www.davvonline.com www.davvonline.com

September 2013

Master of Business Administration (MBA) Examination

IV Semester

International Strategic Finance

Time : 3 Hours] [Max. Marks : 80

Note : Attempt any four questions from Section A. Each question carries 15 marks. Section B is compulsory and carries 20 marks.

www.davvonline.com www.davvonline.com

Section A

1. Evaluate the issues to be addressed for Domestic and International Financial Management.
2. How would you measure Economic Exposure? Elaborate your answer.
3. Define and explain the concept of Foreign Exchange Market. Also explain the various components of Foreign Exchange Market.
4. What are the benefits of centralized perspective of Multinational Cash Flow Analysis? Explain.
5. Critically analyse the different techniquės of Mtiltinational Capital Budgeting.
6. Write short notes on any two of the following :
   (a) Eurocurrency Markets.
   (b) International Bonds Markets.
   (c) External Commercial Borrowings.
7. Differentiate between Cost of Capital of MNCs and Cost of Capital of Domestic Firms.

www.davvonline.com www.davvonline.com

Section B

Case Study : ABC LTD. Translation and Transaction Exposure

ABC Ltd. has been one of the major players in the country in its field of chemicals. It produced and supplied speciality chemicals and adhesives and was presently operating at about full capacity with an annual turnover in excess of Rs. 1,000 crore. The industry had been growing at about 25% per annum while the growth of ABC Ltd. was constrained due to the capacity it had. The limitation of growth is evidenced in its income statement presented in Table A.

www.davvonline.com www.davvonline.com

www.davvonline.com www.davvonline.com

Table A Income Statement

Rs. crore

	Mar-06	Mar-05	Mar-04
Income	**1,130**	**940**	**650**
Material	630	512	340
Wages	66	58	52
Overhead	254	218	140
Total	950	788	532
PBDIT	**180**	**152**	**118**
Interest	5	5	4
Depreciation	65	55	46
Profit before tax	**110**	**92**	**68**
Tax	31	31	23
Profit after tax	**79**	**61**	**45**
Dividend	24	12	–
Retained earnings	**55**	**49**	**45**

It had drawn an ambitious plan to expand its business with almost an equal size to that of existing business and asset level. It wanted to become a global player in its field. It planned to increase its turnover twofold in next 3 years. The asset base consisted of about Rs. 350 crore of fixed assets at market values. It needed another Rs. 350 crore to execute the plans over the next 2-3 years.

The firm had believed in the philosophy of funding the growth and expansion of the assets through retained earnings. Unfortunately, the firm did not have enough resources to execute its plans. As a first choice, it considered the mobilization of funds through fresh equity issue. Around November 2006, the CFO of ABC Ltd., Mr. Kulkarni had discussions with several experts of capital markets. The share was moving around in the range of Rs. 100 to Rs. 125. Consultations with merchant bankers revealed that ABC Ltd. could issue fresh capital at no more than Rs. 150 per share arrived on the basis of PE multiple and Book Value multiple. The EPS of the firm was Rs. 15.50 and PE multiple of 10 was considered appropriate. Similarly, the book value of the share was around Rs. 93, which too projected a price of Rs. 150 based on book value multiple of around 1.5. These valuations were optimistic considering the current market price. According to Mr. Kulkarni's opinion, such valuations were not attractive enough.

www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com
www.davvonline.com www.davvonline.com

www.davvonline.com www.davvonline.com

The balance sheet of ABC Ltd. for the last three years is given in Table B.

Table B Balance Sheet

Rs. Crore

	Mar-06	Mar-05	Mar-04
Capital	51	51	51
Reserves	425	370	321
Shareholder's Fund	**476**	**421**	**372**
Loans	45	45	30
Deferred Tax Liability	10	8	6
Total	**531**	**474**	**408**
Fixed Assets	**341**	**302**	**247**
Investment	32	32	32
Net 'Current Assets	158	140	129
Total	**531**	**474**	**408**

www.davvonline.com www.davvonline.com

Mr. Kulkami thought that the situation was ripe for using the debt capacity built over the years. He was keen to raise the required sum of Rs. 350 crore by debt based on the debt-equity ratio of around 1:1. The little debt the firm had was for financing of working capital. Since the focus was on achieving growth through exports, he turned his attention to international capital markets for mobilizing requires resources for expansion. The amount needed for the implementation of the expansion plan was around Rs. 350 crore. The other factor that motivated the consideration of debt in foreign currency was lover interest rates prevailing abroad. In view of favourable investment climate in India and lower interest rates prevailing in the US dollar, Mr. Kulkarni along with all other members decided to raise funds in US dollar.

www.davvonline.com www.davvonline.com

The decision to raise funds in foreign currency warranted consideration of additional risk factor of fluctuations of foreign exchange. While interest rates were attractive in US dollar at around 4%, the depreciation of rupee could offset the advantage of low interest. Mr. Kulkarni reviewed the exchange.rates for the last five years "as presented in Table C. Further, he looked more, closely on the exchange rates of US dollar for the 12-14 months as presented in Table D and depicted in Figure 1.

www.davvonline.com www.davvonline.com

www.davvonline.com www.davvonline.com

Table C Exchange Rates*

Rs. / US$

Period	High	Low	Closing
Year 2002	49.06	47.96	48.03
Year 2003	48.02	45.27	45.61
Year 2004	46.46	43.39	43.58
Year 2005	46.33	43.30	45.07

Table D Exchange Rate*

Rs. / US $

Period	High	Low	Closing
Jan-06	45.05	44.07	44.07
Feb-06	44.56	44.15	44.44
Mar-06	44.69	44.32	44.61
Apr-06	45.30	44.61	44.97
May-06	46.43	44.86	46.43
Jun-06	46.40	45.82	46.08
Jul-06	46.95	45.98	46.51
Aug-06	46.72	46.43	46.55
Sep-06	46.53	45.86	45.96
Oct-06	45.84	45.02	45.02
Nov-06	45.34	44.45	44.76
Dec-06	44.83	44.23	44.23
Jan-07	44.61	44.17	44.17
Feb-07	44.31	44.06	44.31

*RBI Reference Rate

The long-term trend for the rupee in the exchange market was rather steady. If at all, there was an indication it pointed towards small appreciation of rupee. Mr. Kulkarni was rather assured that his interest cost would remain at around 4% only; same as prevailing in the US dollar debt market. If any depreciation took place, it would add to the interest cost in rupee terms, while appreciation would reduce the cost.

www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com

www.davvonline.com www.davvonline.com

www.davvonline.com www.davvonline.com

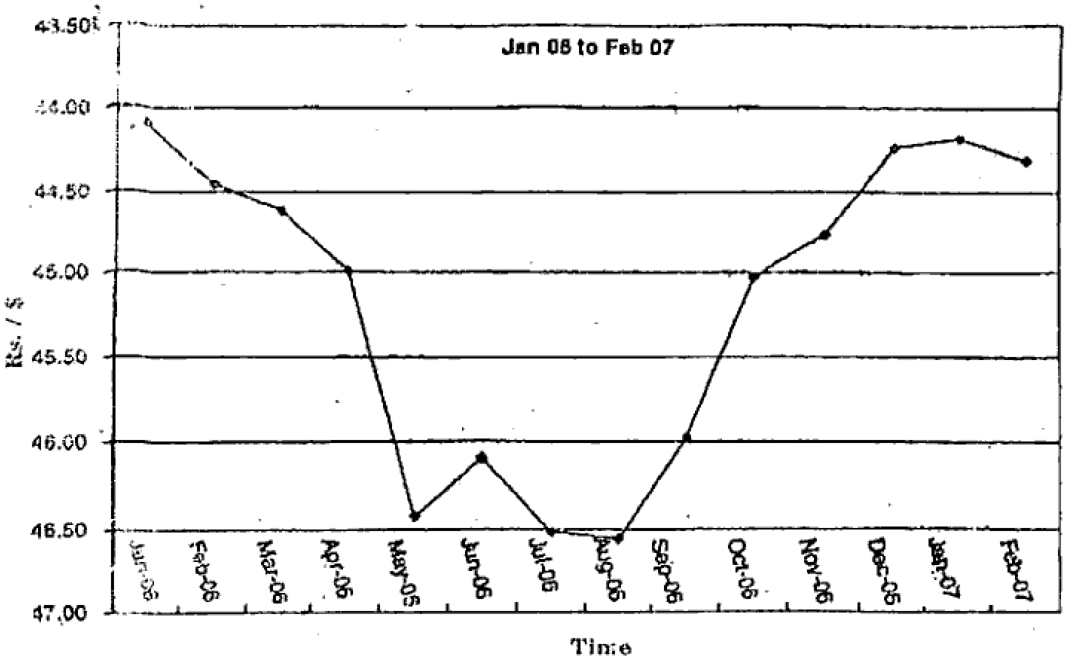

Figure 1 Exchange Rates

Reassuring himself, Mr. Kulkarni decided to come out with the foreign currency borrowing. However, top management's philosophy of relying on equity made Mr. Kulkarni to offer the borrowing with right to conversion into equity. Apart from meeting the requirements of the top management, Mr. Kulkarni was also induced from the fact that valuation of the firm by foreign investors would be higher, and it shall fetch better price for equity than what could be possible in the domestic equity markets.

The news of expansion plan and decision to borrow to fund the expansion were seen as a positive signal in the market, and then the stock price started showing appreciation expecting a substantial rise in the EPS. From a range of around Rs. 120 to Rs. 150, the stock price jumped to Rs. 237 in February 2007. The stock price for the period of last two years for calendar years 2005 and 2006 is shown in Table E and is depicted in Figure 2.

Table E Stock Price

Rs. / Share

Month	Closing Price	Month	Closing Price
Jan-05	86	Jan-06	172
Feb-05	85	Feb-06	152
Mar-05	81	Mar-06	124
Apr-05	80	Apr-06	126
May-05	83	May-06	119
Jun-05	99	Jun-06	100
Jul-05	107	Jul-06	95

www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com

www.davvonline.com www.davvonline.com

Aug-05	152	Aug-06	119
Sep-05	163	Sep-06	127
Oct-05	149	Oct-06	133
Nov-05	167	Nov-06	114
Dec-05	182	Dec-06	196

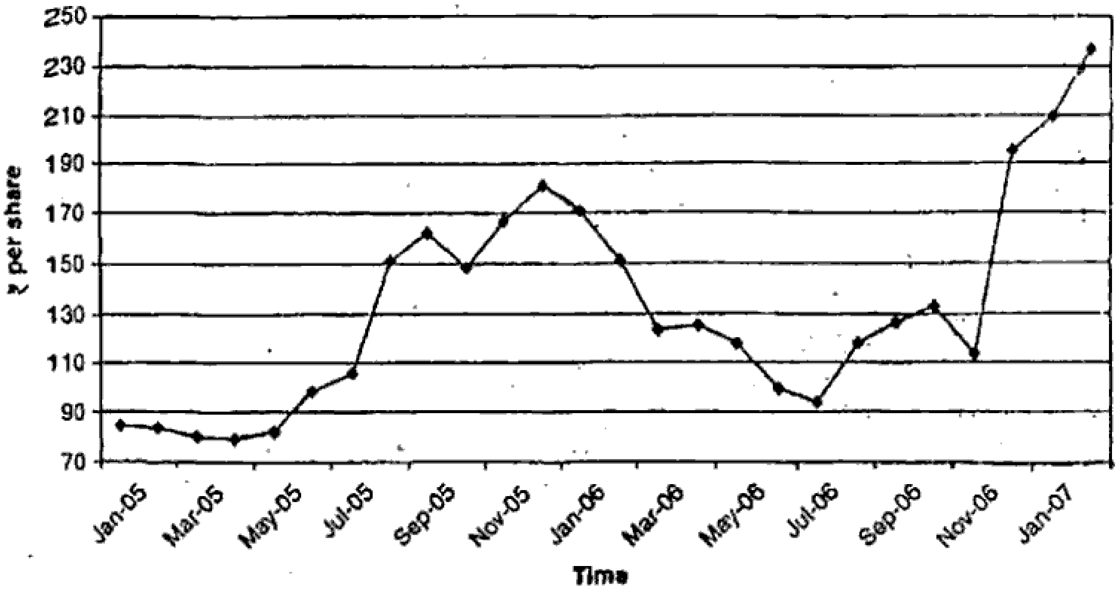

Figure 2 Stock Price Movement

Table F Stock Price - last 6 months

Sep-06	127.00
Oct-06	133.00
Nov-06	114.00
Dec-06	196.00
Jan-07	210.00
Feb-07	237.00
3-m Average	214.33
6-m Average	169.50

Based on all the considerations of utilizing the debt capacity and attraction of better valuation by foreign investors, ABC Ltd. decided to come out with the issue of Foreign Currency Convertible Bonds (FCCB) of US $80 million expected to yield about Rs. 354 crore required for the expansion of capacity. Floatation costs were estimated at about US $1 million. This was an added advantage of the debt issue because the estimated cost of floatation was of the order of 3-5% for an equity share.

Accordingly an attractive and investor-friendly instrument was offered in the global markets. The features of the bond were as follows :

www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com

www.davvonline.com www.davvonline.com

www.davvonline.com www.davvonline.com

Objective	:	Expansion, doubling of the capacity.
Natures	:	FCCBs would not be secured and therefore would be treated as unsecured loan in the balance sheet. Face value: US$1,000
Interest	:	Payable at 4% annually in arrears
Maturity	:	5 years maturing on March 2012
Listing	:	Singapore and London Stock Exchanges
Conversion	:	Each bond shall be convertible into Equity shares of the company at the option of the holder any time before maturity at a fixed price of Rs. 200 and fixed foreign ex change rate of Rs. 44.50 per $, being the rate prevailing on the date of offering.

The conversion price of Rs. 200 was arrived on the basis of average of closing prices of the share for the last 3 months and 6 months as tabulated in Table F.

On 15 March 2007, the firm received the proposed money through the FCCBs, and it was deposited in the bank net of flotation costs. The transaction was recorded in the books as follows:

In crore

	US$	Rs.	US$		Rs.
FCCB Liability	8.00	356.00	Bank Deposit	7.90	351.55
Issue Expenses against reserves	-0.10	-4.45			

Following events occurred between 15 March and 30 March :

1. Immediately upon subscription, some of the bondholders decided to convert their holding into equity shares at Rs. 200 as the share price had already moved beyond Rs. 230. The aggregate value of the bonds so converted into equity till 31 March, 2007 was US $10 million.
2. Out of the 79 million held in the banks in London.
   (a) Mr. Kulkarni repatriated US $10 million on 22 March when the exchange rate was Rs. 43.66.
   (b) Mr. Kulkarni also decided to pay US $20 million directly to the supplier of capital goods who had already supplied some of the machinry required for expansion. This was done on 28 March when the exchange rate was Rs. 43.47.

Discuss

On 31 March 2007, the exchange rate had moved to Rs. 43.59. As on 31 March 2007, Mr Kulkarni was required to prepare his balance sheet at the closing rates. Find out the following:

1. Write the brief summary of the case.
2. The loss incurred by ABC Ltd. upon conversion into equity.
3. How much would be the loss or profit upon translation of foreign currency asset of bank deposit and liability of FCCB on 31 March 2007?

□□□

www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com www.davvonline.com