Paper – 20: Financial Analysis and Business Valuation

Paper 20- Financial Analysis and Business Valuation

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

Question No. 1 which is compulsory and carries 20 marks and answer any 5 questions from Q.No. 2 to Q.No. 8.

1.(a) Sun Ltd. Has announced issue of warrants on 1:1 basis for its equity shareholders. The warrants are convertible at an exercise price of 12. Warrants are detachable and trading at ₹7. What is the minimum price of the warrant and the warrant premium if the current price of the stock is ₹16? **[6]**

(b) Dayal Ltd. furnishes the following information relating to the previous three years, and request you to compute the value of the brand of the company:

Amounts in Lakh ₹

Years	2014	2015	2016
EBIT	75	85.25	150
Loss on Sale of Asset	3		18
Non-Operating Income	12	7.25	8

Inflation was 9% for 2015 and 15% for 2016. If the capitalization factor considering internal and external value drivers to the brand is 14. Determine the brand value. Assume an all inclusive future tax rate of 35%. **[8]**

(c) From the following information, compute the Trend Ratios (%) of Net Sales and comment about the trend in Net Sales

Particulars	2011-12	2012-13	2013-14	2014-15	2015-16
Sales in Lakhs ₹	5959	6500	6809	6649	7262

[6]

2.(a) The following financial statement is summarized from the books of Neel Ltd. as at 31st March, 2016:

Equity and Liabilities	(₹)	Assets	(₹)
Shareholders' Fund:		Non-current Assets:	
Paid-up Capital	15,00,000	Fixed Assets	16,50,000
Reserves and Surplus	6,00,000	Current Assets:	
Non-current Liabilities:		Stock-in-trade	9,10,000
Debentures (Long-term)	5,00,000	Book Debts	12,40,000
Current Liabilities:		Investment (Short-term)	1,60,000
Bank Overdraft	12,00,000	Cash	40,000
Sundry Creditors	2,00,000		
	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:

A. Debt Equity Ratio,

B. Current Ratio,

C. Proprietary Ratio

D. G.P. Ratio

E. Debtors' Turnover Ratio
F. Stock turnover Ratio.
Bank overdraft is payable on demand. **[8]**

(b) The Capital of Madhu Co. Ltd. is as follows:

	(₹)
9% preference shares of ₹10 each	3,00,000
Equity shares of ₹10 each	8,00,000
	11,00,000

The accountant has ascertained the following information:

Profit (after tax at 60%) `2,70,000: Depreciation `60,000; Equity dividend paid 20%; market price of equity shares `50. You are required to state the following, showing the necessary Workings:

(i) Dividend yield on the equity shares.
(ii) Cover for the preference and equity dividends
(iii) Earnings for equity shares
(iv) Price –earnings ratio **[8]**

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

Year	2014-15	2015-16
Sales (₹)	12,00,000	16,80,000
Cost of Goods Sold (₹)	8,00,000	12,60,000
Units Sold	40,000	60,000

Analyze the reasons for changes in profit due to changes in sales quality, cost price and selling price. **[8]**

(b) Using Altman's 1983 Multiple Discriminate Function, calculate Z-score of Somlata & Co. Ltd., where the five accounting ratios are as follows as comment about its financial position:
Working Capital to total Assets = 0.350
Retained Earnings to Total Assets = 50%
EBIT to total Assets = 19%
Book Value of Equity to Book Value of Total Debt = 1.65
Sales to total Assets = 3 times **[8]**

4.(a) Pawan Ltd. The summarized Balance Sheet of the company as on 31st March 2015 and 2016 were:

Liabilities	2015 (₹)	2016 (₹)	Assets	2015 (₹)	2016 (₹)
Issued Share Capital	1,00,000	1,50,000	Freehold Property at cost	1,10,000	1,30,000
Securities Premium	15,000	35,000	Plant & Machinery at cost	1,20,000	1,51,000
Profit & Loss A/c	28,000	70,000	Furniture & fixture at cost	24,000	29,000
Debentures	70,000	30,000	Stocks	43,000	44,000
Bank Overdraft	14,000	-	Debtors	37,000	51,000
Creditors	34,000	48,000	Bank	-	16,000

Proposed Dividends	15,000	20,000	Premium on Redemption of debentures	-	1,000
Plant:	45,000	54,000			
Fixtures:	13,000	15,000			
	3,34,000	**4,22,000**		**3,34,000**	**4,22,000**

The following additional information is relevant:

i) There had been no disposal of freehold property in the year.

ii) The Machine tool which has cost ₹8,000 and in respect of which ₹6,000 depreciation has been provided was sold for ₹3,000, and fixtures, which had cost ₹5,000 in respect of which depreciation of ₹2,000 has been provided, were sold for ₹1,000. The Profit and losses on these transactions had been dealt with through the profit and Loss Account.

iii) The actual premium of the redemption of debentures was ₹2,000 of which ₹1,000 had been written-off to the Profit and Loss A/c

iv) No interim dividend has been paid

v) Interest paid on debentures amounted to ₹4,500

After reading the above financial statements and information's answer the following questions:

a) Calculate the cash flows from the operating activities. Necessary workings should be part of the answer

b) Find out those ratios which are essential to analyze the financial position of the company, based on cash flows. Provided –
Net cash flows from investing Activities: (-) ₹65,000
Net Cash flows from Financing Activities: ₹8,500

c) Interpret and comment on the financial position of the company, based on the date obtained from above point b) **[8]**

(b) A company has an operating leverage of leverage 1.1. as against 1.25 during the previous year. If the current fixed cost is 25% more than that of the previous year, to what extent has the contribution earned by the firm changed over the previous year? **[8]**

5.(a) Sentek Ltd. furnishes the following cash flow estimate -

Year 1	₹20.00 Lakhs
Years 2 to 4	Compounded Growth Rate 6.5%
Years 5 to 8	Compounded Growth Rate 9.5%

Apply 20% Discount Rate and determine the Value of Business. **[8]**

(b) Soft Solution is a small software firm with high growth rate. It has existing assets in which it has capital invested of ₹100 lakh. The other information about Soft solution is as follows

The after tax operating Income on assets in place is ₹15 lakh. This return on capital of 15% is expected to be sustained in the future. Cost of capital of Soft Solution is 10%.

At the beginning of each of the next five years Soft Solution is expected to make new investments of ₹10 lakh each. These investments are also expected to earn 15% as a return on capital, and the cost of capital is expected to remain 10%.

After the year 5, Soft Solution will continue to make Investments, and earnings will grow 5% a year, but the new investments will have a return on capital of only 10%, which is also the cost of capital.

All assets and investments are expected to have infinite lives. The assets in place and the investments made in the first five years will make 15% a year in perpetuity, with no growth. Based on the information given estimate the value of Soft Solution, How much of this value comes from the EVA and how much from capital invested? **[8]**

6.(a) Reliable Industries Ltd. (RIL) is considering a takeover of Sunflower Industries Ltd. (SIL). The particulars of two companies are given below

	RIL	SIL
Earnings After Tax (₹)	20,00,000	10,00,000
Equity shares (No.)	10,00,000	10,00,000
EPS (₹)	2	1
P/E Ratio (Times)	10	5

Required:

i) What is the market value of each company before merger?

ii) Assuming that the management of RIL estimates that the shareholders of SIL will accept an offer of one share of RIL for four shares of SIL. If there are no synergic effects, what is the market value of the post-merger RIL? What is the new price for share? Are the shareholders of RIL better or worse off than they were before the merger?

iii) Due to synergic effects, the management of RIL estimates that the earnings will increase by 20%. What is the new post-merger EPS and price per share? Will the shareholders be better off or worse off than before the merger? **[8]**

(b) Khan Ltd. wishes to acquire Putul Ltd. The shares issued by the two companies are 10,00,000 and 5,00,000 respectively:

(1) Calculate the increase in the total value of Putul Ltd. resulting from the acquisition on the basis of the following conditions:

Current expected growth rate of Putul Ltd.	7%
Expected growth rate under control of Khan Ltd., (without any additional capital investment and without any change in risk of operations)	85
Current Market price per share of Khan Ltd.	₹100
Current Market price per share of Putul Ltd.	₹20
Expected dividend per share of Putul Ltd.	₹0.60

(2) On the basis of aforesaid conditions calculate the gain or loss to shareholders of both the companies. If Khan Ltd. were to offer one of its shares for every four shares of Putul Ltd.

(3) Calculate the gain to the shareholders of both the Companies, if Khan Ltd. pays ₹22 for each share of Putul Ltd., assuming the P/E Ratio of Khan Ltd. does not change after the merger. EPS of Khan Ltd. is ₹8 and that of BCD is ₹2.50. It is assumed that Khan Ltd. invests its cash to earn 10%. **[8]**

7.(a) Following are the information of two companies for the year ended 31st March, 2016:

Particulars	Company X	Company Y
Equity Shares of ₹10 each	20,00,000	25,00,000
10% Pref. Share of ₹10 each	15,00,000	10,00,000
Profit after tax	7,50,000	7,50,000

Assume the Market expectation is 18% and 80% of the Profits are distributed.

- **i)** What is the rate you would pay to the Equity Shares of each company?
  - **a)** If you are buying a small lot.
  - **b)** If you are buying controlling interest shares
- **ii)** If you plan to invest only in preference shares which company's preference shares would you prefer?
- **iii)** Would your rates be different for buying small lot, if the company 'X' retains 30% and company 'Y' 10% of the profits? **[8]**

(b) ABC Ltd Company currently sells for ₹32.50 per share. In an attempt to determine if ABC Ltd is fairly priced, an analyst has assembled the following information.

- The before-tax required rates of return on ABC Ltd debt, preferred stock, and common stock are 7.0 percent, 6.8 percent, and 11.0 percent, respectively.
- The company's target capital structure is 30 percent debt, 20 percent preferred stock, and 50 percent common stock.
- The market value of the company's debt is ₹145 million and its preferred stock is valued at ₹65 million.
- ABC Ltd's FCFF for the year just ended is ₹ 28 million. FCFF is expected to grow at a constant rate of 4 percent for the foreseeable future.
- The tax rate is 35 percent.
- ABC Ltd has 8 million outstanding common shares.

What is ABC Ltd's estimated value per share? Is ABC Ltd's stock under priced? **[8]**

8. Write short note on any four of the following **[16]**

- **a)** Who are the participants in the Merger and Acquisition Process?
- **b)** Discuss the major aspects, assumptions and decision rules of the discounted cash flow model.
- **c)** DuPont Analysis
- **d)** Efficient Market Hypothesis
- **e)** Write a short note on Market Related Off-Balance Sheet Items.