PAPER – 20: Financial Analysis and Business Valuation

Paper – 20 : Financial Analysis and Business Valuation

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

Section – A

Answer Question No. 1 which is compulsory

[2 × 6 = 12]

1. (a) (i) Following figures have been extracted from the records of a company:

Year	2011	2012
Sales ₹	5,00,000	8,40,000
Units Sold	10,000	14,000

Account for changes in sales value due to changes in sales quantity, selling price and both

(ii) AB owns 60% of the issued ordinary share capital of CD. CD owns 60% of the issued ordinary share capital of EF. The effective interest of AB in EF is ……………….%

(iii) For 2012, Rytte Products had net income of ₹ 10,00,000. On 1st January 2012, there were 10,00,000 shares outstanding On 1st July 2012, the company issued 1,00,000 new shares for ₹20 per share. The company paid ₹ 2,00,000 in dividends to common shareholders. What is Rytte's basic earnings per share for 2012

(iv) X Ltd. currently paid a dividend of ₹1 per share and has a share price of ₹ 20. If the dividend is expected to grow @ 12% pa forever. What is firm's required return on equity using dividend discount model?

(v) Mr. Bhupati deposits ₹ 2,00,000 in a bank account which pays 10% interest. How much can he withdraw annually for a period of 15 years?

(vi) A firm's current assets and current liabilities are 2000 and 1000 respectively. How much money the company should repay to have a current ration of 3:1

(b) State whether the following statements are true or false **[1 × 8 = 8]**

(i) Intrinsic value of a share decreases after a bonus issue
(ii) In a synergistic merger, the post-merger value exceeds the sum of the separate companies' pre-merger values
(iii) If expected rate of return is more than required rate, stock should be sold
(iv) One way to increase EVA is to maintain the same operating income with more capital
(v) If EPS of a company is ₹15 and the PE ratio is 10, then market value of the share of the company is 1.5
(vi) In case of Deep Discount Bond, the issue price is always the face value
(vii) Buying the units of mutual funds is an indirect investment
(viii) Specific risk of a firm is also called as Systematic Risk

Sec- B
Answer Any 5 Question from the following

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

Particulars	31-Mar-2012 (Amt ₹)	31-Mar-2013 (Amt ₹)
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 Expenses	13,200	14,960
Selling Expenses:		
Advertisement Expenses	3,000	4,000
Other Selling Expenses	40,800	41,800
Operating Profit	8,000	9,640
Other Income	6,400	9,200
Other Expenses	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

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

[10+6=16]

3. (a) The Balance Sheet of Ignu Ltd on 31.03.2013 and 31.03.2014 are presented

Amount in Lakhs

Equities and Liabilities	2013	2014	Assets	2013	2014
Share Capital	300	300	Free Hold Property	225	240
Reserves	225	240	Plant & Machinery (Net after Dep)	135	165
6% Debentures	75	75	Unquoted Shares- Investments	150	150
Mortgage Loan	27	14.25	Quoted Shares – Investments (Market Value ₹ 120 Lakhs in 2013 and 150 Lakhs in 2014)	112.5	112.5
Creditors	45	45	Stock	52.5	75
Proposed Dividend (Subjected to TDS)	22.5	23.25	Debtors	45	75
Provision for Tax	21	37.5	Bank	10.5	0
Secured Overdraft (By a floating charge on assets)	15	82.5			
	730.5	817.5		730.5	817.5

The following additional information for the year 2013-14 is relevant:

Credit Sales: ₹ 675 Lakhs

Credit Purchases: ₹ 520 Lakhs

Overhead: ₹ 85.75 Lakhs

Depreciation on Plant and Machinery: ₹ 17.5 Lakhs

Dividend for 2012-13 was paid in full.

Amount paid towards taxation for the year 2012-13 is ₹ 21.5 Lakhs.
In view of Credit Squeeze, the company has been asked by the Bank to reduce the overdraft substantially, within six months if possible by 50%.
You are required to prepare a cash flow statement and briefly comment on the financial position of the company on the basis of information of cash flow statement and suggested remedial measures to overcome the financial crises. [13]

(b) Write a short note on Macro-Economic Financial Model [3]

4. (a) The following Financial Statement is summarized from the books of Neel Ltd as on 31-Mar-2014

Equity and Liabilities	Amount (₹)	Assets	Amount (₹)
Paid-up Share Capital	15,00,000	Fixed Assets	16,50,000
Reserves and Surplus	6,00,000	Stock-in-Trade	9,10,000
Debentures Long-term	5,00,000	Book-Debts	12,40,000
Bank Overdraft	12,00,000	Investments-Short term	1,60,000
Sundry Creditors	2,00,000	Cash	40,000
	40,00,000		40,00,000

Annual Sales ₹ 74,40,000. Gross Profit ₹ 7,44,000;
You are required to calculate the following ratios for the year and comment on the financial position as revealed by these ratios.
(i) Debt-Equity Ratio
(ii) Current Ration
(iii) Proprietary Ratio
(iv) Gross Profit Ratio
(v) Debtors Turnover Ratio
(vi) Stock Turnover Ratio

Bank Overdraft is payable on Demand [12]

(b) The following summarizes the percentage changes in operating income, percentage changes in revenues and the betas for four pharmaceutical firms.

Firm	Change in Revenue	Change in Operating Income	Beta
PQR Ltd.	27%	25%	1.00
RST Ltd.	25%	32%	1.15
TUV Ltd.	23%	36%	1.30
WYZ Ltd.	21%	40%	1.40

You are required to Calculate the Degree of Operating Leverage for each of these firms. [4]

5. (a) Given below is the Balance Sheet of Khan Ltd. As on 31.3.2012.

Liabilities	₹ (in lakh)	Assets	₹ (in lakh)
Share Capital (Share of ₹10)	100	Land and Building	40
Reserves and Surplus	40	Plant and Machinery	80
Creditors	30	Investments	10
		Stock	20
		Debtors	15
		Cash at bank	5
	170		170

You are required to work out the value of the Company's, shares on the basis of Net Assets method and Profit-earning capacity (capitalization) method and arrive at the fair price of the shares. By considering the following information

(i) Profit for the current year ₹ 64 lakhs includes ₹4 lakhs extraordinary income and ₹1 lakh income from investments of surplus funds: such surplus funds are unlikely to recur.
(ii) In subsequent years, additional advertisement expenses at ₹5 lakhs are expected to be incurred each year.
(iii) Market value of land and Building & Plant and Machinery has been ascertained at ₹96 lakhs and ₹100 lakhs respectively. This will entail additional depreciation of ₹6 lakhs each year.
(iv) Effective income-tax rate is 30%
(v) The capitalization rate applicable to similar business is 16%. [12]

(b) Given a) future maintainable Profit before Interest - ₹125 Lakhs; b) Normal Rate of Return on Long Term Funds is 19% and on Equity Funds is 24%; c) Long Term Funds of the Company is ₹ 320 Lakhs of which Equity Funds is ₹ 210 Lakhs; d) interest on Loan Funds is 18%. Find out leverage effect on Goodwill if tax rate = 30%. [4]

6. (a) The following information is relating to Fortune India Ltd. having two division Pharma Division and Fast Moving Consumer Goods Division (FMCG Division). Paid up share capital of Fortune India Ltd. is consisting of 3,000 Lakhs equity shares of Re. 1 each. Fortune India Ltd. decided to de-merge Pharma Division as Fortune Pharma Ltd. w.e.f. 1.4.2010.. Details of Fortune India Ltd. as on 31.3.2010 and of Fortune Pharma Ltd. as on 1.4.2010 are given below:

Particulars	Fortune Pharma Ltd.	Fortune India Ltd.
	₹ In lakh	₹ In lakh
Outside Liabilities		
Secured Loans	400	3,000
Unsecured Loans	2,400	800
Current Liabilities & Provisions	1,300	21,200
Assets		
Fixed Assets	7,740	20,400
Investments	7,600	12,300
Current Assets	8,800	30,200
Loans & Advances	900	7,300
Deferred tax/Misc. Expenses	60	(200)

Board of Directors of the Company have decided to issue necessary equity shares of Fortune Pharma Ltd. of ₹1 each, without any consideration to the shareholders of Fortune India Ltd. For that purposes following points are to be considered:
(i) Transfer of Liabilities & Assets at Book value.
(ii) Estimated Profit for the year 2010-11 is ₹ 11,400 Lakh for Fortune India Ltd. & ₹1,470 lakhs for Fortune Pharma Ltd.
(iii) Estimated Market Price of Fortune Pharma Ltd. is ₹ 24.50 per share.
(iv) Average P/E Ratio of FMCG sector is 42 & Pharma sector is 25, which is to be expected for both the companies.

Calculate:
(i) The Ratio in which shares of Fortune Pharma are to be issued to the shareholders of Fortune India Ltd.

(ii) Expected Market price of Fortune India Ltd.
(iii) Book Value per share of both the Companies immediately after Demerger [12]

(b) Infrastructures Ltd. has been regularly paying a dividend of ₹ 3.50 on their shares. The number of equity shares is 25,000. Required
(i) What is the value of equity, if the return for the investors is 14%
(ii) Determine the value of equity, if the dividend is expected to grow at 8% p.a. on a constant basis [4]

7. (a) Marico Ltd. acquired 100% of Sun Ltd. for ₹ 20000 (lacs). As on the date of acquisition, the net assets of Marico Ltd. were:

	(₹ in lacs)
Tangible fixed assets	500
Brand (valued by management)	120
Net current assets	380

Compute goodwill on acquisition under the following situation:
(i) Ignore brand value
(ii) Consider brand value [6]

(b) Shiva Ltd. gives the following information:
- **Profits After tax for the period = ₹ 100 lakhs; Expected Compound Growth Rate = 8% p.a.**
- **Cash Flows after Taxes for the period = ₹ 125Lakhs; Expected Compound Growth Rate = 7% p.a.**
- **Current Market Price per Equity Share = ₹ 900; Equity Share Capital = ₹ 1,00,00,000 into Shares of ₹ 100 each.**

Compute the value of Shiva Ltd. by projecting its PAT/CFAT for a eight year period. Use 10% Discount Rate for your calculations. Also calculate the value of the business by capitalizing the current PAT/ CFAT [5]

(C) From the information given below relating to Unfortunate Ltd., calculate Altman's Z-score and comment:

(i) $\left(\frac{\text{Working Capital}}{\text{Total Assets}}\right) = 0.45$

(ii) $\left(\frac{\text{Retained Earnings}}{\text{Total Assets}}\right) = 0.25$

(iii) $\left(\frac{\text{Earnings before Interest and Taxes}}{\text{Total Assets}}\right) = 0.30$

(iv) $\left(\frac{\text{Market Value of Equity}}{\text{Book Value of total debt}}\right) = 2.50$

(v) $\left(\frac{\text{Sales}}{\text{Total Assets}}\right) = 3$ times **[5]**

8. (a) Write a short note any four of the following
(i) Du-Pont analysis
(ii) Hostile Takeover Bids
(iii) Principles of Valuation
(iv) Limitation of DCF Valuation
(v) Financial Forecasting [4×4 = 16]