

FINAL
GROUP-I PAPER-2
STRATEGIC FINANCIAL
MANAGEMENT

JUL 2021

Roll No

Total No. of Questions – 7

Total No. of Printed Pages – 11

Time Allowed – 3 Hours

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.

Working notes should form part of the respective answers.

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|----|-----|--|----------|
| 1. | (a) | <p>The Asset Management Company of the mutual fund (MF) has declared a dividend of 9.98% on the units under the dividend reinvestment plan for the year ended 31st March, 2021. The investors are issued additional units for the dividend at the rate of closing Net Asset Value (NAV) for the year as per the conditions of the scheme. The closing NAV was ₹ 24.95 as on 31st March, 2021. An investor Mr. X who is having 20,800 units at the year-end has made an investment in the units before the declaration of the dividend and at the rate of opening NAV plus an entry load of ₹ 0.04. The NAV has appreciated by 25% during the year.</p> | 5 |
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Assume the face value of the unit as ₹ 10.00.

You are required to calculate :

- (i) Opening NAV,
- (ii) Number of the units purchased,
- (iii) Original amount of the investment.

- (b) The Bank BK enters into a Repo for 9 days with Bank NE in 6% Government bonds 2022 for an amount of ₹ 2 crore. The other relevant details are as follows :

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First Leg Payment (Start Proceed)	₹ 2,00,06,750
Second Leg Payment (Repayment Proceed)	₹ 2,00,31,759
Initial Margin	1.25%
Days of accrued interest	240

Assume 360 days in a year.

You are required to calculate :

- (i) Repo Rate
- (ii) Dirty Price and
- (iii) Clean Price

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- (c) M/s. SKPD Ltd. employs certainty-equivalent approach in the evaluation of risky investments. The finance department of the company has developed the following information regarding a new project :

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Year	Expected CFAT (₹)	Certainty-equivalent quotient
0 (Initial Outlays)	300,000	1.0
1	140,000	0.8
2	130,000	0.7
3	120,000	0.6
4	115,000	0.4
5	80,000	0.3

Following is the other information :

- The firm's cost of equity capital is 18%;
- Cost of debt is 9%;
- Present risk free rate of interest in the Market on the treasury bonds is 6%, which will rise by 200 basis points from 4th year onwards.

Year (t)	1	2	3	4	5
PVIF(6%, t)	0.943	0.890	0.840	0.792	0.747
PVIF(8%, t)	0.926	0.857	0.794	0.735	0.681

You are required to :

- To find out the viability of the project, and
- To advise on the popularity of this method.

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- (d) NM Ltd. (NML) is aspiring to enter the capital market in a three years' time. The Board wants to attain the target price of ₹ 70 for its shares at the end of three years. The present value of its shares is ₹ 52.03. The dividend is expected to grow at a rate of 15% for the next three years. NML uses dividend growth model for its projections.

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The required rate of return is 15%.

You are required to calculate the amount of dividend to be declared by the board in the base year so as to achieve the target price.

Period (t)	1	2	3
PVIF (15%,t)	0.8696	0.7561	0.6575

2. (a) XL Limited (XLL) is considering a proposal to expand its plant capacity and is seriously considering equipment on lease for a period of three years. The CFO has advised that an amount of ₹ 15,78,039 will be available during the next three years. This amount can be utilized towards annual lease rent to be paid at the end of the each year. However, this amount will be available in an increasing manner such that they are in the ratio of 1 : 2 : 3 over the next three years.

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LF Limited (LFL), a leasing company, can provide the required equipment. Depreciation is to be charged at Written Down Value (WDV) basis at the rate of 20%. Marginal Income Tax Rate of LFL is 30%. The required rate of return is 12%.

Ignore salvage value.

You are required to calculate the cost of equipment (to be leased), which can be supported by the cash flow of XLL.

Year (t)	1	2	3
PVIF (12%, t)	0.893	0.797	0.712

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(b) An investor has recently purchased substantial number of 7 year 6.75% ₹ 1,000 bond with 5% premium payable on maturity at a required Yield to Maturity (YTM) of 9%. However, due to a financial crunch he is looking to sell these bonds and has got a proposal from another investor, who is willing to purchase these bonds by shelling out a maximum amount of ₹ 897 per bond. Investors follow intrinsic value method for valuation of bonds.

(i) You are required to determine

- (1) The Market Price, Duration and Volatility of the bond and
- (2) Required YTM of the new investor

(ii) What is relationship between the price of the bond and YTM ?

Period (t)	1	2	3	4	5	6	7
PVIF (9%, t)	0.917	0.842	0.772	0.708	0.650	0.596	0.547

3. (a) SM Limited has a market capitalization of ₹ 3,000 crore and the current earnings per share (EPS) is ₹ 200 with a price earnings ratio (PER) of 15. The Board of directors is considering a proposal to buy back 20% of the shares at a premium which can be supported by the financials of the company. The Board expects post buy back market price per share (MPS) of ₹ 3057. Post buy back PER will remain same. The company proposes to fund the buy back by availing 8% bank loan since available resources are committed for expansion plans.

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Applicable income tax rate is 30%.

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You are required to calculate :

- (i) The interest amount which can be paid for availing the bank loan,
- (ii) The loan amount to be raised and
- (iii) The premium per share and percentage premium paid over the current MPS.

- (b) Aggressive Ltd., is proposing to fund its expansion plan of ₹ 12 crore by making a rights issue. The current market price (CMP) is ₹ 40. The Board is willing to offer a discount of 20% on the CMP for the rights issue. The Board is also desirous that the fall in Ex - right price of the shares be restricted to 10% of CMP.

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You are required to calculate :

- (i) The number of new equity shares to be offered for each rights held,
- (ii) Theoretical value of right and
- (iii) The total number of equity shares to be issued.

4. (a) M/S. Poor Ltd. (PL) has logged in a credit sales of ₹ 6 crore for the year ended 31st March, 2021. The receivables are 15% of credit sales. The average financing cost of receivables is 5%. Administration cost and Bad debts, on an average, amount to 2% and 7% of the receivables respectively. PL, as per an internal assessment, expects that the Bad debts may rise to 10% of the receivables in the coming year.

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PL is actively looking for a factor who can undertake management of credit administration on non-recourse basis. Factor, as per industry norms, will maintain a receivable collection period of 30 days and keeps a reserve of 20% of the receivables. The Factor charges an interest rate of 7% per annum on the advances.

You are required to advise

- (i) The maximum amount which PL can offer as the commission to the Factor,
- (ii) Whether a deal can be structured, if Factor requires a commission of 2.5% on the credit sales,
- (iii) Whether a deal is possible by negotiation wherein PL may offer extra commission due to savings on account of probable increase in Bad debts and the Factor, who is also eager to get business offers a 20% discount on its commission.

- (b) M/s. Strong an AMC has floated a dividend bonus plan on 1st April, 2016 at a certain net asset value (NAV). The fund has a robust growth and has declared a bonus of 1 : 5 (1 bonus unit for 5 right units held) on 30th September, 2017 and a second bonus of 1 : 4 (1 bonus unit for 4 right units held) on 30th September 2019. The fund, as on 31st March 2021, has generated an average yield of 17.5%.

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Mr. Optimistic has made an investment of ₹ 16 lakhs in the plan before the declaration of the first bonus and remain invested thereafter.

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The following information is also available :

Date	01.04.2016	30.09.2017	30.09.2019	31.03.2021
NAV (₹)	?	85	92	100

You are required to advise to Mr. Optimistic the opening NAV, which is required by him to calculate the capital appreciation.

5. (a) Mr. X is having 1 lakh shares of M/s. Kannyaka Ltd. The beta of the company is 1.40.

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Mr. Y a financial advisor has suggested having the following portfolio :

Security	Beta	% holding
S	1.20	10
K	0.75	10
P	0.40	30
D	1.40	50
		100

Market Return is 12%

Risk free rate is 8%

You are required to calculate the following for the present investment and suggested portfolio :

- (i) What is the expected return based on CAPM and also
- (1) If the market goes up by 2.5%
 - (2) If the market goes down by 2.5%
 - (3) If the market gives Negative Returns of 2.5%

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(i) If the probability of market giving negative return is more, please advise Mr. X whether to continue the holdings of M/s. Kannyaka Ltd. or to buy the portfolio as per the suggestion of Mr. Y. If so why ?

(b) M/s. Raghu Ltd. is interested in expanding its operation and planning to install manufacturing plant at US. It requires 8.82 million USD (net of issue expenses/ floatation cost) to fund the proposed project. GDRs are proposed to be issued to finance this project. The estimated floatation cost of GDRs is 2%.

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Additional information :

(i) Expected market price of share at the time of issue of GDR is ₹ 360 (Face Value ₹ 100)

(ii) Each GDR will represent two underlying Shares.

(iii) The issue shall be priced at 10% discount to the market price.

(iv) Expected exchange rate is INR/USD 72.

(v) Dividend is expected to be paid at the rate of 20% with growth rate of 12%.

(1) You, as a financial consultant, are required to compute the number of GDRs to be issued and cost of the GDR.

(2) What is your suggestion if the company receives an offer from a US Bank willing to provide an equivalent loan with an interest rate of 12% ?

(3) How much company can save by choosing the option as recommended by you ?

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6. (a) On 1st October, 2020 Mr. Guru, an exporter, enters into a forward contract with the Bank to sell USD 1,00,000 on 31st December 2020 at INR/USD 75.40. However, at the request of the importer, Mr. Guru received the amount on 30th November, 2020. Mr. Guru requested the bank take delivery of the remittance on 30th November, 2020 i.e. before due date.

The inter-bank rate on 30th November 2020 was as follows :

Spot INR/USD 75.22-75.27

One Month Premium 10/15

Assume 365 days in a year.

- (i) If bank agrees to take early delivery then what will be net inflow to Mr. Guru assuming that the prevailing prime lending rate is 18%. per annum.
 - (ii) If Mr. Guru can deploy these funds in USD, he gets return at the rate of 3% per annum. Which is better ? Why ?
- (b) Mr. Mammen, an Indian investor invests in a listed bond in USA. If the price of the bond at the beginning of the year is USD 100 and it is USD 103 at the end of the year. The coupon rate is 3% payable annually.

Find the return on investment in terms of home country currency if :

- (i) USD is Flat.
- (ii) USD appreciates during the year by 3%.
- (iii) USD depreciates during the year by 3%.
- (iv) Indian Rupee appreciates during the year by 5%.
- (v) Will your answer differs if Mr. Mammen invests in the bond just before the interest payable.

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Attempt **any four** of the following :

4×4

=16

- (a) Unrelated companies come together to form an entity. What this relationship is called ? Discuss briefly the features of this entity.
- (b) Investors are the lifeline of the capital markets. Who are the other participants giving lifeline to capital markets ? Briefly discuss any one.
- (c) "Liquidity is the effectiveness of working capital management, corporate policies for stock and creditors, management and ability of the corporate to meet their commitment in the short run." This is one of the ingredients in credit rating analysis. What are the other ingredients of the model ? Discuss briefly.
- (d) There exists a vast difference between Project and Parent cash flow ? What are these factors ? Briefly discuss.
- (e) "Cross-Border M & A is a popular route for global growth and overseas expansion." Do you agree or disagree ? Justify your stand.

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