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Question Paper	
Strategic Financial Management	**Duration**: 65
Details: Test – 4	**Marks**: 35

Instructions:

- All the questions are compulsory
- Properly mention test number and page number on your answer sheet, Try to upload sheets in arranged manner.
- In case of multiple choice questions, mention option number only Working notes are compulsory wherever required in support of your solution
- Do not copy any solution from any material. Attempt as much as you know to fairly judge your performance.

Q-1 HDIL Ltd. is a listed real estate development company in India, with significant operations in the Mumbai Metropolitan Region has an export exposure of HKD 12,00,000 payable August 31, 2014. Hong Kong Dollar (HKD) is not directly quoted against Indian Rupee.

The current spot rates are:

INR/GBP	C82.05
HKD/GBP	HKD 9.93

It is estimated that Hong Kong Dollar will depredate to 10.89 level and Indian Rupee to depreciate against GBP to 84.83.

Forward rates for August 2014 are

INR/ GBP	₹ 86.33
HKD /GBP	HKD 10.77

Required:

i. Calculate the expected loss, if the hedging is not done. How the position will change, if the firm takes forward cover?

ii. If the spot rates on August 31, 2014 are:

INR/ GBP = 82.09

HKD /GBP = HKD 9.99

Is the decision to take forward cover justified?

(6 marks)

Q-2 LMN Ltd. is an export oriented business house based in Mumbai. The company invoices in customers' currency. The receipt of US $ 6,00,000 is due on 1st September 2016.

Market information as at 1st June 2016 is:

Exchange rates US $/Rs		**Currency Futures US$/Rs**	
Spot	0.01471	Contract Size	Rs 30,00,000
1 month forward	0.01464	June	0.01456
3 month forward	0.01458	September	0.01449

	Initial Margin	**Interest rates in India**
June	Rs 12,000	8%
September	RS 16,000	8.5%

On 1st September 2016 the spot rate is US$/Rs 0.01461 and currency future rate is US$/Rs 0.01462. It may be assumed that variation in margin would be settled on the maturity of the futures contract. Which of the following methods would be most advantageous to LMN Ltd.?

a) Using forward contract

b) Using Currency futures

c) Not hedging the currency risk

Show the calculation and comment.

(8 marks)

Q-3 An Indian company is planning to set up a subsidiary in South Africa. The initial project cost is estimated to be ZAR 500 million; Working Capital required is estimated to be ZAR 30 million.

The finance manager of company estimated the data as follows:

Variable Cost of Production (Per Unit Sold)	ZAR 5.20
Fixed cost per annum	ZAR 4 million
Selling Price	ZAR 15
Production capacity	16 million units
Expected life of Plant	5 years
Method of Depreciation	Straight Line Method (SLM)
Salvage Value at the end of 5 years	NIL

The subsidiary of the Indian company is subject to 40% corporate tax rate in the South Africa and the required rate of return of such types of project is 15%. The current exchange rate is Rs 5/ZAR and the rupee is expected to depreciate by 3% per annum for next five years.

The subsidiary company shall be allowed to repatriate 60% of the CFAT every year along with the accumulated arrears of blocked funds at the end of 5 years, the withholding taxes are 10%. The blocked fund will be invested in the South African money market by the subsidiary, earning 6% (free of taxes) per year.

Determine the feasibility of having a subsidiary company in the South Africa, assuming no tax liability in India on earnings received by the parent company from the South Africa subsidiary.

(8 marks)

Q-4 An Indian company obtains the following quotes (`/$)

Spot: 35.90/36.10

3 - Months forward rate: 36.00/36.%

6 - Months forward rate: 36.10/36.40

The company needs $ funds for six months. Determine whether the company should borrow in $ or ` Interest rates are :

3 - Months interest rate : ` : 12%, $: 6%

6 - Months interest rate : ` : 11.50%, $: 5.5%

Also determine what should be the rate of interest after 3-months to make the company indifferent between 3-months borrowing and 6-months borrowing in the case of:

i. Rupee borrowing
ii. Dollar borrowing

Note: For the purpose of calculation you can take the units of dollar and rupee as 100 each

(6 marks)

Q-5 Mc. Donald's Hamburger Co. wishes to lend $ 5,00,000 to its Japanese subsidiary. At the same time, Yasufuku Heavy Industries is interested in making a medium-term loan of approximately the same amount to its U.S subsidiary. The two parties are brought together by an investment bank for purpose of making parallel loans. Mc. Donald will lend $ 500.000 to the U.S. subsidiary of Yasufuku for 4 years at 13%. Principal and interest are payable only at the end of the fourth year with interest compounding annually. Yasufuku will lend the Japanese subsidiary of Mc. Donald 70 million Yen for 4 years at 10%. Again the principal and interest (annual compounding) are payable at the end. The current exchange rate is 140 Yen to the $. However, the dollar is expected to decline by 5 Yen to the dollar per year over the next 4 years

a) If these expectations prove to be correct, what will be the dollar equivalent of principal and interest payments to Yasufuku at the end of 4 years?

b) What total dollars will Mc. Donald receive at the end of4 years from the payment of principal and interest on its loan by the U.S. subsidiary of Yasufuku?

c) Which party is better off with the parallel loan arrangement? What would happen if the Yen. Did not change in value?

(7 marks)