

CA-Final AFM Test 2

Topics Covered: Business Valuation and Mergers

Max Marks: 40

Time: 1 Hour

Question 1(6 Marks): T plc wants to acquire L plc. The balance sheet of L plc as on 31st March 2022 is as follows:

Liabilities	£	Assets	£
Equity Capital (35,00,000 shares)	35,00,000	Cash	2,50,000
Retained earnings	15,00,000	Debtors	3,50,000
12% Debentures	15,00,000	Inventories	10,00,000
Creditors and other liabilities	16,00,000	Plants & Eqpt.	65,00,000
	81,00,000		81,00,000

Additional Information:

(i) Shareholders of L plc will get one share in T plc for every two shares. External liabilities are expected to be settled at £ 2.50 Million. Shares of T plc would be issued at its current price of £ 1.50 per share. Debenture holders will get 13% convertible debentures in the purchasing company for the same amount. Debtors and inventories are expected to realize £ 1 Million.

(ii) T plc has decided to operate the business of L plc as a separate division. The division is likely to give cash flows (after tax) to the extent of £ 2.50 Million per year for 6 years. T plc has planned that, after 6 years, this division would be demerged and disposed of for £ 1 Million.

(iii) The company's cost of capital is 16%.

Advise the Board of the company about the financial feasibility of this acquisition.

Net present values for 16% for £ 1 are as follows:

Years	1	2	3	4	5	6
PV	0.862	0.743	0.641	0.552	0.476	0.410

Question 2(6 Marks): There is a privately held company X Pvt. Ltd that is operating into the retail space, and is now scouting for angel investors. The unleveraged beta based on the industry in which it operates is 1.8, and the average debt to equity ratio of X Pvt. Ltd. is hovering at 40:60. The rate of return provided by risk free GOI Bonds is 5%. The rate of market return for the industry is 11%. The FCFs for the next 3 years are as follows:

	Year 1	Year 2	Year 3
Free Cash Flows (Rs Crore)	10	12	15

The pre-tax cost of debt is 12%. Assume a tax regime of 30%.

Determine the potential value to be placed for X Pvt. Ltd, based on above-mentioned FCFs.

Note: Use PVF and round off calculations upto 3 decimal points.

Question 3(8 Marks): Eon Ltd. reported a profit of Rs 120 lakhs after 20% tax for the financial year 2019-20. An analysis of the accounts revealed that the income included extraordinary items of Rs 5 lakhs and an extraordinary loss of Rs 15 lakhs. The existing operations, except for the extraordinary items, are expected to continue in the future. In addition, the results of the launch of a new product are expected to be as follows:

	Rs In lakhs
Sales	100
Material costs	10

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Labour costs	20
Fixed costs	20

You are required to:

- (i) CALCULATE the value of the business, given that the capitalization rate is 10%.
- (ii) DETERMINE the market price per equity share, with Eon Ltd.'s share capital being comprised of 1,00,000 13% preference shares of Rs 100 each and 50,00,000 equity shares of Rs 10 each and the P/E ratio being 10 times.

Question 4(10 Marks): The following information is provided relating to the acquiring company Efficient Ltd. and the target company Healthy Ltd.:

Particulars	Efficient Ltd.	Healthy Ltd.
No. of Shares (FV Rs 10 each)	20 Lakhs	15 Lakhs
Market Capitalization	Rs 800 Lakhs	Rs 1,200 Lakhs
P/E Ratio (times)	10	5
Reserves and Surplus	Rs 400 Lakhs	Rs 273 Lakhs
Promoter's Holding (No. of shares)	8.65 Lakhs	9 Lakhs

Board of Directors of both the companies have decided to give a fair deal to the shareholders and accordingly for swap ratio the weights are decided as 45%, 20% and 35% respectively for Earning, Book Value and Market Price of share of each company.

Required:

- (i) Calculate the swap ratio and also calculate Promoter's holding % after acquisition.
- (ii) What is the EPS of Efficient Ltd. after acquisition of Healthy Ltd.?
- (iii) What is the expected market price per share and market capitalization of Efficient Ltd. after acquisition, assuming P/E ratio of Efficient Ltd. remains unchanged?
- (iv) Calculate free float market capitalization of the merged firm.

Question 5(10 Marks): M/s KPMS Ltd. wants to purchase M/s. BRB Ltd., by exchanging 0.7 of its share for each share of M/s BRB Ltd., relevant financial data are as follows:

	M/s KPMS Ltd.	M/s BRB Ltd.
Equity shares outstanding	20,00,000	8,00,000
EPS (Rs)	40	28
Market price per Share (Rs)	250	160

- (i) Illustrate the impact of merger on EPS of both companies
- (ii) The management of M/s. BRB Ltd., has quoted share exchange ratio of 1:1 for the merger. Assuming that P/E ratio of M/s. KPMS Ltd. will remain unchanged after the merger, what will be gain from merger for M/s. BRB Ltd.?
- (iii) Find out the gain/loss to the shareholders of M/s. KPMS Ltd. if the exchange ratio is 1:1?
- (iv) Determine the maximum exchange ratio acceptable to shareholders of M/s/ KPMS Ltd.