NEW

2017

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 *eight* questions : 8×5

(a) Establish the relationship among P/E ratio, Market Price of Share (MPS) and Earnings Per Share (EPS) using suitable example. 5

(b) State the assumptions of Capital Asset Pricing Model. 5

(c) Describe breifly the motives of merger in strategic financial management. 5

(d) Write a short note on 'Agency Conflicts'. 5

(e) (i) Alpha Ltd. is expected to generate future profits of Rs.60,00,000. What is its value of business if investments of this type are expected to give an annual return of 20%.

(ii) Beta Ltd. agrees to acquire Theta Ltd. based on the capitalisation of last three years profits of Theta Ltd. as below at an earnings yield of 25%.

Profits of Theta Ltd. for the years	Rs. (in lakh)
2014	75
2015	89
2017	82

Calculate the value of business based on earnings yield basis. $2\frac{1}{2}\times 2$

(f) Distinguish between : $2\frac{1}{2}\times 2$

(i) Spin-off and Split-up ;

(ii) Management buyout and Leveraged buyout.

(g) Discuss the contradiction between NPV and IRR in decision making. 5

(h) Corporate restructuring is inevitable for organisations. Discuss. 5

(i) What are the risks associated with diversification strategy ? Discuss. 5

(j) Explain the term 'financial restructuring'. 5

(k) What is vertical merger ? Mention the major points of difference between forward integration and backward integration. 2+3

(l) Retrenchment is an effective corporate restructuring strategy. Explain the scope of such a strategy. 5

2. Answer any *four* questions : 4×10

(a) Explain the following concept of value : $2\frac{1}{2} \times 4$

(i) Book value ;

(ii) Market value ;

(iii) Intrinsic value, and

(iv) Liquidation value.

(b) (i) A firm has reported a profit of Rs.65 lakh, after paying taxes @ 35%. On a close examination, the analyst ascertains that the current year's income includes (i) extra-ordinary income of Rs.10 lakh and (ii) extra-ordinary loss of Rs.3 lakh. Apart from the existing operations, which are normal in nature and are likely to continue in the future, the company expects to launch a new product in the coming year.

Revenue and Cost estimates in respect of the new product are as follows :

	(Rs. in lakh)
Sales	60
Material Cost	15
Labour Cost (Additional)	10
Allocated Fixed Costs	5
Additional Fixed Costs	8

From the given information, compute the value of the business, given that capitalisation rate applicable to such business in the market is 15 per cent.

(ii) PQR Ltd. wants to acquire ABC Ltd. by exchanging its 1.6 shares for every share of ABC Ltd. It anticipates to maintain the existing P/E ratio subsequent to the merger also. The relevant financial data are furnished below :

		PQR Ltd.	ABC Ltd.
Earnings after taxes	Rs.	15,00,000	4,50,000
Number of equity shares outstanding		3,00,000	75,000
Market price per share	Rs.	35	40

(1) What is the exchange ratio based on market prices ?

(2) What is pre-merger EPS and the P/E ratio for each company ?

(3) What was the P/E ratio used in acquiring ABC Ltd. ?

(4) What is the EPS of PQR Ltd. after the acquisition ?

(5) What is the expected market price per share of the merged company ? 5+5

(c) (i) A firm has employed a total capital of Rs.1000 lakh (provided equally by 10 per cent delet and 5 lakh equity shares of Rs.100 each), its cost of equity is 14 per cent and it is subject to corporate tax rate of 40 per cent. The projected free cash flows to all investors of the firm for 5 years are given in the table.

(*Rs. lakh*)

Year end	1	300
	2	200
	3	500
	4	150
	5	600

Compute :

(1) Valuation of firm, and

(2) Valuation from the perspective of equity holders.

Assume 10% delet is repayabale at the year end 5 and interest is paid at each year end.

(ii) A person owns a bond of Rs.1000 face value with five years to maturity. The bond makes annual interest payments of Rs.80. The bond is currently priced at Rs.960. Given that the market interest rate is 10 percent, should the investor hold or sell the bond ? 7+3

(d) (i) Explain the term 'risk adjusted discount rate'.

(ii) A project involves an outlay of Rs.4,00,000. Its cash flow is expected to be Rs.1,20,000 at the end of year 1 after which it will be Rs.1,10,000 for each of the next five years. The certainty equivalent factor is $\alpha_t = 1 - 0.03t$. You are required to compute the net present value under the certainty equivalent approach assuming the risk-free rate to be 5.5% and the average cost of capital to be 13%. 5+5

(e) What are the objectives of corporate restructuring? Disucss any two strategies to restructure. 5+5

(f) Write a short note on Global Depository Receipts as a financial instrument. State its advantages and disadvantages. 5+5

[***Internal Assessment : 20 Marks***]