

Your overall performance is good. Revise all your previous topics at least once in a week rather allocate a day in a week for revision and evaluating your performance. This will help you memorize topics and bind out shortcomings in your preparation. Total Marks 35

Q1

Test 1

NOTES

Date:

• Key decision falling with the scope of financial strategy :-

1) financing decision :- This decision deal with the mode of finance like mix of equity capital & debt capital.

2) Investment decision :- This decision deal with investing firm's funds to long term projects (Capital projects). The projects are evaluated based on their risk & return.

4 Marks

Good Attempt

3) Dividend decision :- This decision deal with the payment of dividend to shareholders & retaining into the business of firms fund.

4) Portfolio decision :- These decision involves evaluation of investments based on their contribution to the aggregate performance of the entire Corporation rather than on the isolated characteristics of the investments themselves.

Q3

• Counter party risk :- The various hints that provide counterparty risk are as follows :-

- 1) Failure to obtain necessary resources to complete the project or transaction undertaken.
- 2) Any regulatory restrictions from the Govt.
- 3) Hostile action of foreign Govt.
- 4) Let down by 3rd party.
- 5) Have become insolvent.

3 Marks

NOTES

Date:

• Various techniques to manage this type of risk are as follows:-

1. Carrying out Due Diligence before dealing with any 3rd party.
2. Do not over commit to a single entity or group or connected entities.
3. Know your exposure limits.
4. Review the limits & procedures for credit approval regularly.
5. Rapid action in the event of any likelihood of default.
6. Use of performance guarantees, insurance or other instruments.

Q2

4 Marks

Volatility in terms of rupees

$$1 \text{ crore} \times 2\% \Rightarrow 22 \text{ lakh}$$

Maximum loss for 1 day at 99% Confidence level shall be:-

$$22 \text{ lakh} \times 2.33 \Rightarrow 51.26 \text{ lakh}$$

Maximum loss for 10 day at 99% Confidence level shall be

$$\sqrt{10} \times 51.26 \text{ lakh} \Rightarrow 162.74 \text{ lakh}$$

Q4

SD of the daily changes of the Investment in L & T i.e. 1 cr \$ in Sun Pharma i.e. 50 lakh. The variance of the portfolio's daily changes is

$$\sigma_p^2 \Rightarrow (1)^2 \times (0.5)^2 + 0.2 \times 1 \times 0.5 \times 2$$

$$\Rightarrow 1 + 0.25 + 0.7$$

$$\Rightarrow 1.95$$

$$\sigma_p \Rightarrow \sqrt{1.95} \Rightarrow 1.40 \text{ lakh}$$

Accordingly, the SD of the 10 day change is

$$1.40 \text{ lakh} \times \sqrt{10} \Rightarrow 4.43 \text{ lakh}$$

Avoid cutting in your final examination.

NOTES

From the Normal table we see that z score for 1% is 2.33
The 10 day 99% value at risk is therefore
 $2.33 \times 4.43 \text{ lakh} \Rightarrow 10.32 \text{ lakh}$

Date:

185

Ex right price of shares & value of a right if
(a) The firm offers one right share for every 2 shares held.

$$\text{Subscription price} \rightarrow \frac{2200000}{50000} \rightarrow 24$$

(No. of sh. to be issued $1000000 \times \frac{1}{2}$ i.e. 500000)

$$\text{Ex right price} \rightarrow \frac{21300000 + 2000000}{1000000 + 500000} \rightarrow 10$$

$$\text{Value of a right} \rightarrow 10 - 4 \rightarrow 6$$

$$\text{Value of a right per share basis} \rightarrow 6/2 \rightarrow 3$$

(b) The firm offers 1 right sh. for every four sh. held

$$\text{No. of sh. to be issued} \rightarrow 1000000 \times \frac{1}{4} \rightarrow 250000 \text{ sh}$$

$$\text{Subscription price} \rightarrow \frac{2200}{2.52} \rightarrow 8$$

$$\text{Ex right price} \rightarrow \frac{21300000 + 2200000}{1000000 + 250000} \rightarrow 12$$

$$\text{Value of a right} \rightarrow 12 - 8 \rightarrow 4$$

$$\text{Value of a right per share basis} \rightarrow 4/4 \rightarrow 1$$

(c) Calculation of effect of right issue on wealth of shareholder's wealth

(a) When firm offer 1 sh for 2 sh held.
 value of shares after right issue $(1.5L \times 10) \rightarrow 15,000,000$
 less: Amt paid to acquire right share $(5L \times 4) \quad (20,000,000)$
 $\underline{13,000,000}$

You have attempted this answer very nicely.

(b) When firm offer 1 sh for 4 sh held
 value of sh after right issue $(12.5L \times 12) \quad 15,000,000$
 less: Amt paid to acquire right sh $(2.5L \times 8) \quad (20,000,000)$
 $\underline{13,000,000}$

(c) Wealth of Shareholders before right issue $13,000,000$

Thus, there will be no change in the wealth of Shareholders. (i) & (ii).

106

(1) Preference Conversion Value

No. of pref sh i.e 40000, and preference shares are convertible into 2 shares for each preference shares held i.e

$$40000 \times 2 \rightarrow 80000 \text{ sh} \times 221/\text{sh} \rightarrow 21,680,000$$

$$2 \times 21 \rightarrow 42$$

2) Conversion premium

$$\frac{50 - 42}{42} \times 100 \rightarrow 19.05\%$$

3) Total earnings $\rightarrow 15,000,000$

$$\text{Before conversion EPS} \rightarrow \frac{15,000,000 - 40,000 \times 3.50}{80,000} \rightarrow 22.72$$

$$\text{After Conversion EPS} \rightarrow \frac{15,000,000 - 0}{5L + 80,000} \rightarrow 22.586$$

6 Marks

Good Attempt

NOTES

Date:

4) Before Conversion EPS $\Rightarrow \frac{21500000 + 1000000 - 40000 \times 3.5}{500000}$

After Conversion EPS $\Rightarrow \frac{2151 + 210000}{51 + 80000} \Rightarrow 24.31$

(87)

- A. Differential Annual Interest Savings
- | | |
|---|---------|
| Interest on Outstanding bonds ($300 \times .14$) | 420000 |
| Int. on new bonds ($300 \times .12$) | 360000 |
| Annual Interest Savings | 60000 |
| less: Taxes (0.40×60000) | (24000) |
| Annual Int. Saving after tax | 36000 |
| PV of Savings over the next 25 years @ 8%
(PVIFA 8%, 25) | 3842919 |
- B. Call premium
- | | |
|---|--------|
| Before tax $(21140 - 21000) \times 30000$ bonds | 420000 |
| less: Tax (0.40×420000) | 168000 |
| After tax Cost of Call premium | 252000 |
- C. Flotation Cost of New Bond
- | | |
|--|--------|
| | 400000 |
|--|--------|
- D. Saving on Amortization of Flotation cost of issue of New bonds
- | | |
|--|--------|
| PV of immediate tax saving arising out of amortization the entire balance flotation cost $(25 \times 360000 \times 0.4)$ | 360000 |
| Had the firm retained the debt - PV of int. would have been $(212000 \times 40\% \times 10.675)$ | 51239 |
| Difference - PV of tax saving | 68761 |

6 Marks

NOTES

Good Conceptual clarity

Date:

F. Differential tax saving from amtz. of discount for issue
 PV of immediate tax saving arising out of amort. the
 entire unamortized discount: $\left[\frac{250}{30} \times (-300000) \times 0.4 \right] \times 300000$

had the firm retained debt - PV of amtz. would have been: 128097
 $\frac{1}{30} \times 230 \times 300000 \times 40\% \times 10.875$
 Difference - PV of tax savings 171902

G. Overlapping with Old bond 420000
 $(0.14 \times 300 \times \frac{2}{12} \times (1 - 40))$

NPV of refunding Decision $\rightarrow A+B+C+D+E+F+G$ 811902

The proposed refunding is recommended because of positive benefit.

184

6 Marks

Variance of portfolio

$$\sigma_p^2 \rightarrow 2 \times 10^2 \times 0.02^2 + 0.01^2 \times 25^2 + 2 \times 0.7 \times 0.02 \times 210 \times 0.01 \times 25$$

$$\rightarrow 70.0565$$

$$\sigma_p \rightarrow \sqrt{70.0565} \rightarrow 8.371 \text{ million}$$

Since $N(-2.33) = 0.01$, then 1 day 99% VAR is 2.33×8.371
 $\rightarrow 19.5038 \text{ million}$

The 10 day 99% VAR $\rightarrow 19.5038 \times \sqrt{10} \rightarrow 61.514 \text{ million}$
 The total 10 day 99% VAR is therefore $\rightarrow 1751400$

The 10 day 99% VAR for the L&T investment is:

$$0.02 \times 210 \text{ million} \times \sqrt{10} \times 2.33 \rightarrow 1473621$$

The 10 day 99% VAR for the Sun Pharma investment is

$$0.01 \times 25 \text{ million} \times \sqrt{10} \times 2.33 \rightarrow 368405$$

The diversification benefit is $\rightarrow 1473621 + 368405 - 1751400$
 $\rightarrow 90626$