MOCK TEST PAPER 1

FINAL 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) On 1st October 2021 Mr. P an exporter enters into a forward contract with a XYZ Bank to sell US$ 5,00,000 on 31 December 2021 at ₹ 75.40/$. However, due to the request of the importer, Mr. P received amount on 28th November 2021. Mr. P requested the bank to take the delivery of the remittance on 30th November 2021 i.e. before due date. The inter-banking rates on 28th November 2021 were as follows:

Spot ₹ 75.22/75.27

One Month Premium 10/15

If bank agrees to take early delivery then what will be net inflow to Mr. P assuming that the prevailing prime lending rate is 18%.

Note: 1. Consider 365 days a year

2. Round off final calculation in Rupees i.e. not in paisa **(10 Marks)**

(b) The risk free rate of return (R_f) is 8 percent and the expected rate of return on market portfolio (R_m) is 12 percent. The expected rate of growth for the dividend of J Ltd. is 6 percent. The last dividend paid on the equity stock was ₹ 5.00. The beta of J Ltd. equity stock is 1.5.

(i) What is the equilibrium price of the equity stock of J Ltd.?

(ii) Evaluate the impact of following factors jointly on the equilibrium price of equity stock of J Ltd.

- the inflation premium increases by 2 percent;
- the expected growth rate increases by 2 percent in absolute terms;
- the beta of J Ltd. equity rises to 1.8 and
- market return remains the same. **(6 Marks)**

(c) Explain how financial risk can be evaluated from different point of views. **(4 Marks)**

2. (a) Compute EVA of X Ltd. with the following information:

Profit and Loss Statement		Balance Sheet	
Revenue	1500	PPE	1500
Direct Costs	-585	Current Assets	450
Selling, General & Admin. Exp. (SGA)	-300		**1950**
EBIT	615	Equity	1050
Interest	-15	Reserves	150
EBT	600	Non-Current Borrowings	150
Tax Expense @30%	-180	Current Liabilities & Provisions	600
EAT	**420**		**1950**

Assume Bad Debts provision of ₹ 30 Lac is included in the SGA, and same amount is reduced from the trade receivables in current assets.

Also assume that the pre-tax Cost of Debt is 12% and Equity shareholder's expected return is 10%.

Note: Make calculation in ₹ lac and round off up to 2 decimal points. **(8 Marks)**

(b) Calculate the justified price of 3 months ABC futures, if share of ABC (FV ₹ 10) quotes at ₹ 450 on NSE and the one month borrowing rate is given as 12 percent per annum and the expected annual dividend is 20 percent, payable before expiry. Also demonstrate is there any arbitrage opportunities if the three months Futures Price quotes at ₹ 470. **(8 Marks)**

(c) Not only Bundling and Unbundling is only feature of Securitisation, there are other features too of the same. Explain. **(4 Marks)**

OR

Explain the key features of Alternative Investments that make them different from other investment avenues. **(4 Marks)**

3. (a) The data given below relates to a convertible bond :

Face value	₹ 250
Coupon rate	12%
No. of shares per bond	20
Market price of share	₹ 12
Straight value of bond	₹ 235
Market price of convertible bond	₹ 265

Calculate:

(i) Stock value of bond.

(ii) The percentage of downside risk.

(iii) The conversion premium

(iv) The conversion parity price of the stock. **(8 Marks)**

(b) Mr. A is having 500 units of a Mutual Fund which has shown its per unit NAV of ₹ 9.75 and ₹ 12.35 at the beginning and at the end of the year respectively. The Mutual Fund has given two options:

(i) Receive a payment of ₹ 1.25 per unit as dividend and ₹ 0.80 per unit as a capital gain, or

(ii) Reinvestment of these distributions at an average NAV of ₹ 11.05 per unit.

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

(8 Marks)

(c) Explain the term Corporate Level Strategy and what are the three basic questions it answers? **(4 Marks)**

4. (a) MN 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 30% a year. Inflation in India is currently 10% a year. Management of MN 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
Cashflows in Indian ₹ (000)	-100,000	-3,000	-4,000	-5,000
Cash flows in African Rands (000)	-4,00,000	+1,00,000	+1,40,000	+1,80,000

MN 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 ₹ 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 its high risk.

(iii) Ignore taxation.

	Year - 1	Year - 2	Year - 3
PVIF @ 20%	0.833	0.694	0.579

(8 Marks)

(b) A mutual fund made an issue of 5,00,000 units of ₹ 10 each on January 01, 2020. No entry load was charged. It made the following investments:

Particulars	₹
25,000 Equity shares of ₹ 100 each @ ₹ 160	40,00,000
7% Government Securities	4,00,000
9% Debentures (Unlisted)	2,50,000
10% Debentures (Listed)	2,50,000
	49,00,000

During the year, dividends of ₹ 6,00,000 were received on equity shares. Interest on all types of debt securities was received as and when due. At the end of the year equity shares and 10% debentures are quoted at 175% and 90% respectively of face value. Other investments are valued at par.

Find out the Net Asset Value (NAV) per unit given that operating expenses paid during the year amounted to ₹ 2,50,000. Also find out the NAV, if the Mutual fund had distributed a dividend of ₹ 0.80 per unit during the year to the unit holders. **(8 Marks)**

(c) "Though in recent period of time the concept of securitisation has become popular in India as a source of Off Balance Sheet source of financing but its level of growth is still far behind" Explain. **(4 Marks)**

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

Market Return	Aggressive	Defensive
10.50%	6%	13.50%
37.50%	60%	27%

You are required to calculate:

(1) The Betas of the two stocks.

(2) Expected return of each stock, if the market return is equally likely to be 10.50% or 37.50%.

(3) The Security Market Line (SML), if the risk free rate is 11.25% and market return is equally likely to be 10.50% or 37.50%.

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

(b) A textile manufacturer has taken floating interest rate loan of ₹ 40,00,000 on 1st April, 2012. The rate of interest at the inception of loan is 8.5% p.a. interest is to be paid every year on 31st March, and the duration of loan is four years. In the month of October 2012, the Central bank of the country releases following projections about the interest rates likely to prevail in future.

Dates	Interest Rate
31st March, 2013	8.75%
31st March, 2014	10.00%
31st March, 2015	10.50%
31st March, 2016	7.75%.

(i) Advise how borrower can hedge the risk arising out of expected rise in the rate of interest when he is interested in pegging his interest cost at 8.50% p.a. and if option on Interest Rate is available at 0.75% p.a.

(ii) Assume that the premium negotiated by both the parties at the above-mentioned rate which is to be paid on upfront basis and the actual rate of interest on the respective due dates happens to be as follows:

Dates	Interest Rate
31st March, 2013	10.20%
31st March, 2014	11.50%
31st March, 2015	9.25%
31st March, 2016	8.25%.

(8 Marks)

(c) During Pitch Presentation to convince the investors to put money into the proposed business how promoters deal with following points:

(i) Problem (ii) Solution (iii) Marketing/Sales (iv) Business Model **(4 Marks)**

6. (a) Following information is provided relating to the acquiring company M Ltd. and the target company R Ltd:

	M Ltd.	R Ltd.
Earnings after tax (₹ lakhs)	4,000	8,000
No. of shares outstanding (lakhs)	400	2,000
P/E ratio (No. of times)	5	2.50

Required:

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

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

(iii) What is the expected market price per share of M 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) Your bank's London office has surplus funds to the extent of USD 10,00,000/- for a period of 3 months. The cost of the funds to the bank is 4% p.a. It proposes to invest these funds in London, New York or Frankfurt and obtain the best yield, without any exchange risk to the bank. The following rates of interest are available at the three centres for investment of domestic funds there at for a period of 3 months.

London	5 % p.a.
New York	8% p.a.
Frankfurt	3% p.a.

The market rates in London for US dollars and Euro are as under:

London on New York	
Spot	1.5350/90
1 month	15/18
2 months	30/35
3 months	80/85
London on Frankfurt	
Spot	1.8260/90
1 month	60/55
2 months	95/90
3 months	145/140

At which centre, investment will be made & what will be the net gain (to the nearest pound) to the bank on the invested funds? **(8 Marks)**

(c) **"**Investors can use Stock Index Futures to perform myriad tasks". Explain. **(4 Marks)**