Topic 1. On Analysis of Financial Statements

Introduction

Profit is an excess of revenues over associated expenses for an activity over a period of time. Terms with similar meanings include ‘earnings’, ‘income’, and ‘margin’. Profit is the yardstick for judging not just the economic, but the managerial efficiency and social objectives also.

Profit & Profitability

Sometimes, the terms ‘Profit’ and ‘Profitability’ are used interchangeably. But in real sense, there is a difference between the two. Profit is an absolute term, whereas, the profitability is a relative concept. However, they are closely related and mutually interdependent, having distinct roles in business.

Profit refers to the total income earned by the enterprise during the specified period of time, while profitability refers to the operating efficiency of the enterprise. It is the ability of the enterprise to make profit on sales. It is the ability of enterprise to get sufficient return on the capital and employees used in the business operation.

Analysis of Profitability of GSRTC

Apart from the short term and long term creditors, owners and management or a company itself also interests in the soundness of a firm which can be measured by profitability ratios. Profitability ratios are of two types — those showing profitability in relation to sales (revenue in case of GSRTC) and those showing profitability in relation to investment. Together, these ratios indicate firm’s overall effectiveness of operation.

With a view to appraise profitability of GSRTC, the analysis has been made from the point of view of management and shareholders. The management of the firm is naturally eager to measure its operating efficiency. Similarly, the owners invest their funds in the expectation of reasonable returns. The analysis throws the light on the following questions:

1. **Is the profit earned by the firm adequate?**

2. **What rate of return does it represent?**
3. **What is the rate of profit for various segments of the firm?**
4. **What is the rate of return to equity holders?**

Caselet-1

ABC Ltd. has annual sales for the previous year 2012-13 `2,30,000 and profit after tax `13,340. The budgeted annual sales for the next year, i.e. 2013-14 is amounted to be `2,42,000 and the budgeted profit thereof is estimated at `14,278. ABC Ltd. excluded goodwill, patents, trademarks, preliminary expenses, cost of issue of shares and debentures etc. while calculating the capital employed. The company also decided to exclude the extraneous and fortuitous expenditure and income and abnormal losses. The average total assets amounted to `2,00,000 for the first of the two years and are estimated to be `2,20,000 for the next year. The capital employed thus calculated is comes at 6.67% for the year 2012-13 and 6.5% for the next year.

What are the reasons for the change in the ratio of return on capital employed from 6.67% to 6.5%?

Caselet-2

Dell's Summary Financial Data

($ in millions, except per share data)	2005	2004	2003	2002	2001
Revenues	49,205	41,444	35,404	31,168	31,888
Net Income	3,043	2,645	2,122	1,246	2,177
Total Assets	23,215	19,311	15,470	13,535	13,670
Shareholders' Equity	6,485	6,280	4,873	4,694	5,622
Cash Flow from Operations	5,310	3,670	3,538	3,797	4,195
Basic Earnings per Share	1.21	1.03	0.82	0.48	0.84

Book Value per Share	2.61	2.46	1.89	1.80	2.16
Closing Stock Price	33.44	23.86	26.8	25.19	37.25

From the above table, analyse the impact on profit from the point of view sales and cash flows?

Caselet-3

Aryaan Ltd. had net sales of `6,00,000 and `6,84,000 for the year 2011-12 and 2012-13 respectively. The cost of goods sold included materials — `2,75,000 (2011-12) and `3,23,000 (2012-13), labour — `1,25,000 (2011-12) and `1,85,000 (2012-13), variable overheads — `37,000 (2011-12) and `41,500 (2012-13) and fixed overhead — `55,000 (2011-12) and `62,000 (2012-13). It is observed that the sales volume for the year 2012-13 has gone up by 10% over the year 2011-12. Moreover the cost of materials, labour and overhead has gone up by 10% each. The number of units produced and sold is 1,000 units in 2011-12.

From the given information analyse the profit on the basis of sales and different items of costs.

Caselet-4

The operating section begins with net income of $84,000, which is then adjusted for noncash depreciation and amortization expense. Next, the gain on sale of assets is subtracted to zero it out (the proceeds will be reflected in net cash flows from investing activities). Finally, changes in current assets and liabilities are reflected as cash inflows (outflows) using the matrix presented above. Gould realized $113,000 in net cash flow from operations in Year 2.

GOULD CORPORATION

Statement of Cash Flows

For Year Ended December 31, Year 2 (Amount in $)

Net Income	84,000	
Add (deduct)		
Depreciation and amortization expense	35,000	
Gain on sale of assets	(5,000)	

Accounts receivable	(9,000)	
Inventories	6,000	
Prepaid expenses	3,000	
Accounts payable	(5,000)	
Accrued expenses	4,000	
Net cash flow from operating activities		113,000
Purchase of equipment	(70,000)	
Sale of equipment	7,000	
Net cash flows from investing activities		(63,000)
Mortgage payable	(150,000)	
Preferred stock	175,000	
Dividends	(51,000)	
Net cash flows from financing activities		(26,000)
Net increase in cash		24,000
Beginning cash		51,000
Ending cash		75,000

Note: Assets costing $ 30,000 were purchased during Year 2 and were financed in whole by the manufacturer.

Net cash flows from investing activities include purchases (P) and sales (s) of plant assets. Purchases can be inferred from the T-account for plant assets (PP&E):

Plant Assets

	350,000		
(p)	100,000	10,000	(s)
	440,000		

Analyse the different activities of cash flows with the help of the Plant Assets. How were the long term liability and equity accounts changed?

Topic 2. On Direct Tax

Case Study 1

Whether amounts of excise refund and interest subsidy received by industrial units in pursuance of incentives announced in terms of new industrial policy for accelerated industrial development in State of Jammu and Kashmir for creation of such industrial atmosphere and environment which would provide additional regular sources of employment to unemployed in State, were, in fact, in nature of creation of new assets of industrial atmosphere and environment, having potential of employment generation to achieve a social object and such incentives would be capital receipts in hands of such industrial units.

Case Study 2

Gift received by assessee on occasion of his daughter's marriage won't be exempt as the word individual appearing in proviso to sub-clause (vi) of sec. 56(2) relates to marriage of assessee and not of his daughter. Comments

Case Study 3

In case the share capital is raised in a foreign country and repatriated to India on a need basis from time to time for approved uses, can the gain arising on the balance sheet date due to fluctuation in foreign exchange, in respect of that part of share capital which is to be used as working capital, be treated as a revenue receipt?

Case Study 4

In case, there is no possibility of recovery of loans issued by a non-banking financial company (NBFC), which is non-performing assets (NPA) as per RBI guidelines, can the interest on such loan be treated as income of the NBFC, following mercantile system of accounting?

Case Study 5

Smifs Securities Ltd. acquired the business of Y Ltd. under the scheme of amalgamation. Transferee paid an excess consideration over the net assets acquired from transferor as goodwill on which transferee claimed depreciation. The assessee's claim for depreciation on goodwill was rejected by the Assessing Officer on ground that goodwill was not an asset falling under Explanation 3 to section 32(1).

Is the assesee entitled to depreciation on the value of goodwill considering it as an asset within the meaning of explanation 3(b) to section 32(1)?

Case Study 6

Where the provision for bad and doubtful debts under section 36(1)(viia) relates to rural advances, can deduction for actual write off under section 36(1)(vii) in respect of urban advances be restricted to the amount in excess of the credit balance in the provision for bad and doubtful debts made under section 36(1)(viia)?

Case Study 7

Can a company engaged in the business of owning, running and managing hotels claim interest on borrowed funds, used by it for investing in the equity share capital of a wholly owned subsidiary company, as deduction where the subsidiary company was formed for exercising effective control of new hotels acquired by the parent company under its management?

Case Study 8

Assessee was engaged in business of manufacturing of textiles - It had four manufacturing units out of which one unit located in Delhi had to be closed down as according to master plan in Delhi, it was located in non-confirming area - It claimed deduction of expenses pertaining to closed unit on account of retrenchment compensation paid to employees and interest on monies borrowed for payment of retrenchment compensation, provident fund and legal expenses - Assessing Officer disallowed assessee's claim on ground that closure of unit would amount to closure of business.

Is the expenditure incurred on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation on closure of one of the textile manufacturing units of the assessee-company revenue in nature?

Case Study 9

Would non-resident match referees and umpires in the games played in India fall within the meaning of sportsmen to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer?

Case Study 10

Assessee society received `2 lakhs from WAFM for holding a national convention for farmers - According to assessee, it was an advance for holding convention which could not be held in that year but was held in subsequent year and amount was utilized therefore. Assessing Officer denied benefit of accumulation as he was of view that objects for which accumulation was sought were not particularized in as much as they covered entire range of objects of trust.

Whether the Tribunal was right in negating the assessee's claim for accumulation of unspent income?

Topic 3. On Indirect Tax

Case Study 1

Gramin Power Corporation Ltd. is engaged in the activity of generation and distribution of electricity in the rural area of the state of Maharashtra. The central excise officer demanded notice for generation and distribution of electricity. The assessee contended that before levy of excise duty, electricity must fall under the definition of goods i.e. movable (or tangible) and marketable. Advice whose contention is correct.

Case Study 2

Zotec Engineering Ltd. was engaged in fabrication, assembly and erection of water treatment plant. He build Water Treatment Plant for one of its client for `1.5 crores. Zotec Engineering Ltd. purchased duty paid parts of water treatment plant in unassembled form and assembled to the ground with civil work at client site. The Department alleged that the assessee had fabricated/ manufactured the water treatment plant. It further alleged that water treatment plant came into existence in an unassembled form before the same was installed and assembled to the ground with civil work. It became operational after it was embedded in the civil work and, therefore, the excise duty was payable on it. Advise the taxability of the same.

Case Study 3

Appu Ltd. is a manufacturer of motor parts (two-wheeler) suffering loss due to low production since last five years. The management of the company appoint cost accountant to identify the bottleneck of the production process. The cost accountant submitted his report. The management on the basis of report initiates repairs & maintenance job to improve the production capacity of the company. After repair & maintenance, the production capacity is increase twice. The excise department alleged that the process amount to manufacture and raise demand for the same. Is the contention of the department is tenable?

Case study 4

DNA Pharma Ltd is a manufacturer of electronic transformers, semi-conductor devices and other electrical and electronics equipments. During the course of such manufacture, the appellant also manufactured machinery in the nature of testing equipments to test their final products.

Whether assembling of the testing equipments for testing the final product in the factory amounts to manufacture?

Case Study 5

Notor India Ltd. was engaged in the assembling and installing the parts and components of asphalt mix, drum mix/hot mix plant. The Department alleged that the assembling and installation of asphalt batch mix, drum mix/hot mix plant amounted to manufacture. It contended that the said plant was not per se immovable. Attachment of plant with nuts and bolts was only intended to provide stability and prevent vibration. The attachment was easily detachable from foundation and was not permanent. Therefore, the assessee was liable to pay duty on the said plant.

Whether the machine which is not assimilated in permanent structure would be considered to be moveable so as to be dutiable under the Central Excise Act?

Case Study 6

Green Furniture India Ltd. engaged in the business of acquiring Office Furniture System/ Work Station from his supplier in completely Knock down (CKD) condition and the same is assembled and installed at its customers' premises. Whether the assessee is required to pay duty on the activity of assembling and installing furniture at its customers' premises out of the components of Office Furniture System/ Work Stations (OFS/WS) purchased from the supplier?

Case Study 7

Eco-System Entertainment Pvt Ltd. is engaged in importing compact disk from Korea and repacks it along with inlay card for sale in local distributor. The Department of revenue contended that the process is manufacture and raise a demand for ` 20 lakhs. The assessee appoint Cost Audit firm to defense his case against the revenue. Does the activity of packing of imported compact discs in a jewel box along with inlay card amount to manufacture?

Case Study 8

The assessee Minwool Rock Fibres Ltd.'s contention was that the appropriate classification for their product "rockwool and slagwool" was under Chapter sub-heading No. 6807 10 of the Act while the Department contended that the appropriate classification was under Chapter sub-heading No. 6803 00 of the Act. In case of specific classification viz-a-viz classification based on material used/ composition of goods, which one should be adopted?

Case Study 9

"Dant Manjan Lal" (DML) manufactured by M/s. Baidyanath Ayurved Bhawan Limited. While Baidyanath contended that the product DML was a medicament under Chapter sub-heading 3003 31 of the Central Excise Tariff Act, 1985, but the stand of the Department was that the said product was a cosmetic/ toiletry preparation/tooth powder classifiable under Chapter heading 3306.

How to determine whether a product is covered by 'cosmetics' or 'medicaments?

Case Study 10

Fiat India Pvt. Ltd. (Fiat) was the manufacture the motor car namely Fiat UNO and sell it into the market at the price of 50% (approx) of its cost price. Department raise the issue that loss selling price is not considered as the normal selling price and raise demand of duty. The Department adopted an average manufacturing cost supported by the finding of a Practicing Cost accountant and confirmed the demand of differential duty said of ` 432 crores. The assessee contended that the price which was adopted assessable value & to penetrate the market.

Whether the price used for selling of a product below the cost price for penetration of market can be considered as transaction value?

Topic 4. On Corporate Laws

Caselet 1:

Can auditors continue in office if AGM is not held in time or is adjourned without considering the appointment or reappointment of auditor?

Ram & Co. was appointed as auditor of ABC Limited at the Annual General Meeting held on 30th September, 2010. Can Ram & Co. continue as auditor of the company in case the next annual general meeting has not been held in time? What would be the position in case the next annual general meeting was held on 30th September, 2011, but adjourned without considering the business of appointment or re-appointment of auditor?

Caselet 2:

Appointments as a managing director and a chief executive officer – Applicability and requirements of section 314

M/s Akin Consultants Private Ltd. seeks your legal advice regarding the following appointments relating to directors and their relatives:

(i) Mr. K, who is a relative of one of the directors, is to be appointed as the managing director on a monthly salary of `80,000 plus other perquisites as applicable to other executives of the company.

(ii) Miss N, a relative of a director, is to be appointed as Chief Public Relations Officer on a salary of `65,000 per month.

(iii) Mr. W, a relative of a director, is to be appointed as Chief Executive Officer on a consolidated salary of `2,55,000 per month.

Advise explaining the relevant provisions of the Companies Act, 1956.

Caselet 3:

Director of 14 companies appointed as a director in 4 other companies – Legal requirements

Mr. PC is Director in 14 Public Limited Companies as on 30th July, 2010. He continues to be so till 24th September, 2010. The following companies appoint Mr. PC as a director at their respective annual general meetings held on dates mentioned against their names:

(i) PQR Ltd. (AGM held on 29th September, 2010)

(ii) BCD Private Ltd. (AGM held on 25th September, 2010)

(iii) City Traders Association (A company registered under section 25 of the Companies Act, 1956 September, 2010)

(iv) TSP Ltd. (AGM held on 25th September, 2010).

You are required to state with reference to the relevant provisions of the Companies Act, 1956 the options available to Mr. PC in respect of accepting or not accepting the appointment of director of the above companies.

Caselet 4:

Raman Ltd having Paid Up Share Capital of `5 Crores owns an agency of Cement Corporation of India Ltd and proposes to supply cement, on credit, to Raman enterprises (P) Ltd. Raman is a common Director in both the Companies.

State the requirements of the Companies Act, 1956, if any, to be complied with by the Company on the facts of this case.

Will it make any difference, if –

(a) M/s Raman Enterprises (P) Ltd were a Public Company.

(b) M/s Raman Ltd were carrying on real estate business and it proposes to sell a flat to M/s Raman Enterprises (P) Ltd for `50 Lakhs?

Case let 5:

Position of alternate directors while computing quorum

The articles of association of XYZ Computers Limited provide for a maximum of 15 directors. But the company has only 10 directors and for 2 of them representing foreign collaborator, alternate directors have been appointed. Board meeting held on 1st August, 2008 was attended by 4 directors including 2 alternate directors.

Examine with reference to the relevant provisions of the Companies Act, 1956 whether quorum was present at the Board meeting held on 1st August, 2008. Will your answer be different, if the articles provide for a quorum of 6 directors?

Caselet 6:

No condition in agreement that appointment of a sole selling agent is subject to prior approval in general meeting – Consequences

The Board of directors of a multi-product company, namely PQR Limited having a paid up capital of `25 lakhs appointed XYZ Limited as sole selling agent for all its products in India without prior approval of the company in general meeting without any condition that the appointment is subject to the approval of the company in general meeting. XYZ Limited, its directors and their relatives are not holding any shares in PQR Limited. Discuss whether the appointment of XYZ Limited as sole selling agent is valid. State with reasons whether your answer will be different if -

(a) XYZ Limited are appointed as sole selling agents only for the State of Maharashtra, or for whole of India; and

(b) For only some of the products manufactured by PQR Limited or for the entire range of products.

Caselet 7:

Aggregate amount of all the loans, investments, securities and guarantees provided by ABN Private Limited stand at `75.00 lacs as on 31st March 2010 against the paid up capital of `50.00 lacs and free reserves of `60.00 lacs. For making any investments or providing any loan, security or guarantee, members' approval was not obtained. On 15th April 2010, ABN Private Limited was converted into a public company. Is it necessary for such a company to obtain approval of members after conversion into public company as the aggregate amount of all the loans, investments, securities and guarantees exceed 60% of the company's paid-up capital and free reserves?

Caselet 8:
Following information is available from the audited Balance Sheet as at 31st March, 2010 of ASK Ltd.:

Share Capital	`
Equity share Capital (5,00,000 shares of `10 each fully paid up in cash)	50,00,000
Less: calls in arrear	
	50,000
	49,50,000
Preference Share Capital	
Share Application Money	15,00,000
	10,00,000
Reserves and Surplus:	
Securities Premium	
Capital Redemption	15,00,000
Fixed Assets Revaluation Reserve	12,00,000
Sinking Fund Reserve	10,50,000
General Reserve	11,00,000
Profit and Loss Account	40,00,000
Dividend Equalization Reserve	22,00,000
Secured Loans:	6,00,000
Cash Credit facility from Bank	
	1,00,00,000

You are required to find out, explaining the relevant provisions of the Companies Act, 1956, the amount upto which the Board of Directors can invest in securities of other bodies corporate and/or give loans.

Caselet 9:

Withdrawal of consent - Whether invalidates the application?

A group of shareholders of M/s. Elite Engineering Company Ltd. has filed a petition before the Company Low Board alleging various acts of oppression and mismanagement by the majority shareholders. The petitioner group holds 15% of the issued share capital of the company. During the course of hearing before Company Law Board, some of the petitioner group of shareholders holding about 6% of the issued share capital of the company have withdrawn their consent by stating that they are misled by the group to sign the petition and after coming to know of the true facts they have disassociated themselves with the petition and they, along with the other majority shareholders have submitted that the petition should be dismissed on the ground of non-maintainability. Examine their contention having regard to the provisions of the Companies Act.

Caselet 10:

A past member when liable as a contributory?

By an order of the Court M/s ABC Limited was wound up with effect from 15.03.2008. Mr. Guha, who ceased to be a member of the company from 01.06.2007 received a notice from the liquidator to deposit a sum of `15,000 as his contribution towards the liability on the shares previously held by him. Mr. Guha seeks your opinion about his liability.

Topic 5. On Business Valuation

Question No. 1. Valuation of Investment

The finance Director of CMC Ltd. is investing a potential ` 250 lakh investment. The investment would be in a bio-tech project away from existing mainstream activities of computer hardware manufacture. ` 60 lakh of investment would be financed by internal funds, ` 90 lakh by long term and ` 100 lakh by right issue. The investment is expected to generate pre-tax net cash flows of approximately ` 50 lakh a year, for a period of 10 years. The residual value at the end of year 10 is forecast to be ` 50 lakh after tax. Government loan of ` 40 lakh out of total 90 lakh is also available. This will cost 2% below the company's normal cost of long term debt finance which is 8%.

CMC Ltd's financial gearing is 60% equity and 40% debt by market value and its equity beta is 0.85. The average equity beta in computer hardware industry is 1.2, and average gearing 50% debt and 50% equity by market value.

The risk free rate is 5.5% per annum and the market return is 12% per annum.
Issue costs are estimated to be 1 % for debt financing (excluding subsidized loan) and 4% for equity financing. The corporate tax is 30%.
(Issue costs are not tax deductable).

(a) Estimate the adjusted present value of the proposed investment.
(b) Explain the circumstances under which Adjusted Present Value (APV) might be a better method of evaluating a capital investment than Net Present Value (NPV).

Question 2 Dividend Policy

The Copper industry has been through a very trying period in the last five years and the constraints on operations have been removed in the early part of the year. The Company hopes to improve its position in the years to come and has plans to put up an additional plant in the neighborhood of the present factory. Increased profits due to expansion in capacity are expected to be 25% of the additional capital investment after meeting interest charges but before depreciation on the additional plant installed. Shares of this Copper Company are widely distributed and there is large majority of holdings in the hands of middle class investors whose average holding do not exceed 500 shares. The following data is also made available to you.

Last five years:

Particulars	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Earnings per shares (`)	6.00	5.00	4.50	4.50	4.00	17.50
Cash availability per share (Rs.)	7.50	6.00	5.00	4.00	4.00	20.00
Dividend/Share (`)	3.00	3.00	3.00	2.00	Nil	?
Payout ratio (%)	50.00	60.00	67.00	45.00	Nil	?
Average Market price (Face value ` 100)	80.00	70.00	70.00	70.00	60.00	140

P/E ratio	13.33:1	14:1	15.6:1	15.6:1	15	

Copper Company requires you to advise them with respect to the dividend policy they have to follow for the current year. What recommendations would you make? Give reasons for your answers.

Question no 3 DCF

A Company is setting up a project for 10 years at a cost of ` 300 lakh. It has to decide whether to locate the plant in Forward Area (FA) or Backward Area (BA). Locating in Backward Area means a cash subsidy of ` 15 lakh from the Central Government. Besides, the taxable profits to the extent of 20% are exempt for 10 years. The project involves a borrowing of ` 200 lakh in either case. The cost of borrowing will be 12% in forward area and 10% in backward area. However the revenue costs are bound to be higher in the backward area. The borrowings (principals) have to be repaid in 4 equal annual installment beginning from the end of 4^{lh} year.

With the help of following information and by using DCF Technique you are required to suggest the proper location for the project. The cost of owner's fund is 14% and tax rate is 50%. Assume straight-line depreciation with no residual value.

<u>Profit before depreciation and tax</u> (` lakh)

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Forward Area	(6)	34	54	74	108	142	156	230	330	430
Backward Area	(50)	(20)	10	20	45	100	155	190	230	330

Question No 4 Leveraged Buyout

Sun Ltd. is a successful publicly traded manufacturer of consumer durables. It acquired a smaller company Moon Ltd., manufacturing glassware. However, Moon Ltd. did not fit into its mould and suffered for a number of years. In the year 2012, a small group of disappointed executives of Moon Ltd. began to consider a leveraged buyout. Sun Ltd. was ready to consider the divestiture as it was never comfortable with Moon's product line. Moon Ltd. always had stable production costs and good contribution margins which consistently resulted in a strong and steady cash flow. Though, the production equipment was old it was in a good condition. Moon Ltd. was always managed well and had very little debt.

The following financial information for the year 2012 is available for Moon Ltd.:

Revenues = ` 80 lakhs
EBIT = ` 12 lakhs
Net Income = ` 7.2 lakhs

After negotiations the purchase price was settled for ` 30 lakhs. Because of the high replacement cost of its assets, its strong cash flow, and its relatively unencumbered balance sheet Moon Ltd. was able to take on large amount of debt that banks supplied nearly ` 20 lakhs of the senior debt at an interest rate of 13%. This was secured by finished goods inventory, plant and equipment and was amortized over a five year period. An insurance company also provided a loan of ` 6 lakhs in the form of subordinated debt. Finally the management of the company took an equity position of ` 5 lakhs. Assume tax rate is 36% and depreciation is calculated on a straight line basis over a period of 15 years.

Estimate the value of the firm after the Leveraged buyout.

Question No. 5 CAPM: Betas and Mergers

The following are the betas of three companies involved in a merger battle. The target firm is Goodyear Communications, and the competing bidders are KRBL and Century Enka:

Company	**Beta**	**Market Value of Equity**	**Debt**
Goodyear	1.05	`6,500 million	`817 million
KRBL	1.70	`2,000 million	`100 million
Century Enka	1.15	`7,500 million	`2,500 million

(Assume that all firms have a tax rate of 35 %.)

A. If KRBL acquires Goodyear, using a mix of debt and equity comparable to its current debt/equity ratio, what would the beta of the combined firm be?

B. If KRBL acquires Goodyear, using only debt, what would the beta of the comparable firm be?

C. If Century Enka acquires Goodyear, using a mix of debt and equity comparable to its current debt/equity ratio, what would the beta of the combined firm be?

D. If Century Enka acquires Goodyear, using only equity, what would the beta of the comparable firm be?

Topic 6. On Strategic Cost Management

Caselet 1:

In 1990 Chrysler Corporation found itself in a very unhappy financial situation. Profits were down, cash flow was tight, and the stock was trading at a low price of `10 per share. The Japanese auto industry posed a serious threat. Despite a strong Yen, they had captured and continued to preserve a healthy share of the U.S. auto market. Chrysler management decided it was time to change their approach to new car design. They adopted a competitive weapon that the Japanese auto industry had used for many years called target costing. Target costing was applied to all product development efforts in the Company including the NEON, a new small car developed for the lower price range. A price and profit target was set for the car and it was then designed to meet that profit without sacrificing major customer requirements. The results of using target costing on the NEON were impressive. The NEON:

• Provided dual airbags and a powerful engine for a small car.
• Was named" Auto of the Year" in 1994.
• Had a relatively short development time going from product concept to market in 31 months.
• Came in below its project development and investment budget.
• Is one of a handful of small cars made in India that makes a positive return.
• Is environmentally friendly built using a recyclable facia and non-toxic materials.

Since the introduction of target costing, Chrysler's profits have increased significantly. Its share price went up from `10 per share in 1990 to `54 per share in 1995.

Assume that you worked for Chrysler in 1990 and were assigned to the development team for the Neon project. This project was developed under the target costing approach rather than the traditional cost-plus approach. Answer the following questions regarding the development of the Neon car. Be creative, using your knowledge of cars in general, in answering the questions. You should provide car specific examples.

Required:

i) Identify the seven steps in the establishment phase of target costing. Provide specific examples of activities undertaken for each of the seven steps.

ii) Discuss how each of the three steps in attaining target costs might have applied to the Neon project. Also discuss how Chrysler could design costs out or reduce costs through design improvements.

iii) List some behavioral problems that may occur when target costing is used. Provide an example of how these problems may have impacted the Neon project.

Caselet 2:

DD is the India's premier public service broadcaster with more than 1,000 transmitters covering 90% of the country's population across on estimated 70 million homes. It has more than 20,000 employees managing its metro and regional channels. Recent years have seen growing competition from many private channels numbering more than 65, and the cable and satellite operators (C & S). The C & S network reaches nearly 30 million homes and is growing at a very fast rate.

DD's business model is based on selling half – hour slots of commercial time to the programme producers and charging them a minimum guarantee. For instance, the present tariff for the first 20 episodes of a programme Rs.30 lakhs plus the cost of production of the programme. In exchange the procedures get 780 seconds of commercial time that he can sell to advertisers and can generate revenue. Break-even point for procedures, at the present rates, thus is Rs.75,000 for a 10 second advertising spot. Beyond 20 episodes, the minimum guarantee is Rs.65 lakhs for which the procedures has to charge Rs.1,15,000 for a 10 second spot in order to break-even. It is at this point the advertisers face a problem – the competitive rates for a 10 second spot is Rs.50,000. Procedures are possessive about buying commercial time on DD. As a result the DD's projected growth of revenue is only commercial time on DD. As a result the DD's projected growth of revenue is only 6-10% as against 50-60% for the private sector channels. Software suppliers, advertisers and audiences are deserting DD owing to its unrealistic pricing policy. DD has options before it. First, it should privates, second it should remain purely public service broadcaster and third, a middle path.

The challenge seems to be exploit DD's immense potential and emerge as a formidable player in the mass media.

i. What is the best option, in your view, for DD?

ii. Analyse the SWOT factors the DD has.

iii. Why do you think that the proposed alternative is the best?

Caselet 3:

In 2006-07 PTC Food division decided to enter the fast growing (20-30% annually) snacks segment, an altogether new to it. It had only one national competitor-Trepsico's Trito. After a year its wafer snack brand-Ringo, fetched 20% market share across the country. Ringo's introduction was coincided with the cricket world cup. The wafer snacks market is estimated to be around Rs. 250 crores.

The company could take the advantage of its existing distribution network and also source potatoes from farmers easily. Before the PTC could enter the market a cross-functional team made a customer survey through a marketing research group in 14 cities of the country to know about the snacks eating habits of people. The result showed that the customers within the age-group of 15-24 years were the most promising for the product as they were quite enthusiastic about experimenting new snack taste. The company reported to its chefs and the chefs came out with 16 flavours with varying tastes suiting to the targetted age-group.

The company decided to target the youngsters as primary target on the assumption that once they are lured in, it was easier to reach the whole family.

Advertising in this category was extremely crowded. Every week two-three local products in new names were launched, sometimes with similar names. To break through this clutter the company decided to bank upon humour appeal.

The Industry sources reveal that PTC spent about Rs. 50 crores on advertisement and used all possible media-print and electronic, both including the creation of its own website, Ringoringoyoungo.com with offers of online games, contests etc. Mobile phone tone downloading was also planned which proved very effective among teenagers. The site was advertised on all dotcom networks. Em TV, Shine TV, Bee TV and other important channels were also used for its advertisement along with FM radio channels in about 60 cities with large hoardings at strategic places.

Analysts believes that Ringo's success story owes a lot to PTC's widespread distribution channels and aggressive advertisements. Humour appeal was a big success. The `Ringo' was made visible by painting the Railway bogies passing across the States. It has also been successful to induce Lovely Brothers' Future Group to replace Trito in their Big-Bazaar and chain of food Bazaars. PTC is paying 4% higher margin than Trepsico to Future group and other retailers.

Ringo to giving Trepsico a run for its money. Trito's share has already been reduced considerably. Retail tie-ups, regional flavours, regional humour appeals have helped PTC. But PTC still wants a bigger share in the market and in foreign markets also, if possible.

Answer the following questions:

a. What is SWOT Analysis?

b. What are the strength of PTC?

c. What are the weaknesses of PTC for entering into the branded snacks market?

d. What kind of marketing strategy was formulated and implemented for Ringo?

What else need to be done by Ringo so as to enlarge its market?

Caselet 4:

Unilever is one of the world's oldest multinational companies. Its origin goes back to the 19th century when a group of companies operating independently, produced soaps and margarine. In 1930, the companies merged to form Unilever that diversified into food products in 1940s. Through the next five decades, it emerged as a major fast-moving consumer goods (FMCG) multinational operating in several businesses. In 2004, the Unilever 2010 strategic plan was put into action with the mission to 'bring vitality to life' and 'to meet everyday needs for nutrition, hygiene and personal care with brands that help people feel good, look good and get more out of life'. The corporate strategy is of focusing on core businesses of food, home care and personal care. Unilever operates in more than 100 countries, has a turnover of €39.6 billion and net profit of €3.685 billion in 2006 and derives 41 per cent of its income from the developing and emerging economies around the world. It has 179,000 employees and is a culturally-diverse organization with its top management coming from 24 nations. Internationalisation is based on the principle of local roots with global scale aimed at becoming a 'multi-local multi-national'.

The genesis of Hindustan Unilever (HUL) in India, goes back to 1888 when Unilever exported Sunlight soap to India. Three Indian subsidiaries came into existence in the period 1931-1935 that merged to form Hindustan Lever in 1956. Mergers and acquisitions of Lipton (1972), Brooke Bond (1984), Ponds (1986), TOMCO (1993), Lakme (1998) and Modern foods (2002) have resulted in an organization that is a conglomerate of several businesses that have been continually restructured over the years.

HUL is one of the largest FMCG company in India with totao sales of Rs.12,295crore and net profit of 1855 crore in 2006. There are over 15000 employees, including more than 1300 managers. The present corporate strategy of HUL is to focus on core businesses. These core businesses are in home and personal care and food. There are 20 different consumer categories in these two businesses. For instance, home and personal care is made up of personal wash, laundry, skin care, hair, oral care, deodorants, colour cosmetics and ayurvedic personal and health care, while food businesses have tea, coffee, ice creams and processed food brand. Apart from the two product divisions, there are separate departments for specialty exports and new ventures.

Strategic management at HUL is the responsibility of the board of directors headed by a chairman. There are five independent and five whole-time directors. The operational management is looked after by a management committee comprising the Vice Chairman, CEO and managing director and executive directors of the two business divisions and functional areas. The divisions have a lot of autonomy with dedicated assets and resources. A divisional committee having the executive director and heads of functions of sales, commercial and manufacturing looks after the business level decision-making. The functional-level management is the responsibility of the functional head. For instance, a marketing manager has a team of brand managers looking after the individual brands. Besides the decentralized divisional structure, HUL has centralized some functions such as finance, human resource management, research, technology, information technology and corporate and legal affairs.

Unilever globally and HUL nationally, operate in the highly competitive FMCG products are finicky: it's difficult to create customers and much more difficult to retain them. Price is often the central concern in a consumer purchase decision requiring producers to be on continual guard against cost increases. Sales and distribution are critical functions organizationally. HUL operates in such a milieu. It has strong competitors such as the multinationals Proctor & Gamble, Nivea or L'Oreal and formidable local companies such as, Amul, Nirma or the Tata FMCG companies to contend with. Rivals have copied HUL's strategies and tactics, especially in the area of marketing and distribution. Its innovations such as new style packaging or distribution through women entrepreneurs are much valued but also copied relentlessly, hurting its competitive advantage.

HUL is identified closely with India. There is a ring of truth to its vision statement: 'to earn the love and respect of India by making a real difference to every Indian'. It has an impeccable record in corporate social responsibility. There is an element of nostalgia associated with brands like Lifebuoy (introduced in 1895) and Dalda (1937) for senior citizens in India. Consequently, Indians have always perceived HUL as an Indian company rather than a multinational. HUL has attempted to align its strategies in the past to the special needs of the

Indian Business environment. Be it marketing or human resource management, HUL has experimented with new ideas suited to the local context. For instance, HUL is known for its capabilities in rural marketing, effective distribution systems and human resource development. But this focus on India seems to be changing. This might indicate a change in the strategic posture as well as a recognition that Indian markets have matured to the extent that they can be dealt with by the global strategies of Unilever. At the corporate level, it could also be an attempt to leverage global scale while retaining local responsiveness to some extent.

In line, with the shift in corporate strategy, the locus of strategic decision-making seems to have moved from the subsidiary to the headquarters. Unilever has formulated a new global realignment under which it will develop brands and streamline product offerings across the world and the subsidiaries will sell the products. Other subtle indications of the shift of decision-making authority could be the appointment of a British CEO after nearly forty years during which there were Indian CEOs, the changed focus on a limited number of international brands rather than a large range of local brands developed over the years and the name-change from Hindustan Lever to Hindustan Unilever.

The shift in the strategic decision-making power from the subsidiary to the headquarters could however, prove to be double-edged sword. An example could be of HUL adopting Unilever's global strategy of focusing on a limited number of products, called the 30 power brands in 2002. That seemed a perfectly sensible strategic decision aimed at focusing managerial attention to a limited set of high-potential products. But one consequence of that was the HUL's strong position in the niche soap and detergent markets suffering owing to neglect and competitors were quick to take advantage of the opportunity. Then there are the statistics to deal with: HUL has nearly 80 percent of sales and 85 per cent of net profits from the home and personal care businesses. Globally, Unilever derives half its revenues from food business. HUL does not have a strong position in the food business in India though the food processing industry remains quite attractive both in terms of local consumption as well as export markets. HUL's own strategy of offering low price, competitive products may also suffer at the cost of Unilever's emphasis on premium priced, high end products sold through modern retail outlets.

There are some dark clouds on the horizon. HUL's latest financials are not satisfactory. Net profit is down, sales are sluggish, input costs have been rising and new food products introduced in the market have yet to pick up. All this while, in one market segment after another, a competitor pushes ahead. In a company of such a big size and over powering presence, these might still be minor events or developments in a long history that needs to be taken in stride. But, pessimistically, they could also be pointers to what may come.

QUESTIONS

1. **State the strategy of Hindustan Unilever in your own words.**
2. **At what different levels is strategy formulated at HUL?**
3. **Comment on the strategic decision-making at HUL.**
4. **Give your opinion on whether the shift in strategic decision-making from India to Unilever's headquarters could prove to be advantageous to HUL or not.**

Topic 7. On Corporate Financial Reporting

Caselet – 1

ABC Ltd. as business of bottling and supplying mineral water. It supplies the bottles in cartons of different sizes. Cartons of 250 ml. bottles, cartons of 500ml bottles, cartons of 1 lt. bottles, cartons of 2 lt. bottles and cartons of 5 lt. bottles. It supplies the cartons to the hotels within West Bengal, Bihar, Orissa and other eastern states of India.

During 2012-13 ABC Ltd. supplied cartons valuing `690 lakhs on credit and estimated that there will be bad debt of `41.40 lakhs which is 6% of credit sales. It made a provision accordingly after analyzing the credit worthiness of the customers. ABC Ltd. had always maintained a provision of 2% to 3% of credit sales in past years.

Discuss whether the company has prepared the financial statement in compliance with accounting standards.

Caselet – 2

Mayukh Ltd. wanted to buy 30% equity shares of Omkar Ltd. with an intention to establish an associate relationship between the two on 01.04.2012 Mayukh Ltd. purchased such percentage of equity shares at a cost of `15 Lakhs. On that date the balance sheet of Omkar Ltd. Was as under:

Name of the Company: Omkar Ltd.

Balance Sheet as at: 31st March, 2012 (` in lakh)

Ref No.		Particulars	Note No.	As at 1st April, 2012	As at 1st April, 2011
	I	**EQUITY AND LIABILITIES**			
	1	Shareholder's Fund			
		(a) Share capital	1	30.00	
		(b) Reserves and surplus	2	9.00	
		(c) Money received against share warrants			
	2	**Share application money pending allotment**			

	3	**Non-current liabilities**			
		(a) Long-term borrowings			
		(b)Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	**Current Liabilities**			
		(a) Short-term borrowings			
		(b) Trade payables	3	3.00	
		(c) Other current liabilities	4	1.00	
		(d) Short-term provisions			
		Total (1+2+3+4)		**43.00**	
	II	**ASSETS**			
	1	Non-current assets			
		(a) Fixed assets			
		) Tangible assets	5	36.00	
		i) Intangible assets			
		ii) Capital work-in-progress			
		v) Intangible assets under development			
		(b)Non-current investments			
		(c) Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets			
	2	**Current assets**			
		(a) Current investments			
		(b) Inventories	6	3.00	
		(c) Trade receivables	7	3.00	
		(d) Cash and cash equivalents	8	1.00	
		(e)Short-term loans and advances			
		(f) Other current assets			
		Total (1+2)		**43.00**	

(` in lakh)

Note 1. Share Capital	**As at 1st**	**As at 1st**

	April, 2012	April, 2011
Authorized, Issued, Subscribed and paid-up Share capital:		
30,000 Equity share of ` 100 each	30.00	
Total	30.00	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	**As at 1st April, 2012**		**As at 1st April, 2011**	
	Nos.	**Amount (`)**	**Nos.**	**Amount (`)**
Opening Balance as on 01.04.12	30,000	30.00		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)	----	----		
	30,000	30.00		
Less: Buy Back of share	---	---		
Total	30,000	30.00		

Note 2. Reserve & Surplus	**As at 1st April, 2012**	**As at 1st April, 2011**
Reserves & Surplus	9.00	
Total	9.00	

Note 3. Trade Payables	**As at 1st April, 2012**	**As at 1st April, 2011**
Sundry Creditors	3.00	
Total	3.00	

Note 4. Other Current Liabilities	**As at 1st April, 2012**	**As at 1st April, 2011**
Bank Overdraft	1.00	
Total	1.00	

Note 5. Tangible Assets	**As at 1st April, 2012**	**As at 1st April, 2011**

Tangible Assets	36.00	
Total	36.00	

Note 6. Inventories	**As at 1st April, 2012**	**As at 1st April, 2011**
Stock in trade	3.00	
Total	3.00	

Note 7. Trade Receivables	**As at 1st April, 2012**	**As at 1st April, 2011**
Sundry debtors	3.00	
Total	3.00	

Note 8. Cash and cash equivalents	**As at 1st April, 2012**	**As at 1st April, 2011**
Balance at Bank	1.00	
Total	1.00	

During the year 2012-13 Omkar Ltd. earned a profit of `15 lakhs and on 2013 – 14 it suffered a loss of `90 lakhs. Mayukh Ltd. did not have any subsidiary during 2012-13 but on 01.04.2013 it purchase 60% equity shares of Umang Ltd. for `160 lakhs.
Discuss the impact of the associate relationship on the Balance sheet of 2012-13 & 2013 -14 of Mayukh Ltd.

Caselet - 3
Tufan Motors manufactures motor bikes and scooties and sell them through its own outlets, showrooms and also no consignment basis. It has inventories of parties other required items and finished products. Inventories of Tufan Motors includes the value of such items that are required to manufacture a particular model but the items were removed from the production line about eight years back at the cost price.
Evaluate the impact of the above incidence.

Caselet - 4
Mithi Mint Masala a Pan Masala has a very good market. Another Pan Masala entered the market 3 years back. It includes some other ingredients that had attracted the market more. That is why Mithi Mint Masala is suffering from heavy losses. It was incurring losses since last 3 years. As it could not withstand the competition in the market. In the mean time the state in which the registered office is situated had moved a bill in the State Assembly to ban manufacture and sale of all kinds of Pan Masalas within the state Mithi Mint Masala has its

major sales in t5hat states only. At the time of finalizing the accounts for the year ended 31.03.2012, the CFO of Mithi Mint Masala created a Deferred Tax Asset for the tax benefits that would arise in future year as a result of earlier years unabsorbed losses in income tax. Evaluate the appropriateness of account.

Caselet - 5

Following are the Balance Sheet of Lata Ltd. and Asha Lts on 31st March 2013:

Name of the Company: Lata Ltd. and Asha Ltd.

Balance Sheet as at: 31st March, 2013

(Amount in `)

Ref No.		Particulars	Note No.	Lata Ltd		Asha Ltd	
				As at 31st March, 2013	As at 31st March, 2012	As at 31st March, 2013	As at 31st March, 2012
	I	**EQUITY AND LIABILITIES**					
	1	Shareholder's Fund					
		(a) Share capital	1	54,00,000		18,00,000	
		(b) Reserves and surplus	2	13,60,800		3,96,000	
		(c)Money received against share warrants					
	2	**Share application money pending allotment**					
	3	**Non-current liabilities**					
		(a) Long-term borrowings	3			10,80,000	
		(b)Deferred tax liabilities (Net)					
		(c) Other Long term liabilities					
		(d) Long-term provisions					
	4	**Current Liabilities**					
		(a) Short-term borrowings					
		(b) Trade payables	4	6,00,000		3,00,000	
		(c)Other current liabilities		1,20,000		24,000	
		(d) Short-term provisions					

		Total (1+2+3+4)		**74,80,800**		**36,00,000**	
	II	**ASSETS**					
	1	Non-current assets					
		a) Fixed assets					
		(i) Tangible assets	6	36,00,000		1,80,000	
		(ii) Intangible assets					
		(iii) Capital work-in-progress					
		(iv) Intangible assets under development					
		b) Non-current investments	7	5,40,000		18,00,000	
		c) Deferred tax assets (Net)					
		(d) Long-term loans and advances					
		(e) Other non-current assets					
	2	**Current assets**					
		a) Current investments					
		(b) Inventories	8	17,28,000		7,56,000	
		(c) Trade receivables	9	10,44,000		5,40,000	
		(d) Cash and cash equivalents	10	5,68,800		3,24,000	
		e) Short-term loans and advances					
		(f) Other current assets					
		Total (1+2)		**74,80,800**		**36,00,000**	

(Amount in `)

	Lata Ltd		**Asha Ltd**	
Note 1. Share Capital	**As at 31st March, 2013**	**As at 31st March, 2012**	**As at 31st March,2013**	**As at 31st March, 2012**
Authorized, Issued, Subscribed and				

paid-up Share capital:				
Equity share of ` 100 each	54,00,000		18,00,000	
Total	54,00,000		18,00,000	

RECONCILIATION OF SHARE CAPITAL

	Lata Ltd				**Asha Ltd**			
FOR EQUITY SHARE	**As at 31st March, 2013**		**As at 31st March, 2012**		**As at 31st March, 2013**		**As at 31st March, 2012**	
	Nos.	**Amount (`)**	**Nos.**	**Amount (`)**	**Nos.**	**Amount (`)**	**Nos.**	**Amount (`)**
Opening Balance as on 01.04.12	54,000	54,00,000			18,000	18,00,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)								
	54,000	54,00,000			18,000	18,00,000		
Less: Buy Back of share								
Total	54,000	54,00,000			18,000	18,00,000		

	Lata Ltd		**Asha Ltd**	
Note 2. Reserve & Surplus	**As at 31st March, 2013**	**As at 31st March, 2012**	**As at 31st March, 2013**	**As at 31st March, 2012**
General Reserve	4,80,000		3,60,000	
Profit & Loss Account	8,80,800		36,000	
Total	13,60,800		3,96,000	

	Lata Ltd	**Asha Ltd**

Note 3. Long-term Borrowings	As at 31st March, 2013	As at 31st March, 2012	As at 31st March, 2013	As at 31st March, 2012
14% Debenture			10,80,000	
Total			10,80,000	

	Lata Ltd		Asha Ltd	
Note 4. Trade Payables	**As at 31st March,2013**	**As at 31st March,2012**	**As at 31st March,2013**	**As at 31st March,2012**
Sundry Creditors	6,00,000		3,00,000	
Total	6,00,000		3,00,000	

	Lata Ltd		Asha Ltd	
Note 5. Other Current Liabilities	**As at 31st March, 2013**	**As at 31st March, 2012**	**As at 31st March, 2013**	**As at 31st March, 2012**
Other Current Liabilities	1,20,000		24,000	
Total	1,20,000		24,000	

	Lata Ltd		Asha Ltd	
Note 6. Tangible Assets	**As at 31st March, 2013**	**As at 31st March, 2012**	**As at 31st March, 2013**	**As at 31st March, 2012**
Tangible Assets	36,00,000		1,80,000	
Total	36,00,000		1,80,000	

	Lata Ltd	Asha Ltd

Note 7. Non-current Investment	As at 31st March, 2013	As at 31st March, 2012	As at 31st March, 2013	As at 31st March, 2012
3,000 Shares of Asha Ltd.	5,40,000		---	
9,000 Shares of Lata Ltd.	---		18,00,000	
Total	5,40,000		18,00,000	

	Lata Ltd		Asha Ltd	
Note 8. Inventories	**As at 31st March, 2013**	**As at 31st March, 2012**	**As at 31st March, 2013**	**As at 31st March, 2012**
Stock	17,28,000		7,56,000	
Total	17,28,000		7,56,000	

	Lata Ltd		Asha Ltd	
Note 9. Trade Receivables	**As at 31st March, 2013**	**As at 31st March, 2012**	**As at 31st March, 2013**	**As at 31st March, 2012**
Sundry Debtors	10,44,000		5,40,000	
Total	10,44,000		5,40,000	

	Lata Ltd		Asha Ltd	
Note 10. Cash and Cash Equivalents	**As at 31st March, 2013**	**As at 31st March, 2012**	**As at 31st March, 2013**	**As at 31st March, 2012**
Bank Balances	5,68,800		3,24,000	
Total	5,68,800		3,24,000	

Stock of Lata Ltd. includes goods worth `3,60,000 purchased from Asha Ltd., which made a profit of 20% on selling price. As on 31,03,2013, Lata Ltd. owes to Asha Ltd. `1,44,000. Lata Ltd., absorbs Asha Ltd. on the basis of the intrinsic value of the shares of both companies as on 31st March,2013. Before absorption Lata Ltd. has declared a dividend of 12%. Dividend tax is 10%.