MMS-III Finance 29.10.2010

MAC03

Roll no. Merger, Acquisitions & Corporate Restructuring.

Time : 3 hours

Printed pages: 3

Total No. of Qs. : 05

Marks: 60

Answer any 3 questions. All questions carry equal marks.

1.

A. define and explain the following terms with example -

a. Demerger
b. Hostile takeover
c. Leveraged buy out
d. Discounted cash flow method

B.

a. Explain the concept of beta and various approaches adopted in arriving at the value of beta of an asset.
b. What are bottom up betas and default risk?

2.

A. Explain the provisions under Section 391 – 394 of Companies Act relating to scheme of merger.

B. Professor ABC wrote a book on Mergers and Acquisitions Management and has a copyright on it. The copyright is for 7 years.
The book is sold to corporates and the sales are steady growing at 7%. The sales in the first year from this segment were Rs. 1,000,000
The book is sold to college libraries, the revenues in the first year were Rs. 7,50,000, growing at 5%
The book is also bought by students the revenues in the first year were Rs. 300,000 growing at 4%.
Production and distribution costs are 50%, 60% and 80% respectively.
Estimate value of copyright. Make and state any assumptions.

3.

A. Explain Amalgamation and its taxability under the Income Tax Act

B. Management of Insoft targets a debt to equity ratio of 1:1, however, in terms of market value of debt to market capital of equity it is 1:1.2
Government risk free bond earn a return of 4.55% pa
When the stock market moves by 1% Insoft prices move by 1.42%
Estimate the cost of capital for Insoft

4.

A. Explain the importance of value in M&A. What are the different methods, which methods are best for which applications?

B. Smart Operaters Ltd. reported net income of Rs. 77 Cr in one year, after interest expenses of Rs. 30 cr. (The corporate tax rate was 33%.) It reported depreciation of Rs. 100 cr in that year, and capital expenditure was Rs. 100 cr. The firm also had Rs. 400 cr in debt outstanding on the books, trading at par (up from Rs. 380 cr at the end of the earlier year). The beta of the stock is 1.1, andthere were 20cr shares outstanding (trading at Rs. 50 per share), with a book value ofRs. 55per share. Ignore dividends and working capital requirements. The risk free rate of return is 6.5%.)

a. Estimate the free cash flow to the firm in this year.
b. Estimate the value of the firm at the end of this year.

5. Valuing a Taxi service

Peru cabs is authorised to operate radio taxies in Mumbai. There are several licencing requirements.

They typically have cars that cost Rs. 500,000 all inclusive, and last for about 10 years. The car can be depreciated over this period (simplifying assumption) and there is no resale value.

A cab can be expected to be on the road 330 days of the year, with an expected downtime (for maintenance) of 35 days, and make Rs. 5000 a day prior to meeting operating expenses,maintenance expenses and covering the cost of time for the driver.

The annual cost of fuel and operating expenses is expected to be 25% of revenues andthe maintenance expenses are expected to amount to Rs. 25,000 a year.

The cost of automobile insurance is Rs. 20,000 per year.The annual fee to be paid to the Taxi Controller Authority is Rs. 2000. Other licensing costs are expected to amount to Rs. 2000 a year.

The total other costs per day, inclusive of benefits, of the driver of the cab is expected to amount to Rs. 500. (This also includes the 35 days where the car is down for maintenance.)

The capacity of a cab to pull in the expected revenues is a function of several variables, but mainly on the state of the city's economy: The more buoyant the economy of the city, the greater are the potential revenues from owning and operating a cab in it.Since the state of Mumbai's economy is, in large part, driven by the state of the financial services sector, there is in all likelihood a positive correlation between cab revenues and financial service sector health.

The availability of cabs and satisfaction from the present services: The value of a Peru is derived directly from the fact that though there are many cabs are available, there is general dissatisfaction with the existing services.

Risk free return is estimated to be 7%, market risk premium is 5.5%, beta for financial services business is 1.25 and for automotive business is 1.15.

Financing Mix

Assume that the Peru will be financed half with equity and half with debt,and that the debt will carry an interest rate of 12% per annum. Consider marginal tax rate of 33%.

Assume there will be 3% growth year on year in the business.

Make and state any reasonable assumptions and estimate the value of Peru cab service. (Hint – calculate cost of capital, cash flows from operations, estimate investment requirement, calculate growth using growth related concepts)
