Paper – 20: Financial Analysis & Business Valuation

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

This paper contains 4 questions, representing two separate sections as prescribed under syllabus 2012. All questions are compulsory, subject to the specific guidance/ instructions stated against every question. All workings, wherever necessary, must form a part of your answer. Assumptions, if any, should be clearly stated.

Question No. 1. (Answer **all** questions. Each question carries **10 marks**)

1(a). The following are condensed comparative financial statements, of Rajarshi Ltd., for the three years ended 31st March, 2013, 2014 and 2015.

	2014-15 (₹)	**2013-14 (₹)**	**2012-13 (₹)**
Current Assets:			
Bank	20,500	7,600	17,000
Debtors	38,000	30,000	20,000
Stock	60,000	40,000	30,000
Prepaid Expenses	1,500	2,400	3,000
Total Current Assets	1,20,000	80,000	70,000
Non-current Assets:			
Plant and Equipment	2,60,000	1,50,000	76,000
Total Assets	**3,80,000**	**2,30,000**	**1,46,000**
Current Liabilities:			
Creditors	98,000	78,000	48,500
Provision for Income Tax	2,000	2,000	1,500
Total Current Liabilities	1,00,000	80,000	50,000
Non-current Liabilities:			
Debentures	50,000	50,000	---
Shareholders' Fund:			
Equity Share Capital (₹ 100 shares)	2,00,000	80,000	80,000
Profit and Loss Account	30,000	20,000	16,000
Total Liabilities	**3,80,000**	**2,30,000**	**1,46,000**

Comparative Operating Statement
For the three years ended on 31st March,

	2015 (₹)	**2014 (₹)**	**2013 (₹)**
Sales	2,10,000	1,20,000	1,00,000
Cost of Sales	1,57,500	80,000	55,000
Gross Profit	52,500	40,000	45,000
General and Selling Expenses	42,500	36,000	37,000
Net Profit	**10,000**	**4,000**	**8,000**

Additional information:

(i) The company's closing inventory on 31st March, 2012 was ₹ 10,000.

(ii) Credit terms are net 60 days from the date of invoice.

You are required to calculate the following ratios with brief comments thereon:
(1) Current ratio, (2) Acid-test ratio, (3) Inventory turnover ratio, (4) Debtors' collection period (or average age of outstanding), (5) Gross profit margin percentage, (6) Earnings per share, and (7) Fixed assets to shareholders' equity. **[10]**

1(b). The Balance Sheet (Extracts) of Ignu Ltd as at 31.03.14 and 31.03.15 are presented:

Balance Sheets (Extracts) as at 31st March,

(₹ in Lakhs)

Equities & Liabilities	2014	2015	Assets	2014	2015
	₹	₹		₹	₹
Shareholders' Fund:			Non-Current Assets:		
Share Capital	300.00	300.00	Freehold Property (at cost)	225.00	240.00
Reserves	225.00	240.00	Plant & Machinery	135.00	165.00
Non-current Liabilities:			(at cost less Depreciation)		
6% Debentures (unsecured)	75.00	75.00	Investment in shares of companies under the management (unquoted)	150.00	150.00
Mortgage on Freehold Property	27.00	14.25	Investment in shares of other companies (quoted) (Market value 2014 : ₹ 120 lakhs; 2013 : ₹ 150 lakhs)	112.50	112.50
Current Liabilities:			Current Assets:		
Creditors	45.00	45.00	Stock	52.50	75.00
Proposed Dividend (Subject to deductions of tax)	22.50	23.25	Debtors	45.00	75.00
Provision for Taxation	21.00	37.50	Bank	10.50	—
Secured Overdraft	15.00	82.50			
(by a floating charge on assets)					
	730.50	**817.50**		**730.50**	**817.50**

The following additional information for the year 2014-15 is relevant:

(1)	Credit Sales	₹ 675 lakhs
(2)	Credit Purchases	₹ 520 lakhs
(3)	Overhead	₹ 85.75 lakhs
(4)	Depreciation on Plant & Machinery	₹ 17.50 lakhs
(5)	Dividend for 2013-14 was paid in full	
(6)	Amount paid towards taxation for the year 2013-14	₹ 21.50 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 suggest remedial measures to overcome the financial crises. **[10]**

Question No. 2. (Answer **any two** questions. Each question carries **15 marks**)

2(a)(i). The following information's are related to financial position of Rungta Ltd. for 3 years which ended on 31st March every year:

Particulars	2013 (₹)	2014 (₹)	2015 (₹)
Share capital	1,40,000	1,80,000	1,90,000
Current Liabilities	40,000	?	?
Working Capital	60,000	50,000	1,40,000
Long-term Loan	1,00,000	?	1,20,000
Fixed assets	2,40,000	2,50,000	2,35,000
Net Worth	2,00,000	2,20,000	2,55,000
Current Assets	?	1,20,000	2,00,000
Capital Employed	3,00,000	?	?
Reserves & Surplus	?	40,000	65,000

You are required to find out the values of the missing figures and prepare a Vertical Trend Balance Sheet taking 2012-13 as the base and also interpret the result. **[4+3+3]**

2(a)(ii). The following figures apply to a small manufacturing company:

Particulars	Amount (₹)
Annual sales for the previous year	2,30,000
Profit after tax for the previous year	13,548
Budgeted annual sales for the next year	2,42,000
Budgeted profit after tax for the next year	14,000

In the first of the two years, the average total assets amounted to ₹2,00,000, and are estimated to be ₹2,20,000 for the next year.

Assuming full budget realization and taking turnover into account, calculate the alteration that will take place in the ratio representing return on capital employed and discuss the reasons for such alteration. **[5]**

2(b)(i). Emmie Ltd. has a machine having an additional life of 5 years, which costs ₹1,00,000 and which has a book value of ₹25,000. A new machine costing ₹2,20,000 is available. Though its capacity is same as that of the old machine, it will mean a saving in variable costs to the extent of ₹ 70,000 p.a. The life of the machine will be 5 years at the end of which it will have a scrap value of ₹40,000. The rate of income tax is 60% and Emmie Ltd. does not make an investment, if it yields less than 12%. The old machine, if sold, will fetch ₹10,000.

Advise Emmie Ltd. whether the old machine should be replaced or not.

Note:
P.V. of ₹ 1 receivable annually for 5 years at 12% = 3.605
P.V. of ₹ 1 receivable at the end of 5 years at 12% = 0.567
P.V. of ₹ 1 receivable at the end of 1 year at 12% = 0.893 **[5]**

2(b)(ii). 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? **[5]**

2(b)(iii). Discuss Financial Modelling. State the attributes of a financial model. $\left[2\frac{1}{2}+2\frac{1}{2}\right]$

2(c)(i). The following Financial Statement is summarised from the books of Neel Ltd. as at 31st March, 2015:

Equity and Liabilities	₹	**Assets**	₹
Shareholders' Fund:		Non-current Assets:	
Paid-up Capital	15,00,000	Fixed Assets (at cost)	25,00,000
Reserves and Surplus	6,00,000	Current Assets:	
Non-current Liabilities:		Stock-in-trade	9,10,000
Long-term borrowings:			
Debentures	5,00,000	Book Debts	12,40,000
Long term Provision:			
Accumulated depreciation on Fixed Assets	8,50,000		
Current Liabilities:		Investment (Short-term)	1,60,000
Bank Overdraft	12,00,000	Cash	40,000
Sundry Creditors	2,00,000		
	48,50,000		**48,50,000**

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. **[6+6]**

2(c)(ii). State Sustainable Growth Rate and its importance in relation to the growth of a firm. Also state the formula which is to be used in this context. **[1+1+1]**

Question No. 3. (Answer **all** questions. Each question carries **10 marks**)

3 (a). Rajjan Ltd. provides you the following information:

Net Assets at their current values:		₹ 100 lacs
Average Annual Earnings available for Equity Share holders		₹ 15 lacs
8,00,000 Equity Shares of ₹ 5 each fully paid	₹ 40 lacs	
1,00,000 Equity Shares of ₹ 10 each fully paid-up	₹ 10 lacs	₹ 50 lacs
Normal Rate of Expectation		12%

Calculate the Fair Value of an Equity Share assuming that controlling interest is to be transferred. **[10]**

3 (b). DABU Ltd. is planning to acquire BALSA Ltd. another company in the same industry. The financial details of the two companies are as follows:

Details	DABU	BALSA
Profit after tax	₹ 3,000 lakhs	₹ 600 lakhs
Market Price	₹550	₹100
P/E ratio	25	16

DABU wants to merge BALSA with itself after acquiring k. The earnings of the merged entity are expected to be higher than the sum of earnings of the two companies by ₹15 lakhs and its P/E ratio is expected to be 22.

The Management of DABU is offering one share of DABU for every ten shares of BALSA, while the management of BALSA is expecting at least two. Can a deal be struck between the two companies? **[10]**

Question No. 4. (Answer **any two** questions. Each question carries **15 marks**)

4 (a). Sundar Manufacturing Company Limited's Operating Profits and Operating Capital Employed during last 5 years are – (₹ in Lakhs)

Particulars	Operating Profit	Opening Capital	Closing Capital
2010-2011	410	4,000	6,000
2011-2012	690	6,000	7,000
2012-2013	800	7,000	9,000
2013-2014	1500	9,000	10,000
2014-2015	1800	10,000	12,000

The Company is expected to commission a new project in April 2015 at a cost of ₹ 9,000 Lakhs, which would generate operational flow amounting to ₹1,200 Lakhs p.a. for atleast 4 years. Moreover the Company expects a 2% annual growth of existing profits over the next 4 years. Industry Average Rate of Return is 6% p.a.

Determine the Company's Goodwill taking 4 years purchase of Discounted Super Profit. The Company is in 25% tax bracket. Consider 5% Capital Growth and 10% WDV depreciation from April 2015 onwards. 60% of Capital Employed comprise of depreciable Fixed Assets. Use 10% Discount Factor.

Also assume that the Company has the following Capital Structure as on 31.03.2015 - (a) Equity Share Capital (₹ 10 each) = ₹ 5,000 Lakhs, (b) Reserves and Surplus = ₹ 4,000 Lakhs, (c) 14% Debentures = ₹ 3,000 Lakhs.

The funds for the new project (₹ 9,000 Lakhs) are to be raised by issue of shares and availing loans. The Company wants to maintain the existing Debt-Equity Ratio. It can arrange for 16% Term Loan.

How much maximum premium should the Company fix for its new Equity Issue? Assume that the Company desires to link Premium to the Intrinsic Value of Shares after taking into account the Value of Goodwill. **[15]**

4 (b)(i). From the following data compute the Economic value Added: **[7]**

Share Capital	1,600 Crores	Beta Factor	1.05
Long Term Debt	320 Crores	Market Rate of Return	14%
Interest	32 Crores	Risk Free Rate	10%
Reserve and Surplus	3,200 Crores		
PBIT	1,432 Crores		
Tax Rate	30%		

4(b)(ii). From the following information, calculate the value of a share if you want to

1. Buy a small lot of shares;
2. Buy a controlling interest in the company.

Year	Profit (₹)	Capital Employed (₹)	Dividend (%)
2011	55,00,000	3,43,75,000	12
2012	1,60,00,000	8,00,00,000	15
2013	2,20,00,000	10,00,00,000	18
2014	2,50,00,000	10,00,00,000	20

The market expectation is 12%. **[4+4]**

4(c)(i). Suraj Ltd. is a closely held company engaged M2M business offering logistic services mainly to small and medium sized companies through internet, who cannot afford sophisticated logistics practices. Company is planning to go for public issued in the coming year and is interest to know what the company's share will worth. The company engaged a consultant based in Mumbai. The consultant evaluated company's future prospects and made following estimates of future free case flows:

	Years (Amount in ₹)			
	1	**2**	**3**	**4**
Sales	1,00,000.00	1,15,000.00	1,32,250.00	1,32,250.00
Operating Income (EBIT)	16,000.00	18,400.00	21,160.00	21,160.00
Less: Cash tax payments	(4,800.00)	(5,520.00)	(6,348.00)	6,348.00
Net Operating Profit after	11,200.00	12,880.00	14,812.00	14,812.00
Less: Investments:				
Investments in Net Working Capital	(1,695.65)	(1,950.00)	(2,242.50)	---
Capital Expenditures (CAPEX)	(2,347.83)	(2,700.00)	(3,105.00)	---
Total Investments	(4,043.48)	(4,650.00)	(5,347.50)	---
Free Cash Flow	**7,156.52**	**8,230.00**	**9,464.50**	**14,812.00**

Further, the company's investment banker had done a study of the company's cost of capital and estimated WACC to be 12%. You are required to determine.

I. Value Suraj Ltd. based on these estimates.
II. Market Value Added (MVA) by company supposing that invested capital in the year 0 was ₹ 31,304.05 lacs.
III. Value of per share, if company has 2,000 Equity Shares outstanding and debt amounting to ₹ 4,000 lacs. **[3+1+3]**

4(c)(ii). CAS Ltd. gives the following information about past profits:

Year	2010	2011	2012	2013	2014
Profits ('000 ₹)	43,40	45,00	47,40	49,00	42,20

On scrutiny it is found (i) that upto 2012, The Company Ltd. followed FIFO method of finished stock valuation thereafter adopted LIFO method, (ii) that upto 2013 it followed Straight Line Method of Depreciation and thereafter adopted Written Down Value Method. Given below the details of Stock Valuation Straight Line and Written Down Value Depreciation:

(Figures in ₹ '000)

Year	Opening Stock		Closing Stock		Depreciation	
	FIFO	**LIFO**	**FIFO**	**LIFO**	**SLM**	**WDV**
2010	80,00	79,60	92,00	82,40	24,20	34,00
2011			98,40	95,80	28,30	36,20
2012			77,80	78,20	30,00	38,50
2013			84,00	77,00	33,40	39,20
2014			90,00	86,20	36,00	38,80

Determine Future Maintainable Profits (based on average of past 4 years) that can be used for Valuation of Goodwill. **[8]**