

Roll No.

Total No. of Questions – 7

Time Allowed – 3 Hours

FINAL
GROUP-I PAPER-2
STRATEGIC FINANCIAL
MANAGEMENT
Total No. of Printed Pages – 8

NOV 2012

Maximum Marks – 100

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Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi medium, his/her answers in Hindi will not be valued.

Question No. 1 is compulsory

Candidates are also required to answer any **five** questions from the remaining **six** questions.

Wherever necessary suitable assumptions may be made and disclosed by way of a note.

Working Notes should form part of the answer.

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1. (a) X Ltd. earns ₹ 6 per share having a capitalization rate of 10 percent and has a return on investment of 20%. According to Walter's model, what should be the price of the share at 25% dividend payout ? **4×5 =20**
- (b) Calculate the Current price and the Bond equivalent yield (using simple compounding) of a money market instrument with face value of ₹ 100 and discount yield of 8% in 90 days. Take 1 year = 360 days.
- (c) The following information is extracted from Steady Mutual Fund's Scheme :
- | | |
|---|---------------------|
| – Asset Value at the beginning of the month | – ₹ 65.78 |
| – Annualised return | – 15% |
| – Distributions made in the nature of Income & Capital gain (per unit respectively) | – ₹ 0.50 and ₹ 0.32 |
- You are required to :
- (1) Calculate the month end net asset value of the mutual fund scheme (limit your answers to two decimals).
 - (2) Provide a brief comment on the month end NAV.

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(d) The US dollar is selling in India at ₹ 55.50. If the interest rate for a 6 months borrowing in India is 10% per annum and the corresponding rate in USA is 4% :

- (i) Do you expect that US dollar will be at a premium or at discount in the Indian Forex Market ?
- (ii) What will be the expected 6-months forward rate for US dollar in India ? and
- (iii) What will be the rate of forward premium or discount ?

2. (a) H Ltd. agrees to buy over the business of B Ltd. effective 1st April, 2012. 12
The summarized Balance Sheets of H Ltd. and B Ltd. as on 31st March 2012 are as follows :

Balance Sheet as at 31st March, 2012 (in Crores of Rupees)		
<u>Liabilities :</u>	H Ltd.	B Ltd.
Paid up Share Capital :		
– Equity Shares of ₹ 100 each	350.00	
– Equity Shares of ₹ 10 each		6.50
Reserves & Surplus	950.00	25.00
Total	1,300.00	31.50
<u>Assets :</u>		
Net Fixed Assets	220.00	0.50
Net Current Assets	1,020.00	29.00
Deferred Tax Asset	60.00	2.00
Total	1,300.00	31.50

H Ltd. proposes to buy out B Ltd. and the following information is provided to you as part of the scheme of buying :

- (1) The weighted average post tax maintainable profits of H Ltd. and B Ltd. for the last 4 years are ₹ 300 crores and 10 crores respectively.

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- (2) Both the companies envisage a capitalization rate of 8%.
- (3) H Ltd. has a contingent liability of ₹ 300 crores as on 31st March, 2012.
- (4) H Ltd. to issue shares of ₹ 100 each to the shareholders of B Ltd. in terms of the exchange ratio as arrived on a Fair Value basis. (Please consider weights of 1 and 3 for the value of shares arrived on Net Asset basis and Earnings capitalization method respectively for both H Ltd. and B Ltd.)

You are required to arrive at the value of the shares of both H Ltd. and B Ltd. under :

- (i) Net Asset Value Method
- (ii) Earnings Capitalisation Method
- (iii) Exchange ratio of shares of H Ltd. to be issued to the shareholders of B Ltd. on a Fair value basis (taking into consideration the assumption mentioned in point 4 above.)

- (b) With the help of the following information of Jatayu Limited compute the Economic Value Added : 4

Capital Structure	:	Equity capital ₹ 160 lakhs
		Reserves and Surplus ₹ 140 lakhs
		10% Debentures ₹ 400 lakhs
Cost of equity	:	14%
Financial Leverage	:	1.5 times
Income Tax Rate	:	30%

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3. (a) You as an investor had purchased a 4 month call option on the equity shares of X Ltd. of ₹ 10, of which the current market price is ₹ 132 and the exercise price ₹ 150. You expect the price to range between ₹ 120 to ₹ 190. The expected share price of X Ltd. and related probability is given below :

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Expected Price (₹)	120	140	160	180	190
Probability	.05	.20	.50	.10	.15

Compute the following :

- (1) Expected Share price at the end of 4 months.
 - (2) Value of Call Option at the end of 4 months, if the exercise price prevails.
 - (3) In case the option is held to its maturity, what will be the expected value of the call option ?
- (b) Z Ltd. importing goods worth USD 2 million, requires 90 days to make the payment. The overseas supplier has offered a 60 days interest free credit period and for additional credit for 30 days an interest of 8% per annum. The bankers of Z Ltd offer a 30 days loan at 10% per annum and their quote for foreign exchange is as follows :

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	₹	
Spot 1 USD	–	56.50
60 days forward for 1 USD	–	57.10
90 days forward for 1 USD	–	57.50

You are required to evaluate the following options :

- (I) Pay the supplier in 60 days, or
- (II) Avail the supplier's offer of 90 days credit.

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4. (a) Eagle Ltd. reported a profit of ₹ 77 lakhs after 30% tax for the financial year 2011-12. An analysis of the accounts revealed that the income included extraordinary items of ₹ 8 lakhs and an extraordinary loss of ₹ 10 lakhs. The existing operations, except for the extraordinary items, are expected to continue in the future. In addition, the results of the launch of a new product are expected to be as follows :

	₹ in lakhs
Sales	70
Material costs	20
Labour costs	12
Fixed costs	10

You are required to :

- (i) Calculate the value of the business, given that the capitalization rate is 14%.
- (ii) Determine the market price per equity share , with Eagle Ltd.'s share capital being comprised of 1,00,000 13% preference shares of ₹ 100 each and 50,00,000 equity shares of ₹ 10 each and the P/E ratio being 10 times.
- (b) Mr. FedUp wants to invest an amount of ₹ 520 lakhs and had approached his Portfolio Manager. The Portfolio Manager had advised Mr. FedUp to invest in the following manner :

Security	Moderate	Better	Good	Very Good	Best
Amount (in ₹ lakhs)	60	80	100	120	160
Beta	0.5	1.00	0.80	1.20	1.50

You are required to advise Mr. FedUp in regard to the following, using Capital Asset Pricing Methodology :

- (i) Expected return on the portfolio, if the Government Securities are at 8% and the NIFTY is yielding 10%.
- (ii) Advisability of replacing Security 'Better' with NIFTY.

5. (a) Following Financial Data for Platinum Ltd. are available :

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For the year 2011 : (₹ in lakhs)

Equity Shares (₹ 10 each)	100
8% Debentures	125
10% Bonds	50
Reserves and Surplus	200
Total Assets	500
Assets Turnover Ratio	1.1
Effective Tax Rate	30%
Operating Margin	10%
Required rate of return of investors	15%
Dividend payout ratio	20%
Current market price of shares	₹ 13

You are required to :

- Draw income statement for the year
- Calculate the sustainable growth rate
- Compute the fair price of the company's share using dividend discount model, and
- Draw your opinion on investment in the company's share at current price.

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- (b) Tiger Ltd. is presently working with an Earning Before Interest and Taxes (EBIT) of ₹ 90 lakhs. Its present borrowings are as follows : 8

	₹ in lakhs
12% term loan	300
Working capital borrowings :	
From Bank at 15%	200
Public Deposit at 11%	100

The sales of the company are growing and to support this, the company proposes to obtain additional borrowing of ₹ 100 lakhs expected to cost 16%. The increase in EBIT is expected to be 15%.

Calculate the change in interest coverage ratio after the additional borrowing is effected and comment on the arrangement made.

6. (a) Yes Ltd. wants to acquire No Ltd. and the cash flows of Yes Ltd. and the merged entity are given below : 8

	(in ₹ lakhs)				
Year	1	2	3	4	5
Yes Ltd.	175	200	320	340	350
Merged Entity	400	450	525	590	620

Earnings would have witnessed 5% constant growth rate without merger and 6% with merger on account of economies of operations after 5 years in each case. The cost of capital is 15%.

The number of shares outstanding in both the companies before the merger is the same and the companies agree to an exchange ratio of 0.5 shares of Yes Ltd. for each share of No Ltd.

PV factor at 15% for years 1-5 are 0.870, 0.756, 0.658, 0.572, 0.497 respectively.

You are required to :

- Compute the Value of Yes Ltd. before and after merger.
- Value of Acquisition and
- Gain to shareholders of Yes Ltd.

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(b) Given the following information :

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Current Dividend	₹ 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 ₹ 40, ROE = 8% and EPS = ₹ 3.00. Show your calculations under the PE Multiple approach and Earnings Growth model.

7. Answer any **four** from the following :

4×4
=16

- (a) Interface of Financial Policy and Strategic Management
- (b) Commercial Paper
- (c) American Depository Receipt
- (d) Advantages of holding securities in 'Demat' form
- (e) Synergy in the context of Mergers and Acquisitions

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