Institute of
Management Technology
Centre for Distance Learning, Ghaziabad
Recognised by University Grants Commission

IMT-142

STRATEGIC FINANCIAL MANAGEMENT

Notes:

a. Write answers in your own words as far as possible and refrain from copying from the text books/handouts.
b. Answers of I[st] Set (Part-A), II[nd] Set (Part-B), III[rd] Set (Part – C) and Set-IV[th] (Case Study) must be sent together.
c. Submit the assignments in IMT CDL H.O. along with the assignments Question Papers for evaluation .
d. Only hand written assignments shall be accepted.

A. First Set of Assignments	5 Questions, each question carries 1.5 marks.
B. Second Set of Assignments	5 Questions, each question carries 1.5 marks.
C. Third Set of Assignments	5 Questions, each question carries 1.5 marks. Confine your answers to 150 to 200 Words.
D. Forth Set of Assignments	Two Case Studies : 7.5 Marks. Each case study carries 3.75 marks.

SECTION - A

Q. 1. What are the critical factors to be observed while making capital budgeting decisions under capital rationing?

Q. 2. The Moon Ltd. is examining two mutually exclusive proposals. The management of the company uses certainty equivalent (CE) approach to evaluate new investment proposals. From the following information pertaining to these projects, advise the company as to which project should be taken up.

	Proposal A		**Proposal B**	
Year	Cash Flow After Taxes	CE	Cash Flow After Taxes	CE
0	(25000)	1.0	(25000)	1.0
1	15000	.8	9000	.9
2	15000	.7	18000	.8
3	15000	.6	12000	.7
4	15000	.5	16000	.4

Q. 3. What is the indifference point and why is it so called? What is its usefulness?

Q. 4. The following particulars are available in respect of corporate:

1. Capital employed Rs 500 million
2. Operating profits after taxes for the last three years are :Rs 80 million, Rs 100 million and Rs 90 million.
3. Riskless rate of return 10%
4. Risk premium relevant to business 5 %.

You are required to calculate the value of goodwill, based on the present value of super profit method. Super profits are to be computed on the basis of the average profits of 4 years. It is expected that the firm is likely to earn super profits for the next 5 years only.

Q. 5. What synergies exist in :

a) Horizontal mergers

b) Vertical Mergers

c) Conglomerate mergers

SECTION - B

Q. 1. A machine purchased four years ago has been depreciated to its current book value of Rs 50,000. The machine originally had a projected life of 10 years and zero salvage value. A new machine will cost Rs 80,000. Its installation cost estimated by the technician is Rs 20,000. The technician also estimates that the installation of the new machine will result in a reduced operating cost of Rs 30,000 per year for the next 6 years. The old machine would be sold for Rs 20,000. The new machine will have a 6 year life with no salvage value. The company's income is taxed at 35%. Determine whether existing machine should be replaced, if cost of capital 10%. Depreciation is at straight line basis.

Q. 2. What is the sensitivity approach for dealing with the project risk? What is one of the most common methods used to evaluate projects using sensitivity analysis?

Q. 3. Distinguish between

- Gross working capital and net working capital.
- Permanent and temporary working capital.

Q. 4. Following information is available in respect of a trading firm:

- On an average, debtors are collected after 45 days; inventories have an average holding period of 75 days and creditor's payment period on an average is 30 days.
- The firm spends a total of Rs 120 lakh annually at a constant rate.
- It can earn 10% on investments.

From the above information compute:

a) Cash cycle and cash turnover.

b) Minimum amount of cash required to meet the payment obligations.

c) Savings by reducing the average inventory holding period by 30 days.

Q. 5. What is credit standards? What key variables should be considered in evaluating possible changes in credit standards?

SECTION - C

Q. 1. From the following data determine the EOQ

- Annual requirement, 12,00,000 units.
- Purchase Price Rs 3 per unit.
- Ordering cost Rs 50 per order.
- Carrying cost of inventory, 10% of the cost.

Q. 2. What are the features of trade credit as a short term source of working capital finance? How can the cost of trade credit be calculated?

Q. 3. A call option at a strike price of Rs 170 is selling at a premium of Rs 15. At what share price on maturity will it break even for the buyer of the option? Will the writer of the option also break even at the same price?

Q. 4. Explain and illustrate the option pay off.

Q. 5. A proforma cost sheet of a company provides the following particulars:

	Amount (Rs)
Raw Material	80
Direct Labour	30
Overheads	60
Total Cost	**170**
Profit	**30**
Selling price	200

The following particulars are available:

Raw material in stock, on average one month; material in process, on average half a month; finished goods in stock, on average one month. Credit allowed by suppliers is one month, credit allowed to debtors is two months, lag in payment of wages is one and a half weeks, lag in payment of overhead expenses is one month; one fourth of the output is sold against cash; cash at bank is expected to be Rs 25000. You are required to prepare a statement showing the working capital needed to finance a level of activity of 1,04,000 units of production. Assume that production is carried out during the year evenly.

CASE STUDY - 1

Bose Engineering has had a very poor bad debt record and, for this reason it has devised the method of credit control based on analyses of its debt experience and of the personal characteristics of its customers. It is ascertained its good and bad debt experiences from a sample of actual orders executed. It ranked its customers using a points system from 0 to 100, where 0 denoted a class of customers with the highest percentage of bad debts and 100 denoted a class with the highest percentage of good debts. These analysis led to the preparation of following tables:

Point Ratings	**Cumulative total no. of orders received**	**Cumulative no. of orders received which turn out to be good debts**	**Cumulative no. of orders received which turn out to be bad debts**
0-10	1150	200	950
0-20	2100	450	1650
0-30	2850	750	2100
0-40	3950	1500	2450
0-50	6600	4000	2600
0-60	8150	5400	2750
0-70	9100	6250	2850
0-80	9500	6600	2900
0-90	9750	6800	2950
0-100	10000	7000	3000

The table shows, cumulatively, an analysis of the customers by class and an analysis of good & bad debts within each class per 10,000 orders received.

During 2005, the company rejected all orders from customers with a credit rating of 50 and below with the result that a sample profit and loss account, based on the table of 10,000 orders received, appeared as follows:

Sales (3400 orders @ Rs 14/- per order)		47600
Variable Costs:		
Purchases 3400 @ Rs 3/-	10200	
Distribution 3400 @ Rs 2/-	6800	17000
		30600
Overheads:		
Administration & Selling Expenses	18200	
Bad Debts @ Rs14/-	5600	23800
		6800

Assume that administration and selling expenses remaining constant

a) Apply the 2005 prices and costs to the statistical table to show cumulatively for the first five classes of customers the effect on profits of declining to accept orders in each class. Present your answer in columnar form in terms of contributions to overheads and profit lost, costs saved and the total gain or loss.

b) Prepare a sample profit and loss account, similar to that shown and based on 10000 orders received, assuming that all orders from customers with a credit rating of 20 and below are rejected.

CASE STUDY - 2

A ltd is considering takeover of B Ltd and C Ltd. The financial data for the three companies are as follows:

Particulars	A Ltd.	B Ltd	C Ltd.
Equity Share Capital of Rs 10 each (Rs/million)	450	180	90
Earnings (Rs/million)	90	18	18
Market price of each share (Rs)	60	37	46

Calculate the:

a. Price-Earnings exchange ratios.
b. Earnings per Share of A Ltd after the acquisition of B Ltd and C Ltd separately.
c. Will you recommend the merger of either/both of the companies? Justify your answer.