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Answer Paper	
Strategic Financial Management	**Duration**: 60
Details: Test – 5	**Marks**: 30

Instructions:

- All the questions are compulsory
- Properly mention test number and page number on your answer sheet, Try to upload sheets in arranged manner.
- In case of multiple choice questions, mention option number only Working notes are compulsory wherever required in support of your solution
- Do not copy any solution from any material. Attempt as much as you know to fairly judge your performance.

SOL 1 -

i. Computation of Business Value

			(Rs. Lakhs)
Profit before tax $\frac{100.32}{1-0.34}$			152
Less: Extraordinary income			(14)
Add: Extraordinary losses			5
Profit from new product			143
		(Rs. Lakhs)	
Sales		70	
Less: Material costs	20		
Labour costs	16		
Fixed costs	10		
		(46)	24
			167.00
Less: Taxes @34%			56.78
Future Maintainable Profit after taxes			110.22
Relevant Capitalisation Factor			0.12
Value of Business (Rs.110.22/0.12)			**918.50**

ii. Determination of Market Price of Equity Share

Future maintainable profits (After Tax)	Rs.1,10,22,000
Less: Preference share dividends 80,000 shares of Rs.100 @9%	Rs.7,20,000
Earnings available for Equity Shareholders	Rs. 1,03,02,000
No. of Equity Shares	50,00,000
Earnings per share=$\frac{Rs.1,03,02,000}{50,00,000}$	Rs.2.06
PE ratio	6
Market price per share	Rs.12.36

SOL 2-

Stage I + Stage II = Explict forecast period (1st 10 years)

$$E_0 = 32$$

i.

Yrs	Growth Rate of EPS	EPS	Payout Ratio	DPS	β	R_e	PV
1	25%	40	20%	8	1.4	25.4%	6.38
2	25%	50	20%	10	1.4	25.4%	6.36
3	25%	62.5	20%	12.5	1.4	25.4%	6.34
4	25%	78.13	20%	15.63	1.4	25.4%	6.32

5	25%	97.66	20%	19.53	1.4	25.4%	6.30
6	22%	119.14	28%	33.36	1.32	17.88%	9.13
7	19%	141.78	36%	51.04	1.24	17.16%	11.92
8	16%	164.46	44%	72.36	1.16	16.44%	14.52
9	13%	185.84	52%	96.64	1.08	15.72%	16.76
10	10%	204.43	60%	122.66	1	15%	18.49
							102.5

Stage 3

Horizon Period (Beyond 10 yrs)

D_{11} 122.66 x 1.1= 134.93

$P_{10} = \frac{D_{11}}{R_e - g} = \frac{134.93}{0.15-0.10} = 2698.6$

PV of $P_{10} = P_{10} \times \frac{18.49}{122.66}$

$= 2698.6 \times \frac{18.49}{122.66} = 406.79$

Share price today = 406.79 +102.5 = 509.29

ii. P/E ratio of TIL = $\frac{\text{Price}}{EPS} = \frac{509.29}{32} = 15.92.$

This is significantly less than P/E ratio of top 5 firms in the industry. So, TIL is relatively underpriced - Mr. Jain is advised to buy the stock.

SOL 3

Estimation of Ratio

SI No.	Particulars	SK Ltd.	AS Ltd.	Average
(i)	Market to book value	$\left(\frac{450}{400}\right)$=1.125	$\left(\frac{400}{300}\right)$=1.333	1.2290
(ii)	Market to Replacement cost	$\left(\frac{450}{600}\right)$=0.750	$\left(\frac{400}{550}\right)$=0.727	0.7385
(iii)	Market to sales	$\left(\frac{450}{550}\right)$=0.818	$\left(\frac{400}{450}\right)$=0.889	0.8535
(iv)	Market to Net Income	$\left(\frac{450}{18}\right)$=25	$\left(\frac{400}{16}\right)$=25	25

Application of ratios to XY Ltd.

SI No.	Particulars	XY Ltd.	Average	Indicative Value of XY Ltd. (Rs.)
(i)	Book value	250	1.2290	250×1.2290=307.25
(ii)	Replacement cost	500	0.7385	500×0.7385=369.25
(iii)	Sales	500	0.8535	500×0.8535=426.75
(iv)	Net Income	14	25	14× 25=350.00
	Average			Rs.363.31

Value of XY Ltd. according to the comparable method is Rs. 363.31

SOL 4 –

As per TK Ltd.'s Offer

	Rs. In Lakhs
(i) Net consideration Payable	
7 times EBIDAT, i.e $7\times$ Rs. 230 lakh	1610
Less: Debt	480
	1130
(ii) No. of shares to be issued by TK Ltd.	
Rs. 1130 lakh/ Rs. 220 (rounded off) (Nos.)	5,13,600
(iii) EPS of TK Ltd. after acquisition	
Total EBIDT (Rs.800 lakh + Rs.230 lakh)	1030.00
Less: Interest (Rs.116 lakh+ Rs.60 lakh)	176.00
	854.00
Less:30% Tax	256.20
Total earnings (NPAT)	597.80
Total No. of shares outstanding	29,13,600
(24 lakh+5,13,600)	
EPS (Rs.597.80 lakh/29,13,600	Rs.20.52

(iv) Expected Market price:

Pre-acquisition P/E multiple:	
EBIDAT	800.00
Less: Interest ($1160\times\frac{10}{100}$)	116.00
	684.00
Less:30% Tax	205.20
	478.80
No. of shares (lakhs)	24
EPS	Rs.19.95
Hence, PE multiple (220/19.95)	11.03
Expected market price after acquisition (Rs.20.52× 11.03)	Rs.226.34

As per TK Ltd.'s Offer

	Rs. In Lakhs
(i) Net consideration Payable	
12 Lakhs shares$\times$ Rs. 10	1320
(ii) No. of shares to be issued by TK Ltd.	
Rs.1320 lakhs$\div$ Rs. 220	6 lakh

(iii) EPS of TK Ltd. after acquisition	
NPAT (as per earlier calculations)	597.80
Total no. of shares outstanding (24lakhs+6 lakhs)	3 lakh
Earnings Per share (EPS) Rs. 597.8/30 lakh	Rs. 19.93
(iv) Expected Market price (Rs. 19.93$\times$ 11)	219.23

(v) Advantages of Acquisition to TK Ltd.

Since the two companies are in the same industry, the following advantages could accrue:

- Synergy, cost reduction and operating efficiency.
- Better market share.
- Avoidance of competition.

<u>SOL 5 –</u>

Cost of Acquisition:

Proposed Payments :		
Dissolution Expenses	0.50	
Current Liabilities	25.00	
10.50% debentures	44.00	
11% Convertible Preference Shares	100.00	

Equity Shares	250.00	419.50
Less :		
Sales proceeds from		
Investments	150.00	
Debtors	15.00	
Inventories	*9.75*	
	174.75	
Cash and Bank Balance	4.25	179.00
Net cost of Acquisition		240.50

The present value of operating cash flows after tax (Crores) @16%, using the discount factors given would be:

= 70 x 0.8621 + 75 x 0.7432 + 85 x 0.6407 + 90 x 0.5523 + 100 x 0.4761 + 125 x 0.4104 + 140 x 0.3538 + 50 x 0.3538 = Rs 386.69 Crores

Since the present value of the future cash flows is more than the cost of acquisition, it will be a profitable proposition to take over the said company, BMCL.