NEW

2016

M B A

4th Semester Examination

Subject : STRATEGIC FINANCIAL MANAGEMENT

(Specialization : Financial Management)

PAPER—F-402

Full Marks : 100

Time : 3 Hours

The figures in the right-hand margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

Illustrate the answers wherever necessary.

1. Answer any *four* questions : 4×5

(a) Why do you need valuation approach in performing finance function ?

(b) Explain in brief, the agency problem.

(c) The capital of E Ltd. is as follows :

9% Pref. shares, Rs. 10 each	Rs. 3,00,000
Equity shares of Rs. 10 each	Rs. 8,00,000
	Rs. 11,00,000

(Turn Over)

Additional Information :

Profit (after tax at 35 per cent)	Rs. 2,70,000
Depreciation	Rs. 60,000
Equity dividend paid	20 percent
market price of equity shares	Rs. 40

You are required to compute the following showing the necessary workings :

(i) Dividend yield on the equity shares ;

(ii) Coverage for preference and equity dividends ;

(iii) Earnings per share ;

(iv) Price-earnings ratio.

(d) A security pays a dividend of Rs. 3·85 and sells currently at Rs. 83. The security is expected to sel at Rs. 90 at the end of the year. The security has beta of 1·15. The risk free rate is 5 per cent and the expected return on market index is 12 per cent. Assess whether the security is currently priced.

(e) A chemical company paid a dividend of Rs. 2·75 during the current year. Forecasts suggest that earnings and dividends of the company are likely to grow at the rate of 8 per cent over the next five years and at the rate of 5 per cent thereafter. Investors have traditionally required a rate of return of 20 per cent on these shares. What is the present value of the stock ?

(f) The following data concern companies A and T :

Particulars	*Company A*	*Company B*
Earnings after taxes (Rs.)	1,40,000	37,500
Equity shares outstanding	20,000	7,500
EPS (Rs.)	7	5
P/E ratio (times)	10	8
Market price (Rs.)	70	40

Company A is the acquiring company, exchange its one share for every 1·5 shares of B. Assume that company A expects to have the same earnings and P/E ratio after the merger as before (no synergy effect), show the extent of grain accruing to the shareholders of the two companies as a result of the merger. Are they better or worse off than they were before the merger?

2. Answer any *two* questions : 2×10

(a) The most recent accounts of a corporate firm engaged in manufacturing business are given below :

Income Statement for the current year ended March 31

(Rs. Million)

Sales revenue	93.5
EBIT	18·0
Less : Interest on loan	1.8
Earning before taxes	16.2
Less : Corporate taxes (0.35)	5.67
Earnings after taxes	10.53

Balance Sheet as at March 31, current year

(Rs. Million)

Liabilities	*Rs.*	*Assets*	*Rs.*
Equity share capital (1 lakh shares of Rs. 100 each)	10·0	Freehold land and buildings (net)	20·0
Reserve and Surplus	32·5	Plant & Machinery (net)	29·5
10% Loan	18·0	Current Assets :	
Creditors and Other Liabilities	18·0	Stock	10·0
		Debtors	15·0
		Bank and Cash balance	4·0
	78·5		78·5

10

Additional Information :

(i) The finance manager of the firm has estimated the future free cash flows of the company as follows :

(Rs. million)

Year 1	22
2	23
3	24·5
4	26·0
5	30·0
6	32·0

Free cash flows in subsequent years, after year 6, are estimated to grow at 4 per cent. The company's weighted average cost of capital is 12 per cent.

(ii) The current resale value of the following assets has been assessed by the professional valuer as follows :

Freehold land and buildings	Rs. 60 million
Plant and Machinery	20
Stock	11

The current resale values of the remaining assets are as per their book values.

(iii) A similar sized company listed on BSE and is engaged in the same business has a P/E ratio of 7 times.

You are required to compute the value of the firm as well as value on an equity share on the basis of the (i) Net assets method and (ii) Price-earnings ratio method.

(b) Sagar industries deals in production and sales of customer durables. Its expected sales revenues for the next 8 years (in Rs. million) are given in the table :

Years	*Sales Revenue* (Rs.)
1	80
2	100
3	150
4	220
5	300
6	260
7	230
8	200

Its condensed balance sheet as on March 31, current year is as follows :

(*Rs. Million*)

Liabilities	Rs.	Assets	Rs.
Equity funds	120	Current assets	30
12% Debt	80	Long-term assets (net)	170
	200		200

Additional Information :

(i) Its variable expenses will amount to 40 per cent of sales revenue. Fixed cash operating costs are estimated to be Rs. 16 million per year for the first 4 years and at Rs. 20 million for years 5–6. In addition, an extensive advertisement campaign will be launched, requiring annual outlays as follows :

(*Rs. million*)

1	5
2 – 3	15
4 – 6	30
7 – 8	10

10

(ii) Long-term assets are subjected to 15 per cent rate of depreciation on diminishing balance method.

(iii) The company has planned the following capital expenditure (assumed to have been incurred in the beginning of each year) for the next 8 years :

(*Rs. million*)

Year	1	5
	2	8
	3	20
	4	25
	5	35
	6	25
	7	15
	8	10

(iv) Working capital in terms of investment in current assets are estimated at 20 per cent of sales revenue.

(v) It is expected to have non-operating assets in terms of investments in marketable securities in the initial year. The expected offer tax non-operating cash flow in year 1 = Rs. 0·5 million.

(vi) Given the tax benefits available to Sagar industries, the effective tax rate estimated is 30 per cent.

(vii) The corporate equity capital is estimated at 16 per cent.

(viii) The free cash flows of the firm are expected to grow at 5 per cent per annum, after 8 years.

Determine the discounted cash flow value of the (a) firm and (b) equity. 10

(c) (i) What are secured premium notes ? Why are they issued with warrants ?

(ii) Distinguish between convertible security and warrant.

(2+3)+5

3. Answer any *four* of the following questions : 4×5

(a) Explain the term 'diversification'.

(b) What is financial and operational restructuring ?

(c) What are the different motives behind mergers ?

(d) Write a short note on takeovers.

(e) What do you understand by spin-offs and diversiture ?

(f) Discuss the term concept of risk-adjusted discount rate.

4. Answer any *two* of the following : 2×10

(a) Discuss the different ways of corporate restructuring. 10

(b) (i) Explain the different types of mergers.

(ii) What do you understand by synergy in mergers ? 7+3

(c) (i) What do you understand by American Depository Receipts ?

(ii) As a manager of a company, you have two projects to choose from, the details of which are given below :

Project 1			Project 2		
Year	*Cash flows*	*Certainty equivalent factor*	*Year*	*Cash flows*	*Certainty equivalent factor*
0	– 5,25,000	0·83	0	– 4,70,000	0·85
1	+ 1,50,000	0·76	1	+1,70,000	0·81
2	+ 2,80,000	0·74	2	+2,40,000	0·72
3	+ 3,90,000	0·67	3	+3,75,000	0·69
4	+ 4,15,000	0·59	4	+4,18,500	0·62

Assuming that the cost of capital is 12.5%, you are required to decide which project to choose using certainty equivalent method. 4+6

[*Internal Assessment : 20 Marks*]