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) The market value of a property is the price paid to acquire it.
(ii) Insurable Value of real property does not include site value.
(iii) Intangible assets are treated as fictitious assets.
(iv) The CAPM model assumes perfect market competition.
(v) Value Gap in context of acquisitions refer to the difference between book value and the purchase price of a company.
(vi) Take-over defenses are also referred to as anti-takeover defenses.
(vii) Replacement value of an asset is future cost of a new asset at the time of replacement.
(viii) EVA is inversely related to shareholders' value.
(ix) Under DCF mode of asset valuation, we need to estimate the cash flows during life of the asset.
(x) The concept of 'value' is different from cost and price.

(b) Fill in the blanks by using the words/phrases given in the brackets: **[1x5=5]**

(i) Revaluation of assets is undertaken to attract investors by indicating to them **------------------** value of the asset. (current,future).

(ii) Synergy is whole that is **------------------** than sum of its parts. (less, more).

(iii) In a conglomerate merger, the concerned companies are in **------------------** lines of business. (related, unrelated).

(iv) For trading investments, the valuation is at **------------------** value. (book, market).

(v) One of the methods of valuation of equity is –Constant Growth Dividend Discount Model. As per this model, the growth rate is used is the growth rate in **------------------** (Earnings per share/ dividend per share/ Market price of share).

(c) In each of the questions given below one out of the four options is correct. Indicate the correct answer: **[2×5=10]**

(i) Which of the following best describes free cash flow?

(a) Free cash flow is the amount of cash flow available for disturbing to all investor after all necessary investments in operating capital have been made
(b) Free cash flow is the amount of cash flow available for disturbing to shareholders after all necessary investments in operating capital have been made
(c) Free cash flow is the net change in the cash account on the balance sheet.
(d) Free cash flow is equal to net income plus depreciation.

(ii) A share, Y, currently sells for ₹50. It is expected that in one year it will either rise to ₹55 or decline to ₹45. The value of a European call, if the strike price of the underlying share is ₹48 and the risk free interest rate is 9% p.a. is
(a) ₹9.33
(b) ₹11.33
(c) ₹18.33
(d) ₹20.50

(iii) The beta (β) of portfolio is equal to
(a) The beta of the market portfolio
(b) The arithmetic average of the individual security betas
(c) The weighted average of the individual security betas
(d) None of these

(iv) A company is having Book Value per share of ₹15 while the market value per share is ₹20. If a company has 20 crores number of shares and Book Debt of ₹100 crores, then its Enterprise Value will be
(a) ₹300 Crores
(b) ₹400 Crores
(c) ₹500 Crores
(d) None of the above

(v) If the company has a P/E Ratio of 12 and a ROE of 13%, then its Market to Book Value Ratio will be
(a) 1.09
(b) 1.56
(c) 9.34
(d) Nothing can be concluded as information available is insufficient

2. (a) Amit Ltd. is planning to acquire and absorb the running business of Ankita Ltd. The valuation is to be based on the recommendation of merchant bankers and the consideration is to be discharged in the form of equity shares to be issued by Amit Ltd. As on 31.3.2014, the paid up capital of Amit Ltd. consists of 80 lakhs shares of ₹ 10 each. The highest and the lowest market quotation during the last 6 months were ₹ 570 and ₹ 430. For the purpose of the exchange, the price per share is to be reckoned as the average of the highest and lowest market price during the last 6 months ended on 31.3.14.

Ankita Ltd.'s balance sheet as at 31.3.2014 is summarized as follows:

Sources	**₹ Lakhs**
Share Capital	
20 Lakhs Equity Shares of ₹10 Each Fully Paid	200
10 Lakhs Equity Shares of ₹ 5 Each Paid	50
Loans	100
Total	350
Uses	
Fixed Assets (Net)	150
Net Current Assets	200
Total (Lakhs)	350

An independent firm of merchant bankers engaged in the negotiation has produced the following estimates of cash flows from the business of Ankita Ltd.:

Year ended	**31.3.15**	**31.3.16**	**31.3.17**	**31.3.18**	**31.3.19**	**Terminal Value**
By way of	After tax earnings on equity					
₹ Lakhs	105	120	125	120	100	200

It is the recommendation of the merchant banker that the business of Ankita Ltd. may be valued on the basis of the average of

(a) Aggregate of discounted cash flows at 8% and (ii) Net assets value. Present value factors at 8% for years 1-5: 0.93 0.86 0.79 0.74 0.68

You are required to:

(i) Calculate the total value of the business of Ankita Ltd.

(ii) The number of shares to be issued by Amit Ltd.; and

(iii) The basis of allocation of the shares among the shareholders of Ankita Ltd. **[2+2+2]**

2. (b) Following is the Profit and Loss Account and Balance Sheet for M/s Henry Ltd. **[9]**

(₹ in lakhs)

	2013	**2014**
Turnover	652	760
Pre-tax accounting profit	134	168
Taxation	46	58
Profit after tax	88	110
Dividends	30	36
Retained earnings	58	74

Balance Sheet extracts are as follows:

(₹ in lakhs)

	2013	**2014**
Fixed Assets	240	312
Net current assets	260	320
Total	500	632
Equity Share holders funds	390	472

Medium and long-term bank loan	110	160

The Companies performance in regard to turnover had increased by 17% along with increase in pre-tax profit by 25% but shareholders are not satisfied by the company's preference in the last 2 years. You are required to calculate economic value added as suggested by M/s. Stern Stewert5 & Co., USA, so that reasons of non-satisfaction can be evaluated. You are also given

SN.	Particulars	2013	2014
1.	Pre-tax cost of debt	9%	10%
2.	Cost of equity	15%	17%
3.	Tax rate	35%	35%
4.	Interest expense	₹ 8	₹ 12

3. (a) Find out the average capital employed of Macro Ltd. From its Balance Sheet as at 31st March, 2014:

Equity and Liability	₹ in lakhs	Assets	₹ in lakhs
(1) Shareholders Fund:		**(1) Non-Current Assets:**	
(a) Share Capital		(a) Fixed Assets	
(i) Equity Share Capital of ₹ 10 each	50.00	(i) Tangible Assets:	
(ii) 9% Preference Shares fully paid up	10.00	— Land and Building	25.00
(b) Reserve & Surplus		— Plant and Machinery	80.25
(i) General Reserve	12.00	— Furniture and Fixtures	5.50
(ii) Profit and Loss A/c	20.00	— Vehicles	5.00
		(b) Non-Current Investments	10.00
(2) Non-Current Liabilities:		(c) Other Non-Current Assets	
Long Term Borrowings		— Preliminary Expenses	0.50
(i) 16% Debentures	5.00		
(ii) 16% Term Loan	18.00	**(2) Current Assets:**	
(iii) Cash Credit	13.30	(a) Inventories	6.75
		(b) Trade Receivables	
(3) Current Liabilities:		— Sundry Debtors	4.90
(a) Trade Payables – Sundry Creditors	2.70	(c) Cash and Cash Equivalents	10.40
(b) Short Term Provision			
— Provision for Taxation(Net)	6.40		
— Proposed Dividend			
• Equity Shares	10.00		
• Preference Shares	0.90		
Total	**148.30**	**Total**	**148.30**

Non-trade investments were 20% of the total investments.
Balances as on 1.4.2013 to the following accounts were:
Profit and Loss account ₹8.70 lakhs, General reserve ₹6.50 lakhs. **[6]**

3. (b) Why is brand valuation needed? What are the steps in valuation of a brand? **[9]**

4. (a) What is Human Resource Accounting? What are its benefits? State the two main methods of its measurement. **[2+2+2]**

4. (b) Shyam Ltd. has announced issue of warrants on 1:1 basis for its equity share holders. The current price of the stock ₹10 and warrants are convertible at an exercise price of ₹11.71 per share. Warrants are detachable and are trading at ₹3. What is the minimum price of the warrant? What is the warrant premium? Now had the current price been ₹16.375, what is the minimum price and warrant premium? (Consider warrants are tradable at ₹9.75). **[4]**

4. (c) ABC reported earnings per share of ₹ 2.40 in 2013, and paid dividends per share of ₹ 1.06. The earnings had grown 7.5% a year over the prior five years, and were expected to grow 6% a year in the long term (starting in 2014). The stock had a beta of 1.05 and traded for ten times earnings. The Treasury bond rate was 7%.

(i) Estimate the P/E Ratio for ABC.
(ii) What long term growth rate is implied in the firm's current P/E ratio?
(iii) What is the value of an equity share if P/E is 8 (assuming current EPS)? **[2+2+1]**

5. (a) Vijay Ltd's shares are currently selling at ₹13 per share. There are 10,00,000 shares outstanding. The firm is planning to raise ₹ 20 lakhs to finance a new project to be started soon at Bangalore. You are required to calculate the ex-right price of shares and the value of a right, if:

(i) The firm offers one right share for every two shares held
(ii) The firm offers one right share for every four shares held
(iii) How does the shareholder's wealth change from (i) to (ii) above? How does right issue increases shareholder's wealth? **[3+3+3]**

5. (b) Given – (1) Future maintainable Profit before Interest = ₹125 Lakhs; (2) Normal Rate of Return on Long Term Funds is 19% and on Equity Funds is 24%; (3) Long Term Funds of the Company is ₹320 Lakhs of which Equity Funds is ₹210 Lakhs; (4) Interest on Loan Fund is 18%. Find out leverage effect on Goodwill if tax rate = 30%. **[6]**

6. (a) Shah Ltd had earned a PAT of ₹48 Lakhs for the year just ended. It wants you to ascertain the value of its business, based on the following information.

(i) Tax Rate for the year just ended was 36%. Future Tax rate is estimated at 34%.
(ii) The Company's Equity Shares are quoted at ₹120 at the Balance Sheet date. The Company had an Equity Capital of ₹100 Lakhs, divided into Shares of ₹50 each.
(iii) Profits for the year have been calculated after considering the following in the P & L Account:-

- Subsidy ₹2 Lakhs received from Government towards fulfillment of certain social obligations. The Government has withdrawn this subsidy and hence, this amount will not be received in future.
- Interest ₹8 Lakhs on Term Loan. The final instalment of this Term Loan was fully settled in the last year.
- Managerial Remuneration ₹15 Lakhs. The Shareholders have approved an increase of ₹6 Lakhs in the overall Managerial Remuneration, from the next year onwards.
- Loss on sale of Fixed Assets and Investments amounting to ₹8 Lakhs. (Ignore Tax Effect thereon). **[8]**

6. (b) What are the steps of formulating a strategy? **[3]**

6. (c) Following information is obtained from Pankaj Ltd.

Opening Stock	Finished goods	1,000 Kg	₹ 25,000
	Raw material	1,100 Kg	₹ 11,000
Purchases		10,000Kg	₹1,00,000
Labour			₹ 76,500
Overheads (fixed)			₹75,000
Sales		10,000Kg	₹ 2,80,000
Closing Stock	Raw materials	900 Kg	
	Finished goods	1200 Kg	

The expected production for the year was 15,000 Kg of the finished product. Due to fall in market demand, the sales price for the finished goods was ₹ 20 per Kg. and the replacement cost for the material was ₹ 9.50 per Kg on the closing day. You are required to calculate the closing stock as on that date. Compute closing stock as on that date. **[4]**

7. Hindustan Lever Ltd. and Ponds India Ltd. are in the same industry. The former is in negotiation for acquisition of the latter. Important information about the two companies as per their latest financial statements is given below:

	Hindustan Lever Ltd.	Ponds India Ltd.
₹10 Equity shares outstanding	12 lakhs	6 lakhs
Debt:		
10% Debentures (₹ lakhs)	580	---
12.5% Institutional Loan (₹ lakhs)	---	240
Earnings before interest, depreciation and tax (EBIDTA) (₹ lakhs)	400.86	115.71
Market Price per share (₹)	220.00	110.00

Hindustan Lever Ltd. plans to offer a price for Ponds India Ltd., business as a whole which will be 7 times EBIDTA reduced by outstanding debt, to be discharged by own shares at market price.

Ponds India Ltd. is planning to seek one share in Hindustan Lever Ltd. for every 2 shares in Ponds India Ltd. based on the market price. Tax rate for the two companies may be assumed as 30%.

Calculate and show the following under both alternatives - Hindustan Lever Ltd.'s offer and Ponds India Ltd.'s plan:

(i) Net Consideration Payable.
(ii) No. of Shares to be issued by Hindustan Lever Ltd.
(iii) EPS of Hindustan Lever Ltd. after acquisition.
(iv) Expected Market Price per share of Hindustan Lever Ltd. after acquisition.
(v) State briefly the advantages to Hindustan Lever Ltd. from the acquisition.

Calculations (except EPS) may be rounded off to 2 decimals in lakhs. **[2+2+4+5+2]**

8. Write short notes **(any three):** **[3×5=15]**

(i) Intrinsic Value
(ii) Valuation of Preference Share
(iii) Fair Market Value of Intangible assets
(iv) Put Option