Paper-18: BUSINESS VALUATION MANAGEMENT

Time Allowed: 3 Hours **Full Marks: 100**

Working Notes should form part of the answer.
"Whenever necessary, suitable assumptions should be made and indicated in answer by the candidates."

The figures in the margin on the right side indicate full marks.
Answer Question No. 1 which is compulsory carrying 25 marks and any five from the rest.

1. (a) State whether the following statements are true or false: **[1x5=5]**

(i) The book value of an asset is the historical cost less depreciation.
(ii) Possession of complimentary resources is one of the reasons for Merger negotiations.
(iii) Divestitures represent the sale of a part of the total undertaking.
(iv) Valuing a firm using discounted cash flow method is conceptually different from valuing a capital project using present value method.
(v) Market value per share is expected to be lower than the book value per share in case of profitable and growing firms.

(b) Fill in the blanks by using the words/phrases given in the brackets: **[1x10=10]**

(i) DCF analysis requires the revenue and expenses of …………………….. [past/future].

(ii) Estimated fair value of an asset is based on the …………………….. [current / discount / future] value of operating cash flows.

(iii) The …………………….. Assets Monitor is a management tool for organizations that wish to track and value their …………………….. Assets. [tangible / intangible].

(iv) A theory that explains why the total value from the combination resulted from a merger is greater than the sum of the values of the component companies operating independently is known as …………………….. Theory. [Synergy/Hubris/Agency].

(v) Key to income based approach of valuation is …………………….. [Capitalisation rate / Internal rate of return].

(vi) An investment is risk-free when actual returns are always …………………….. the expected returns. [less than / equal to / more than].

(vii) Shares of listed companies which are traded on the stock exchange are …………………….. [quoted/ unquoted].

(viii) Organizational Capital is a ……………………. component of Intellectual Capital. [primary/secondary].

(ix) In balance sheet, equity and fixed assets are expressed in terms of their ……………………. [market value/book value/replacement value].

(x) Post merger control and the ……………………. are two of the most important issues in agreeing on the terms of merger. [calculated price/ negotiated price].

(c) In each of the questions given below one out of the four options is correct. Indicate the correct answer: [2×5=10]

(i) An anti takeover defense that creates securities that provide their holders with special rights in the event of a takeover is called
(a) White Knight
(b) Poison Put
(c) Poison Pill
(d) Bear Hug

(ii) The following approach states that value of a firm is unaffected by its dividend policy
(a) CAPM approach
(b) Modigliani-Miller approach
(c) Walter's Valuation model
(d) None of the above

(iii) If the company has a P/E Ratio of 12 and a ROE of 13% then its Market to Book Value Ratio will be
(a) 1.56
(b) 9.34
(c) 1.09
(d) None of the above

(iv) Which one of the following is not a valid assumption of the Modigliani and Miller Model of Dividend policy?
(a) There are no stock floatation or transaction cost
(b) Stocks are divisible
(c) There are no arbitrage opportunities in the market
(d) There is asymmetric information between the managers and investors

(v) If the current yield of a bond is more than its yield to maturity, then a bond is trading at …………………….
(a) Par
(b) At discount
(c) At premium
(d) Nothing can be said about the prices of bond as information is not complete

Q. 2. The following is the Balance Sheet as at 31st December 2013 of Techno group Ltd.

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital:		Fixed Assets:	
8000 Equity shares of ₹10 each fully paid up	80,000	Goodwill	10,000
5000 Equity shares of ₹10 each ₹8 paid up	40,000	Plant & Machinery	80,000
3600 Equity shares of ₹5 each fully paid up	18,000	Land and Building	1,00,000
3000 Equity shares of ₹5 each ₹4 paid up	12,000	Furniture and Fixtures	10,000
300, 10% Preference shares of ₹100 each fully paid up	30,000	Vehicles	20,000
		Investments	30,000
Reserve and Surplus:			
General reserve	14,000	Current Assets:	
Profit & Loss account	21,000	Stock	21,000
Secured loan; 12% Debenture	20,000	Debtors	19,500
Unsecured loan : 15% term loan	15,000	Prepaid Expenses	4,000
Deposits	10,000	Advances	4,500
Current Liabilities:		Cash and Bank balance	20,000
Bank Loan	5,000	Preliminary expenses	1,000
Creditors	15,000		
Outstanding expenses	2,000		
Provision for tax	20,000		
Proposed Dividend:			
Equity	15,000		
Preference	3,000		
	3,20,000		**3,20,000**

Additional Information:

(a) In 2011 a new machinery costing ₹ 5,000 was purchased, but wrongly charged to revenue (no rectification has yet been made for the same)

(b) Stock is overvalued by ₹ 1,000 in 2012. Debtors are to be reduced by ₹ 500 in 2013, some old furniture (Book value ₹1000) was disposed of for ₹ 600.

(c) Fixed assets are worth 5 per cent more than their actual book value. Depreciation on appreciated value of fixed assets except machinery is not be considered for valuation of goodwill.

(d) Of the investment 20 per cent is trading and the balance is non-trading. All trade investment are to be valued at 20 per cent below cost. Trade investment was purchased on 1st January, 2013. So per cent of the non-trade investments were acquired on 1st January, 2012 and the rest on 1st January, 2011. As uniform rate of dividend of 10 per cent is earned on all investments.

(e) Expected increase in expenditure without commensurate in selling price is ₹ 2,000.

(f) Research and Development expenses anticipated in future ₹ 3,000 per annum.

(g) In a similar business a normal return on capital employed is 10%.

(h) Profit (after tax) are as follows:
In 2011 – ₹ 21,000, in 2012 – ₹ 19,000 and in 2013 ₹ 20,000.

(i) Current income tax rate is 50%, expected income tax rate will be 45%.

From the above, ascertain the ex-dividend and cum-dividend intrinsic value for different categories of equity shares. For this purpose goodwill may be taken as 3 years purchase of super profit. Depreciation is charged on machinery @ 10% on reducing system. **[15]**

Q. 3. (a) Bikram Ltd has hired a Marketing Consultancy Firm for doing market research and provides data relating to Tyre industry for the next 10 years. The following were the observations and projections made by the consultancy firm -----

I. The Tyre Industry in the target area i.e., whole of India, is expected to grow at 5% p.a. for the next 3 years, and thereafter at 7% p.a. over the subsequent seven years.

II. The market size in terms of unencumbered basic sales of tyres was estimated at ₹8,000 lakhs in the last year, dominated by medium and large players. This includes roughly 9.0% of fake brands and locally manufactured tyres. Market share of this segment is expected in increase by 0.5%.

III. Cheap Chinese imports accounts for 40% of the business (but 60% of the volume. This is expected to increase by 0.25% over the next decade.

IV. The other large players account for roughly 35% of the business value, which is expected to go down by 0.5% over the next ten years, due to expansion of Bikram Ltd's product portfolio.

V. The Company is in the process of business re-engineering, which will start yielding results in 2 years time, and increase its profitability by 3% from its existing 12%.

If the appropriate discount rate is 16% what is the Brand Value of Bikram Ltd., under Market oriented Approach.

(b) From the following information taken from the books of Progressive Ltd. relating to staff and community benefits, prepare a statement showing value of benefits to staff and community at large, as required under Corporate Social Reporting.

	₹
Environment Improvements	20,10,000
Medical Facilities to staff and family	45,00,000
Training Programmes conducted in-house	10,25,000
Generation of Job Opportunities in the locality	60,75,000
Municipal Taxes paid	10,70,000
Increase in cost of living in the vicinity due to a thermal power station	16,55,000
Concessional transport, water supply to staff	11,25,000
Extra work put in by company staff and officers for drought relief	18,50,000
Leave encashment and leave travel benefits	52,00,000
Educational facilities for children of staff members	21,60,000
Subsidised canteen facilities on premises	14,40,000
Generation of business in the district	25,00,000

(c) Are Real options and Managerial options the same? **[7+(3+3)+2]**

Q. 4. (a) State the various methods of payment in case of mergers and amalgamations.

(b) Explain the concept of Human Resource Accounting (HRA) and outline the basic models for HRA.

(c) Firm A acquires Firm B. As of date Firm B has accumulated losses of ₹ 1,000 Lakh. Firm A is well managed company with a good profit record. The projected profits before taxes, of Firm A, for the next three years are given in the table :

Year	Amount (₹)
1	350
2	500
3	700

Assuming corporate tax rate of 35 per cent and discount rate of 12 per cent,

Determine the present value of tax gains likely to accrue on account of merger to A.

[4+6+5]

Q. 5. (a) As the finance manager of R Ltd., you are investigating the acquisition of S Ltd. company. The following facts are given:

Particulars	R Ltd.	S Ltd.
Earning per share	₹67.50	₹25
Dividend per share	₹32.50	₹10
Price per share	₹480.00	₹150
Number of shares	600 lakhs	200 lakhs

Investors currently expect the dividends and earnings of S Ltd. to grow a steady rate of 7% after acquisition this growth rate would increase to 8% without any additional investment.

Required:

(i) What is the benefit of this acquisition?

(ii) What is the cost of this acquisition to R Ltd. if it pays

I. ₹170 per share compensation (cash) to R Ltd. and

II. Offers 2 shares for every 6 shares of S Ltd? **[2+(1+2)]**

(b) S. Mondal has just completed his post qualification internship in a reputed medical hospital. He wants to buy the running practice of Dr. Mukherjee, a renowned child specialist located at Lansdowne in Kolkata. The revenue and the costs of this practice in 2013 – 2014 were as under:

Particulars	₹
Revenue	1,00,000
Employee expenses	30,000
Annual rent for the facilities	10,000
Rental of medical equipments	8,000
Medical insurance	9,000
The tax rate on the income	
Including local taxes and subscription	40%
The cost of capital for this practice	10%

The above revenue and all the associated expenses are estimated to grow at 4% p.a. for the next 10 years if Dr. Mukherjee continues to run the practice.

Dr. S Mondal anticipates that upon the changeover there will be drop in revenue by 25% in the first year of his practice. The growth rate in revenue and expenses will remain at 4% p.a. thereafter i.e., for year 2 onwards.

Dr. S Mondal wants your advice for the price he should offer to Dr. Mukherjee to purchase the latter's practice at Lansdowne, Kolkata. **[6]**

(c) Describe the advantages and disadvantages associated with holding companies. **[4]**

Q 6. Write short notes on *any three*. **[5×3=15]**

(a) Net Realizable value of Inventories

(b) Features of a future contract

(c) Expansion and Diversification

(d) IRR & NPV

(e) Net realizable value of Inventories

Q. 7. (a) TUB Ltd. and VAM Ltd. propose to amalgamate. Their balance sheets as at 31st March, 2014 were as follows:

Liabilities	**TUB Ltd.** ₹	**VAM Ltd.** ₹	**Assets**	**TUB Ltd.** ₹	**VAM Ltd.** ₹
Share capital:			Fixed assets		
Equity shares of ₹10 each	15,00,000	6,00,000	Less: Depreciation	12,00,000	3,00,000
General reserve	6,00,000	60,000	Investments (face value of ₹ 3 lacs, 6% tax free G.P. notes)	3,00,000	-
Profit & Loss A/c	3,00,000	90,000	Stock	6,00,000	3,90,000
Creditors	3,00,000	1,50,000	Debtors	5,10,000	1,80,000
			Cash and bank balances	90,000	30,000
	27,00,000	**9,00,000**		**27,00,000**	**9,00,000**

Their net profits (after taxation) were as follows:

Year	TUB Ltd.	VAM Ltd.
2011-12	3,90,000	1,35,000
2012-13	3,75,000	1,20,000
2013-14	4,50,000	1,68,000

Normal trading profit may be considered as 15% on closing capital invested. Goodwill may be taken as 4 years' purchase of average super profits. The stock of TUB Ltd. and VAM Ltd. are to be taken at ₹ 6,12,000 and ₹ 4,26,000 respectively for the purpose of amalgamation. WWF Ltd. is formed for the purpose of amalgamation of two companies. Assume tax rate 40%

(i) Suggest a scheme of capitalization of WWF Ltd. and ratio of exchange of shares; and

(ii) Draft the opening balance sheet of WWF Ltd.

(b) The 6-months forward price of a security is ₹ 208.18. The borrowing rate is 8% per annum payable with monthly rests. What should be the spot price? **[(6+6)+3]**

Q. 8. RAYMONDS Garments Ltd. is a company which produces and sells to retailers a certain range of fashion clothing. They have made the following estimates of prudential cash flows for the next 10 years.

(₹ in lakhs)

Yr.	1	2	3	4	5	6	7	8	9	10
Cash flow	3750	4250	5000	6250	7500	8500	9500	11250	12500	15000

SONA Ltd. is a company which owns a series of boutiques in a certain locality. The boutiques buy clothes from various suppliers and retail them. Each boutique has a manager and an assistant but all purchasing and policy decisions are taken centrally. An independent cash flow estimate of SONA Ltd. was as follows;

(₹ in lakhs)

Yr.	1	2	3	4	5	6	7	8	9	10
Cash flow	300	400	500	700	850	1150	1300	1500	1650	2000

RAYMONDS Garments Ltd. is interested in acquiring SONA Ltd. in order to get some additional retail outlets. They make the following cost-benefit calculation;

(i) Net value of assets of SONA Ltd.

₹ in lakh

Sundry fixed assets	2000
Investments	500
Stock	1000
Total	3500
Less : Sundry Creditors	1000
Net Assets	2500

(ii) Sundry fixed assets amounting to ₹125,00,000 cannot be used and their net realisable value is ₹112,50,000

(iii) Stock can be realised immediately at ₹ 1,175 lakh.

(iv) Investments can be disposed off for ₹530 lakhs.

(v) Some workers of SONA Ltd. are to be retrenched for which estimated compensation is ₹325 lakh.

(vi) Sundry creditors are to be discharged immediately.

(vii) Liabilities on account of retirement benefits not accounted for in the balance sheet by SONA Ltd. is ₹120 lakhs.

(viii) Expected cash flows of the combined business will be as follows:

(₹ in lakhs)

Yr.	1	2	3	4	5	6	7	8	9	10
Cash flow	4500	4750	5750	7375	8750	10000	11250	13250	14500	17250

Find out the maximum value of SONA Ltd. which RAYMONDS Garments Ltd. can quote. Also show the difference in valuation had there been no merger. Use 20% as discount factor.

Year	1	2	3	4	5	6	7	8	9	10
Discounting factor @ 20%	0.8333	0.6944	0.5787	0.4823	0.4019	0.3349	0.2791	0.2326	0.1938	0.1615

[15]