Paper-12: FINANCIAL MANAGEMENT & INTERNATIONAL FINANCE

Time Allowed: 3 Hours **Full Marks: 100**

The figures in the margin on the right side indicate full marks.
Answer Question No. 1 from Part A which is compulsory and any five questions from Part B.
Working notes should form a part of the answer
"Wherever necessary, suitable assumptions should be made and indicated in answers by the candidates"

PART A (25 Marks)

Question.1

(a) In each, of the cases given below, one out of four answers is correct. Indicate the correct answer(=1mark)and give workings/reasons briefly in support of your answer (=1mark)
[2x9=18]

(i) Optimistic Ltd has an EPS of ₹90 per share. Its Dividend Payout Ratio is 40%. Its earnings and dividends are expected to grow at 5% per annum. Find out the cost of Equity Capital if its Market Price is ₹360 per share.
A. 5%
B. 10.5%
C. 15%
D. 15.5%

(ii) X owns a stock portfolio equally invested in a risk free asset and two stocks. If one of the stocks has a beta of 0.8 and the portfolio is as risky as the market what must be the beta of the other stocks in the portfolio?
A. 2.1
B. 2.2
C. 2.4
D. 2.6

(iii) An American company's Japanese subsidiary, Tahoma Japan, has exposed assets of ¥8 billion and exposed liabilities of ¥6 billion. During the year, the yen appreciates from ¥125/$ to ¥95/$.What is Tahoma Japan's net translation exposure at the beginning of the year in dollars?
A. $16 million
B. $18 million
C. $14 million
D. $12 million

(iv) The NAV of each unit of a closed-end fund at the beginning of the year was ₹18.By the end of the year its NAV equals ₹18.50. At the beginning of the year each unit was selling at a 2% premium to NAV and by the end of the year each unit is selling at a 4% discount to NAV. If the closed-end fund paid year end distribution of income of ₹2.50 on each unit, the rate of return to the investor in the fund during the year would be
A. 10.35%
B. 11.51%
C. 11.95%
D. None of the above

(v) The share price of Kaustav Ltd. (F.V. ₹10) quotes ₹500 in the NSE and the 3 months future price quotes at ₹525. The borrowing rate is 12% p.a.if the expected annual dividend yield is 15% payable before expiry, then the price of 3 months Kaustav Ltd's future would be

A. ₹500.00
B. ₹513.50
C. ₹516.50
D. Insufficient information

(vi) T Ltd. requires ₹3 million in cash for meeting its transaction needs over the next 6 months, its planning horizon for liquidity decision. The company currently has the amount in the form of marketable securities. The cash payment will be made evenly over the six month period. T Ltd. earns 12% annual yield on its marketable securities. Conversion and marketable securities into cash entails a fixed cost of ₹1000 per transaction. What will be the optimal conversion size as per Baumol model of cash management?
A. ₹3,15,628
B. ₹3,16,228
C. ₹3,17,678
D. ₹3,18,428

(vii) The total asset – turnover ratio and total asset to net- worth ratio of a company are 2.20 and 2.60 respectively. If the net profit margin of the company is 6%, what would be the return on equity?
A. 32.32%
B. 34.32%
C. 35.60%
D. 36.60%

(viii) The price of Swedish krones is $0.14 today. If it appreciates by 10% today, how many krones a dollar will buy tomorrow?
A. 6.49351
B. 4.69351
C. 3.49513
D. 5.64913

(ix) Samudra Steel earns 12% on the equity. The growth rate of the dividends and earnings is 6%. The book value per share is ₹60. If the cost of equity is 14% which of the following is the market price of the share of company, accounting to the Marakon Model of Valuation?
A. ₹36
B. ₹39
C. ₹45
D. ₹48

(b) State if each of the following sentences is true or false: [1 × 7]

(i) The amount of cheques issued by a company not yet paid out is referred to as net float.
(ii) Global Depository Receipts are issued to investors in India, who want to subscribe to shares of foreign companies.
(iii) IRR and NPV always give the same profitability ranking.
(iv) Retention Ratio is the product between growth rate and rate of return on investments.
(v) If Profitability Index is 1, cash inflow and cash outflow would be equal.
(vi) A currency swap converts a stream of cash flow from one currency to another without exchange rate risk.
(vii) A call option is 'in-the-money' when the price of the underlying asset is below the exercise price of the call.

PART B (75 MARKS)

Question. 2

(a) The annual turnover of S Ltd. is ₹60 lakhs of which 80% is on credit. Debtors are allowed one month to clear off the dues. A factor is willing to advance 90% of the bills raised on credit for a fee of 2% a month plus a commission of 4% on the total amount of debts.S Ltd. as a result of this arrangement is likely to save ₹21600 annually in management costs and avoid bad debts at 1% on the credit sales.
A scheduled bank has come forward to make an advance equal to 90% of the debts at an interest rate of 18% p.a. However its processing fee will be at 2% on the debts. Would you accept factoring offer or the offer from the bank? [10]

(b) Discuss Stochastic Model of Cash Management. [5]

Question. 3

A company has an old machine having book value zero – which can be sold for ₹50,000.The company is thinking to choose one from following two alternatives:
(i) To incur additional cost of ₹10,00,000 to upgrade the old existing machine.
(ii) To replace old machine with a new machine costing ₹20,00,000 plus installation cost ₹50,000.

Both above proposals envisage useful life to be 5 years with salvage value to be nil.
The expected after tax profits for the above alternatives are as under:

Year	Old Existing Machine	Upgraded Machine	New Machine
	₹	₹	₹
1	5,00,000	5,50,000	6,00,000
2	5,40,000	5,90,000	6,40,000
3	5,80,000	6,10,000	6,90,000
4	6,20,000	6,50,000	7,40,000
5	6,60,000	7,00,000	8,00,000

The tax rate is 40%. The company follows straight line method of depreciation. Assume cost of capital to be 15%.PVF of 15% for 5 years= 0.870, 0.756, 0.658, 0.572 and 0.497. You are required to advise the company as to which alternative is to be adopted. [15]

Question. 4

(a) Consider the following information for Target Ltd.
EBIT ₹1120 Lakhs
PBT ₹320 Lakhs
Fixed Cost ₹700 Lakhs
Calculate the percentage of change in earnings per share, if sales increased by 5%. [5]

(b) A company plans to manufacture and sell 400 units of a domestic appliance per month at a price of ₹600 each. The ratio of cost to selling price are as follows:

Raw materials	30%
Packing materials	10%
Direct labour	15%
Direct expense	5%

Fixed overheads are estimated at ₹4,32,000 per annum.
The following norms are maintained for inventory management:

Raw materials	30 days

Packing materials	15 days
Finished goods	200 units
Work-in-progress	7 days

Other particulars are given below:
(a) Credit sales represent 80% of total sales and the dealer enjoy 30 working days credit. Balance 20% are cash sales.
(b) Creditors allow 21 working days credit for payment.
(c) Lag in payment of overheads and expenses is 15 working days.
(d) Cash requirements to be 12% of net working capital.
(e) Working days in a year are taken as 300 for budgeting purpose.
Prepare a working capital requirement forecast for the budget year. [10]

Question. 5

(a) How is Economic Value Added (EVA) different from Market Value Added (MVA)? [5]
(b) The capital structure of Assembly Traders Ltd. as on 31.03.2014 is as follows:

(₹ in crores)

Equity capital(100 lakhs equity shares of ₹10 each)	10
Reserves	2
14% Debentures of ₹100 each	3

For the year ended 31.03.2014 the company has paid equity dividend at 20%. As the company is a market leader with good future, dividend is likely to grow by 5% every year. The equity shares are now treated at ₹80 per share in the stock exchange. Income – tax rate applicable to the company is 50%.
Required:
(I) The current weighted cost of capital.
(II) The company has plans to raise a further ₹5 crores by way of long term loan at 16% interest. When this takes place the market value of the equity shares is expected to fall to ₹50 per share. What will be the new weighted average cost of capital of the company? [10]

Question. 6

(a) The finance director of Patni Ltd. has been studying exchange rates and interest rates relevant in India and USA. Patni Ltd. has purchased goods from the US Co. at a cost of $ 51 lakhs payable in $ in 3 months time. In order to maintain profit margins the finance director wishes to adopt, if possible a risk free strategy that will ensure that the cost of goods to Patni Ltd. is no more than ₹22crores.
₹/$ (Spot) 40/42
₹/ $ (1 month forward) 41/43
₹/$ (3 months forward) 42/45
Interest rates available to Patni Ltd.

	India (Rates in %)		USA (Rates in %)	
	Deposit	Borrowing	Deposit	Borrowing
1 month	13.00	15.00	7.00	10.00
3 month	13.00	16.00	8.00	11.00

Calculate whether it is possible for Patni Ltd. to achieve a cost directly associated with transaction no more than ₹22 crores, by means of a forward market hedge or money market hedge. Transaction costs may be ignored. [9]

(b) The annual interest rate is 5% in the United States and 8% in the UK. The spot exchange rate is £/$ -1.50 and forward exchange rate, with one year maturity, is £/$ =1.48. In view of the fact that the arbitrager can borrow $ 100000 at current spot rate, what would be the arbitrageur profit/loss? [6]

Question. 7

(a) What is meant by "Exercising the Option"? What are the implications for a buyer? [5]

(b) The actual ratios of a company compared to the industry standard are given below. Comment on each ratio and indicate in one or two sentences the nature of action to be taken by the company. [10]

Ratio	Industry Standard	Actual for the company
Current ratio	2.2	2.7
Debtors' Turnover Ratio	6	8
Stock Turnover Ratio	10	3
Net Profit Ratio	5%	2.4%
Total debt to total assets	7.5%	40%

Question. 8

Write Short Notes on any three of the following [5 × 3]

(a) Euro Convertible Bonds
(b) Money Market Hedge
(c) Greenfield Privatization
(d) Interest Rate Floors