FINAL EXAMINATION

June 2014

F–P18(BVM)
Syllabus 2008

Business Valuation Management

Time Allowed: 3 Hours | Full Marks: 100

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: 1×5=5

(i) While valuing a company, one has to use financial information from its financial statements after making a number of adjustments for items like Extraordinary write-off; deferred tax assets and liabilities; etc.

(ii) When a company is publicly traded, the value of equity equals the market capitalization of the company.

(iii) Mutually exclusive investments serve the same purpose and compete with each other.

(iv) In condition of rising prices for change from LIFO to FIFO method, earnings should rise.

(v) A lower discount would be applied to the cash flows of the government bonds, as compared to shares of a company.

(b) Fill in the blanks by using the words / phrases given in the brackets: 1×10=10

(i) A ratio between the market value of a company to the replacement value of its assets is known as _______________ Ratio. (Market Value to Book Value/Tobin's Q/ Price to Book Value)

(ii) Net Operating Profit After Taxes — (Capital Employed × the Cost of Capital) is called _______________. (Book Value Added/Market Value Added/ Economic Value Added)

(iii) Production capacity is a _______________ variable for valuation. (operational / financial)

(iv) Replacement cost is current cost of replacing _______________ assets of a company. (current / all)

(v) The required rate of return may also be called _______________ of capital. (cost / opportunity cost)

(vi) For firms with negative FCFE and positive FCFF the present value of _______________ is the suitable model of valuation of equity. (FCFE/FCFF).

(vii) Super profit is the excess of future maintainable profits over _______________ expected profits. (normally/ abnormally)

(viii) _______________ measures the variation of distribution for the expected returns. (Standard deviation/ Regression)

(ix) Dividend yield ratio is equal to dividend per share divided by _______________ and the quotient multiplied by 100. (EPS/market price per equity share)

(x) Current liabilities are payable _______________ (within/beyond) a period of 1 year.

Please Turn Over

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

(i) In the context of an acquisition of a firm, which one of the following concepts of value is least relevant?

(A) Market Value

(B) Opportunity Cost

(C) Synergy Value

(D) Value Gap

(ii) Assume that in a Stock Market, the CAPM is working. A company has presently beta of 0.84 and its going to finance its new project through debt. This would increase its Debt/Equity Ratio to 1.56 from the existing 1.26. Due to increased Debt/Equity Ratio, the Company's beta would

(A) Increase

(B) Decrease

(C) Remain unchanged

(D) Nothing can be concluded

(iii) The dividend per share is ₹ 2 and its market value is ₹ 25 the dividend yield ratio will be

(A) 5%

(B) 7%

(C) 12.25%

(D) 8%

(iv) If Cash Flows amount to ₹ 60 lakhs, Depreciation ₹ 30 lakhs and capital expenditure ₹ 40 lakhs, FCFF in ₹ lakhs will be

(A) 90

(B) 50

(C) 30

(D) 20

(v) Shareholders of target companies are typically paid in

(A) Government bonds held by the target company

(B) Government bonds held by the acquiring company

(C) Cash and / or shares of the acquiring company

(D) None of the above

2. ABC Limited wants to takeover XYZ Limited in all equity deal. For that purpose, Mr. K. S. Goel, CFO of ABC Limited has collected the following financial information.

Summarized Balance Sheet as on March 31, 2014

(₹ in crores)

Particulars	ABC LIMITED	XYZ LIMITED
EQUITY AND LIABILITIES		
Share Capital (Face Value ₹ 10)	100.00	80.00
Reserves and Surplus	26.00	5.00
Non-Current Liabilities	50.00	30.00
Current Liabilities	64.00	35.00
TOTAL LIABILITIES	**240.00**	**150.00**
ASSETS		
Non-Current Assets	145.00	102.00
Current Assets	95.00	48.00
TOTAL ASSETS	**240.00**	**150.00**

Summarized Statement of Profit and Loss for the year ending on March 31, 2014

(₹ in crores)

Particulars	ABC LIMITED	XYZ LIMITED
Sales	345.00	170.00
Less: Cost of Goods Sold	276.00	136.00
Gross Profit	69.00	34.00
Depreciation	19.69	10.10
Profit Before Interest and Tax	49.31	23.90
Interest	6.97	4.61
Profit Before Tax	42.34	19.29
Tax @ 35%	14.82	6.75
Profit After Tax	**27.52**	**12.54**
Additional Information:		
• Estimated Cost of Equity	15%	18%
• Dividend Rate for the FY 2014	13.75%	6.40%
• Market Price	₹ 52.25	₹ 24.00
• Both the companies are following constant Dividend – Payout Policy.		

Mr. K. S. Goel wants to explore the possibility that if the exchange ratio is determined on the basis of the companies respective intrinsic values, then what would be the scenario

Assume that you are working in ABC Limited and Mr. Goel requests you to determine the following:

(i) On the basis of the intrinsic values of the shares of both the companies, determine the exchange ratio. 7

(ii) Determine the post-merger EPS of ABC Limited assuming the exchange ratio calculated above and there are no synergy gains. 5

(iii) Assuming that ABC Limited P/E Ratio will continue to be the same post-merger and the exchange ratio calculated in (i) above, determine the expected post-merger market price of ABC Limited. 3

3. (a) ₹ 100 shares of SBC Ltd. were being quoted at ₹ 180. The company launched an expansion programme worth ₹ 25 crores and decided to make a public issue. Part of the issue was to be rights. Members were offered one right share for every six ordinary shares held by them, at a premium of ₹ 50 per share.

   Determine the minimum price that can be expected of the shares after the issue. 4

   (b) Vipul Ltd. has a surplus cash of ₹ 90 lakhs and wants to distribute 30% of it to the shareholders. The company decides to buyback shares. The finance manager of the company estimates that its share price after repurchase is likely to be 10% above the buyback price, if the buyback route is taken. The number of shares outstanding at present is 10 lakhs and the Current EPS is ₹ 3.

   Find—

   (i) The price at which the shares can be repurchased, if the market capitalization of the company should be ₹ 200 lakhs after buyback. 5

   (ii) The number of shares that can be repurchased. 2

   (iii) The impact of share repurchase on the EPS, assuming the net income remains same. 4

4. You are provided with particulars about A Ltd. and four other firms in the same industry.

Firms	Book Value (₹)	EPS (₹)	DPS (₹)	CFPS (₹)	Number of shares	Price per share
B. Ltd.	20,00,000	10	5	8	1,00,000	30
C. Ltd.	28,80,000	6	5	5	2,00,000	16.2
D Ltd.	12,00,000	2	2	2	1,00,000	15
E Ltd.	40,00,000	20	8	15	2,00,000	28
A Ltd.	30,00,000	8	5	6	1,50,000	

EPS = Earnings Per Share, DPS = Dividend Per Share, CFPS = Cash Flow Per Share,

(a) You are required to compute values of the following variables for each of the other firms from the above table: 8

   (i) Market Value to Book Value

   (ii) Dividend Yield

   (iii) Price Earning ratio (P/E)

   (iv) Price to Cash Flow

(b) You are also required to compute the market value of Equity and value per share of A Ltd. under relative valuation method based on each of the four variables above. Use simple average of values of four other firms to form the relative valuation bases for A Ltd. 6

(c) Should you buy A Ltd. share at ₹ 40? 1