Test Series: March, 2018

MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP – I

PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT (NEW COURSE)

*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) Reliable Industries Ltd. (RIL) is considering a takeover of Sunflower Industries Ltd. (SIL). The particulars of 2 companies are given below:

Particulars	Reliable Industries Ltd	Sunflower Industries Ltd.
Earnings After Tax (EAT)	₹ 20,00,000	₹ 10,00,000
Equity shares O/s	10,00,000	10,00,000
Earnings per share (EPS)	2	1
PE Ratio (Times)	10	5

(i) Calculate the market value of each Company before merger. ***(3 Marks)***

(ii) Calculate the market value of the Post-merger RIL assuming that the management of the shareholders of SIL will accept an offer of one share of RIL for four shares of SIL and there are no synergic effects. Also, calculate the new price per share. ***(4 Marks)***

(iii) Evaluate whether the shareholders of RIL better or worse off than they were before the merger. ***(1 Mark)***

(iv) Calculate the new post-merger EPS and Price per share if the management of RIL estimates that the earnings will increase by 20% due to synergic effects. ***(3 Marks)***

(v) Evaluate whether the shareholders are better off or worse off than before the merger. ***(1 Mark)***

(b) Compare and contrast startups and entrepreneurship. Describe the priorities and challenges which startups in India are facing. ***(8 Marks)***

2. (a) Mr. Dayal is interested in purchasing equity shares of ABC Ltd. which are currently selling at ₹ 600 each. He expects that price of share may go upto ₹ 780 or may go down to ₹ 480 in three months. The chances of occurring such variations are 60% and 40% respectively. A call option on the shares of ABC Ltd. can be exercised at the end of three months with a strike price of ₹ 630.

(i) Recommend the combination of share and the option which Mr. Dayal should select if he wants a perfect hedge. ***(2 Marks)***

(ii) Analyze and calculate the value of option today. (the risk free rate is 10% p.a.) ***(4 Marks)***

(iii) Calculate the expected rate of return on the option. ***(2 Marks)***

(b) M/s. Parker & Co. is contemplating to borrow an amount of ₹ 60 crores for a Period of 3 months in the coming 6 month's time from now. The current rate of interest is 9% p.a., but it may go up in 6 month's time. The company wants to hedge itself against the likely increase in interest rate.

The Company's Bankers quoted an FRA (Forward Rate Agreement) at 9.30%p.a.

Analyze the effect of FRA and actual rate of interest cost to the company, if the actual rate of interest after 6 months happens to be (i) 9.60% p.a. and (ii) 8.80% p.a. ***(8 Marks)***

(c) Explain Financial Risk from the point of view of Stakeholder, Company and the Government.

(4 Marks)

3. (a) On 1 April 2015, Sunidhi was holding a portfolio of 10 securities whose value was ₹ 9,94,450, the weighted average of beta of 9 securities was 1.10.

Since she was expecting a fall in the prices of the shares in near future to hedge her portfolio she sold 5 contract of NIFTY Futures (Multiplier of 25) expiring in May 2015, which was trading at 8767.07 on 1 April.

(a) Calculate the beta of the 10th security.

(b) Reconcile the reasons in spite of 2% fall in the market as per Sunidhi's apprehension if she would have earned some profit on her cash position. ***(8 Marks)***

(b) Odessa Limited has proposed to expand its operations for which it requires funds of $ 15 million, net of issue expenses which amount to 2% of the issue size. It proposed to raise the funds through a GDR issue. It considers the following factors in pricing the issue:

(i) The expected domestic market price of the share is ₹ 300

(ii) 3 shares underly each GDR

(iii) Underlying shares are priced at 10% discount to the market price

(iv) Expected exchange rate is ₹ 60/$

Calculate the number of GDR's to be issued and cost of GDR to Odessa Limited, if 20% dividend is expected to be paid with a growth rate of 20%. ***(8 Marks)***

(c) Describe the various Islamic Finance Instruments. ***(4 Marks)***

4. (a) Following is the data regarding six securities:

	U	V	W	X	Y	Z
Return (%)	10	10	15	5	11	10
Risk (%) (Standard deviation)	5	6	13	5	6	7

(i) Recommend at least three securities which shall be selected among the six securities mentioned above. ***(3 Marks)***

(ii) Assuming perfect correlation, evaluate whether it is preferable to invest 80% in security U and 20% in security W or to invest 100% in Y. ***(4 Marks)***

(b) SAM Ltd. has just paid a dividend of ₹ 2 per share and it is expected to grow @ 6% p.a. After paying dividend, the Board declared to take up a project by retaining the next three annual dividends. It is expected that this project is of same risk as the existing projects. The results of this project will start coming from the 4th year onward from now. The dividends will then be ₹ 2.50 per share and will grow @ 7% p.a.

An investor has 1,000 shares in SAM Ltd. and wants a receipt of atleast ₹ 2,000 p.a. from this investment.

Evaluate whether the market value of the share is affected by the decision of the Board. Evaluate also as to how the investor can maintain his target receipt from the investment for first 3 years and improved income thereafter, given that the cost of capital of the firm is 8%. ***(7 Marks)***

(c) Explain Dow Jones theory. ***(6 Marks)***

5. (a) A Mutual Fund having 300 units has shown its NAV of ₹ 8.75 and ₹ 9.45 at the beginning and at the end of the year respectively. The Mutual Fund has given two options:

(i) Pay ₹ 0.75 per unit as dividend and ₹ 0.60 per unit as a capital gain, or

(ii) These distributions are to be reinvested at an average NAV of ₹ 8.65 per unit.

Evaluate the difference it would make in terms of return available and which option is preferable.

(8 Marks)

(b) Closing values of BSE Sensex from 6th to 17th day of the month of January of the year 200X were as follows:

Days	Date	Day	Sensex
1	6	THU	14522
2	7	FRI	14925
3	8	SAT	No Trading
4	9	SUN	No Trading
5	10	MON	15222
6	11	TUE	16000
7	12	WED	16400
8	13	THU	17000
9	14	FRI	No Trading
10	15	SAT	No Trading
11	16	SUN	No Trading
12	17	MON	18000

Calculate Exponential Moving Average (EMA) of Sensex during the above period. The 30 days simple moving average of Sensex can be assumed as 15,000. The value of exponent for 30 days EMA is 0.062.

Give detailed analysis on the basis of your calculations. ***(7 Marks)***

(c) Describe the role of financial market in economic development.

OR

Describe various securitization instruments. ***(5 Marks)***

6. (a) The following information is given for 3 companies that are identical except for their capital structure:

	Orange	Grape	Apple
Total invested capital	1,00,000	1,00,000	1,00,000
Debt/assets ratio	0.8	0.5	0.2
Shares outstanding	6,100	8,300	10,000
Pre tax cost of debt	16%	13%	15%
Cost of equity	26%	22%	20%
Operating Income (EBIT)	25,000	25,000	25,000
Net Income	8,970	12,350	14,950

The tax rate is uniform 35% in all cases.

(i) Calculate the Weighted average cost of capital for each company. ***(2 Marks)***

(ii) Calculate the Economic Valued Added (EVA) for each company. ***(2 Marks)***

(iii) Recommend on the basis of EVA, which company would be considered for best investment by giving reasons. ***(1 Mark)***

(b) A hypothetical company ABC Ltd. issued a 10% Debenture (Face Value of ₹ 1000) of the duration of 10 years is currently trading at ₹ 850 per debenture. The bond is convertible into 50 equity shares being currently quoted at ₹ 17 per share.

Calculate the spread of yield of the above bond from this comparable bond, if equivalent yield of the same is 11.80%. ***(5 Marks)***

(c) A Ltd. of U.K. has imported some chemical worth of USD 3,64,897 from one of the U.S. suppliers. The amount is payable in six months time. The relevant spot and forward rates are:

Spot rate	USD 1.5617-1.5673
6 months' forward rate	USD 1.5455 –1.5609

The borrowing rates in U.K. and U.S. are 7% and 6% respectively and the deposit rates are 5.5% and 4.5% respectively.

Currency options are available under which one option contract is for GBP 12,500. The option premium for GBP at a strike price of USD 1.70/GBP is USD 0.037 (call option) and USD 0.096 (put option) for 6 months period.

The company has three choices:

(i) Forward cover

(ii) Money market cover, and

(iii) Currency option

Recommend the alternative (among the three choices mentioned above) that would be preferable by the company. ***(10 Marks)***