

Gurukripa's Guideline Answers to Nov 2012 Exam Questions

Final Group I – Strategic Financial Management

Question 1 is compulsory (4 × 5 = 20 Marks)

Answer **any five** questions from the **remaining six** questions (16 × 5 = 80 Marks). [Answer any 4 out of 5 in Q.7]

Question 1(a):

N 12 (5 Marks)

X Ltd earns ₹ 6 per Share having a Capitalization Rate of 10% and has a Return on Investment of 20%. According to Walter's Model, what should be the price of the Share at 25% dividend payout?

Solution:

$$\text{Value of Firm (P}_0\text{)} = \frac{D + \left[(E - D) \times \frac{r}{K_e} \right]}{K_e} = \frac{(25\% \times 6) + \left[(6 - 25\% \times 6) \times \frac{20\%}{10\%} \right]}{10\%} = \frac{1.5 + (4.5 \times 2)}{10\%} = \frac{10.5}{10\%} = ₹ 105$$

Question 1(b):

N 12 (5 Marks)

Calculate the Current Price and the Bond Equivalent Yield (using Simple Compounding) of a Money Market Instrument with Face Value of ₹ 100 and Discount Yield of 8% in 90 days. Take 1 year = 360 days.

Solution:

1. Current Price of the Instrument

$$\text{Discount on the Bond} = 100 \times \frac{90}{360} \times 0.08 = 2. \text{ So, Current Price of the Bond} = \text{Face Value} - \text{Discount} = 100 - 2 = ₹ 98$$

2. Bond Equivalent Yield

$$\begin{aligned} \text{Bond Equivalent Yield} &= [\text{Face Value} - \text{Current Price}] \div \text{Current Price of the Bond} \times \frac{360}{90} \\ &= \frac{100 - 98}{98} \times \frac{360}{90} = 8.16 \% \text{ p.a} \end{aligned}$$

$$\text{Alternatively, Bond Equivalent Yield} = \text{Coupon Rate} / \text{Current Price} = \frac{8\%}{98} \times 100 = 8.16 \% \text{ p.a}$$

Question 1(c):

N 12 (5 Marks)

The following information is extracted from Steady Mutual Fund's Scheme –

Asset Value at the beginning of the month	₹ 65.78
Annualized Return	15%
Distributions made in the nature of Income and Capital Gain (per unit respectively)	₹ 0.50 and ₹ 0.32

You are required to –

- Calculate the month-end Net Asset Value of the Mutual Fund Scheme (limit your answers to two decimals).
- Provide a brief comment on the month-end NAV.

Solution:

$$\begin{aligned} 1. \text{ Monthly Return} &= \frac{\text{Income} + \text{Capital Gain} + \text{Capital Appreciation}}{\text{Opening NAV}} = 15/12 = 1.25\% \\ \frac{0.50 + 0.32 + (X - 65.78)}{65.78} &= 0.0125, X = \text{Closing NAV of the Mutual Fund Scheme} \end{aligned}$$

Solving for X, we obtain Closing NAV = ₹ 65.78

- Closing NAV is approximately same as Opening NAV, since the distributions from the Fund equals Returns from the Fund. ₹ 65.78 × 1.25% = ₹ 0.82 (approx.), i.e. 0.50 + 0.32 = ₹ 0.82

Question 1(d):

N 12 (5 Marks)

The US Dollar is selling in India at ₹ 55.50. If the interest rate for a 6 months' borrowing in India is 10% p.a and the corresponding rate in USA is 4%:

- Do you expect that US Dollar will be at a Premium or at Discount in the Indian Forex Market?
- What will be the expected 6 months' forward rate for US Dollar in India?
- What will be the rate of forward premium or discount?

Solution:**1. Premium or Discount**

- **Interest Rate:** Indian Interest Rate of 10% is higher than US Interest Rate of 4% p.a.
- **Inference:** Rupee is expected to weaken at a higher rate than US Dollar. Therefore, in the Forward Market, US Dollar will be quoted at a **Premium**.

2. Calculation of Forward Rate

$$\begin{aligned}\text{Forward Rate (FR)} &= \text{Spot Rate} \times \frac{(1 + \text{Home Currency Rate i.e India Rate for the Forward Period})}{(1 + \text{Foreign Currency Rate i.e USD Rate for the Forward Period})} \\ &= ₹ 55.50 \times \frac{[1 + 10\% \times (6 \text{ Months} / 12 \text{ Months})]}{[1 + 4\% \times (6 \text{ Months} / 12 \text{ Months})]} = ₹ 55.50 \times \frac{[1 + 5\%]}{[1 + 2\%]} = ₹ 55.50 \times 1.05 / 1.02 \\ &= ₹ 57.1324\end{aligned}$$

3. Computation of Premium

$$\begin{aligned}\text{Forward Premium} &= \frac{\text{Forward Rate} - \text{Spot Rate}}{\text{Spot Rate}} \times 100 \times \frac{12 \text{ Months}}{\text{Forward Period}} = \frac{57.1324 - 55.5000}{55.5000} \times 100 \times \frac{12 \text{ Months}}{6 \text{ Months}} \\ &= 5.88\%\end{aligned}$$

Question 2(a):**N 12 (12 Marks)**

H Ltd agrees to buy over the business of B Ltd effective 1st April 2012. The summarized Balance Sheet of H Ltd and B Ltd as on 31st March 2012 are as follows –

(₹ in Crores)

Liabilities	H Ltd	B Ltd	Assets	H Ltd	B Ltd
Paid Up Share Capital – Equity Shares of ₹ 100 each	350		Net Fixed Assets	220	0.50
– Equity Shares of ₹ 10 each		6.50	Net Current Assets	1020	29
Reserves and Surplus	950	25	Deferred Tax Asset	60	2
Total	1300	31.50	Total	1300	31.50

H Ltd proposes to buy out B Ltd and the following information is provided to you as part of the scheme of buying –

1. Weighted Average Post Tax Maintainable Profits of H Ltd & B Ltd for the last 4 years are ₹ 300 Crores & ₹ 10 Crores respectively.
2. Both the Companies envisage a Capitalization Rate of 8%.
3. H Ltd has a Contingent Liability of ₹ 300 Crores as on 31st March 2012.
4. H Ltd to issue Shares of ₹ 100 each to the Shareholders of B Ltd in terms of the Exchange Ratio as arrived on a Fair Value basis. (Please consider Weights of 1 and 3 for the value of Shares arrived on Net Asset Basis and Earnings Capitalization Method respectively for both H Ltd and B Ltd)

You are required to arrive at the Value of the Shares of both H Ltd and B Ltd under –

- (i) Net Asset Value Method
- (ii) Earnings Capitalization Method
- (iii) Exchange Ratio of Shares of H Ltd to be issued to the Shareholders of B Ltd on a Fair Value basis (taking into consideration the assumption mentioned in point 4 above).

Solution:**1. Computation of Value per Share under Net Assets Method (in ₹ Crores)**

Particulars	H Ltd	B Ltd
(a) Total Assets	1,300	31.50
(b) Contingent Liabilities	(300)	NIL
(c) Net Asset Value of the Company (a) – (b)	1,000	31.50
(d) No. of Equity Shares (Paid up Capital ÷ Face Value)	3.5 Crores	0.65 Crores
(e) Net Asset Value per Share (c) ÷ (d)	285.71	48.46

Note: Contingent Liabilities have been subtracted following concept of Prudence. Alternatively, settlement of Contingent Liability may be considered as remote and ignored.

2. Computation of Value per Share under Earnings Capitalization Method (in ₹ Crores)

Particulars	H Ltd	B Ltd
(a) Future Maintainable Earnings after Tax	300	10
(b) Capitalization Rate (after tax)	8%	8%
(c) Value of Equity (a) ÷ (b)	3750	125
(d) No. of Equity Shares	3.5 Crores	0.65 Crores
(e) Value per Share (c) ÷ (d)	1071.43	192.31

3. Computation of Exchange Ratio (on per Share basis)

Details	NAV	Weight	Product	Earnings	Weight	Product	Total	Weighted Average Value per Share
(1)	(2)	(3)	(4) = (2) × (3)	(5)	(6)	(7) = (5) × (6)	(8) = (4) + (7)	(9) = $\frac{(8)}{(3) + (6)}$
H Ltd	285.71	1	285.71	1071.43	3	3214.29	3500	875
B Ltd	48.46	1	48.46	192.31	3	576.93	625.39	156.3475

$$\text{Exchange Ratio} = \frac{\text{Value of Selling Company's Shares}}{\text{Value of Buying Company's Shares}} = \frac{156.3475}{875} = 0.1787$$

Question 2(b):**N 12 (4 Marks)**

With the help of the following information of Jatayu Limited, compute the Economic Value Added –

Equity Share Capital	₹ 160 Lakhs	10% Debentures	₹ 400 Lakhs	Financial Leverage	1.5 times
Reserves and Surplus	₹ 140 Lakhs	Cost of Equity	14%	Income Tax Rate	30%

Solution:**1. Computation of Capital Employed**

Particulars	₹ Lakhs
Equity Capital	160
Add: Reserves and Surplus	140
Total Equity Funds	300
Add: 10% Debentures	400
Total Capital Employed	700

2. Computation of EBIT

$$\text{Financial Leverage} = 1.5 \quad \frac{\text{EBIT}}{\text{EBT}} = 1.5.$$

Assuming EBIT to be "X", EBT = EBIT Less Interest of 40 Lakhs (400 Lakhs × 10%) = X – 40

$$\frac{X}{X - 40} = 1.5 \quad \text{Solving for X, we get, EBIT} = ₹ 120 \text{ Lakhs}$$

3. Computation of Cost of Capital

Source	Amount (₹ Lakhs)	Cost in ₹ Lakhs (After Tax)
Equity Capital	300	14% on 300 Lakhs = 42
Debt Funds	400	$400 \times [10\% \times (100\% - 30\%)] = 28$
Total	700	70

Cost of Capital = Total Cost ₹ 70 Lakhs ÷ Total Funds ₹ 700 Lakhs = 10 %.

4. Computation of Economic Value Added

Particulars	₹ Lakhs
Earnings before Interest and Tax	120
Less: Taxes at 30% (₹ 120 Lakhs × 30%)	36
Operating Profit After Taxes	84
Less: Normal Profit (i.e. Cost of Capital × Capital Employed = 10% × 700)	70
Economic Value Added	14

Question 3(a):**N 12 (8 Marks)**

You as an Investor had purchased a 4 month Call Option on the Equity Shares of X Ltd of ₹ 10, of which the Current Market Price is ₹ 132 and the Exercise Price ₹ 150. You expect the price to range between ₹ 120 to ₹ 190. The Expected Share Price of X Ltd and related probability is given below:

Expected Price (₹)	120	140	160	180	190
Probability	0.05	0.20	0.50	0.10	0.15

Compute the following:

- Expected Share Price at the end of 4 months.
- Value of Call Option at the end of 4 months, if the Exercise Price prevails.
- In case the Option is held to its maturity, what will be the Expected Value of the Call Option?

Solution:**1. Expected Share Price at end of 4 months**

Expected Price	Probability	Expected Price × Probability
120	0.05	6
140	0.20	28
160	0.50	80
180	0.10	18
190	0.15	28.5
Total		160.50

2. Value of Call Option at the end of 4 months, if expected price equals to exercise price is NIL as the Option Holder is indifferent between spot and options market.

3. Computation of Value of Call Option

Expected Price	Exercise Price	Action	Gain	Probability	Expected Gain
120	150	Lapse	–	0.05	–
140	150	Lapse	–	0.20	–
160	150	Exercise	10	0.50	5
180	150	Exercise	30	0.10	3
190	150	Exercise	40	0.15	6
Expected Value of Call Option					14

Alternatively, Expected Value of call may be calculated as $160.50 - 150.00 = 10.50$.

Question 3(b):**N 12 (8 Marks)**

Z Ltd importing goods worth USD 2 Million, requires 90 days to make the payment. The overseas supplier has offered 60 days interest free credit period and for additional credit for 30 days an interest of 8% per annum. The Bankers of Z Ltd offer a 30-day loan at 10% per annum and their quote for Foreign Exchange is as follows –

Spot 1 USD = ₹ 56.50, 60 days forward for 1 USD = ₹ 57.10, 90 days forward for 1 USD = ₹ 57.50

You are required to evaluate the following options:

- Pay the supplier in 60 days, or
- Avail the supplier's offer of 90 days credit.

Solution:**1. Option I – Pay Supplier in 60 days – Course of action**

- Avail interest free credit period of 60 days and enter into Forward Contract for USD with period as 60 days and Forward Rate as ₹ 57.10.
- Borrow from Banker at 10% p.a for 30 days on 60th day.
- Settle payment to overseas supplier with Borrowed Funds (amount of borrowing required = $\text{USD } 20,00,000 \times ₹ 57.10 = ₹ 11,42,00,000$).
- On 90th day, settle Interest and Principal to Banker. Interest = $(11,42,00,000 \times 10\% \times \frac{30}{365}) = ₹ 9,38,630.14$. Total amount to be settled = $(11,42,00,000 + 9,38,630.14) = ₹ 11,51,38,630.14$.

2. Option II – Avail the Supplier's offer of 90 days credit – Course of action

- Avail interest free credit period of 60 days and credit period with interest of 8% p.a. for 30 days and enter into Forward Contract for USD with period as 90 days and Forward Rate as ₹ 57.50.
- On 90th day, settle Interest and Principal to Overseas Creditor. Interest = $(\text{USD } 20,00,000 \times 8\% \times \frac{30}{365}) = \text{USD } 13,150.6849$.
Total amount to be settled = $\text{USD } (20,00,000 + 13,150.6849) = \text{USD } 20,13,150.6849$
- Cash Outflow in INR on 90th day = $20,13,150.6849 \times 57.50 = ₹ 11,57,56,164.38$

Suggestion: Under Option I, i.e. payment to Supplier on 60th day, Z Ltd gains by ₹ 6,17,534.24 ($11,57,56,164.38 - 11,51,38,630.14$). Hence, Z Ltd may make payment to its Overseas Supplier in 60 days.

Question 4(a):**N 12 (8 Marks)**

Eagle Ltd reported a Profit of ₹ 77 Lakhs after 30% tax for the Financial Year 2011 – 12. An analysis of the accounts revealed that the Income included extraordinary items of ₹ 8 Lakhs and an Extraordinary Loss of ₹ 10 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 –

Sales – 70 Lakhs, Labour Costs – 12 Lakhs, Material Costs – 20 Lakhs, Fixed Costs – 10 Lakhs

You are required to:

- Calculate the Value of the Business, given that the Capitalization Rate is 14%.
- Determine the Market Price per Equity Share, with Eagle Ltd's Share Capital being comprised of 1,00,000 13% Preference Shares of ₹ 100 each and 50,00,000 Equity Shares of ₹ 10 each and the P/E ratio being 10 times.

Solution:

1. Computation of Value of Business

Particulars		₹ Lakhs
Profits After Taxes for FY 2011-12		77
Add: Taxes at 30% ($77 \text{ Lakhs} \times \frac{30\%}{100\% - 30\%}$)		33
Profits Before Taxes		110
Less: Extraordinary Income – Not to recur in future		(8)
Add: Extraordinary Loss – Not to recur in future		10
Add: Sales of New Product	70	
Less: Material + Labour + Fixed Costs (20 + 12 + 10)	(42)	28
Future Expected Earnings before tax		140
Less: Tax at 30%		(42)
Future Expected Earnings after tax		98
Less: Preference Dividend (13% of 100 Lakhs)		(13)
Equity Earnings		85
Capitalization Rate		14%
Value of Business (Ignoring Capital Structure) [98 ÷ 14%]		700.00
Alternatively, After Considering Capital Structure		
(a) Value of Equity = $\frac{85 \text{ Lakhs}}{14\%}$ (Assuming Capitalization Rate represents Equity Expectations)	607.14	
(b) Value of Preference Capital (Face Value, in the absence of an identified Preference Expectation Rate)	100	707.14

2. Market Price per Equity Share

Particulars	Result
Equity Earnings	₹ 85 Lakhs
No. of Equity Shares (Lakhs)	50 Lakhs
Earnings per Share (₹ 85 Lakhs / 50 Lakhs)	₹ 1.7
PE Ratio	10
MPS = EPS × PE Ratio	₹ 17

Question 4(b):

N 12 (8 Marks)

Mr. Fed Up wants to invest an amount of ₹ 520 Lakhs and has approached his Portfolio Manager. The Portfolio Manager had advised Mr. Fed Up to invest in the following manner:

Security	Moderate	Better	Good	Very Good	Best
Amount (in ₹ Lakhs)	60	80	100	120	160
Beta	0.5	1.00	0.80	1.20	1.50

You are required to advise Mr. Fed Up in regard to the following, using Capital Asset Pricing Methodology:

- Expected Return on the Portfolio, if the Government Securities are at 8% and the NIFTY is yielding 10%
- Advisability of replacing Security 'Better' with NIFTY.

Solution:

1. Computation of Portfolio Beta and Portfolio Return

Security	Amount in ₹ Lakhs	Beta	Product
(1)	(2)	(3)	(4) = (2) × (3)
Moderate	60	0.50	30
Better	80	1.00	80
Good	100	0.80	80
Very Good	120	1.20	144
Best	160	1.50	240
Total	520		574

$$\text{Portfolio Beta} = \text{Weighted Average Beta} = \frac{574}{520} = 1.104$$

$$\text{Portfolio Return} = R_f + [(R_m - R_f) \beta_p] = 8 + [(10 - 8) 1.104] = 8 + 2.208 = 10.208\%$$

2. When Security "Better" is replaced by NIFTY, the return of the Portfolio will remain the same as both "Better" and NIFTY have the same Beta of 1.00.

Question 5(a):**N 12 (8 Marks)**

Following are the financial data of Platinum Ltd for the year 2011 – (₹ Lakhs)

Equity Shares (₹ 10 each)	100	Effective Tax Rate	30%
8% Debentures	125	Operating Margin	10%
10% Bonds	50	Required Rate of Return of Investors	15%
Reserves and Surplus	200	Dividend Payout Ratio	20%
Total Assets	500	Current Market Price of Shares	₹ 13
Assets Turnover Ratio	1.1		

You are required to –

- | | |
|---------------------------------------|--|
| 1. Draw Income Statement for the year | 3. Compute the Fair Price of the Company's Share using Dividend Discount Model |
| 2. Calculate Sustainable Growth Rate | 4. Draw your opinion in the Company's Share at Current Price. |

Solution:**1. Income Statement**

Particulars		₹ Lakhs
Sales	(Total Assets 500 × Assets T/O Ratio 1.1)	550
Less: Operating Expenses	[500 × (100% – Operating Margin 10%)]	(495)
	Operating Profit	55
Less: Interest	[(125 × 8%) + (50 × 10%)]	(15)
	Earnings Before Tax	40
Less: Tax at 30%		12
	Earnings after Tax	28
Less: Dividend at 20%		5.6
	Retained Earnings	22.40

2. Computation of Sustainable Growth Rate

Particulars	Value
Return on Equity (RoE) = $\frac{\text{Earnings after Tax}}{\text{Net Worth}} = \frac{28}{(100 + 200)}$	9.33%
Sustainable Growth Rate = ROE (1 – Dividend Payout Ratio) Sustainable Growth Rate = $0.0933 \times (1 - 0.20)$	7.5%

3. Computation of Fair Price using Dividend Discount Model

$$\text{Dividend per Share (D}_0\text{)} = \frac{5.6 \text{ Lakhs}}{10 \text{ Lakh Shares}} = ₹ 0.56$$

$$\text{Fair Price per Share, P}_0 = \frac{D_0 (1 + g)}{K_e - g} = \frac{0.56 (1 + 0.0750)}{0.15 - 0.0750} = ₹ 8.03$$

4. The Current Market Price of Share ₹ 13 being greater than Fair Price of ₹ 8.03 imply the Share is overvalued. Hence, the Investor should not invest in the Company.

Note:

- In the above computation of Sustainable Growth Rate, the Growth Rate keeps changing each year due to change in Earnings After Tax. Hence, Sustainable Growth Rate does not remain constant.
- Also, in the above computation, Sustainable Growth Rate is used as the Growth Rate for computation of Share Price. However, under Sustainable Growth Rate, Debt Component also grows at SGR.

Hence, the computation may be made alternatively as follows –

$$\text{Sustainable Growth Rate (See Below)} = \frac{P \times S_0 \times b (1 + D/E)}{A - [P \times S_0 \times b (1 + D/E)]} = \frac{35.530}{500 - 35.530} = 7.65\%$$

Computation of Factors

Factor	Value	Factor	Value
NP Margin (P)	5.10%	Debt Equity Ratio (D/E)	175/300 = 0.5833
Sales (S ₀)	550	Retention Ratio (b)	(100 – 20)% = 0.80
Total Assets (A)	500		

$$\text{Growth Rate for the purpose of Dividend Discount Model} = \frac{\text{Retained Earnings}}{\text{Equity Shareholders' Funds}} = \frac{22.40}{300} = 7.47\%$$

Computation of Factors

Factor	Value	Factor	Value
Growth Rate	7.47%	Equity Earnings for next year	30.09
Equity Earnings for the current year	28	Dividend for next year	30.09 × 20% = 6.018 Lakhs
Cost of Equity	15%	Dividend per Share	6.018 Lakhs ÷ 10 Lakh Shares = 0.6018 per Share

$$\text{Fair Price per Share, } P_0 = \frac{D_0 (1 + g)}{K_e - g} = \frac{0.6018 (1 + 0.0747)}{0.15 - 0.0747} = ₹ 8.59$$

The Current Market Price of Share ₹ 13 being greater than Fair Price of ₹ 8.59 imply the Share is overvalued. Hence, the Investor should not invest in the Company.

Question 5(b):**N 12 (8 Marks)**

Tiger Ltd is presently working with Earnings before Interest and Taxes (EBIT) of ₹ 90 Lakhs. Its present borrowings are –

12% Term Loan – 300 Lakhs, Working Capital Borrowings from Bank (15%) – 200 Lakhs, Working Capital Borrowings – Public Deposit (11%) – 100 Lakhs

The Sales of the Company are growing and to support this, the Company proposes to obtain additional borrowing of ₹ 100 Lakhs expected to cost 16%. The increase in EBIT is expected to be 15%. Calculate the change in Interest Coverage Ratio after the additional borrowing is effected, and comment on the arrangement made.

Solution:**(₹ in Lakhs)**

Particulars	Present	Proposed
1. Earnings before Interest and Taxes	90	90 + 15% = 103.50
2. Interest –		
(a) 12% Term Loan (300 × 12%)	36	36
(b) Loan from Bank (200 × 15%)	30	30
(c) Public Deposit (100 × 11%)	11	11
(d) Additional Borrowing (100 × 16%)	–	16
	77	93
3. Interest Coverage Ratio (1) ÷ (2)	1.17	1.11

Since the increase in EBIT is not sufficient to cover the increase in interest due to additional borrowing, there is a decrease in the Interest Coverage Ratio. The Company should not go for the Additional Working Capital for increasing the Sales.

Question 6(a):**N 12 (8 Marks)**

Yes Ltd wants to acquire No Ltd and the Cash Flows of Yes Ltd and the merged Entity are given below – (₹ Lakhs)

Year	1	2	3	4	5
Yes Ltd	175	200	320	340	350
Merged Entity	400	450	525	590	620

Earnings would have witnessed 5% constant growth rate without merger and 6% with merger on account of economies of operations after 5 years in each case. The Cost of Capital is 15%.

The number of Shares outstanding in both the Companies before merger is the same and the Companies agree to an exchange ratio of 0.5 Shares of Yes Ltd for each share of No Ltd. PV factor at 15% for years 1–5 are 0.870, 0.756, 0.658, 0.572, 0.497 respectively.

You are required to –

1. Compute the Value of Yes Ltd before and after merger
2. Value of Acquisition
3. Gain to Shareholders of Yes Ltd

Solution: 1. Terminal Value of Cash Flows $= C \times \frac{(1 + G)}{K_e - g}$

Before Merger $= 350 \times \frac{(1 + 5\%)}{15\% - 5\%} = 350 \times \frac{1.05}{0.10} = 3,675.00$

After Merger $= 620 \times \frac{(1 + 6\%)}{15\% - 6\%} = 620 \times \frac{1.06}{0.09} = 7,302.22$

2.Computation of Value of Yes Ltd (₹ Lakhs)

Particulars	Year	PV Factor at 15%	Before Merger		After Merger	
			Cash Flow	Disc. Cash Flow	Cash Flow	Disc. Cash Flow
Annual Cash Inflow	1	0.870	175.00	152.25	400.00	348.00
	2	0.756	200.00	151.20	450.00	340.20
	3	0.658	320.00	210.56	525.00	345.45
	4	0.572	340.00	194.48	590.00	337.48
	5	0.497	350.00	173.95	620.00	308.14
Terminal Value	5	0.497	3,675.00	1,826.48	7,302.22	3,629.20
Value of Yes Ltd				2,708.92		5,308.47

Value of Acquisition = ₹ 2,599.55 Lakhs

3.Gain to Shareholders of Yes Ltd

Particulars	₹ Lakhs
Value of Yes Ltd After Merger	5,308.47
Stake of existing Shareholders ($₹ 5308.47 \text{ Lakhs} \times \frac{1}{1.5}$)	3,538.98
Less: Value of Yes Ltd Before Merger	(2,708.92)
Additional Value to Shareholders on Acquisition	830.06

Note: After Merger, the number of Shares outstanding in Yes Ltd will be **1.5 times** of Shares outstanding Before Merger.**Question 6(b):****N 12 (8 Marks)**

Given the following information –

Current Dividend – ₹ 5.00

Discount Rate – 10%

Growth Rate – 2%

Calculate the Present Value of Stock. Is the Stock over valued if the Price is ₹ 40, ROE = 8% and EPS = ₹ 3.00. Show your calculations under the PE Multiple Approach and Earnings Growth Model.

Solution:**Computation of Value of Stock**

Particulars	Computation	Value	Inference
1. Dividend Growth Model	$\frac{D_0 (1 + g)}{K_e - g} = \frac{5 \times (1 + 2\%)}{10\% - 2\%} = \frac{5 \times 1.02}{0.08}$	₹ 63.75	–
2. PE Multiplier Approach	$EPS \times PE \text{ ratio} = 3 \times \frac{1}{ROE \ 8\%} = 3 \times 12.5$	₹ 37.50	As MPS of ₹ 40 > desired MPS of ₹ 37.50, the Stock is overvalued
3. Earnings Growth Model	$\frac{E_0 (1 + g)}{K_e - g} = \frac{3 \times (1 + 2\%)}{8\% - 2\%} = \frac{3 \times 1.02}{0.06}$	₹ 51	As MPS of ₹ 40 < desired MPS of ₹ 51, the stock is undervalued .

Question 7: Answer any four from the following:**N 12 (16 Marks)**

(a) Interface of Financial Policy and Strategic Management	Page 2.11, Q.No.20
(b) Commercial Paper	Page 9.7, Q.No.11,12
(c) American Depositary Receipt	Page 13.19, Q.No.31
(d) Advantages of holding securities in 'Demat' Form	Page 4.7, Q.No.14, Pt 4
(e) Synergy in the context of Mergers and Acquisitions	Page 14.1, Q.No.1, Pt 1