Paper-18: 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.

Working Notes should form part of the answer.

"Whenever necessary, suitable assumptions should be made and indicated in answer by the candidates."

1. (a) State whether the following statements are true or false: [1x10=10]

(i) Diversification is an important strategic alternative to growth.
(ii) Zero coupon bonds have no coupon rate, hence no yield.
(iii) Floating rate loans have interest payments that increase as market rates fall and fall as rates rise.
(iv) Under DCF method, in general, higher the risk level, higher will be the discount rate.
(v) Market value per share is expected to be lower than the book value per share in case of profitable and growing firms.
(vi) A lower discount would be applied to the cash flows of the government bond.
(vii) Variable dividend feature makes the computation of share value difficult.
(viii) A brand is nothing but a glorified product name, hence it has no value.
(ix) Intrinsic value and market price of equity shares are always equal.
(x) Possession of complimentary resources is one of the reasons for mergers negotiations.

(b) Fill in the blanks by using the words/phrases given in the brackets: [1x10=10]

(i) A theory that explains why the total value from the combinations resulted from a merger is greater than the sum of the values of the component companies operating independently is known as ------------ theory. (synergy/hubris/agency)

(ii) A --------------- is essentially a container for a customer's complete experience with the offer and the company. (goodwill/brand)

(iii) In a debt for equity swap, a firm replacing equity with debt ------------- its average ratio. (increases/decreases)

(iv) Estimated fair value of an asset is based on the ………….. (current/discounted/future) operating cash flows.

(v) Key to income-based approach of valuation is ------------ (capitalization rate / internal rate of return)

(vi) In case of Deep Discount Bonds, the issue price is always ----------- the face value (less than / more than)

(vii) The risk that the cash flows will not be delivered is called ------------- (liquidity risk/default risk)

(viii) Organizational capital is a -------------- component of intellectual capital (primary/secondary)

(ix) ----------------- companies have volatile earnings and high-growth potential choose low-debt ratios. (telephones/software)

(x) -------------------- measures the variation of distribution for the expected returns (standard division/regression).

(c) In each of the questions given below one out of the four options is correct. Indicate the correct answer: [1×5=5]

(i) If a bond is currently trading at a premium then-
(a) Its current yield is more than its yield-to-maturity.
(b) Its current yield is less than its yield-to-maturity.
(c) Its current yield is equal to its yield-to-maturity future
(d) Nothing can be concluded.

(ii) Which one of the following statements is not true about Efficient Markets?
(a) Share price behave randomly and do not show any systematic pattern in the behavior.
(b) Share prices fully reflect all available information.
(c) Price of one share is independent of the price of other shares in the market.
(d) None can earn abnormally high profiles on a constant basis.

(iii) Which is not a human-capital related intangible asset?
(a) Trained workforce
(b) Employment agreements
(c) Union contracts
(d) Design patents

(iv) 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

(v) Indian Oil Corporation has ₹100 crores worth of common equity on its balance sheet and 50 lakhs shares of stock outstanding. The company's Market Value Added (MVA) is ₹24 crores. What is the company's stock price?
(a) ₹ 230
(b) ₹ 238
(c) ₹ 248
(d) ₹ 264

2. (a) Strenous Limited is in the Pharmaceutical Industry and has a business strategy of growing inorganically. For this purpose, it is contemplating to acquire Placenta Limited which has a strong hold in cardiac segment. Strenous Limited has 30 crores shares outstanding which is trading on an average price of 300 while Placenta Limited has outstanding shares 20 crores and are selling at an average price of 195 per share.The EPS are 12 and 6 for Strenous Limited and Placenta Limited respectively. Recently, the management of both the companies had a meeting wherein numbers of alternative proposals were considered for exchange of shares. They are

(i) Exchange ratio should be in proposition to the relative EPS of two companies.

(ii) Exchange ratio should be in proposition to the relative Prices of two companies.

(iii) Exchange ratio should be 3 shares of Strenous Limited for every 5 shares of Placenta Limited.

You are required to estimate EPS and Market Price assuming the P/E of Strenous Limited after merger will remain unchanged, under each of the three options.

(b) What is Slump Sale? Give examples. [(4x3) + 3]

3. (a) The following financial data pertaining to ZIZO LTD. an IT company are made available

Year ended 31st March	2014	2013	2012
EBIT (₹)	696.03	325.65	155.86
Non-branded income (₹)	53.43	35.23	3.46
Inflation compound factor @ 8%	1.000	1.087	1.181
Remuneration of capital	5% of average capital employed		
Average capital employed(₹)	1112.00		
Corporate tax rate	35%		
Capitalization factor	16%		

You are required to calculate the Brand Value for ZIZO Ltd.

(b) From the following information taken from the books of Aggressive Ltd. relating to staff and community benefits, prepare a statement showing value of benefits to staff and community at large, as required under Corporate Social Reporting.

Environmental Improvements	₹20,10,000
Medical Facilities to staff and family	₹45,00,000
Training Programmes conducted in-house	₹10,25,000
Generation of Job Opportunities in the locality	₹60,75,000
Municipal Taxes paid	₹10,70,000
Increase in cost of living in the vicinity due to a thermal power station	₹16,55,000
Concessional transport, water supply to staff	₹11,25,000
Extra work put in by company staff and officers for drought relief	₹18,50,000
Leave encashment and leave travel benefits	₹52,00,000
Educational facilities for children of staff members	₹21,60,000
Subsidized canteen facilities on premises	₹14,40,000
Generation of business in the district	₹25,00,000

[8+7]

4. (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
Annual average earning of an employee till the retirement age	₹60,000	₹40,000
Age of retirement	65 years	62 years
Discount rate	15%	15%
No of employees in the group	30	40
Average age	62 years	60 years

(b) A company needs ₹5.1 crores to finance its investments for which ₹1.1 crore is available out of profits. The market price per share at the end of the current financial year is expected to be ₹100. If the discount rate is 10%, determine the present value of a share using the M-M Model. (Outstanding shares=10 lakhs) [7+8]

5. Write short notes on : [3×5=15]
   (i) Credit Derivatives
   (ii) Knowledge Companies
   (iii) Currency Swap

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

Particulars	Operating Profit	Opening Capital	Closing Capital
2008 - 2009	410	4,000	6,000
2009-2010	690	6,000	7,000
2010-2011	800	7,000	9,000
2011-2012	1500	9,000	10,000
2012-2013	1800	10,000	12,000

The Company is expected to commission a new project in April 2013 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 2013 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 31.03.2013 - (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]

7. Timby Ltd is in the business of making Sports Equipment. The Company operates from Thailand. To globalize its operations Timby has identified Fine Toys Ltd, an Indian Company, as a potential takeover candidate. After due diligence of Fine Toys Ltd, the following information is available –

(a) Cash Flow Forecasts (₹ in Crores)

Year	10	9	8	7	6	5	4	3	2	1
Fine Toys Ltd	24	21	15	16	15	12	10	8	6	3
Timby Ltd	108	70	55	60	52	44	32	30	20	16

(b) The Net Worth of Fine Toys Ltd (in Lakh ₹) after considering certain adjustments suggested by the due diligence team reads as under-

Tangible	750	
Inventories	145	
Receivables	75	970
Less: Creditors	165	
Bank Loans	250	(415)
Represented by Equity Shares of ₹ 1,000 each		555

Talks for the takeover have crystallized on the following -

1. **Timby Ltd will not be able to use Machinery worth ₹ 75 Lakhs which will be disposed off by them subsequent to takeover. The expected realization will be ₹ 50 Lakhs.**
2. **The Inventories and Receivables are agreed for takeover at values of ₹ 100 and ₹ 50 Lakhs respectively, which is the price they will realize on disposal.**
3. **The liabilities of Fine Toys Ltd will be discharged in full on take over alongwith an employee settlement of ₹ 90 Lakhs for the employees who are not interested in continuing under the new management.**
4. **Timby Ltd will invest a sum of ₹ 150 Lakhs for upgrading the Plant of Fine Toys Ltd on takeover. A further sum of ₹ 50 Lakhs will also be incurred in the second year to revamp the machine shop floor of Fine Toys Ltd.**
5. **The anticipated Cash Flows (in ₹ Crore) post takeover are as follows –**

Year	1	2	3	4	5	6	7	8	9	10
Cash Flows	18	24	36	44	60	80	96	100	140	200

You are required to advise the management the maximum price which they can pay per share of Fine Toys Ltd. if a discount factor of 20% is considered appropriate. [15]

8. (a) Why do many mergers fail? [5]
(b) Why do Companies want to measure intellectual capital? [5]
(c) Discuss Synergy with reference to merger. [5]