursed back to health by proper financial restructuring. Consequently the following scheme of reconstruction has been drawn up :

(1) Equity shares are to be reduced to Rs. 25/- per share, fully paid up;

(2) Preference shares are to be reduced (with coupon rate of 10%) to equal number of shares of Rs. 50 each, fully paid up.

(3) Debenture holders have agreed to forgo the accrued interest due to them. In the future, the rate of interest on debentures is to be reduced to 9 percent.

(4) Trade creditors will forego 25 percent of the amount due to them.

(5) The company issues 6 lakh of equity shares at Rs. 25 each and the entire sum was to be paid on application. The entire amount was fully subscribed by promoters.

(6) Land and Building was to be revalued at Rs. 450 lakhs, Plant and Machinery was to be written down by Rs. 120 lakhs and a provision of Rs.15 lakhs had to be made for bad and doubtful debts.

Required:

(i) Show the impact of financial restructuring on the company's activities.

(ii) Prepare the fresh balance sheet after the reconstructions is completed on the basis of the above proposals. ***(8 Marks)***

(b) Sumana wanted to buy shares of EIL which has a range of Rs. 411 to Rs. 592 a month later. The present price per share is Rs. 421. Her broker informs her that the price of this share can sore up to Rs. 522 within a month or so, so that she should buy a one month CALL of EIL. In order to be prudent in buying the call, the share price should be more than or at least Rs. 522 the assurance of which could not be given by her broker.

Though she understands the uncertainty of the market, she wants to know the probability of attaining the share price Rs. 592 so that buying of a one month CALL of EIL at the execution price of Rs. 522 is justified. Advice her. Take the risk free interest to be 3.60% and $e^{0.036}$ = 1.037. ***(4 Marks)***

(c) Explain Asset Allocation Strategies. ***(4 Marks)***

(d) Explain different constituents of International Financial Centre (IFC). ***(4 Marks)***

5. (a) GHI Ltd., AAA rated company has issued, fully convertible bonds on the following terms, a year ago:

Face value of bond	Rs. 1000
Coupon (interest rate)	8.5%
Time to Maturity (remaining)	3 years
Interest Payment	Annual, at the end of year
Principal Repayment	At the end of bond maturity
Conversion ratio (Number of shares per bond)	25
Current market price per share	Rs. 45
Market price of convertible bond	Rs. 1175

AAA rated company can issue plain vanilla bonds without conversion option at an interest rate of 9.5%.

Required: Calculate as of today:

(i) Straight Value of bond.

(ii) Conversion Value of the bond.

(iii) Conversion Premium.

(iv) Percentage of downside risk.

(v) Conversion Parity Price.

t	1	2	3
$PVIF_{0.095,\, t}$	0.9132	0.8340	0.7617

(8 Marks)

(b) XYZ Limited borrows £ 15 Million of six months LIBOR + 10.00% for a period of 24 months. The company anticipates a rise in LIBOR, hence it proposes to buy a Cap Option from its Bankers at the strike rate of 8.00%. The lump sum premium is 1.00% for the entire reset periods and the fixed rate of interest is 7.00% per annum. The actual position of LIBOR during the forthcoming reset period is as under:

Reset Period	LIBOR
1	9.00%
2	9.50%
3	10.00%

You are required to show how far interest rate risk is hedged through Cap Option.

For calculation, work out figures at each stage up to four decimal points and amount nearest to £. It should be part of working notes. ***(8 Marks)***

(c) Explain various stages of Venture Capital Funding. ***(4 Marks)***

6. (a) XY Limited is engaged in large retail business in India. It is contemplating for expansion into a country of Africa by acquiring a group of stores having the same line of operation as that of India.

The exchange rate for the currency of the proposed African country is extremely volatile. Rate of inflation is presently 40% a year. Inflation in India is currently 10% a year. Management of XY Limited expects these rates likely to continue for the foreseeable future.

Estimated projected cash flows, in real terms, in India as well as African country for the first three years of the project are as follows:

	Year – 0	Year – 1	Year – 2	Year - 3
Cash flows in Indian Rs. (000)	-50,000	-1,500	-2,000	-2,500
Cash flows in African Rands (000)	-2,00,000	+50,000	+70,000	+90,000

XY Ltd. assumes the year 3 nominal cash flows will continue to be earned each year indefinitely. It evaluates all investments using nominal cash flows and a nominal discounting rate. The present exchange rate is African Rand 6 to Rs. 1.

You are required to calculate the net present value of the proposed investment considering the following:

(i) African Rand cash flows are converted into rupees and discounted at a risk adjusted rate.

(ii) All cash flows for these projects will be discounted at a rate of 20% to reflect it's high risk.

(iii) Ignore taxation.

	Year - 1	Year - 2	Year - 3
PVIF @ 20%	.833	.694	.579

(8 Marks)

(b) Explain the features of Value-at-Risk (VaR). ***(4 Marks)***

(c) Discuss briefly the primary participants in the process of Securitization. ***(4 Marks)***

OR

Explain the features of 'Securitization'.

(d) Calculate the value of share from the following information:

Profit of the company	Rs. 290 crores
Equity capital of company	Rs. 1,300 crores
Par value of share	Rs. 40 each
Debt ratio of company (Debt/ Debt + Equity)	27%
Long run growth rate of the company	8%
Beta 0.1; risk free interest rate	8.7%
Market returns	10.3%
Capital expenditure per share	Rs. 47
Depreciation per share	Rs. 39
Change in Working capital	Rs. 3.45 per share

(4 Marks)