## FINAL EXAMINATION

December 2013

P–20(FABV)
Syllabus 2012

**Financial Analysis & Business Valuation**

Time Allowed: 3 Hours | Full Marks: 100

*The figures in the margin on the right side indicate full marks.*

### SECTION A

*Answer* **Question No. 1** *and* **Question No. 2** *which are compulsory carrying 15 marks each and* **any two** *from the rest in this section.*

1. (a) Jenex Ltd. reported net profit for the year ending 31st March, 2013 as under: 6

| | | ₹ |
|---|---|---|
| Sales | | 10,00,000 |
| Operating Expenses (excluding depreciation) | 6,80,000 | |
| Depreciation | 84,000 | 7,64,000 |
| Net Profit before tax | | 2,36,000 |
| Extraordinary gains | | 24,000 |
| | | 2,60,000 |
| Provision for Tax (@) 40% (including surcharge and education cess, if any) | | 1,04,000 |
| Net Profit after Tax | | 1,56,000 |

Additional information are given below:

(i) Operating expenses include ₹ 12,000 being loss on sale of machinery.

(ii) Actual taxes paid for the year 2012-13 was ₹ 88,000

(iii) Following are the balances of current items:

| | 31.03.2012 | 31.03.2013 |
|---|---|---|
| Book—Debts | 50,000 | 60,000 |
| Inventories | 50,000 | 44,000 |
| Creditors | 30,000 | 36,000 |

You are required to calculate cash flows from operating activities of Jenex Ltd.

(b) On 1st September, 2012, Rama Ltd. held 60% of the ordinary share capital of its only subsidiary Krishna Ltd. The consolidated equity of the group at that date was ₹ 5,76,600, of which ₹ 1,27,000 was attributable to the minority interest.

On 28th February 2013 exactly halfway through the financial year, Rama Ltd. bought a further 20% of the ordinary share capital of Krishna Ltd. In the year ended 31st August, 2013, Rama Ltd.'s profit for the period were ₹ 98,970 and Krishna Ltd.'s were ₹ 30,000. Rama Ltd. paid a dividend of ₹ 40,000 on 1st July, 2013. There were no other movements in equity. It can be assumed that profits accrue evenly throughout the year.

Prepare a consolidated statement of changes in equity for the Rama Ltd. group for the year ended 31st August, 2013. 9

Please Turn Over

2. The following are the income statements of A Ltd. for the years ended 31.03.2012 and 31.03.2013:

| Particulars | 31.03.2012 ₹ | 31.03.2013 ₹ |
|---|---|---|
| Net Sales | 1,70,000 | 1,90,400 |
| *Less:* Cost of goods sold | 1,05,000 | 1,20,000 |
| Gross Profit | 65,000 | 70,400 |
| Administrative Exps. | 13,200 | 14,960 |
| *Selling Exps:* | | |
| Advt. Exps. | 3,000 | 4,000 |
| Other Selling Exps. | 40,800 | 41,800 |
| Operating Profit | 8,000 | 9,640 |
| Other Incomes | 6,400 | 9,200 |
| Other Exps. | 6,800 | 4,800 |
| Profit before tax | 7,600 | 14,040 |
| Income Tax | 3,800 | 6,200 |
| Profit after tax | 3,800 | 7,840 |

You are required—

(i) To prepare a comparative income statement. 9

(ii) To comment on the performance of the company supported by your analysis. 6

3. Comment on the financial state/position of a company if it has following cash flow patterns: (each pattern is independentof the other) 2×5=10

| Cash Flow Patterns | Net Cash flows from Operating Activities | Net Cash flows from Investing Activities | Net Cash flows from Financing Activities |
|---|---|---|---|
| (i) Pattern 1 | (–) | (–) | (–) |
| (ii) Pattern 2 | (+) | (–) | (–) |
| (iii) Pattern 3 | (–) | (+) | (–) |
| (iv) Pattern 4 | (–) | (+) | (+) |
| (v) Pattern 5 | (+) | (–) | (+) |

4. (a) What are the various ways of identification of distress firm? 4

(b) Balance Sheet of Dayal Ltd. as on March 31, 2013 is given below: 6

| Liabilities | ₹ in Crores | Assets | ₹ in Crores |
|---|---|---|---|
| Equity Shares | 20·80 | Fixed Assets | 105·60 |
| Long-term Liabilities | 104·00 | Current Assets | 57·60 |
| Current Liabilities | 78·40 | P & L A/c | 40·00 |
| | 203·20 | | 203·20 |

The following are the additional information:

(i) Depreciation written off ₹ 8 crores.

(ii) Preliminary Expenses written off ₹ 1·60 crores.

(iii) Net loss ₹ 25.60 crores.

You are required to ascertain the stage of sickness and comment on them.

5. (a) During 2012, Raghuvans Ltd. reported net income of ₹ 1,15,600 and had 2,00,000 equity shares outstanding for the entire year. Raghuvans Ltd. also had 1000 preference shares of 10%, ₹ 100 par, outstanding during 2012.

Raghuvans Ltd. has 10,000 stock options (or warrants) outstanding in the entire year. Each option allows its holder to purchase of one equity share at ₹ 15 per share. The average market price of Raghuvans Ltd.'s equity share during 2012 is ₹ 20 per share. Calculate the diluted EPS. 6

(b) On 1st March, 2012, XPR acquired control of YQS, purchasing 60% of its issued ordinary share capital. YQS is located in a country where compliance with most but not all, IFRS is required by law. For example, there is no requirement to discount liabilities. No material fair value adjustments were identified at the date of acquisition of YQS, except in respect of a deferred liability to a supplier which will fall due on March 01, 2014. The amount payable on that date will be ₹ 3,00,000. The discount rate relevant to the liability is 8%.

YQS's profit for the period ended 28th February 2013 was ₹ 67,600 before taking into account any unwinding of the discount in respect of the liability referred to above.

Calculate the share of profit for the period attributable to equity shareholders of the parent, after taking into account any adjustment required in respect of the liability. (PV of ₹ 1 at 8% in year 1, 2, 3, 4 & 5 are 0·926, 0·857, 0·794, 0·735 and 0·681 respectively) 4

## SECTION B

*Answer* **Question No. 6** *and* **Question No. 7** *which are compulsory carrying 15 marks each and* **any two** *from the rest in this section.*

6. Acquiring Ltd. is in the business of making bicycles. The Company operates from North India. To diversify its operations Acquiring Ltd. has identified Target Tyres Ltd., a South India based company, as a potential takeover candidate. After due diligence, the following information is available: 15

(i) Cash Flow Forecasts (₹ in Lakhs)

| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| Target Tyres Ltd. | 150 | 300 | 400 | 500 | 600 | 750 | 800 | 750 | 1,050 | 1,200 |
| Acquiring Ltd. | 800 | 1,000 | 1,500 | 1,600 | 2,200 | 2,600 | 3,000 | 2,750 | 3,500 | 5,400 |

(ii) Balance Sheet of Target Tyres Limited as at March 31st, 2013 (₹ in lakhs)

| Particulars | 2013 |
|---|---|
| **EQUITY AND LIABILITIES** | |
| **Shareholders' Funds:** | |
| Share Capital (Face Value ₹ 10) | 100·00 |
| Reserves and Surplus | 2,170·95 |
| | 2,270·95 |
| **Non-Current Liabilities** | |
| Long-Term Borrowings | 565·00 |
| Bank Loan | 78·50 |
| | 643·50 |
| **Current Liabilities** | |
| Trade Payables | 163·50 |
| Other Current Liabilities | 47·25 |
| | 210·75 |
| **TOTAL EQUITY AND LIABILITIES:** | **3,125·20** |

( ₹ in lakhs)

| Particulars | 2013 |
|---|---|
| **ASSETS** | |
| **Non-Current Assets** | |
| Fixed Assets: | |
| Tangible Assets | 1,291·00 |
| Intangible Assets | 120·20 |
| | 1.411·20 |
| Non-Current Investments | 155·00 |
| Other Non-Current Assets | 21·25 |
| | 1,587·45 |
| **Current Assets:** | |
| Inventories | 511·40 |
| Trade Receivables | 745·50 |
| Cash and Bank Balances | 268·50 |
| Other Current Assets | 12·35 |
| | 1,537·75 |
| **TOTAL ASSETS:** | **3,125·20** |

(iii) Talks for the takeover have crystallized on the following:

(a) Acquiring Ltd. will not be able to use Machinery worth ₹ 175 lakhs which will be disposed off by them subsequent to take over. The expected realization will be ₹ 150 lakhs.

(b) The inventories and receivables are agreed for take over at value of ₹ 400 and ₹ 700 lakhs respectively, which is the price they will realize on disposal.

(c) The liabilities of Target Tyres Ltd. will be discharged in full on take over along with an employee settlement of ₹ 120 lakhs for the employees who are not interested in continuing under the new management.

(d) Acquiring Ltd. will invest a sum of ₹ 250 lakhs for upgrading the Plant of Target Tyres Ltd. on take over. A further sum of ₹ 250 lakhs will also be incurred in the second year to revamp the machine shop floor of Target Tyres Ltd.

(e) The anticipated cash flows of the combined business post take over are as follows:

( ₹ in lakhs)

| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| Cash Flows | 900 | 1,200 | 1,800 | 2,200 | 3,000 | 4,000 | 4,800 | 5,000 | 7,000 | 10,000 |

The management of Target Ltd. is not ready to accept its present standalone value as consideration for the takeover. Acquiring Ltd. wishes to know upto what extent they can quote higher price, without suffering any loss in value post merger.

You are required to advice the management the upper limit price which they can pay per share of Target Tyres Ltd., if a discount factor of 15% is considered appropriate.

Use the following Discount Factor Table:

| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| Discount Factor at 15% | 0·8696 | 0·7561 | 0·6575 | 0·5718 | 0·4972 | 0·4323 | 0·3759 | 0·3269 | 0·2843 | 0·2472 |

7. The Balance Sheets of Resurgent Ltd. for the years ended on 31.3.2011, 31,3,2012 and 31.3.2013 are as follows: 15

| *Liabilities* | 31.3.2011 ₹ | 31.3.2012 ₹ | 31.3.2013 ₹ |
|---|---|---|---|
| 3,20,000 Equity Shares of ₹ 10 each fully paid | 32,00,000 | 32,00,000 | 32,00,000 |
| General Reserve | 24,00,000 | 28,00,000 | 32,00,000 |
| Profit and Loss Account | 2,80,000 | 3,20,000 | 4,80,000 |
| Creditors | 12,00,000 | 16,00,000 | 20,00,000 |
| Total | 70,80,000 | 79,20,000 | 88,80,000 |

| *Assets* | 31.3.2011 ₹ | 31.3.2012 ₹ | 31.3.2013 ₹ |
|---|---|---|---|
| Goodwill | 20,00,000 | 16,00,000 | 12,00,000 |
| Building & Machinery (*Less*: Depreciation) | 28,00,000 | 32,00,000 | 32,00,000 |
| Stock | 20,00,000 | 24,00,000 | 28,00,000 |
| Debtors | 40,000 | 3,20,000 | 8,80,000 |
| Bank Balance | 2,40,000 | 4,00,000 | 8,00,000 |
| Total | 70,80,000 | 79,20,000 | 88,80,000 |

Actual valuation were as under:

| Particulars | 31.3.2011 ₹ | 31.3.2012 ₹ | 31.3.2013 ₹ |
|---|---|---|---|
| Building & Machinery | 36,00,000 | 40,00,000 | 44,00,000 |
| Stock | 24,00,000 | 28,00,000 | 32,00,000 |
| Net Profit (including opening balance) after writing off depreciation and goodwill, tax provision and transfer to General Reserve | 8,40,000 | 12,40,000 | 16,40,000 |

Capital employed in the business af market values at the beginning of 2010-2011 was ₹ 73,20,000, which included the cost of goodwill. The normal annual return on Average Capital employed in the line of business engaged by Resurgent Ltd. is 12½%.

The balance in the General Reserve account on 1st April 2010 was ₹ 20 lakhs.

The goodwill shown on 31.3.2011 was purchased on 1.4.2010 for ₹ 20,00,000 on which date the balance in the Profit and Loss Account was ₹ 2,40,000. Find out the average capital employed each year

Goodwill is to be valued at 5 years purchase of super profits (Simple average method). Also find out the total value of the business as on 31.3.2013.

8. (a) The following financial share data pertaining to Infotech Ltd. an IT company are made available to you: 6

(₹ in crores)

| Year ended March 31st | 2012 | 2011 | 2010 |
|---|---|---|---|
| EBIT | 696·03 | 325·65 | 155·86 |
| Non-branded Income | 53·43 | 35·23 | 3·46 |
| Inflation Compounded Factor @ 8% | 1·000 | 1·087 | 1·181 |
| Remuneration of Capital | 5% of average Capital Employed | | |
| Average Capital Employed | ₹ 1112·00 crores | | |
| Corporate Tax rate | 35% | | |
| Capitalization Factor | 16% | | |

You are required to calculate the Brand value for Infotech Ltd.

(b) What are the uncertainties in business valuation? 4

9. (a) State under what conditions/assumptions the following statements are true: (state only one important condition/ assumption for each): 1×5=5

(i) Fair Value of an asset is always equal to its Market Value.

(ii) Gordon's Dividend Growth Model provides a good estimate of intrinsic value of a share.

(iii) A Company can show Goodwill in its Balance Sheet.

(iv) Tobin Q of a company indicates that it is earning a rate of return higher than that justified by the cost of its assets and such a return could not persist in the absence of long-run entry barriers.

(v) Market Value of a Company AA rated 12% Debenture is equal to its book value which is recorded at its face value.

(b) A share, Y, currently sells for ₹ 120. It is expected that in one year it will either rise to ₹ 150 or decline to ₹ 100, with 50% probability of each. A call option is written on Y with the strike price of the underlying of ₹ 125 and the risk free interest rate is 10% p.a. You are required to determine the Option Premium. 5

10. (a) Discuss the amalgamation in the nature of merger as per Accounting Standard, AS–14. 6

(b) What are the factors that favour external growth and diversification through mergers and acquisitions? 4