Paper 20 - Strategic Performance Management and Business Valuation

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

Section – A (50 marks)

Strategic Performance Management

Answer Question No. 1 which is compulsory and any two from the rest of this Section.

1. Choose the most appropriate answer from the four alternatives given: [2x5=10]

(i) ___________ ___________ is an application of process benchmarking, within an organization by comparing the performance of similar business units or business process.
(A) Internal Benchmarking;
(B) Process Benchmarking;
(C) Product Benchmarking;
(D) None of the above.

(ii) ____________ _____________serve middle level managers and help in taking decisions for a period of 2-3 years.
(A) Tactical-level information systems;
(B) Strategic-level information systems;
(C) Operational-level information systems;
(D) None of the above.

(iii) TQM has _______ concepts.
(A) 2
(B) 3
(C) 4
(D) None of the above.

(iv) Demand schedules are of _____ types.
(A) three
(B) two
(C) Four
(D) None of the above

(v) One of the forms of risk management mostly practiced by insurance companies is ________ _______.
(A) Probability of Ruin;
(B) Risk reduction;
(C) Risk Pooling;
(D) Risk Mapping.

2. (a) (i) An overwhelming 91 percent of the respondents indicated that risk management is either a very important (55 percent) or moderately important (36 percent) aspect to their CRM projects. Why is it so important? **[5]**

(ii) 'There are five basic components of Supply Chain Management' — Discuss. **[5]**

(b) Enumerate the essential elements of Manufacturing Resource Planning (MRP II). **[10]**

3. (a) (i) A firm assumes a cost function $c(x) = x\left(\frac{x^2}{10} + 200\right)$, x is a monthly output in thousands of units. Its revenue function is given by $R(X) = \left(\frac{2200 - 3x}{2}\right)x$. Find i) If the firm decides to produce 10,000 units per month, the firms cost and Marginal cost. ii) If the firm decides to produce Marginal cost of 320, the total cost of the firm. iii) The marginal revenue function. iv) If a decision is taken to produce 10,000 units each month, the total revenue and marginal revenue of the firm. v) If the firm produces with a marginal revenue of 1040, the firm's monthly revenue. **[12]**

(b) Using Altman's Multiple Discriminant Function, calculate Z-score of S & Co. Ltd., where the five accounting ratios are as follows and comment about its financial position:
Working Capital to Total Assets = 0.250
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) "Risk Management Process refers to the process of measuring or assessing risk and then developing strategies to manage risk." Discuss the steps, which are taken to minimize the risk. **[10]**

(b) Discuss — 'OLAP'. **[10]**

Section - B (50 marks)

Business Valuation

Answer Question No. 5 which is compulsory and any two from the rest of this Section.

5. Choose the most appropriate answer from the four alternatives given: [2x5=10]

(i) If a company has a P/E ratio of 12 and a Market to Book Value Ratio 2.10, then its Return on Equity will be
(A) 14.10%
(B) 17.50%
(C) 25.20%
(D) None of the above

(ii) Ting-Tong Ltd.'s share beta factor is 1.40. The risk free rate of interest on government securities is 9%. The expected rate of return on the company equity shares is 17%. The cost of equity capital based on CAPM is
(A) 17%
(B) 12.6%
(C) 20.2%
(D) 9%

(iii) Firms that intend to buy only a small percentage of the outstanding stock can buy them in the market, in a process called
(A) Repurchase tender offer
(B) Open market purchase
(C) Privately negotiated repurchase
(D) None of the above

(iv) Assume that the following details are given for a company:
Sales - ₹1,00,000; Costs - ₹75,000; Depreciation - ₹20,000; Tax - 30%; Change in Net Working Capital - ₹1,000; Change in Capital Spending - ₹10,000. The Free Cash Flow to Firm (FCFF) for the given data would be:

(A) ₹ 10,000
(B) ₹ 12,500
(C) ₹ 13,500
(D) ₹ 15,000.

(v) ______________ is a measure of value of which tells whether a company is able to generate returns that exceed the costs of capital employed.
(A) Cost of capital
(B) Economic Value Added
(C) Market value added
(D) Financial profit

6. (a) If, Earnings per share: ₹ 3.15;
Capital Expenditure per share: ₹3.15.
Depreciation per share: ₹ 2.78
Change in working capital per share: ₹0.50 Debt financing ratio: 25%

Earnings, Capital expenditure, Depreciation, Working Capital are all expected to grow at 6% per year. The beta for stock is 0.80. Treasury bond rate is 7.5%. A premium of 5.50% is used for market.

Calculate value of stock. **[10]**

(b) Yummy Ltd. had earning per share of ₹11.04 in 2016-17 and paid a dividend of ₹7 per share. The growth rate in earnings and dividends in the long term is expected to be 5%. The return on equity at Yummy Ltd. is expected to be 13.66%. The beta of Yummy Ltd. is 0.80 and the risk free Treasury bond is 6% while risk premium is 4%. Based on the information, calculate price to Book Value Ratio. **[5]**

(c) Describe the three variations of Relative Valuation. **[5]**

7. (a) Two firms R and K Corporation operate independently and have the following financial statements:

Particulars	R	K
Revenues	₹8,00,000	₹4,00,000
Cost of Goods Sold (COGS)	₹6,00,000	₹2,40,000
EBIT	₹2,00,000	₹1,60,000
Expected growth rate	6%	8%
Cost of capital	10%	12%

Both firms are in steady state, with capital spending offset by depreciation. No working capital is required, and both firms face a tax rate of 40%. Combining the two firms will create economies of scale in the form of shared distribution and advertising cost, which will reduce the cost of goods sold from 70% of revenues to 65% of revenues. Assume that the firm has no debt capital.

Estimate

(i) The value of the two firms before the merger
(ii) The value of the combined firm with synergy effect **[5+5]**

(b) The following information is provided related to the acquiring firm Big Limited and the target firm Tall Limited:

	Big Ltd.	Tall Ltd.
Profit after tax (PAT)	₹ 2,000 Lakhs	₹ 400 Lakhs
Number of Shares outstanding	200 Lakhs	100 Lakhs
P/E ratio	10	5

You are required to calculate -

(i) What is the swap ratio based on current market price? **[2]**

(ii) What is the EPS of Big Ltd after acquisition? **[2]**

(iii) What is the expected market price per share of Big Limited after acquisition, assuming P/E ratio of Big Limited remains unchanged? **[2]**

(iv) Determine the market value of the merged firm. **[2]**

(v) Calculate gain/loss for shareholder of the two independent companies after acquisition. **[2]**

8. (a) From the following details, compute the total value of human resources of skilled and unskilled group of employees according to Lev and Schwartz (1971) model:

Particulars	Skilled	Unskilled
(i) Annual average earning of an employee till the retirement age.	₹1,40,000	₹1,00,000
(ii) Age of retirement	65 years	62 years
(iii) Discount rate	15%	15%
(iv) o. of employees in the group	30	40
(v) Average age	62 years	60 years

[10]

(b) Give below is the Balance sheet (draft) of Laxmi Ltd. as on 31-03-2018:

Liabilities	₹ (In lakh)	Assets	₹ (In lakh)
Share Capital (Share of ₹ 10)	100	Land & Buildings	40
Reserves & Surplus	40	Plant & Machinery	80
Creditors	40	Investments	10
		Stock	30
		Debtors	15
		Cash at Bank	05
	180		180

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 lakh 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 lakh each year.

(iv) Effective income tax rate is 30% including all other charges.

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