Test Series: March, 2015

MOCK TEST PAPER –1

FINAL COURSE: GROUP – I

PAPER – 2 : STRATEGIC FINANCIAL MANAGEMENT

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

Time Allowed – 3 Hours | Maximum Marks – 100

1. (a) Blue Tooth Mutual Fund is planning to float a fixed income fund of Rs. 100 crore on 1 January 2015 with a term of 7 years. If the target duration of fund is 5½ years and has expected rate of return of 8.00%, then determine the amount of interest it has to earn annually on it investment after defraying management expenses of 10% of amount income earned. *(5 Marks)*

(b) You, a foreign exchange dealer of your bank, are informed that your bank has sold a T.T. on Copenhagen for Danish Kroner 10,00,000 at the rate of Danish Kroner 1 = Rs. 6.5150. You are required to cover the transaction either in London or New York market. The rates on that date are as under:

Mumbai-London	Rs. 74.3000	Rs. 74.3200
Mumbai-New York	Rs. 49.2500	Rs. 49.2625
London-Copenhagen	DKK 11.4200	DKK 11.4350
New York-Copenhagen	DKK 07.5670	DKK 07.5840

In which market will you cover the transaction, London or New York, and what will be the exchange profit or loss on the transaction? Ignore brokerages.

(5 Marks)

(c) Given the following information:

Current Dividend	Rs. 5.00
Discount Rate	10%
Growth rate	2%

(i) Calculate the present value of the stock.

(ii) Is the stock over valued if the price is Rs.40, ROE = 8% and EPS = Rs. 3.00. Show your calculations under the PE Multiple approach and Earnings Growth model. *(5 Marks)*

(d) The following data relate to Anand Ltd.'s share price:

Current price per share	Rs. 1,800
6 months future's price/share	Rs. 1,950

Assuming it is possible to borrow money in the market for transactions in securities at 12% per annum, you are required:

(i) to calculate the theoretical minimum price of a 6-months forward purchase; and

(ii) to explain arbitrate opportunity. *(5 Marks)*

2. (a) Khalid Tour Operator Ltd. is considering to buy a new car for its fleet for local touring purpose. Purchase Manager has identified Renault Duster model car for this purpose. Company can acquire it either by borrowing the fund from bank at 12% or go for leasing option involving yearly payment (in the end) of Rs. 270000 for 5 years.

The new car shall cost Rs. 1000000 and would be depreciable at 25% as per WDV method for its owner. The residual value of car is expected to be Rs. 67,000 at the end of 5 years.

The corporate tax rate is 33%. You are required to:

(i) Calculate which of the two options borrowings or leasing shall be financially more advantageous for the Company.

(ii) Measure the sensitivity of Leasing/ Borrowing Decision in relation to each of the following parameters:

(1) Rate of Borrowing

(2) Residual Value

(3) Initial Outlay

Among above which factor is more sensitive. *(12 Marks)*

(b) GKL Ltd. is considering installment sale of LCD TV as a sales promotion strategy. In a deal of LCD TV, with selling price of Rs. 50,000, a customer can purchase it for cash down payment of Rs. 10,000 and balance amount by adopting any of the following options:

Tenure of Monthly installments	Equated Monthly installment
12	Rs. 3800
24	Rs. 2140

Required:

Estimate the flat and effective rate of interest for each alternative.

$PVIFA_{2.05\%, 12} = 10.5429$ $PVIFA_{2.10\%, 12} = 10.5107$

$PVIFA_{2.10\%, 24} = 18.7014$ $PVIFA_{2.12\%, 24} = 18.6593$ *(4 Marks)*

3. (a) B Ltd. is a highly successful company and wishes to expand by acquiring other firms. Its expected high growth in earnings and dividends is reflected in its PE ratio of 17. The Board of Directors of B Ltd. has been advised that if it were to take over firms with a lower PE ratio than it own, using a share-for-share exchange, then it could increase its reported earnings per share. C Ltd. has been suggested as a possible target for a takeover, which has a PE ratio of 10 and 1,00,000 shares in issue with a share price of Rs. 15. B Ltd. has 5,00,000 shares in issue with a share price of Rs. 12.

Calculate the change in earnings per share of B Ltd. if it acquires the whole of C Ltd. by issuing shares at its market price of Rs.12. Assume the price of B Ltd. shares remains constant. *(6 Marks)*

(b) SRK Ltd. is a listed company and it has just announced annual dividend for the year ending 2013-14. Earning Per Share (EPS) and Dividend Per Share (DPS) for 5 years is as follows:

	2013-14	2012-13	2011-12	2010-11	2009-10
EPS (Rs.)	14.00	13.60	13.10	12.70	12.20
DPS (Rs.)	8.20	8.10	7.90	7.80	7.70

In the opinion of MD of SRK Ltd.,if current dividend policy is maintained annual growth in Earning and Dividends will be no better than the annual growth in earnings over the past years.

Since the Board of SRK Ltd. is reluctant to take debt to finance growth it is considering changing its dividend policy by retaining 50% of its earnings for investment in various projects having a post tax rate of return of 15%. The beta of SRK Ltd. is 1.5, market risk premium is 4% and Risk Free Rate of Return is 6%.

You are required to calculate expected market price of share, if

(1) SRK Ltd. does not announce a change in its Dividend Policy.

(2) SRK Ltd. does announce a change in its Dividend Policy by retaining 50% of its earnings.

Note: Growth Rate can be assumed to be remain stable. *(10 Marks)*

4. (a) On January 1, 2013 an investor has a portfolio of 5 shares as given below:

Security	Price	No. of Shares	Beta
A	349.30	5,000	1.15
B	480.50	7,000	0.40
C	593.52	8,000	0.90
D	734.70	10,000	0.95
E	824.85	2,000	0.85

The cost of capital to the investor is 10.5% per annum.

You are required to calculate:

(i) The beta of his portfolio.

(ii) The theoretical value of the NIFTY futures for February 2013.

(iii) The number of contracts of NIFTY the investor needs to sell to get a full hedge until February for his portfolio if the current value of NIFTY is 5900 and NIFTY futures have a minimum trade lot requirement of 200 units. Assume that the futures are trading at their fair value.

(iv) The number of future contracts the investor should trade if he desires to reduce the beta of his portfolios to 0.6.

No. of days in a year be treated as 365.

Given: In (1.105) = 0.0998 and $e^{(0.015858)}$ = 1.01598 *(8 Marks)*

(b) Expected returns on two stocks for particular market returns are given in the following table:

Market Return	Aggressive	Defensive
7%	4%	9%
25%	40%	18%

You are required to calculate:

(a) The Betas of the two stocks.

(b) Expected return of each stock, if the market return is equally likely to be 7% or 25%.

(c) The Security Market Line (SML), if the risk free rate is 7.5% and market return is equally likely to be 7% or 25%.

(d) The Alphas of the two stocks. *(8 Marks)*

5. (a) A money market instrument with face value of Rs.100 and discount yield of 6% will mature in 45 days. You are required to calculate:

(i) Current price of the instrument.

(ii) Bond equivalent yield

(iii) Effective annual return. *(6 Marks)*

(b) 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 3 choices:

(i) Forward cover

(ii) Money market cover, and

(iii) Currency option

Which of the alternatives is preferable by the company? *(10 Marks)*

6. (a) The following information is relating to Fortune India Ltd. having two division, viz. Pharma Division and Fast Moving Consumer Goods Division (FMCG Division). Paid up share capital of Fortune India Ltd. is consisting of 3,000 Lakhs equity shares of Re. 1 each. Fortune India Ltd. decided to de-merge Pharma Division as Fortune Pharma Ltd. w.e.f. 1.4.2009. Details of Fortune India Ltd. as on 31.3.2009 and of Fortune Pharma Ltd. as on 1.4.2009 are given below:

Particulars	Fortune Pharma Ltd. Rs.	Fortune India Ltd. Rs.
Outside Liabilities		
Secured Loans	400 lakh	3,000 lakh
Unsecured Loans	2,400 lakh	800 lakh
Current Liabilities & Provisions	1,300 lakh	21,200 lakh
Assets		
Fixed Assets	7,740 lakh	20,400 lakh
Investments	7,600 lakh	12,300 lakh
Current Assets	8,800 lakh	30,200 lakh
Loans & Advances	900 lakh	7,300 lakh
Deferred tax/Misc. Expenses	60 lakh	(200) lakh

Board of Directors of the Company have decided to issue necessary equity shares of Fortune Pharma Ltd. of Re. 1 each, without any consideration to the shareholders of Fortune India Ltd. For that purpose following points are to be considered:

1. Transfer of Liabilities & Assets at Book value.
2. Estimated Profit for the year 2009-10 is Rs. 11,400 Lakh for Fortune India Ltd. & Rs. 1,470 lakhs for Fortune Pharma Ltd.
3. Estimated Market Price of Fortune Pharma Ltd. is Rs. 24.50 per share.

4. Average P/E Ratio of FMCG sector is 42 & Pharma sector is 25, which is to be expected for both the companies.

Calculate:

1. The Ratio in which shares of Fortune Pharma are to be issued to the shareholders of Fortune India Ltd.
2. Expected Market price of Fortune India (FMCG) Ltd.
3. Book Value per share of both the Companies immediately after Demerger.

(10 Marks)

(b) JKL Ltd., an Indian company has an export exposure of JPY 10,000,000 payable August 31, 2014. Japanese Yen (JPY) is not directly quoted against Indian Rupee.

The current spot rates are:

INR/US $	=	Rs. 62.22
JPY/US$	=	JPY 102.34

It is estimated that Japanese Yen will depreciate to 124 level and Indian Rupee to depreciate against US $ to Rs. 65.

Forward rates for August 2014 are

INR/US $	=	Rs. 66.50
JPY/US$	=	JPY 110.35

Required:

(i) Calculate the expected loss, if the hedging is not done. How the position will change, if the firm takes forward cover?

(ii) If the spot rates on August 31, 2014 are:

INR/US $	=	Rs. 66.25
JPY/US$	=	JPY 110.85

Is the decision to take forward cover justified? *(6 Marks)*

7. Write short notes on any of four of the following:

(a) Linkage between Financial Policy and Strategic Management

(b) Meaning of Caps, Floors and Collar's Options

(c) Exchange Traded Funds

(d) Repo and Reverse Repo

(e) Dow Jones Theory *(4 ×4 = 16 Marks)*