NCRD's Sterling Institute of Management Studies,

Nerul, Navi Mumbai

TERM END EXAMINATION MMS SEM III Nov- Dec. 2013

Sub: - Corporate valuation

Date: 08.11.2013   Time: 10.30 am to 1.30 pm

Day: Friday   Marks: 60 Marks

Roll No:

Instructions: Section I is compulsory. (1 Question x 20 Marks = Total 20 Marks)

Section II - Attempt any two. (2 Questions x 10 Marks = Total 20 marks)

Section III – Attempt any four. (4 Questions x 5Marks = Total 20 marks)

Section I

Q No.1. You have been asked by the owner of a small firm that produces and sells computer software to estimate the value of his firm. The firm had revenues of Rs20 million in the most recent year, on which it made earnings before interest and taxes of Rs 2 million. The firm had debt outstanding of Rs 10 million, on which pre-tax interest expenses amounted to Rs 1 million. The book value of equity is Rs 10 million. The average beta of publicly traded firms that are in the same business is 1.30, and the average debt-equity ratio is 0.2 (based upon the market value of equity). The market value of equity of these firms is, on average, three times the book value of equity. All firms face a 40% tax rate. Capital expenditures amounted to Rs1 million in the most recent year, and were twice the depreciation charge in that year. Both items are expected to grow at the same rate as revenues for the next five years, and to offset each other in steady state.

The revenues of this firm are expected to grow 20% a year for the next five years, and 5% after that. Net income is expected to increase 25% a year for the next five years, and 8% after that. The treasury bond rate is 7%.

A. Estimate the cost of equity for this private firm.

B. Estimate the cost of capital for this private firm.

C. Estimate the value of the owner's stake in this private firm, using both the firm approach and the equity approach.

Section II

Q No.2 R Ltd. is having an issued and subscribed capital of 50,000 equity shares of Rs. 100 each fully paid up. The company's after tax profit for the year 2008-09 amounting to Rs. 30 lakhs. The average present stock exchange price of the company's share is Rs. 190. The Price/Earning ratio of the four listed companies to be used for calculation, their type of business seems to be similar to R Ltd. are:

Company	2007	2008	2009
A Ltd.	5.7	6.3	7.1
B Ltd.	6.5	5.9	6.8
C Ltd.	7.4	6.8	7.0
D Ltd.	5.0	5.9	6.1

Calculate the valuation of business and per share based on average P/E ratio of the industry.

Q No.3 You are an investor who is interested in the emerging markets of Asia. You are trying to value some stocks in Malaysia, which does not have a long history of financial markets. During the last two years, the stock market has gone up 60% a year, while the government borrowing rate has been 15%, yielding an historical premium of 45%. Would you use this as your risk premium, looking into the future? If not, what would you base your estimate of the premium on?

Q No. 4. M Ltd. is studying the possible acquisition of N Ltd. by way of merger. The following data are available in respect of the companies:

Particulars	M Ltd.	N Ltd.
Profits after tax (PAT)	Rs. 80,00,000	Rs. 24,00,000
No. of equity shares	16,00,000	4,00,000
Market value per share	Rs. 200	Rs. 160

(i) If the merger goes through by exchange of equity and the exchange ratio is based on the current market price, what is the new earnings per share for M Ltd.?

(ii) N Ltd. wants to be sure that the earnings available to its shares holders will not be diminished by the merger. What should be the exchange ratio in that case?

Section III

QNo. 5 What do you mean by a brand? Explain the process of valuing a brand?

QNo. 6 What do you mean by intrinsic value? What are the drivers of intrinsic value of a business firm?

QNo. 7 Discuss in detail the various multiples used in relative valuation methods

QNo. 8 What do you mean by CFROI? How CFROI is is better than ROI related to valuation?

QNo. 9 What do you mean by real option valuation? When will you use this approach?

QNo. 10 Why is the DCF approach considered to be a superior method of valuation?