Group - IV ①

Business Valuation Management
Test paper - IV/18/BVM/2008/T-2

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8-6 1) TOTAL VALUE OF FIRM A & B After Acquisition

Value of firm A	750,00,000
Value of Firm B	150,00,000
TOTAL Value of Firm AB	900,00,000
+ present value of given synergy	150,00,000
	10,50,00,000

The cost of acquiring B
i.e cost of A = Benefit to shareholder of B

No of share given to share of B	= 250000	($\frac{250000}{1250000} = \frac{1}{5}$ share)
(+) original share of A	10,00,000	
	12,50,000	

Total value of Merge firm = 1050 150,00,000

Share given to B = $\frac{1}{5}$ × 105000000 = 2,10,00,000

Less - Net worth prior to Merger of B = 150,00,000

TRUE cost of Merger. 60,00,000

2

ii Net present value of Merger to firm B

TOTAL gain from Merger	150,00,000
Less - True cost of firm A	60,00,000
	90,00,000

(2)

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Q 3 a. What are the takeover defenses available for the target company-

The term takeover refers to the attempt, and often sprung as a surprise, one of firm acquire ownership or control over another firm against the wishes of the latters management and perhaps some of its stockholders.

Takeover defenses also reffered to as anti-takeover defense comprise of the following strategies.

Operating performance
Financial Techniques.
Restructuring & financial engineering
Anti take over charter Amendments.
Other board or management methods
post acquisition bid techniques.

Takeover Methods
a. proxy contest
b. Acquisition
c. Leveraged Buyout
d. Management Buyout
e. Merger.
f. Tender offers

Balancescore card

The balance score-card (BSC), developed by Prof. Robert Kaplan of Harvard Business School is an Organisational framework for implementing & managing strategy at all level of enterprises by linking activities

The BSC translates a business vision & strategy into objective and measured across four balanced perspectives Financial performance, customers, Internal business process & organisational growth learning & Innovation

A BSC. is structured way of communicating measurements and targets and is becoming and becoming a widespread way & cor of how to manage, measures & communicate the financial & non-financial and intangible assets of a company. The BSC allows an organization to monitor both its current performance & its efforts to improve processes, motivate & educate employees and enhance its ability to learn and improve.

Q1.

(a) i Value is defined as.

a) The worth, desirability or utility of thing or the qualities on which this depend
b) worth estimated
c) The amount for which a thing can be exchanged in market
d) purchasing power.
e) establi estimate the value of appraise

Value is different from cost & price.

Cost is defined as resources sacrificed to produce & obtain a things

price is what is charged by seller or provider of product or service, many a time it is function of market force.

Oscar wilde said, " A cynic is one who knows the price of everything and value of nothing.'

Value have value as they guide a person through life and provide the moorings and anchorages in the sea of life.

Value Drivers

In business valuation, It is Important to understand the value creation process in a Company and this warrants an understanding of the hundreds of value-drivers and their effect on the company's future cash flow

value drivers include financial value driver such as operating margins return on investment or invested capital

6

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Q→3 | 6

Reorder level.
= Maximum usage x minimum lead time.
= 140 x3
= 4200 units

Minimum level.

Reorder level - Avg usage for Avg lead time.

4200 - (110x27.5)

= 1175 units

Maximum level.

Reorder level + 5000 (minimum. usage. x Minimum lead time)

= 4200 + 5000 - (50x25) = 9200 - 1250 = 7950 units

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and operational non financial value drivers. While Financial drivers are generic, Operational value drivers differ from company to company and from Industry to Industry

According to David Frykman & Jakob Tolleryd the key value drivers can be divided into three distinct areas.

1. The companies Internal resources & its intellectual capital
   (Such as Brand strength, innovation power management and board invitation and past performance. person independent knowledge)

2. The company's external environment and its Industry structure (Sector growth, relative market share & barriers to entry)

3. The company's strategy the way the company chooses to exploit the key value drivers)

Relative valuation

Relative valuation approach is based on the premise that value of any asset can be estimated by analysing how the market prices 'similar' or 'comparable' Assets. The Basic Belief here is that it is impossible or extremly difficult to estimate the intrinsic value of Assets and therefore the value of an asset is whatever the Market is willing to pay for it

Most valuation is the stock Market are relative valuations.

+ 8

The following data relating to the US Market are quite revealing.

a. Almost 85% of equity research are based upon a multiple and comparable.

b. More than 50% of allocation acquisition valuation are based upon multiples.

c. Rules of thumbs based on multiples are not only common but are often the basis for final valuation judgement.

Application of Relative valuation

a. There will always be a significant proportion of securities that are under and over valued.

b. Relative valuation is more suited to the needs to portfolio managers as they are most often Judge Based upon how they perform on a comparable or relative basis to many and other fund / mony managers.

c. Relative valuation generally requires less informat than DCF valuation.

Advantage of Relative Valuation

a) as already mentioned, Relative valuation is much more likely to reflect market perceptions & mood than DCF valuation.

b) Relative valuation generally requires less information than DCF valuation.

Q.8. Write in brief

(C) Efficient Market Hypothesis.

The efficient Market Hypothesis [EMH] has been the central proposition of finance for nearly thirty years. In his classic statement hypothesis Fama 1970 defined an efficient financial market as one in which securities prices always fully reflect the available resources information

The EMH then states that real-world financial market such as the stock market are actually efficient according to this definition. The EMH rules out the possibility of trading systems based only on currently available information that have expected profits or returns in excess of equilibrium expected profit on return (Fama 1970).

In other words an average investor - whether an individual, a pension fund or a mutual fund cannot hope to consistently beat the market and the vast resources that such investor dedicate to analyzing, picking, a trading securities are wasted Better, a passively hold the market portfolio & to forget active money management altogether. If the EMH holds the market truly knows best.

The basic theoretical case for the EMH rests on three arguments which rely on progressively weaker assumptions.

1) Investor are assumed to be rational and hence to value security rationally
2) To the extent that some investors are not rational, their trades are random & therefore cancel each other out without affecting prices

3 To the extent that investors are ~~xxx~~ + irrational in similar ways they are met in the market by rational arbitrageurs who eliminate their influence on prices (6)

When investors are rational, they value each security for its fundamental values :-

The net present value of future cash flow discounted using their risk characteristics when investors learn something about fundamental value of securities they quickly respond to the new information by bidding up prices when the news is good + binding them down when the news is bad. As a consequence, security prices incorporate all the available information almost immediately and prices adjust to new levels corresponding to new net present value of cash flows.

Q-8
(b) Human Resource Accounting

Meaning.

human resource management activities include attraction, selection, retention, development & utilization

In the past these activities were evaluated in behavioral & statistical terms. Behavioral measures were the reaction various groups of what individual have learned or of how their behaviors have changed on the job, Statistical Measures were ratios, percentages measures of central tendency and variability and measures of correlation.

Today because of rising costs there is need to evaluate HR management activities in economic terms. This requires gathering information from Accounting finance. Economic & behavioral science.

Definition

An American Accounting Association committee on Human Resource Accounting (1973) has defined Human Resource Accounting as

"The process of identifying and measuring data about human resources & communicating this information to interested parties"

Benefit of HRA

According to Likert (1971) HRA serves the following purposes in an organization

a) It furnishes cost/volume information for making management decision about acquiring, allocating developing, & maintaing human resources in order to attain cost-effectiveness

b) It allows management personnel to monitor effectively the uses of human resource

c) It provides a sound & effective basis of human asset control, that is, whether the asset is appreciated depleted or conserved.

d It helps in the development of management principles by classifying the financial consequences of various practices

e Basically HRA is management tool which is designed to assist senior management understanding the long term cost and benefit implications of their HR decision so that better business decision can be taken

f) HRA also provides the HR professionals & management with information for managing the human resources efficiently & effectively

g . It facilitate internal decision making process

HRA Measurement

Two Main approaches employed in HRA
(1) The cost Approach
(2) The economic value Approach

Q5

The skandia Navigator

The worlds first intellectual capital Report was prepared by the swedish financial services firm Skandia's 1994 IC report visualising intellectual capital represented a coherent first attempt to report the value intellectual capital in an organization.

The Skandia "Navigator" is the best known business model developed to identify the intangible Asset that are key to company performance.

The Navigator is designed to provide a balanced picture of the financial and intellectual capital. It incorporate measures in categories similar to those of the balance Scorecard.

The focus on financial results, capital and monetory flows is complemented by a discription of intellectual capital and its development.

The Navigator framework as expected, has it its top end a series of measures relating to the financial focus. But it also has "below the line" measures of intellectual capital These involve four areas and two dimensions. The four areas are.

Customer Focus - which quantifies how the organization is to look to its customer.

process focus - which quantifies what is being done to renewal and develop the intellectual assets base.

~~Human focus~~ -
Renewal & Development focus - which quantifies what is being done to renewal & develop the intellectual asset base

Human focus - The "virtual" binding force of customer process, renewal & development & finance.

The Navigator incorporates a total about 30 key Indicator in the various areas. which are monitored internally on yearly Basis

The skandia Navigator is used to identify, the important areas of know-how in the organization which developed need to be developed & shared.

(c) Intangible Asset Scoresheet:

From 1840's to early 1990s, a corporate value was mainly driven by its intangible Assets - values provided in corporate balancesheet.

The management of companies valued those resources and linked all their performance goals and matrices to those assets -

Return on Investment

- capital turnover Ratio etc.

A knowledge Intensive companies leverages know-how, innovation & reputation to achieve success in market place. Hence these attributable should be measured & improved upon year after year to ensure continued success.

Managing a knowledge organization necessitates a focus on the critical issues of organizational adoption, survival & competence in the face of ever increasing discountinue environ changes. The profitability of knowledge depends on its ability to leverages the learnability of its professional and to enhance the reusability of their knowledge & expertise. The Intangible assets of a company includs its brand its ability to attract and remain marquechi

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(C) ~~Intangible asset scoresheet.~~

~~From~~ 1840's ~~to early~~

(13) performance prism.

The performance prism is a second generation performance measurement and ~~management~~ management approach developed by cranfield school of management in collaboration with consultancy Accenture, It recognises the importance of companies taking a holistic approach to stakeholder management in today's climate of involvement its advantages are that it addresses all stakeholders not only investors but customers and intermediaries employees, suppliers, regulators and communities. It does in two ways: by considering the requirements of those stakeholders and uniquely, what the organizations wants & needs from its stakeholder is examined. The performance prism address the strategies, process and importantly the capabilities that are needed to satisfy those two critical sets of wants and needs

The flexibility of the performance prism allows is to be applied to any organization a organizational component. The focus on intangible performance interrelate. It explicitly acknowledge that all five facets of the ~~prism~~ performance prism should be covered in so-called success map.

This way, it avoids the often-criticised narrowness of the balance scorecard.

Q-37 (a) Discuss in details the various multiples used in relative valuation method.

Sl No	Valuation multiple.	Description	Pros	Cons
1)	Net asset value.	Non current Asset + current Assets - current liabilities - preformance shares	Easy to complete. useful for companion easily valued Fixed Assets	Relies on accounting value a. not econom value.
2)	Dividend yield	The Ratio of Dividend per share to market price per share. A measure of income yield from a share and ignores the capital gain or loss elements of returns		Difficulty associated with market price per share varying expectations investors
3	Price to book Ratio	The ratio of the share price to the book value per share. At the company level the, ratio of market value of the equity to the book value of shareholder. The most fund A measure of how much more than assets value is being paid.		