PAPER – 20: FINANCIAL ANALYSIS & BUSINESS VALUATION

The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	Learning objectives	Verbs used	Definition
LEVEL C	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence
	SYNTHESIS How you are expected to utilize the information gathered to reach an optimum conclusion by a process of reasoning	Discuss	Examine in detail by argument
		Interpret	Translate into intelligible or familiar terms
		Decide	To solve or conclude
	EVALUATION How you are expected to use your learning to evaluate, make decisions or recommendations	Advise	Counsel, inform or notify
		Evaluate	Appraise or asses the value of
		Recommend	Propose a course of action

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) Balance Sheet (extract) of Q Ltd. as on 31st March 2015.

Liabilities	₹ in Crores	Assets	₹ in Crores
Equity Shares	20.80	Fixed Assets	105.60
Long-term Liabilities	104.00	Current Assets	57.60
Current Liabilities	78.40	Profit & Loss A/c	40.00
	203.20		203.20

Additional Information:

- Depreciation written off ₹ 8 crores.
- Preliminary Expenses written off ₹ 1.60 crores.
- Net Loss ₹ 25.60 crores.

Ascertain the stage of sickness. **[10]**

1. (b) On 1st September 2014, BLT held 60% of the ordinary share capital of its only subsidiary CMU. The consolidated equity of the group at that date was ₹ 5,76,600, of which ₹ 1,27,000 was attributable to the minority interest.

On 28th February 2015, exactly halfway through the financial year, BLT bought a further 20% of the ordinary share capital of CMU. In the year ended 31st August 2015 BLT's profits for the period were ₹ 98,970 and CMU's were ₹ 30,000. BLT paid a dividend of ₹ 40,000 on 1st July 2015. There were no other movements in equity. It can be assumed that profits accrue evenly throughout the year.

Prepare a consolidated statement of changes in equity for the BLT group for the year ended 31st August 2015. **[10]**

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

2. (a) Following figures have been extracted from the records of Debya Ltd.:

Year	2013-14 (₹)	2014-15 (₹)
Sales	5,00,000	6,32,500
Cost of Goods Sold:		
Materials	2,50,000	3,30,000
Labour	1,50,000	1,65,000

Variable Overheads	30,000	35,200
Fixed Expenses	50,000	60,000
Net Profit	20,000	42,300

It is learnt that sales volume for the year 2014-15 has gone up by 10% over the year 2013-14. Moreover, cost of materials, labour and overhead have gone up by 10% each. Account for changes in net profit in the year 2014-15. **[15]**

2. (b) (i) The following are the Balance Sheet of Khan Ltd. as on 31.03.2014 and 31.03.2015:

Liabilities	**31.03.2014 (₹)**	**31.03.2015 (₹)**
Current Assets:		
Cash and Bank Balance	23,600	2,000
Debtors	41,800	38,000
Inventory	32,000	26,000
Other Current Assets	6,400	2,600
(A)	1,03,800	68,600
Fixed Assets:		
Land and Building	54,000	34,000
Plant and Machinery	62,000	1,57,200
Furniture	5,800	9,600
(B)	1,21,800	2,00,800
Long term investment (C)	9,200	11,800
Total Assets (A+B+C)	2,34,800	2,81,200
Current Liabilities (D)	52,400	25,400
Long-term debt (E)	40,000	65,000
Owners' Equity:		
Equity share capital	80,000	1,20,000
Reserve and surplus	62,400	70,800
(F)	1,42,400	1,90,800
Total Liabilities and capital (D+E+F)	2,34,800	2,81,200

Prepare comparative Balance sheet and study its financial position. **[8+4]**

2. (b) (ii) Rambow Corporation purchased a 8% bond, at par, for ₹10,00,000 at the beginning of the year. Interest rates have recently increased and the market value of the bond declined by ₹30,000. Determine the bond's effect on Rambow's financial statements under each classification of securities. **[3]**

2. (c) (i) Prinsley Ltd. has drawn up the following Sales Budget for July, 2015:

Product 'A'	5,500 units at ₹ 90 each
Product 'B'	4,700 units at ₹ 80 each
Product 'C'	7,500 units at ₹ 120 each

The actual sales for July, 2014 were:

Product 'A'	5,650 units at ₹ 110 each
Product 'B'	4,800 units at ₹ 70 each
Product 'C'	6,000 units at ₹ 100 each

The costs per unit of Product 'A', Product 'B' and Product 'C' were ₹ 70, ₹ 60 and ₹ 85 respectively. Analyse the variances to show the effects on turnover:

(I) Sales price variance;
(II) Sales mix variance;
(III) Sales quantity variance;
(IV) Total sales value variance. **[2.5×4=10]**

2. (c) (ii) The consolidated financial statements of P for the year ended 31st March 2015 showed the following balances:

Minority interest in the consolidated balance sheet at 31st March 2015 is ₹ 6 million [₹ 3.6 million at 31st March 2014].

Minority interest in the consolidated income statement for the year ended 31st March 2015 is ₹2 million.

During the year ended 31st March 2015, the group acquired a new 75% subsidiary whose net assets at the date of acquisition were ₹6.4 million. On 31st March 2015, the group revalued all its properties and the minority interest in the revaluation surplus was ₹1.5 million. There were no dividends payable to minority shareholders at the beginning or end of the year.

Required:

Calculate the amount of dividend paid to minority shareholders that will be shown in the consolidated cash flow statement of P for the year ended 31st March 2015. **[5]**

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

3. (a) Consider two firms that operate independently and have following characteristics.

(₹ in lakh)

Particulars	M Ltd.	R Ltd.
Reserves	6,000	3,000
Cost of goods sold	3,500	1,800
EBIT	2,500	1,200
Expected growth rate	5%	7%
Cost of capital	8%	9%

Both firms are in steady state, with capital spending offset by depreciation. Both firms have an effective tax rate of 40% and are financed only by equity.

Scenario I

Assume that combining of the two firms will create economics of scale that will reduce the cost of goods sold to 48% of reserves.

Scenario II

Assume that as consequence of the merger the combined firm is expected to increase its future growth to 7% while cost of goods sold is 60% and do not come down to 48%.

Scenario I & II are mutually exclusive.

You are required to

(I) Compute the values of both the firms as separate entities.

(II) Compute the value of both the firms together if there were absolutely no synergy at all from the merger.

(III) Compute the value of capital and the expected growth rate for the combined entity.

(IV) Compute the value of synergy in Scenario I and Scenario II. **[2+1+2+5]**

3. (b) X Ltd. purchased machinery from Y Ltd. on 30/09/2014. The price was 522.50 lakhs after charging 10% Vat and giving a trade discount of 5% on the quoted price. Transport charges were 0.25% on the quoted price and installation charges come to 1% on the quoted price.

A loan of ₹ 500 lakhs was taken from bank on which interest at 15% per annum was to be paid. Expenditure incurred on the trial run was: Material ₹ 50,000, wages ₹ 40,000 and overheads ₹ 30,000.

Machinery was ready for use on 01/12/2014. However it was actually put to use only on 01/05/2015. Find out the cost of the machine and suggest the accounting treatment for the expenses incurred in the interval between the dates 01/12/2014 to 01/05/2015. The entire loan amount remained unpaid on 01/05/2015. X Ltd. does not intend to utilize the input tax paid on capital good. **[10]**

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

4. (a) (i) The following information is available for a concern. Compute EVA.

Debt Capital 12%	₹ 2,000 Crores	Risk Free Rate	9%
Equity Capital	₹ 500 Crores	Beta Factor	1.05
Reserves & Surplus	₹ 7,500 Crores	Market Rate of Return	19%
Capital Employed	₹ 10,000 Crores	Equity (Market) Risk Premium	10%
Operating Profit after Tax	₹ 2,100 Crores	Tax Rate	30%

[7]

4. (a) (ii) From the following details, compute according to Lev and Schwartz (1971) model the total value of human resources for employee groups - skilled and un-skilled.

	Particulars	Skilled	Un-skilled
A	Annual average earning of an employee till age of retirement	₹1,00,000	₹60,000

B	Age of retirement	65 years	62 years
C	Discount rate	20%	20%
D	No. Of employees in the group	25	20
E	Average age	62 Years	60 Years

It is assumed that employees will leave the organization only on retirement. **[4+4]**

4. (b) (i) Describe H Model as modification to the existing mode. **[5]**

4. (b) (ii) Navaratna Ltd. furnishes the following particulars about their investment in shares of Samay Ltd. for the year 2014-15

Balance of shares held on 1st April 2014	₹ 2,62,000	(10,000 shares of ₹ 10 each)
Purchased 2000 shares on 1st July 2014	₹ 60,000	
Sold 500 shares on 1st August 2014 @ ₹ 35 per share cum dividend	₹ 17,500	
Navaratna Ltd. declared final dividend for 2013-14 on 1st September 2014. Received 1:5 bonus shares on 1st February, 2015.	20%	

Brokerage for each transaction is 2%. Find out cost of shares held by Navaratna Ltd. as on 31st March 2015. **[10]**

4. (c) Yogesh Ltd. showed the following performance over five years ended 31.03.2015 –

Year ending 31st March	Net Profit before Tax	Prior Period Adjustment	Remarks
2011	4,00,000	(1,00,000)	Relating to 2009 – 2010
2012	3,50,000	(2,50,000)	Relating equally to 2009 –2010 and 2010 -2011
2013	6,50,000	1,50,000	Relating to 2011 – 2012
2014	5,50,000	(1,75,000)	Relating to 2011 – 2012
2015	6,00,000	(1,00,000) 25,000	Relating to 2011 - 2012 Relating to 2013 - 2014

Net Profit before tax is after debiting or crediting the figures of Loss (within Brackets) or Gains mentioned under the columns for prior period adjustments.

The Net Worth of the business as per the Balance Sheet of 31.03.2010 is ₹ 6,00,000 backed by 10,000 fully paid Equity Shares of ₹ 10 each. Reserves and Surplus constitute the balance Net Worth.

You are asked to value Equity Shares on –

(I) Yield basis as on 31.03.2015 assuming:
- 40% Rate of Tax.
- Anticipated after tax yield of 20%.
- Differential weightage of 1 to 5 being give for the five years starting on 01.04.2011 for the actual profits of the respective years.

(II) Net Assets Basis as per corrected balance Sheets for each of the six years ended 31.03.2015.

(III) Looking at the performance of the Company over the five year period, would you invest in the Company? **[6+6+3]**