Paper 20 – Financial Analysis & Business Valuation

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Full Marks: 100 **Time allowed: 3 hours**

Question No. 1 which is compulsory and carries 20 marks and answer any five questions from Question No. 2 to Question No. 8

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

(i) Production, employment and consumption are significant data for financial analysis.
(ii) A financial model specifies the relationship between inputs and outputs.
(iii) Ratio analysis helps in determining the liquidity position of the firm. It is measured with the help of liquidity ratios.
(iv) Trend ratio shows the nature and rate of movement of various financial factors.
(v) Higher the Dividend Payout Ratio of a company, higher is its Price/Earning (P/E) Ratio.
(vi) If a company has built up intangibles over a period of time. then it can show them in its Balance Sheet and thus, the book value of the company's share will increase.
(vii) Whenever the yield on a bond is more than coupon rate, the bond will be trading at a discount.
(viii) According to basic valuation model the value of a financial asset is present value of its expected future cash flows.

(b) From the following particulars of Z Ltd. find its cash flow from operation:

Particulars	₹ lakhs
Net Income	780
Depreciation	85
Impairment Loss	12
Profit on Sale of Land	12
Increase in Inventory	23
Decrease in Wages Payable	11
Increase in Deferred Tax Liability	8
Increase in Accounts Receivables	24

[6]

(c) Amrutha Cements Ltd. earned free cash flow to Equity Shareholders during the Financial Year ending 2015 at ₹ 4.5 lakhs and its cost of equity is 13% with a projected earnings growth rate of 10%. The market value of debt is ₹ 50 lakhs. What will be the value of firm as per Constant Growth Valuation Model? **[6]**

2.(a) What kinds of conditions of a company are represented by the following pattern of cash flows? You are requested to provide your analysis of each case separately:

I. Net cash flows from Operating Activities are positive, net cash flows used in Investing Activities are negative and net cash flows from Financing Activities are positive.
II. Net cash flows from Operating Activities are negative, net cash flows used in Investing Activities are positive and net cash flows from Financing Activities are negative.
III. Net cash flows from Operating Activities are negative, net cash flows used in Investing Activities are negative and net cash flows from Financing Activities are positive.
IV. Net cash flows from Operating Activities are positive, net cash flows used in Investing Activities are negative and net cash flows from Financing Activities are negative.

V. Net cash flows from Operating Activities are negative, net cash flows used in Investing Activities are positive and net cash flows from Financing Activities are positive. **[12]**

(b) Financial statements of Moonlight Ltd. reveals the following information:
(I) PBT ₹ 1,000 lakhs
(II) Inventory overvalued by ₹ 100 lakhs
(III) Revenue expenses capitalised ₹ 6 lakhs
(IV) Increase in depreciation due to capitalization ₹ 0.60 lakhs
(V) Tax Rate 30%.
Calculate PAT after reworking and adjusting the financial manipulation undertaken by the company. **[4]**

3.(a) The Balance Sheets of Maras Ltd. for the years ended on 31.03.2016 and 31.03.2017 are as follows: (Amount in ₹ Lakhs)

	As at 31.03.16	As at 31.03.17
Equity & Liabilities		
Shareholder's Fund:		
Share capital	696.60	726.70
Equity Share suspense	30.07	—
Equity Share warrants	—	841.20
Reserve & Surplus	31,256.89	39,156.40
Non-Current Liabilities:		
Secured Loans	4,784.56	3,300.09
Unsecured Loans	9,128.31	14,939.75
Deferred Tax liabilities	3,491.00	3,936.27
Current Liabilities:		
Other current liabilities	8,432.77	10,522.73
Provisions	856.44	1,496.31
	58,676.64	74,919.45
Assets		
Non-current assets	—	—
Fixed Assets (Net)	31,830.23	30,941.81
Capital work in progress	3,764.07	11,502.92
Non-Current Investment:		
Investment	8,125.67	11,031.80
Current Assets:		
Inventories	6,068.25	7,123.77
Trade receivables	1,866.21	3,113.79
Cash and bank balance	917.68	2,140.03
Other current assets	1.53	36.27
Loans and advances	6,103.00	9,029.06
	58,676.64	74,919.45

Required:
(i) Prepare the Common-Size Balance Sheet of Maras Ltd.
(ii) Present and interpret your observations on the common-size Balance Sheet. **[8+5]**

(b) Enumerate different types of financial modeling on the basis of its usage in modeling of economy, industry and company. **[3]**

4.(a) The comparative information for two years relating to Mona Ltd. is as follows:

Particulars	2015-16	2016-17
Sales (₹)	12,00,000	14,62,500

Units Sold	4,000	4,500
Sales Price per unit (₹)	300	325

You are required to account for the change in sales (amount) due to —

(I) Change in quantity

(II) Change in price

(III) Change in quantity and price taken together. **[6]**

(b) The balance sheets of Ocean Ltd. for the past two years are as under: [₹ ' 000]

Liabilities	31-03-16	31-03-17	Assets	31-03-16	31-03-17
Equity Share Capital	50,000	50,000	Gross Fixed Assets	60,000	75,000
General Reserve	12,000	14,000	Less: Accumulated		
Profit and Loss A/c	5,000	6,000	Depreciation Net Fixed Assets	(15,000) 45,000	(20,000) 55,000
Public Deposits	10,000	2,000	Long Term Investments	18,000	20,000
Term Loan	20,000	16,000	Inventories	32,000	24,000
Trade Creditors	7,000	10,000	Sundry Debtors	17,000	12,000
Short Term Bank Borrowings (O/D)	15,000	20,000	Cash and Bank	—	—
Provision for Tax	2,000	3,000	Miscellaneous Expenses	9,000	10,000
Total	1,21,000	1,21,000	Total	1,21,000	1,21,000

Based on the above information:

(I) Comment on the change in 'total outside liabilities to tangible net worth' ratio.

(II) List out the total sources and uses of funds for the year ended 31-03-17 classifying them under the heads long term and short term.

(III) Comment on the uses of funds. **[2+6+2]**

5.(a) Given below is the Balance sheet of Laxmi Ltd. as on 31-03-2016:

Liabilities	₹ (In lakh)	Assets	₹ (In lakh)
Share Capital (Share of ₹ 10)	100	Land & Buildings	40
Reserves & Surplus	40	Plant & Machinery	80
Creditors	30	Investments	10
		Stock	20
		Debtors	15
		Cash at Bank	05
	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 of ₹ 5 lakhs are expected to be incurred each year.

(iii) Market Value of Land and Buildings & 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% including all other charges.

(v) The Capitalization rate applicable to similar business is 16%. **[10]**

(b) Describe Economic Value Added (EVA). Also state the means to enhance EVA of a company. **[6]**

6.(a) M Limited wants to takeover N Limited and their Summarized Balance Sheet as on March 31, 2017 are give below:

	M Limited (₹ in Crores)	N Limited (₹ in Crores)
Equity and Liabilities:		
Equity Capital - ₹ 10 each	500	175
Reserves and Surplus	750	475
Non-Current Liabilities	250	85
Current Liabilities and Provisions	175	65
Total	1,675	800
Assets:		
Non-Current Assets — Net fixed Assets	1,130	435
Current Assets	545	365
Total	1,675	800

Additional Information:

	M Limited	N Limited
(i) Profit After Tax (PAT)	₹ 78 crores	₹ 35 crores
(ii) Market Price Per Share	₹ 75.00	₹ 45.00

I. Using the above information, what should be the share exchange ratio to be offered to the shareholders of N Limited by M Limited based on:
   (i) Net Worth
   (ii) Earnings Per Share (EPS)
   (iii) Market Price
II. Suggest which one out of the above basis should be preferred by N Limited?
III. Assuming that there are no synergy gains, then determine the EPS after merger if the exchange ratio is one as suggested in (II) above. **[9+2+2]**

(b) Why Discounted Cash Flow method is not appropriate for valuation of real estate? **[3]**

7.(a) A company has a capital base of ₹ 5 crores and has earned profits of ₹ 35 lakhs. Return on investment of the industry to which the company belongs is 12% p.a. If the service of a particular executive is acquired by the company, it is expected that the profits will raise ₹ 9 lakhs over and above the target profit as per industry norms.

Calculate the maximum salary that could be offered to the executive and the maximum bid price for acquiring the executive. **[2+2]**

(b) The following data is given to you regarding a company having a share in branded portion as well as unbranded portion:

Branded Revenue	₹ 500 per unit
Unbranded Revenue	₹ 120 per unit
Branded Cost	₹ 350 per unit
Unbranded Cost	₹ 100 per unit
Research and Development	₹ 20 per unit
Branded Products	1 lakh unit
Unbranded Products	40,000 units
Tax rate is 39.55%; Capitalization factor 18%	

Calculate the Brand Value. **[6]**

(c) Kovith Ltd. is contemplating to sell a copyright of a book titled 'Valuation' to another publisher. You are required to estimate the value of the copyright from the following data:

The book is expected to generate ₹ 2,50,000 in after-tax cash flows each year for the next three years and ₹ 1,50,000 a year for subsequent two years. These are the net cash flows after meeting all expenses like royalties, promotional expenses and production costs. About 60% of these cash flows are from bulk orders of large firms stable and predictable, while the rest is from small orders unstable and unpredictable. The cost of capital to be applied to stable cash flows is 8% and to unstable cash flows is 12%.

Discounting Factor	Year 1	Year 2	Year 3	Year 4	Year 5
8%	0.9259	0.8573	0.7938	0.7350	0.6806
12%	0.8929	0.7972	0.7118	0.6355	0.5674

[6]

8. Write Short Notes on any four out of the following: **[4×4]**

(i) Financial Modeling
(ii) Du Pont Analysis
(iii) Distress Prediction
(iv) Key Areas of Valuation
(v) Hostile Takeover.