MERGERS AND ACQUISITIONS

IMPORTANT QUESTIONS

CLASS WORK QUESTIONS

Question 2:

B Ltd. Wants to acquire S Ltd. and has offered a swap ratio of 2:3 (2 shares for every 3 share of S Ltd.). Following information is available:

Particulars	B Ltd.	S Ltd.
Profit after tax (in ₹)	21,00,000	4,50,000
Equity shares outstanding (Nos.)	6,00,000	1,80,000
EPS (₹)	3.5	2.5
PE Ratio	10 times	7 times
Price quoting per share on BSE before the merger announcement (₹)	35.00	17.50

Required:

i. The number of equity shares to be issued by B Ltd. for acquisition of S Ltd.

ii. What is the EPS of B Ltd. after the acquisition?

iii. Determine the equivalent earnings per share of S Ltd. and calculate per share gain or loss to shareholders of S Ltd.

iv. What is the expected market price per share of B Ltd. after the acquisition, assuming its PE Multiple remains unchanged?

v. Determine the market value of the merged firm.

vi. After the announcement of merger, price of shares of S Ltd. rose by 10% on BSE. Mr. X, an investor, having 10,000 shares of S Ltd. is having another investment opportunity, which yields annual return of 14% is seeking your advice whether he needs to offload the shares in the market or accept the shares from B Ltd.

(Source: ICAI)

Question 3:

The following information relating to the acquiring Company Abhiman Ltd. and the target Company Abhishek Ltd. are available. Both the Companies are promoted by Multinational Company, Trident Ltd. The promoter's holding is 50% and 60% respectively in Abhiman Ltd. and Abhishek Ltd.:

	Abhiman Ltd.	Abhishek Ltd.
Share Capital (₹)	200 lakh	100 lakh
Free Reserve and Surplus (₹)	800 lakh	500 lakh
Paid up Value per share (₹)	100	10
Free float Market Capitalisation (₹)	400 lakh	128 lakh
P/E Ratio (times)	10	4

Trident Ltd. is interested to do justice to the shareholders of both the Companies. For the swap ratio weights are assigned to different parameters by the Board of Directors as follows:

Book Value	25%
EPS (Earning per share)	50%
Market Price	25%

a. What is the swap ratio based on above weights?

b. What is the Book Value, EPS and expected Market price of Abhiman Ltd. after acquisition of Abhishek Ltd. (assuming P.E. ratio of Abhiman Ltd. remains unchanged and all assets and liabilities of Abhishek Ltd. are taken over at book value).

c. Calculate:
   i. Promoter's revised holding in the Abhiman Ltd.

ii. Free float market capitalization.

iii. Also calculate No. of Shares, Earning per Share (EPS) and Book Value (B.V.),if after acquisition of Abhishek Ltd., Abhiman Ltd. decided to :
   a. Issue Bonus shares in the ratio of 1 : 2; and
   b. Split the stock (share) as ₹ 5 each fully paid.

(Source: ICAI)

Question 7:

X Ltd. made an attempt to acquire Y Ltd. Following information is available for both the Companies:

	X Ltd.	Y Ltd.
Price for Share (Rs)	30	20
P/E ratio	5	4
No. of Shares (lakhs) (FV of Rs 10)	3.0	2.0
Reserve & Surplus (Rs lakhs)	30	20
Promoters' holding (lakh shares)	1.2	0.75

Board of Directors of both the Companies have decided that a workable swap ratio is to be based on weights of 30%, 30% and 40% respectively for Earning, Book Value and Market Price of share of each company. Find out the following :

i. Swap ratio
ii. After merger, Promoter's holding %
iii. Post merger EPS
iv. Gain in Capital market Value of merged company , assuming Price Earning ratio will remain same

(*Source: ICAI)*

Question 13: Exception

A Ltd. acquires B Ltd. Assuming that it has been ensured that after merger the EPS shall be at least Rs. 5.33 per share and there shall be no synergies gain from merger complete the following table:

	A Ltd.	B Ltd.	Merged Firm
EPS	Rs. 4.00	Rs. 5.00	Rs. 5.33
Price Per Share	Rs. 80.00	Rs. 50.00	?
Price Earning Ratio	20	10	?
No. of Shares	10,00,000	20,00,000	?
Total Market Value	8,00,00,000	10,00,00,000	?

(*Source: ICAI)*

Question 16:

The following are the financial statements of A Ltd., and B Ltd. for the financial year ended 31st March, 2020. Both the companies are working in the same industry.

Balance Sheets (₹)		
Particulars	**A Ltd.**	**B Ltd.**
Total Current Assets	15,00,000	12,00,000
Total Net Fixed Assets	12,00,000	6,00,000
Total Assets	**27,00,000**	**18,00,000**
Equity Capital (Face Value ₹ 10)	10,00,000	8,00,000
Retained Earnings	3,00,000	-
14% Long Term Debt	7,00,000	5,00,000
Total Current Liabilities	7,00,000	5,00,000
Total Liabilities	**27,00,000**	**18,00,000**

Income Statement (₹)		
Particulars	**A Ltd.**	**B Ltd.**
Net Sales	33,10,000	16,60,000
Gross Profit	6,90,000	3,40,000
Operating Expenses	2,00,000	1,00,000
Interest	98,000	70,000
EBT	3,92,000	1,70,000
Tax @ 30%	1,17,600	51,000
PAT	2,74,400	1,19,000
Additional information :		
Dividend Pay-out Ratio	40%	60%
Market Price per Share	40	15

You are required to calculate:

i. Earnings Per share (EPS), Profit Earning Ratio (PER), Return on Equity (ROE) and Book Value Per Share (BVPS) for both the firms.

ii. Estimate future EPS growth rate for both the firms.

iii. If on acquisition of B Ltd. by A Ltd., intrinsic value of B Ltd., will be ₹ 20 per share, develop range of justifiable Exchange Ratio (ER) that can be offered by A Ltd., to shareholders of B Ltd.

iv. Based on your analysis in (i) and (ii) whether the negotiated ratio will be close to upper or lower range. Justify.

v. Post-merger EPS on an ER of 0.4: 1. What will be immediate accretion or dilution to EPS to the shareholders of both the firms?

vi. Post-Merger MPS on the basis of ER of 0.4 : 1 ***(Source: ICAI)***

Question 30:

The CEO of a company thinks that shareholders always look for EPS. Therefore, he considers maximization of EPS as his company's objective. His company's current Net Profits are ₹ 80.00 lakhs and P/E multiple is 10.5. He wants to buy another firm which has current income of ₹ 15.75 lakhs & P/E multiple of 10. The current market price of both the acquirer and the target company are ₹ 42 and ₹ 105 respectively.

Advise:

i. The maximum exchange ratio which the CEO should offer so that he could keep EPS at the current level.

ii. Cash that CEO should offer to buy out the Target Company by paying cash so that he could maintain its current EPS. The CEO can borrow funds at 15%.

Assume tax rate of 30%.

(*Source: ICAI*)

Question 34:

Given is the following information:

	Day Ltd.	**Night Ltd.**
Net Earnings	₹ 5 crores	₹ 3.5 crores
No. of Equity Shares	10,00,000	7,00,000

The shares of Day Ltd. and Night Ltd. trade at 20 and 15 times their respective P/E ratios.

Day Ltd. considers taking over Night Ltd. By paying ₹ 55 crores considering that the market price of Night Ltd. reflects its true value. It is considering both the following options:

i. Takeover is funded entirely in cash.

ii. Takeover is funded entirely in stock.

You are required to calculate the cost of the takeover and advise Day Ltd. on the best alternative.

(*Source: ICAI*)

Question 37:

AB Ltd. is a firm of recruitment and selection consultants. It has been providing consultancy for 10 years and obtained a stock market listing 4 years ago. It has pursued a policy of aggressive growth and specializes in providing services to companies in high- technology and high growth sectors. It is all-equity financed by ordinary share capital of Rs. 500 lakh in shares of Rs. 20 nominal (or par) value.

The company's results to the end of March 2009 have just been announced. Profits before tax were Rs.1,266 lakh. The Chairman's statement included a forecast that earnings might be expected to rise by 4%, which is a lower annual rate than in recent years. This is blamed on economic factors that have had a particularly adverse effect on information technology companies. YZ Ltd. is in the same business but has been established much longer. It serves more traditional service sectors and its earnings record has been erratic. Press comment has frequently blamed this on poor management and the company's shares have been out of favour with the stock market for some time. Its current earnings growth forecast is also 4% for the foreseeable future. YZ Ltd. has an issued ordinary share capital of Rs.1800 lakh in Rs.100 shares. Pre-tax profits for the year to 31 March 2009 were Rs.1,125 lakh.

AB Ltd. has recently approached the shareholders of YZ Ltd. with a bid of 5 new shares in AB Ltd. for every 6 YZ Ltd. shares. There is a cash alternative of Rs. 345 per share. Following the announcement of the bid, the market price of AB Ltd. shares fell 10% while the price of YZ Ltd. shares rose 14%. The P/E ratio and dividend yield for AB Ltd. and YZ Ltd. immediately prior to the bid announcement are shown below.

2009				
High	**Low**	**Company**	**P/E**	**Dividend yield %**
425	325	AB Ltd.	11	2.4
350	285	YZ Ltd.	7	3.1

Both AB Ltd. and YZ Ltd. pay tax at 30%.

AB Ltd.'s post-tax cost of equity capital is estimated at 13% per annum and YZ Ltd.'s at11% per annum.

Assuming that you are a shareholder in YZ Ltd. You have a large, but not controlling interest.

You bought the shares some years ago and have been very disappointed with their performance. Based on the information and merger terms available, plus appropriate assumptions, to forecast post-merger values, evaluate whether the proposed share-for- share offer is likely to be beneficial to shareholders in both AB Ltd. and YZ Ltd. Also identify why the price of share of AB Ltd. fell following the announcement of bid.

Note: As a benchmark, you should then value the two companies AB Ltd. and YZ Ltd. using the constant growth form of the dividend valuation model.

(Source: ICAI)

Question 50:

During the audit of the Weak Bank (W), RBI has suggested that the Bank should either merge with another bank or may close down. Strong Bank (S) has submitted a proposal of merger of Weak Bank with itself. The relevant information and Balance Sheets of both the companies are as under:

Particulars	Weak Bank (W)	Strong Bank (S)	Assigned Weights (%)
Gross NPA (%)	40	5	30
Capital Adequacy Ratio (CAR) Total Capital/ Risk Weight Asset	5	16	28
Market price per Share (MPS)	12	96	32
Book value			10
Trading on Stock Exchange	Irregular	Frequent	

Balance Sheet

(₹ in Lakhs)

Particulars	Weak Bank (W)	Strong Bank (S)
Paid up Share Capital (₹ 10 per share)	150	500
Reserves & Surplus	80	5,500
Deposits	4,000	44,000
Other Liabilities	890	2,500
Total Liabilities	**5,120**	**52,500**
Cash in Hand & with RBI	400	2,500
Balance with Other Banks	-	2,000
Investments	1,100	19,000
Advances	3,500	27,000
Other Assets	70	2,000
Preliminary Expenses	50	-
Total Assets	**5,120**	**52,500**

Required:

i. Prepare the Balance Sheet after merger if Swap ratio based on the above weights is agreed upon.

ii. Analyze the proposed merger from CAR and Gross NPA angle.

(Source: ICAI)

Question 51:

MS Stones has different divisions of home interiors products. Recently, due to economic slowdown, the Managing Director of the Company expressed it desire to divestiture its ceramic tile business. The relevant financial details of this business are as follows:

Estimated Pre Tax Cash Flow Next Year	Rs. 200 Crore
Book Value of Liabilities	Rs. 780 Crore

In an order to increase its share in the ceramic tile market, the Tripati Tiles Ltd. showed its interest in the acquisition of this unit and offered a proceed of Rs. 950 Crore for the same to MS Stones.

The other data pertaining to the business are as follows:

Tax Rate	30%
Growth Rate	4%
Applicable Discount Rate for Tile Business	12%

If market value of liabilities are Rs. 40 Crore more than book value, you are required to advice MD whether she should go for divestiture of the tile business or not.

(Source: ICAI)

Question 53:

The total value (equity + debt) of two companies, A Ltd. and B Ltd. are expected to fluctuate according to the state of the economy

State of the economy	Probability	Value of A Ltd. Rs. in lakh	Value of B Ltd. Rs. in lakh
Rapid growth	0.30	720	1150
Slow growth	0.50	520	750
Recession	0.20	380	600

A Ltd. and B Ltd. currently have a debt of Rs. 420 lakhs and Rs. 80 lakhs, respectively.

The two companies are deciding for merger. Assuming that no operational synergy is expected as a result of the merger, you are required to calculate the expected value of debt and equity of the merged company.

Also explain the reasons for any difference that exists from the expected values of debt and equity, if they do not change.

(Source: ICAI)

Question 56:

M plc and C plc operating in same industry are not experiencing any rapid growth but providing a steady stream of earnings. M plc's management is interested in acquisition of C plc due to its excess plant capacity. Share of C plc is trading in market at £4 each. Other date relating to C plc is as follows:

Particulars	M plc	C plc	Combined Entity
Profit after tax	£4,800,000	£3,000,000	£9,200,000
Residual Net Cash Flow per year	£6,000,000	£4,000,000	£12,000,000
Required return on Equity	12.5%	11.25%	12.00%

Balance Sheet of C plc

Assets	Amount (£)	Liabilities	Amount (£)
Current Assets	27,300,000	Current Liabilities	13,450,000
Other Assets	5,500,000	Long Term Liabilities	11,100,000
Property Plants &Equipments	21,500,000	Reserve & Surplus	24,750,000
		Share Capital (5 million common shares @ £1 each)	5,000,000
	54,300,000		54,300,000

You are required to compute:

i. Minimum price per share C plc should accept from M plc.

ii. Maximum price per share M plc shall be willing to offer to C plc.

iii. Floor Value of per share of C plc. Whether it shall play any role in decision for its acquisition by M plc.

(Source: ICAI)