The Institute of Chartered Accountants of India

Code: FN2SM565894 **Total Marks:** 100
Subject : Strategic Financial Management **Marks Obtained :** 86

Number of Answer Books used : Main + 2 additional sheets

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565894

Q.No.	To be ticked (✓) by the candidate against the Questions answered	Marks Awarded (To be filled by Examiner)					
		a	b	c	d	e	Total
1	✓						
2	✓						
3	✓						
4	✓						
5	✓						
6							
7							
8							
9							
10							
11							
12							
13							
14							
Total							

Total Marks awarded (in words) _____

Examiner's Signature _____

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA NOVEMBER, 2020

23 NOV 2020

Use only Blue / Black Ball Point Pen to write and shade the circles.
AVOID RED PEN.
Write the marks in the boxes before shading the respective circles.

Total Marks awarded

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INSTRUCTIONS TO THE CANDIDATE

Answers are not to be written on this page

1. ...r should be written in figures and words in the allotted space at the right hand corner of the ...et only and nowhere else including additional answer book/s and graph paper.

2. ...l number should be written in the box in numbers and darken the appropriate circles of the OMR portion provided in the right hand corner of the cover page with **Black/ Blue** ball point pen.

3. Fill particulars such as name of Examination, Group No., Paper No. and subject at the appropriate space at the left hand upper corner.

4. Remove the Bar Code sticker of the particular paper from the Attendance sheet and affix the same on the box provided in the right hand corner of the cover page.

5. Since a machine will read the Roll no., please check and ensure that Roll number written in numbers, words and circles darkened are correct. In case any candidate fills this information wrongly, Institute will not take any responsibility for rectifying the mistake.

6. The answers should be written neatly and legibly

7. The answer to each question must be commenced on a fresh page and question number prominently written at the top of each answer. Alternatively, the question number should be distinctly written in the margin.

8. The answer to each question in all parts should be fully completed in one page or in a consecutive set of pages, before the next question is taken up.

9. Writing of Roll number in place/s other than the space provided for the purpose or writing distinguishing mark, symbols like "OM", "Sri", "Jesus", "786", etc., will tantamount to adoption of "unfair means"

10. Before submission of answer book to the invigilator take care to score out (X) blank pages, if any, that you might have left.

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Q5(a)

Amount to be invested = ₹ 200 billion.

⇒ Evaluation of option I :- Index Fund (JPY)

Conversion to JPY → ₹ 200 bn / 1.58

⇒ ₹ 200 bn × 1.58
= ¥ 316 bn

Amount to be received on 30/9/2020 :

	(¥ bn)
Dividend	25
Income from Stock lending	11.9276
Value of Investment @ end (316 − 2%)	309.68
	¥ 346.6076

5aStep1 5aStep2 5aStep3

Equivalent in INR terms ⇒ 346.6076 / 1.57

= ₹ 220.769.

∴ Gain on investment = (220.769 − 200) / 200 × 100

= 10.38% i.e ₹ 20.769 bn.

⇒ Evaluation of Option II :- Treasury Bills (USD)

Conversion to $ ⇒ 200 × 0.014 ⇒ $ 2.8 bn

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Q5(a)

Amount C$ to be received on 30/9/2020

⇒ 2.8 + (2.8 × 5% × 6/12)

1 5aStep4

⇒ $ 2.87 bn.

1 5aStep5

Equivalent in INR terms ⇒ 2.87 bn / 0.013

1 5aStep6

⇒ ₹ 220.769 bn

Gain ⇒ ₹ 20.769 bn i.e 10.38%

Conclusion:

1 5aStep7

The gain is exactly the same in both alternatives.

1 5aStep8

∴ I'd must invest in Treasury Bills in USD since the risk is low as compared to Index funds in Japan..

8 5a

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Q5(b)

⇒ Calculation of β :

	Growth	Balanced	Regular	Market
Variance	92.16	54.76	40.96	57.76
Coefficient of determination (COD)	0.3025	0.6561	0.9604	
Systematic Risk {COD × Variance}	27.878	35.928	39.337	-

We know, Systematic Risk = $\beta^2 \times \sigma_m^2$

5bStep1

(β)	$\sqrt{\frac{27.878}{57.76}}$	$\sqrt{\frac{35.928}{57.76}}$	$\sqrt{\frac{39.337}{57.76}}$
	= 0.69	0.789	0.825

1

② Rank as per Sharpe Ratio :-

5bStep2

Fund	Avg Return ↔ Risk free	σ	$\frac{R_S - R_F}{\sigma}$	Rank.
Growth	-2	9.6	-0.2083	1
Balanced	-3	7.4	-0.4054	2
Regular	-4	6.4	-0.625	3
Market	0	7.6	0	

5bStep3

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Q5(b)

Since the Sharpe Ratio of all funds is less than market, all funds have performed poorly as compared to market:

(*) => Ranking as per Treynor's Ratio :-

Fund	$R_s - R_f$	β	$\frac{R_s - R_f}{\beta}$	Rank.
Growth	-2	0.69	-2.89	1
Balance	-3	0.789	-3.80	2
Regular	-4	0.825	-4.848	3
Market	0	1	0	

As per Treynor's Ratio, all funds have performed poorly as β compared to market Index.

(*) Sharpe Ratio => $\frac{\text{Return (Fund)} - \text{Risk free Rate}}{\sigma}$

(*) Treynor's Ratio => $\frac{\text{Return (Fund)} - \text{Risk free rate}}{\beta}$

5bStep4 5bStep5 5bStep6 5b

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Q5(c)

Technical Analysis is analysing the stock market movements using charts and graphs over no. of years.

→ Supporters of Technical Analysis have advocated that:

1) Trend persists for certain time and technical analyst helps to detect the same.
2) Price movements are gradual
3) All fundamental information is already reflected in stock price.

5cStep1

→ Detractors of Technical analysis have advocated that:

1) There is no clear evidence of such analysis
2) The theory of random walk has casted its shadow over usefulness of technical analysis.
3) It is a self-defeating proposition.
4) By the time trends are identified, it may already have happened.

Basis the above, it can be reasonably concluded that technical analysis may not work perfectly. However, with imperfections and

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Q5(c)

irrationalities, it may be helpful.

This statement is suitably substantiated by the views of supporters and detractors of the theory.

In a rational market, the prices of stocks usually reflect the expectations of market participants.

However, in irrational markets, prices are a random walk. Technical analysis is helpful in identifying trends in prices and predicting future trends.

2 5cStep2

Thus, it is help in imperfect and irrational markets.

4 5c

20 Q5

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~~Q2(a)~~
Q3(a)

(i) Calculation of Current Market Price :

Yr	Cash Flows	DF@10%	PV	PV x Yr (Rounded off)
1	850	0.909	772.65	773
2	850	0.826	702.1	1404
3	850	0.751	638.35	1914
4	850	0.683	580.55	2324
5	10850	0.621	~~63~~ 6737.85	33695

$B_0 = \frac{9431.50}{} \quad \frac{}{40110}$

3aStep1
(i) ∴ Current Market Price = ₹ 9431.50

3aStep2
Macaulay's Duration = $\frac{40110}{9431.5} = \sim 4.25$ years

(ii) Volatility of Bond = $\frac{\text{Duration}}{1+YTM}$

3aStep3
$= \frac{4.25}{1+0.1}$

$= \boxed{\sim 3.86\%}$

(iv) Convexity of Bond = $C^* \times (\Delta y)^2 \times 100$
$\times \ 0.1489 \times 100$

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Q3(a)

$$C^* = \frac{V_+ + V_- - 2V_0}{2V_0 (\Delta)^2}$$

3aStep4

=

(v) If YTM decreases by 200 basis points:
(a) by Macaulay Duration based estimate

If Rate ↓ by 1% → Price ↑ by 3.86%
∴ Rate ↓ 2% → ?? by
= 7.72% ↑

3aStep5 ∴ Expected Market Price = 9431.50 + 7.72%
= ₹ 10,159.61.

(b) by Intrinsic Value Method
i.e Discount @ (10-2)% i.e 8%.

Yr	Cash Flows	DF@8%	PV
1	850	0.926	3394
2	850	0.857	+ 6810
3	850	0.794	
4	850	0.735	
5	10850	0.681	

3aStep6 3a

∴ BO = ₹ 10,204.

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Q3(b)

(a) Bonus Plan: Let no. of units purchased be 'x'

Date.	Bonus Ratio	No. of Additional units	Cl. No. of units
1.4.2015			x
31.12.16	1:4	0.25x	x + 0.25x = 1.25x
31.12.18	1:5	0.25x	1.50x

3bStep6 3bStep7

Closing NAV as on 31.3.2020 ⇒ 44 × 1.50x
⇒ 66x

(−) Investment 10,00,000

3bStep8

Yeild (+) 66x − 10,00,000

Yeild % (p.a) ⇒ $\frac{66x - 10,00,000}{10,00,000} \times 100 \times \frac{1}{5}$

$\frac{6.4}{100}$ ⇒ $\frac{66x - 10L}{10L} \times \frac{1}{5}$

64000 ×5 ⇒ 66x − 10,00,000

3bStep9

x = 16,121 units. x = 20,000 units

(+) It is assumed that the Average yield % given is (%) p.a.

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Q3(b)

∴ Issue price ⇒ ₹10,00,000

3bStep10 ⇒ 20,000 units

⇒ ₹50/unit

(b) Dividend Plan: Let no of units be 'x' & Face value is ₹10

Yr	Op. Units	Dividend Amt	NAV	Unith	Cl. Units
3bStep1 1.04.15	x	-	-	-	x
31.3.17	x	1.2x (10x × 12%)	48	0.025	1.025x
3bStep2 31.3.18	1.025x	1.025x	50	0.0205	1.0455x
31.3.19	1.0455x	1.568x	45	0.035	1.081x

3bStep3

(1) NAV on 31.3.2020 = 1.081x × 49

= 52.9445x.

(2) Investment (920000)

Yeild in ₹ 52.9445x − 920000

(54yrs)

3bStep4 27,748.60 × 5 => 52.9445x − 920000

∴ x = 19997 ~ 20,000 units

(*) It is assumed that Average Profit is

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Q3(b)

for one year and is therefore multiplied by 5 to obtain total profit.

∴ Issue price as on 1.4.15 ⇒ $\frac{920,000}{20,000}$

= ₹46/unit.

1 3bStep5

∴ Issue price of Dividend Plan ⇒ ₹46/unit
& Bonus Plan ⇒ ₹50/unit

10 3b

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Q3(c)

When an individual attempts to found and build a company from personal finances and operating revenues, it is called 'Bootstrapping'.

3cStep1

Bootstrapping can be done by various ways as under:

(i) Trade Credit:

Generally suppliers are reluctant to give credit to new businesses. A well crafted plan and communication skills can help to obtain decent credit period from supplier to procure goods and pay for them at later date.

(ii) Leasing:

Purchasing assets require huge capital base. Instead of purchasing, one can take on lease various assets required for business.

3cStep2

This will also help in claiming tax deductions.

3c

Q3

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Q1 (a)

Payment to be made => $ 80,000.

→ Option 1 :- If forward contract is purchased at USD - INR 74 :-

Outflow :		
1) Upfront premium (80,000 × 74 × 1%)	=	₹ 59,200
2) Interest cost on upfront premium (59200 × 10% × 6/12)		2960
3) Outflow under forward Cover ($80,000 × 74)		₹ 5920,000
Total Outflow (₹)		₹ (5982160)

→ Option 2 : If risk cover via forwards is not taken:

Expected Exchange Rate INR/USD :

= (77 × 0.15) + (71 × 0.25) + (79 × 0.2) + 74 (0.4)

= 74.7

Outflow expected => $ 80,000 × 74.7 => ₹ 5976000

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Q1(a)

Recommendation :

The outflow would be lower if position is not hedged and the expected exchange rate turns out to be as predicted.

However, if the exchange rate turns out to be ₹7 or ₹9, then the company might incur huge losses.

The company can ascertain its risk tolerance and decide on the suitable course of action.

⇒ It would be advisable to cover the risk in forward market since the outflow is marginally higher i.e ₹6160 and would protect Zx Ltd from any adverse price fluctuations.

Thus, Zx Ltd must hedge through forwards.

0 1aStep4

7 1a

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Q1(b)

K: 98
S_0 = ₹ 100
R_f = 5% p.a

⇒ (i) Calculation of probability of price moving up and down:

Let probability of price moving up be 'p'.

$$p = \frac{e^{rn} - d}{u - d}$$

where ⇒ $d = \frac{\text{Lower Price}}{S_0}$

$u = \frac{\text{Upper Price}}{S_0}$

$$= \frac{e^{0.05} - \frac{95}{100}}{\frac{108}{100} - \frac{95}{100}}$$

$$\Rightarrow \frac{1.05127 - 0.95}{1.08 - 0.95}$$

$$= \frac{0.10127}{0.13}$$

$$= 0.779 \sim \text{~~0.80~~}$$

$$\sim 0.781$$

∴ Probability of price moving down = 0.22

1bStep1

1bStep2

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Q1(b)

⇒ (ii) Expected Payoffs at every node :

Value of Call (2 Yrs later) : (S-K)

⇒ (i) 116.64 − 98 = 18.64
(ii) 102.60 − 98 = 4.60
(iii) 90.25 − 98 = 0

(a) ∴ Value at N2 :

$$\Rightarrow \frac{(18.64 \times 0.78) + (4.60 \times 0.22)}{1.05127}$$

$$\Rightarrow \frac{14.54 + 1.012}{1.05127}$$

$$\Rightarrow \frac{15.552}{1.05127}$$

$$= ₹ \boxed{14.793}$$

However, since it is an american option, the value at each node would be (higher) of value - (exercisable anytime)

↑ (a) ~~Calculating~~ Calculated above = ₹ 14.793

or

(b) Intrinsic Value (108-98) = ₹ 10

∴ Value at N_2 ⇒ (14.793) .

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Q1(b)

(b) Value at N3 :

$$= \frac{(4.60 \times 0.78) + (0.22 \times 0)}{1.05127}$$

1bStep4

$$= ₹ 3.413$$

Higher of:
(a) Calculated Value = ₹ 3.413
(b) Intrinsic Value = 95 - 98 = 0 ↑

∴ Value at N3 = ₹ 3.413.

(c) Value at N_1 :

$$\Rightarrow \frac{(14.793 \times 0.78) + (3.413 \times 0.22)}{1.05127}$$

$$= \frac{11.54 + 0.75}{1.05127}$$

$$= ₹ 11.69$$

1bStep5

Value at N_1 = ₹ 11.69
or
Intrinsic Value ⇒ ₹ 2 ↑

i.e N_1 = ₹ 11.69

1b > Values at N_1 = ₹ 11.69
N_2 = ₹ 14.79
N3 = ₹ 3.41

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Q1(c)

Investment is to be made such that VAR does not exceed balance in bank account.

Balance in Bank A/c = ₹ 7,00,000
Minimum balance required at all times = ₹ 1000.
∴ Maximum VAR → ₹ 699,000.

1 1cStep1

We know,

1 1cStep2

Value at Risk ⇒ Confidence Interval × σ per day × Investment × √t

At 99%, Confidence Interval i.e Z Value = 2.33.

- σ per day ⇒ 1.5%
- Time period ⇒ 4 days (Tuesday to Friday)

Let Investment Value be 'x' :-

1 1cStep3

∴ 699000 = 2.33 × 1.5% × x × √4

∴ 699,000 = 0.0699 x

1 1cStep4

x = ₹ 1,00,00,000.

4 1c

19 Q1

∴ Maximum possible Investment = ₹ 1,00,00,000

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Q4(a)

(i) Calculation of premium to be paid using Net worth + PAT method :

(a) Calculation of Net Assets of SVL Ltd :-

Assets	(₹) in Crs
Land and Building (190 × 2.197)	417.43
Plant & Machinery	350
Furnitures & fixtures	10
Current Assets	580
	1357.43
less : Liabilities	
Creditors	(130)
Overdrafts	(10)
Provision for tax	(50)
Provision for Dividends	(50)
Borrowings	(105)
Net Assets	₹ 1012.43

Estimated Profit after tax for next 5 yrs

=> ₹ 250 Crs × FVIF(15%, 5yrs)

= ₹ 250 Crs × 7.7537

= ₹ 1938.425.

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Q4(a)

4aStep4 ∴ Value => $\frac{\text{Net Worth} + 5\text{yrs PAT}}{\text{No. of shares}}$

4aStep5 => $\frac{1012.43 + 1938.425}{12.5}$

= ₹ 236.06 / share

4aStep6 Current Market Price = ₹75

4aStep7 ∴ Premium that can be paid over the current market price => 236.06 - ₹75

4aStep8 = ₹ 161.07 / share

(ii) Premium using Dividend Growth Formula :-

Cost of Equity (Ke) of ~~LEE~~ SVL Ltd : (Gordon's Formula)
(prior to Merger)

$Ke = \frac{D_1}{P_0} + g$

4aStep9 = $\frac{14 \cdot (1.18)}{125} + 0.15$

$= \frac{59.75}{125} + 0.18$

Ke = 29.35% . 39.33% 30.33%

Growth rate of SVL post merger = 18% p.a.

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Q 4(a)

∴ Price as per Dividend Growth Formula :

$= P_0 = \frac{D1}{Ke \cdot g}$ (Using g = 18%)

$= \frac{12.5\ (1.18)}{0.3933 - 0.18}$

$= \frac{11.8}{0.2133}$ ~~0.1233~~

$= ₹ 55.32$ ~~₹ 95.67/share~~

4aStep10

4aStep11 - Premium over current Market price
= ₹ 95.67 - ₹ 75
→ ₹ 20.67/share

(*) It is assumed that K_d of SVL will be same pre & post merger.

(iii) TCL will push forward the dividend growth formula during negotiations because it results in lowest premium to be paid over market price.

4aStep12

→ Note:
The evaluation of earnings (dividend model) is done considering rate of 18% since this will be growth post merger of SVL.

4a

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Q4(b)

Using Triangular Arbitrage:

One way:

~~No. of~~ Amt of € → [€ 8666.26]

($10,000 / 1.1539)

Conversion into GBP → 8666.26 × 0.9094

= [GBP 7881.09]

Conversion back into $ = 7881.09 × 1.2752

= $ 10049.96

~ ($ 10050)

Thus, there is an arbitrage gain of $(10050 - 10,000) = ($50)

Swapping $ into £ would result in arbitrage gain.

4bStep1 4bStep2 4bStep3 4bStep4 4b

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Q4(c)

Side Pocketing does enhance the value of Mutual Fund.

Side Pocketing:

4cStep1 → It is the separation of risky assets and illiquid assets of mutual fund from liquid assets.

→ The objective is to lock the risky assets in a side pocket until the fund is able to realise the value from same. The NAV thus reflects the value of only liquid assets.

→ Whenever the [redacted]ting of mutual fund decreases, the mutual fund separates the riskier [redacted] assets.

→ This is beneficial to long-term investors since the price (NAV) of fund increases.

4cStep2 Side Pocketing was only popular internationally. However, as per IL&FS scam in India, Indian funds have started resorting to this.

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Q2(a)

Sustainable Growth Rate ⇒ $b \times r$
where b ⇒ Retention Ratio
r ⇒ Return on Equity (ROE).

⇒ Evaluation of option I (Proposal 1) :-

Income Statement :

			₹ in lakhs
Sales	$\frac{20}{0.65}$	{Total Assets / Asset to Sales Ratio}	30.769
N.P Margin ⇒ 4%			
∴ Net Profit (PAT)	(30.769 × 4%)		1.230
Target Debt Eq. Ratio ⇒			
Present Debt Eq Ratio ⇒ 2 : 3			

∴ There is no change in present Capital Structure.

∴ ROE ⇒ $\frac{\text{Return for equity shareholders}}{\text{Equity shareholder's funds}}$

$= \frac{1.230}{12}$ (lakhs)

$= 10.25\%$.

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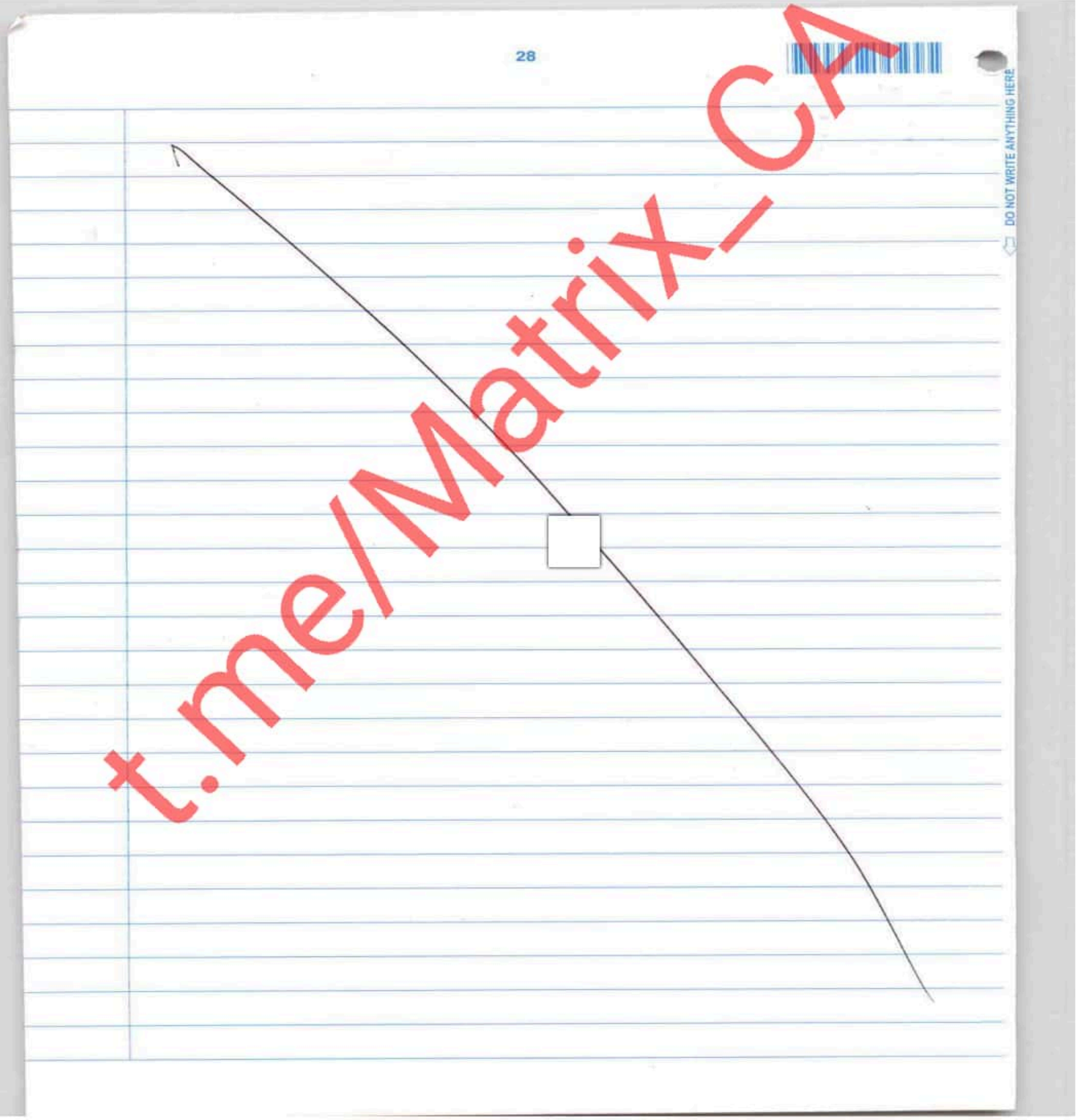

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Addl. Book No. 1

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
ADDL. BOOK

DO NOT WRITE ROLL NUMBER ANYWHERE IN THIS ADDITIONAL ANSWER BOOK

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2aStep4

Q 2(a)

∴ Growth Rate => 0.75 × 10.25%.
= (7.6875%).

=> Evaluation of Proposal 2 : (₹ in lakhs)

Sales $\left(\frac{21\text{(*)}}{0.62}\right)$ 33.871

2aStep5 V.P Margin → 5% 1.6935

(*) Total Assets => Current Assets + New Equity

2aStep6 = 20 lakhs + 1 lakh
= ₹ 21 lakhs.

Target Debt Equity Ratio => 4 : 1

∴ Equity = 21 lakhs × 1/5
= ₹ 4.2 lakhs.

Retention Ratio = 1 − Dividend Payout Ratio

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2aStep7

$$= 1 - \frac{0.3}{1.6935}$$

$$= 82.28\%$$

∴ ROE $\Rightarrow \frac{1.6935}{4.2 \text{ lakhs}}$

$$= 40.32\%$$

∴ Growth Rate $\Rightarrow 0.8228 \times 40.32\%$

$$\Rightarrow 33.17\%$$

∴ Sustainable Growth Rate :

Proposal 1 : 7.6875%

Proposal 2 : 33.17%

2aStep8

2a

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Q2(b)

Requirement of IB => Borrow JPY (Fixed Rate)
Zaki => Borrow Rupee Loan @ Floating Rate.

→ Total Cost of both parties without swap:

=> 2% + BPLR + 2.5%
=> BPLR + 4.5%

→ Total Cost if both parties enter into swap:-

=> BPLR + 0.5% + 2.25%
=> BPLR + 2.75%

Savings arising due to swap => BPLR + 4.5
- BPLR + 2.75
=> 1.75%

(i) ∴ A swap can be beneficially arranged between both parties
Savings => 175 basis points

(ii) Commission of financial Institution => 25 bps.

∴ Total Savings = 175 bps
Share of financial Institution (25)
150 bps

1:1

IB — 75 bps
Zaki — 75 bps

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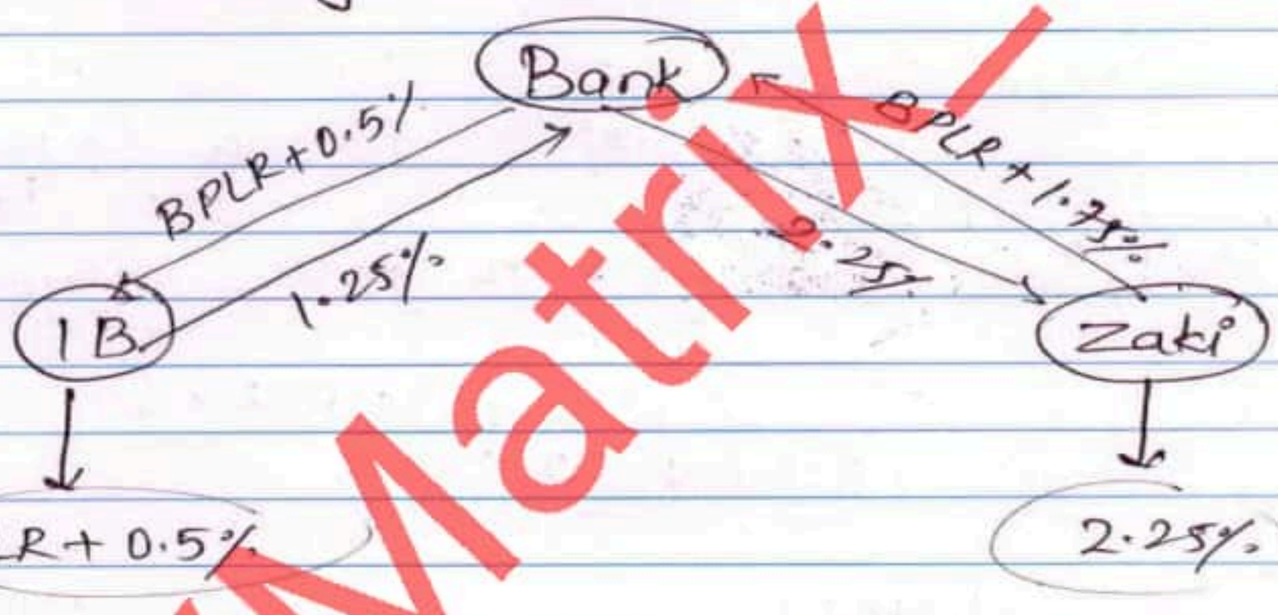
Subject : Strategic Financial Management **Marks Obtained :** 86

4

Swap Arrangement:



Rate of Interest payable by (IB) after Swap:

$\Rightarrow$ Original Rate − Savings due to swap

$\Rightarrow$ 2% − 0.75%

$\rightarrow$ (1.25%)

2 2bStep5

Interest Rate payable by Zaki :-

2 2bStep6

BPLR + 2.5% − 0.75%

$\Rightarrow$ (BPLR + 1.75%)

7 2b

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Addl. Book No. 2

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ADDL. BOOK

DO NOT WRITE ROLL NUMBER ANYWHERE IN THIS ADDITIONAL ANSWER BOOK

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Q2(c)

1 2cStep1

Peer-to-Peer Lending and Crowd funding are not same and traditional methods of funding.

1) Peer-to-Peer Lending:
→ This is when firms operating in same industry or same geographical regions lend their surplus funds to other startups in the same sector/domain.
→ The funding is usually at favourable terms and the intention is to help other firms grow.

1 2cStep2

→ It is relatively a modern method of funding wherein peers lend & borrow from each other as per requirements.

2) Crowd-funding:
- Out of all methods of funding a

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startup, crowdfunding is the most recent
- It has been quite popular in foreign countries. However, the same is extensively resorted in India also.

- In this method, small amount of money is collected from a very large group of people to meet funding requirements.

- Crowdfunding platforms have become a very lucrative funding option for startups in recent times.

2 2cStep3

Thus, peer-to peer lending and crowdfunding are relatively new and quite different methods of funding a startup.

4 2c

15 Q2

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Result Overview

Awarded Marks: 86 **Max Marks:**100

NA Not Attempted O Optional M Marked

Q1_Compulsory (Score: 19/20)

Question No	Awarded Marks	Maximum Marks	Status
Q1	19	20	M
1a	7	8	M
1b	8	8	M
1c	4	4	M

Q2_Q6 (Score: 67/80)

Question No	Awarded Marks	Maximum Marks	Status
Q2	15	20	M
2a	4	8	M
2b	7	8	M
2c	4	4	M
Q3	18	20	M
3a	5	7	M
3b	10	10	M
3c	3	3	M
Q4	14	20	M
4a	6	12	M
4b	4	4	M
4c	4	4	M
Q5	20	20	M
5a	8	8	M
5b	8	8	M
5c	4	4	M

Q6	0	20	○
6a	0	8	○
6b	0	8	○
6c	0	4	○