PGDM, 2014-16

Strategic Financial Management

DM-514/IB 506

Trimester – V, End-Term Examination: December 2015

Time Allowed: 2 Hrs 30 mins **Max Marks: 50**

Sec A

(Answer any three questions out of five. Each question carries five marks)

1. 'EVA™ is an extension on residual income technique, and the concept also goes well with NPV technique' – Discuss.

2. 'Real option is a useful tool to evaluate capital budgeting decisions' – Discuss.

3. 'Dividend policy adopted by firms is often dependent upon subjective factors' – Critically examine this statement.

4. Define the term 'Risk' as a whole as well as in terms of specific industries.

5. Discuss the ways to manage cash in a manufacturing industry.

Sec B

(Answer any two questions out of three. Each question carries ten marks)

6. Project X estimated cash flows in terms of that year's (current year) prices and expected inflation rates for the coming five years are as under:

Year	Expected Inflation Rate	Cash Flow (Rs.)
0	-	-40000
1	9%	7000
2	10%	7000
3	9%	7000
4	9%	7000
5	10%	7000

Compute the inflation adjusted NPV of project X. The real discount rate is 6%.

(10 Marks).

(10 marks)

7. 'Proponents of EVA™ argue that profits calculated in accordance with financial reporting principles do not reflect the economic value generated by company' – Discuss this statement in the light of accounting adjustments required to compute EVA™.
(10 marks)

8. i) Explain the reasons behind success or failure of mergers or acquisitions?

ii) Discuss the ways of identification to possibility of agency conflict in a company?

(5 marks x 2)

Sec C

(Compulsory)

9. Socrates Limited (SL) puts a lot of emphasis on R & D activities for the development of new products. However, the success of a new product is fraught of many pitfalls. One of the projects is about development of a AIDS fighting drug codenamed as *Addidus*. The total estimated cost of the project is INR 150 crores.

The management of SL is anxious as the expected cash inflow from the project is not very sure. Few of the competitor companies are also working on similar projects. The success and failure of competitors' projects will surely impact the cash flow of SL's project.

The total project life is five years and the estimated PV of cash inflow of *Addidus* is INR 200 crore at an appropriate discounting rate.The PV of cash outflow is INR 150 crore. During these five years, HWP may abandon the project if it finds the cash flow not encouraging. In case of abandonment, the possible receipt from sale of intellectual assets may be INR 25 crore.

The estimated annual risk-free interest rate is 7%, and the annual volatility of the logarithmic returns of future expected cash flows is 20%. The management is interested to know the value of abandonment option.

(15 marks)