**Strategic Financial Management**

**December 2023 Examination**

**Question 1**

**A company is evaluating two investment projects, Project A and Project B, each with different levels of risk and an initial investment of Rs. 3,00,000. The risk-free rate of return is 5%. The expected cash flows and their probabilities for each project are as follows:**

**Project A:**

**Expected Cash Flow in Year 1: Rs.100,000**

**Expected Cash Flow in Year 2: Rs.150,000**

**Expected Cash Flow in Year 3: Rs.200,000**

**Project B:**

**Expected Cash Flow in Year 1: Rs.80,000**

**Expected Cash Flow in Year 2: Rs.120,000**

**Expected Cash Flow in Year 3: Rs.180,000**

**The company's financial analysts have determined that Project A has a beta of 1.2, while**

**Project B has a beta of 0.8. The market risk premium is 8%.**

**Calculate the risk-adjusted discount rate for each project using the Capital Asset Pricing Model (CAPM) and then determine which project the company should choose based on the risk-adjusted Net Present Value (NPV) criteria. (10 Marks)**

**Ans 1.**

**Introduction**

Net present value (NPV) is the difference between the current value of cash outflows and the present value of cash inflows over time. Net present value is utilized in investment planning and capital budgeting to analyze a projected venture's profitability.

NPV results from calculations that locate the present value of a future move of bills using the precise discount rate. Tasks with an effective NPV are generally worth the challenge, while those with a negative net present value are not.

• Net present value (NPV) calculates the current price of a future stream of payments from an organization, project, or investment.

• To calculate internet present value, you must calculate the quantity and timing of future

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**Question 2.**

**There are several ways in which Mergers and Acquisitions can be categorized. Explain the different types of Mergers and Acquisitions (M&A) that companies can pursue to achieve strategic objectives and growth. Provide examples of each type and discuss the reasons behind their adoption. (10 Marks)**

**Ans 2.**

**Introduction**

Mergers and acquisitions (M&A) consolidate groups or assets through diverse economic transactions.

Two Or more companies merge their operations into one entity in a merger. On the other hand, in an acquisition, one company acquires every other company, and the contracted employer becomes a subsidiary of the acquiring company.

Mergers and acquisitions are often pursued for various motives. This could be for expanding

**Question 3a.**

**A stock option is for 100 shares of the underlying stock. Ayush, a trader buys one call option contract on stock of Alpha Ltd. with a strike price of Rs.25. He pays Rs.150 for the option. Assuming on the option’s expiration date, Alpha Ltd.’s shares are selling for Rs.35; compute the gain/loss incurred by Ayush. (5 Marks)**

**Ans 3a.**

**Introduction**

Futures and options are financial derivatives that help traders speculate on the cost movements of an asset without actually purchasing it. Futures contracts obligate the dealer to shop for an underlying asset, while the seller (trader) must deliver it at a predetermined date and rate. In options contracts, the dealer has the proper, but not the duty, to promote or buy the underlying

**Question 3b**

**Xenon Ltd., is a multinational manufacturing company, and its management team is evaluating the financial performance of its various divisions. They want to assess each division's contribution to shareholder value using Economic Value Added (EVA). The company's cost of capital is 10%.**

|  |  |  |
| --- | --- | --- |
|  | **Division A** | **Division B** |
| **Total Capital Employed** | **Rs.20,000,000** | **Rs.15,000,000** |
| **Operating Profit** | **Rs.3,500,000** | **Rs.2,800,000** |
| **Tax Rate** | **30%** | **25%** |

**Calculate the Economic Value Added (EVA) for each division and determine which division is creating more value for the shareholders. (5 Marks)**

**Ans 3b.**

**Introduction**

Economic value added (EVA) measures an organization's financial performance based on the residual wealth determined by deducting its COC (cost of capital) from its working profit, adjusted for taxes on a cash basis. EVA can also be referred to as income, as it attempts to seize the actual economic profit of an organization. This measure was devised by the management