FINAL EXAMINATION

December 2013

Financial Management & International Finance

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.

Please: (i) Answer all bits of a question at one place.
(ii) Open a new page for answer to a new question.
(iii) Tick the question number answered on the front sheet of the answer-book.

Answer Question No. 1 *from Part A which is compulsory and* any five *questions from Part B.*

PART A (25 Marks)

1. (a) In each of the cases given below, one out of four answers is correct. Indicate the correct answer (= 1 mark) and give workings/reasons briefly in support of your answer (= 1 mark): 2×9=18

    (i) Dividend-Payers Ltd. has a stable income and stable dividend policy. The average annual dividend payout is ₹ 27 per share (Face Value = ₹ 100). You are required to find out Dividend payout in year 2, if the company were to have an expected market price of ₹160 per share at the existing cost of equity.

    [The market price in year 1 is Rs. 150]
    (A) ₹ 28·88
    (B) ₹ 26·86
    (C) ₹ 28·80
    (D) ₹ 26·98

    (ii) The ratio of current assets (₹ 3,00,000) to current liabilities (₹ 2,00,000) is 1.5 : 1. The accountant of this firm is interested in maintaining a current ratio of 2 : 1 by paying some part of current liabilities. Hence, the amount of current liabilities which must be paid for this purpose is
    (A) ₹ 1,00,000
    (B) ₹ 2,00,000
    (C) ₹ 2,50,000
    (D) ₹ 1,50,000

    (iii) The interest rate in Germany is 11 per cent and the expected inflation rate is 5 per cent. The British interest rate is 9 per cent. How much is the expected inflation rate in Britain?
    (A) 3.0%
    (B) 3.1%
    (C) 4.5%
    (D) 2.9%

    (iv) Annual usage of a firm is 3,60,000 units and 2 to 4 days are taken in receiving delivery of inventory after placing an order. Calculate Re-order level, if the reasonable expected stock out is 100 units per day. (Assume 1 year = 360 days)
    (A) 3000 units
    (B) 3300 units
    (C) 2500 units
    (D) 3500 units

Please Turn Over

(v) A project had an equity beta of 1.2 and was going to be financed by a combination of 30% debt and 70% equity (assume debt beta = 0). Hence, the required rate of return of the project is (assume R_f = 10% and R_m = 18%)

    (A) 16.27%

    (B) 17.26%

    (C) 16.72%

    (D) 12.76%

(vi) M/s. Fine Dress Ltd. has sales of ₹ 800 lakhs and the variable costs amount to 62.5% of sales. The Company has fixed cost of ₹ 100 lakhs. If the sales of the Company increase by 5% from the existing level, what will be the per cent change in the EBIT?

    (A) 7.5%

    (B) 8.7%

    (C) 7.9%

    (D) 10.9%

(vii) Consider the following quotes.

Spot (Euro/Pound) = 1.6543/1.6557

Spot (Pound/NZ$) = 0.2786/0.2800

Calculate the % spread on the Euro/Pound Rate.

    (A) 0.085%

    (B) 0.0085%

    (C) 0.85%

    (D) 0.00085%

(viii) A company has expected Net Operating Income – ₹ 2,40,000; 10% Debt – ₹ 7,20,000 and Equity Capitalisation rate – 20% what is the weighted average cost of capital for the company?

    (A) 0.15385

    (B) 0.13585

    (C) 0.18351

    (D) 0.15531

(ix) The P/V ratio of a firm dealing in precision instruments is 50% and margin of safety is 40%. Calculate net profit, if the sales volume is ₹ 50,00,000.

    (A) ₹ 1,00,000

    (B) ₹ 5,00,000

    (C) ₹ 10,00,000

    (D) ₹ 6,00,000

(b) State if each of the following sentences is T (= true) or F (= false):   1×7=7

  (i) Deterministic model of financial planning yield multiple — point estimate.

  (ii) Risk under transaction exposure can be minimized using Money Market Hedge.

  (iii) Flexibility is one among the performance indicators of the organisation.

  (iv) A project is a "One-shot" major undertaking.

  (v) Fund Managers use futures as a more economical way of achieving their portfolio goals.

  (vi) The profit or loss associated with converting foreign currency dominated assets/liabilities in reporting currency is called Economic Exposure.

  (vii) TRIMs are the rules, a country applies to the domestic regulations to promote Foreign investment, often as a part of an Industrial Policy.

PART B (75 Marks for any five questions)

2. (a) A company is considering, purchase of a new machinery which costs ₹ 8,00,000 and which has an estimated life of 10 years. This machine will generate additional sales of ₹ 4,00,000 per year, while increased cost of maintenance will be ₹ 1,00,000 per year. The cost of the machine is depreciated on a straight line and has no salvage value at the end of its 10 year life. The company has a cost of capital of 12 per cent and a corporate tax rate of 40 per cent.

You are required to calculate:

   (i)   Annual Cash Flow

   (ii) Net Present Value (NPV)

   (iii) Payback period

   (iv) Internal Rate of Return. Should the Company purchase the new machine?

Note : The present value Factors are as follows:

	At the end of 10 years
Present value of annuity of Re.1 @ 12%	5.651
Present value of annuity of Re.1 @ 23%	3.799
Present value of annuity of Re. 1 @ 24%	3.682

2+2+2+3+1=10

   (b) Differenciate between the Capital Market Line and Security Market Line.   5

3. (a) A dealer, having annual sales of ₹ 50 lakhs, extends 30 days credit period to its debtors. The variable cost is estimated at 80% of sales and fixed costs are ₹ 6,00,000.

The dealer intends to change the credit policy for which the following information is given:

Credit Policy	Average Collection Period (days)	Annual Sales (₹ in lakhs)
A	45	56
B	60	60
C	75	62

Rate of Return (Pre-tax) required on investment is 20% [Consider 365 days a year]

You are required to–

Assess the most profitable credit policy with the help of incremental approach.

[Calculations must be restricted to two decimal places].   10

   (b) Describe Sensitivity Analysis as a technique of Risk Analysis in Capital Budgeting Decisions.   5

Please Turn Over

4. (a) From the following data, Using MM Approach, find out (i) the value of each firm and also (ii) Equity Capitalisation rate for each firm.

Particulars	Firm A	Firm B	Firm C
EBIT (₹)	12,00,000	12,00,000	12,00,000
No. of Equity Shares	3,00,000	2,50,000	2,00,000
10% Debentures (₹)	—	9,00,000	10,00,000

Every firm expects 12% Return on Investment.   4

(b) From the following information, prepare the Balance Sheet.
Net Profit after Interest, Tax and Preference Dividend — ₹ 2,22,000
Tax Rate — 50%
18% Preference Share Capital — ?
15% Debentures —?
Return on Capital Employed — 50%
Return on Shareholder's funds — 60%
Return on Equity Shareholders' Funds — 74%
Current Ratio — 2 : 1
Net Fixed Assets ₹ 9,00,000.   6

(c) What is Balance Score Card [BSC]? What are its perspectives?   5

5. (a) The Fund Manager of United Industries which has two separate divisions A and B, wants to maintain optimum cash balance in both the divisions. He furnishes the following information for division A:
He projects that cash outlays of ₹ 45,00,000 will occur uniformly through out the coming year. He plans to meet its cash requirements by periodically selling marketable securities from its portfolio. The firm's marketable securities are invested to earn 10% and the cost per transaction of converting securities to cash is ₹ 100.

You are asked to answer the following w.r.t. Division A:

  (i) Use the Baumol model to determine the optimal transaction size of transfer from marketable securities to cash.

  (ii) What will be the company's average cash balance?

  (iii) How many transfers per year will be required?

  (iv) What will be the total annual cost of maintaining cash balance?   2+1+1+2=6

(b) Investors' Weekly, a news magazine on the happenings at Cloudy Street, publishes the following information in its November 2013 edition for Security D:
Equilibrium Return = 25%,
Market Portfolio Return = 25%,
8.4% Treasury Bills (₹ 100) at ₹ 120,
Covariance of the Security with Market Portfolio = 256%, and
Correlation Co-efficient = 0.85.
Determine the risk of Market Portfolio.   4

(c) Explain the Debt securitisation process.   5

6. (a) Fine the direct cross quote of French Francs in India, given that

    ₹/USD   = 44.04/44.08
    USD/AUD = 18.05/18.08
    GBP/AUD = 0.4119/0.4127
    GBP/FRF = 0.0996/0.0999   5

   (b) Following spot rates are available in the London Market

Currency	Buying rate	Selling rate
French Francs	10.24	10.30
Swedish Kroner	13.50	13.75
Japanese Yen	170	175

   Since these currencies are in short supply, you are required to operate only through sterling, which is quoted at ₹ 75.25 – 75.35 in Mumbai. Compute the quantum of French Francs that you can buy for ₹ 1,20,000.   5

   (c) What are the benefits of Euro-Issues to Issuing Companies?   5

7. (a) AU Ltd., an Indian Company has an export exposure of 120 lakhs Yen value December end.
   The current spot rates are:

   $ / ₹ = 64.5 and
   $ / ¥ = 120.25

   It is estimated that Yen (¥) will depreciate against dollar to 140 and Rupee will depreciate against dollar to 70. Forward rate for December, 2013:

   $ / ¥ = 128.50 and
   $ / ₹ = 66.50

   (i) You are required to calculate the expected loss, if hedging is not done.

   (ii) How the position will change with company taking a forward cover.   5

   (b) JUPITER, a 100% Export oriented company based at Chennai, exports leather jackets to various European countries. All exports are invoiced in Euro. At the end of october, 2013, JUPITER has sent a consignment to an import house based at Frankfurt. The receivable is likely to be realised at the end of January 2014. JUPITER approaches its banker to sell these Euro earnings. The banker has the following information:

   ₹ / $ spot   43.50 / 60
   2 – m forward   25 / 30
   3 – m forward   40 / 50

   Euro / $ spot   1,0420 / 1,0430
   2 – m forward   1,0400 / 1,0415
   3 – m forward   1,0380 / 1,0400

   You are required to calculate the Rupee Inflow for JUPITER in January, 2014, if the expected EURO of one million is sold to the banker forward.   5

   (c) Explain the features of interest rate SWAP.   5

8. Write short notes on (any three):   5×3=15
   (a) Interest Rate Guarantees (IRG) w.r.t. International Finance;
   (b) Zero working capital concept;
   (c) Greenfield Privatisation;
   (d) Measures of Financial Performance.