

NEW SCHEME

Third Semester MBA Degree Examination, July 2007
Business Administration

Merger, Acquisition and Corporate Restructuring

[Max. Marks:100]

Time: 3 hrs.]

- Note : 1. Answer any FOUR full questions out of 1 to 7.
 2. Question No.8 is compulsory.
 3. Show working notes wherever necessary.

- 1 a. What is merger? (03 Marks)
- b. Explain the concepts of horizontal, vertical and conglomerate merger with examples. (07 Marks)
- c. What are the different motives behind merger? Discuss. (10 Marks)
- 2 a. What is takeover? (03 Marks)
- b. How does industry life cycle influence restructuring activities? (07 Marks)
- c. What are the legal procedures for merger and acquisition laid down in the Companies Act, 1956? Discuss. (10 Marks)
- 3 a. What is joint venture? (03 Marks)
- b. Write a note on Leverage Buy Outs (LBO). (07 Marks)
- c. Discuss the five – stage model of merger process. (10 Marks)
- 4 a. What is Master limited Partnership? (03 Marks)
- b. Strong Ltd., takes over Weak Ltd., and it was agreed that the shareholders of Weak Ltd., must be issued shares in Strong Ltd., and the exchange is to be determined on the basis of the intrinsic values of the shares of the two companies concerned. The capital of Weak Ltd., comprises 1,00,000 equity shares of Rs. 10 each. The intrinsic values were Strong Ltd., Rs 40 and Weak Ltd., Rs. 25. In allotment fractional shares are aggregate to 500. The market value of share of Strong Ltd., was Rs 60. You are required to compute the purchase consideration payable to Weak Ltd. (07 Marks)
- c. Discuss the various defensive tactics a target company adopts against hostile take over. (10 Marks)
- 5 a. What is Divestiture? (03 Marks)
- b. Income statement of Infosys Ltd. (07 Marks)

| | |
|--|---------------|
| | Rs. |
| Sales | 1,45,000 |
| Operating cost excluding depreciation | 95,000 |
| Earnings before Depreciation, Interest and Tax | <u>50,000</u> |
| Depreciation | 20,000 |
| EBIT | <u>30,000</u> |
| Interest expenses | 5,000 |
| Earnings before Tax. | <u>25,000</u> |
| Tax @ 40% | 10,000 |
| Net Income | <u>15,000</u> |

Balance Sheet

| | Year 1 | Year 2 | | Year 1 | Year 2 |
|-------------------------|--------|--------|----------------------|--------|--------|
| Current Assets | 40 | 70 | Debt | 30 | 45 |
| Gross fixed Assets | 70 | 100 | (Interest bearing) | | |
| Less : Reserve for Dep. | 10 | 30 | Non Interest bearing | 20 | 30 |
| Net Fixed Assets | 60 | 70 | Debt | 50 | 65 |
| Net Total Assets | 100 | 140 | Share holders Equity | | |
| | | | Claims on Assets | 100 | 140 |

Gross fixed assets increased by Rs 30,000 between the two years, representing the amount of gross investment made by the firm during year 2. It is further assumed that the company pays no dividends, so that share holders equity in year 2 increases by Rs 15,000, the net income is shown in the income statement. Using the above information calculate Free Cash Flow (FCF) of the company.

c. Discuss the human resource management issues during post merger integration. (10 Marks)

- 6 a. What is Synergy in merger? (03 Marks)
 b. What are the salient features of SEBI guide lines for take over? Discuss. (07 Marks)
 c. Small company is being acquired by Large company on a share exchange basis. Their selected data are as follows:

| | Companies | |
|-------------------------------|-----------|-------|
| | Large | Small |
| Profit after Tax (Rs in lakh) | 56 | 21 |
| Number of shares (lakh) | 10 | 8.4 |
| Earnings per share (Rs) | 5.6 | 2.5 |
| Price earnings ratio | 12.5 | 7.5 |

Determine :

- i) Pre - merger market value per share and
 ii) The maximum exchange ratio large company should offer without the dilution of
 1) EPS 2) Market value per share. (10 Marks)

- 7 a. Write a note on employee stock ownership plan. (05 Marks)
 b. Exe Ltd., is takeover by Wye Ltd. Given below are the balance sheets of two companies as on 31st March, 2006. (10 Marks)

| Assets | Exe Ltd. Rs. | Wye Ltd. Rs. |
|---------------|-----------------|-----------------|
| Sundry assets | 16,85,000 | 43,57,500 |
| Cash in hand | 3,500 | 27,500 |
| | 16,88,500 | 43,85,000 |

| Liabilities | Exe ltd. Rs. | Wye Ltd. Rs. |
|--------------------------------------|-----------------|-----------------|
| Authorised share capital : | | |
| 9,000 Equity shares of Rs. 150 each | 13,50,000 | ---- |
| 60,000 Equity shares of Rs. 75 each | ---- | 45,00,000 |
| Paid up share capital : | | |
| 9,000 Equity share – Rs. 135 paid up | 12,15,000 | ---- |
| 40,000 Equity share – Rs. 75 paid up | ---- | 30,00,000 |
| General Reserve | 4,03,500 | 12,85,000 |
| Profit and Loss A/c | 15,000 | 35,000 |
| Sundry Creditors | 55,000 | 65,000 |
| | 16,88,500 | 43,85,000 |

The holder of every three shares in Exe Ltd., was to receive five shares in Wye Ltd.
Pass necessary Journal entries in the books of both the companies and balance sheet of Wye Ltd., after takeover. The amalgamation is by merger. (15 Marks)

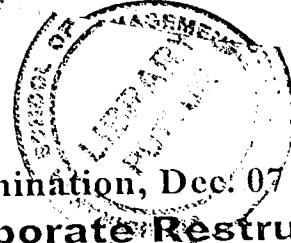
8 Case Study :

Philip company has decided to acquire Kaithan company. The following are the relevant financial data for the two companies :

| | Philip Company | Kaithan Company |
|--|-------------------|--------------------|
| Net Sales (Rs in lakh) | 350.00 | 45.00 |
| Profit after tax (Rs in lakh) | 28.13 | 3.75 |
| Number of shares (lakh) | 7.50 | 1.50 |
| Earnings per share (Rs) | 3.75 | 2.5 |
| Dividend per share (Rs) | 1.30 | 0.60 |
| Total market capitalization (Rs in lakh) | 420.00 | 45.00 |

Calculate :

- Pre merger market value per share for both companies. (05 Marks)
- Post merger EPS, market value per share and price earnings ratio if Kaithan company's share holders are offered a share of i) Rs. 30, or ii) Rs. 56, or iii) Rs. 20 in a share exchange for merger. (05 Marks)
- Philip Company's EPS if Kaithan company's share holders are offered Rs. 100, 15% convertible debenture for each 3 shares held in Kaithan. (05 Marks)
- Post merger dividend or interest available to Kaithan Company's shareholders. Assume 50% tax rate. (05 Marks)



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Third Semester MBA Degree Examination, Dec. 07 / Jan. 08
Mergers, Acquisitions and Corporate Restructuring

Time: 3 hrs.

Max. Marks: 100

- Note : 1. Answer any 4 full questions from questions 1 to 7 and question no 8 is compulsory.
2. Write explanatory notes for any assumptions made. The students are to be allowed and provided with present value tables.

- 1 a. What are Spin offs? (03 Marks)
b. What is Due Diligence? Who is required to undertake it? (07 Marks)
c. Explain various reasons for Corporate Restructuring. (10 Marks)
- 2 a. What is Relative Valuation? (03 Marks)
b. Mona Ltd is planning to acquire Sona Ltd provided there is synergy in the acquisition, which will result in Mona Ltd reporting an EPS of atleast of Rs. 2.75. Consider the following financial data:
- | Particulars | Mona Ltd | Sona Ltd |
|------------------------|----------|----------|
| EPS | Rs. 2.25 | Rs. 2.25 |
| Market price per share | Rs. 18 | Rs. 12 |
| P/E ratio | 8 | 5.3 |
| No. of shares | 1,50,000 | 1,50,000 |
- There is no immediate gain in the merger though there will be long term synergies. Compute the exchange ratio, which will raise the post merger EPS of Mona Ltd to Rs. 2.75. (07 Marks)
- c. Briefly explain the Differential Efficiency and Inefficient Management theory of Mergers. (10 Marks)
- 3 a. What are agency problems? (03 Marks)
b. Briefly explain various types of synergies. (07 Marks)
c. What are the benefits of pure diversification? (10 Marks)
- 4 a. What is mezzanine financing? (03 Marks)
b. Who are the participants in a acquisition process? What sort of service do they provide? (07 Marks)
c. The free cash flow of a firm is projected to grow at a compound annual average rate of 35% for the next 5 years. Growth is then expected to slow down to a normal 5% annual growth rate. The current years cash flow to the firm is Rs 4,00,000. The firm's cost of capital during the high growth period is 18% and 12% beyond the fifth year, as growth stabilizes. Calculate the value of the firm. (10 Marks)
- 5 a. What is cultural shock in a merger? (03 Marks)
b. Briefly explain the concessions available to a firm when they merge under the Income Tax Act of 1961. (07 Marks)
c. Explain various Preventive Anti takeover defense measures undertaken by firms in case of hostile takeover. (10 Marks)
- 6 a. What is Pooling of Interest method in case of mergers? (03 Marks)

b. The relevant financial detail of two firms just prior to merger announcement areas follows:

| | <u>Day Ltd</u> | <u>Night Ltd</u> |
|--------------------------|----------------|------------------|
| Market price per share | Rs. 65 | Rs. 30 |
| No. of shares | 8,00,000 | 5,00,000 |
| Market value of the firm | Rs. 520,00,000 | Rs. 150,00,000 |

The merger is expected to bring gains which have a present value of Rs. 120,00,000. Day ltd offers 2,46,000 shares in exchange for 5,00,000 shares to the shareholders of firm Night ltd. Assuming that the market value of two firms just before the merger announcement are equal to their present values as separate entities. Calculate the NPV to Day ltd and Night ltd respectively. (07 Marks)

c. Explain the 5 pitfalls in a acquisition. (10 Marks)

7 a. What is hubris hypothesis? (05 Marks)

b. The W Co. ltd. is absorbed by the U Co. ltd. the consideration being :

1. Assumption of the liabilities.
2. Discharge of the Debenture debt at a premium of 5% by the issue of 6% Debenture's in U Co ltd.
3. Payment in cash of-Rs 3 per share and exchange of 3 shares of Re1 each. In U Co. ltd at an agreed value of Re. 1.50 per share for every share in W Co. ltd.

The following is the Balance Sheet of W Co. ltd on the date of transfer :

BALANCE SHEET

As on 31-3-2004.

| LIABILITIES | AMOUNT Rs | ASSETS | AMOUNT Rs |
|--|-----------------|-----------------------|-----------------|
| Share Capital 60,000 share of Rs 5 each | 3,00,000 | Goodwill | 25,000 |
| General reserve | 32,000 | Land and Building | 75,000 |
| Profit and loss a/c | 13,000 | Plant and Machinery | 2,20,000 |
| Accident Insurance fund | 5,000 | Patents | 5,000 |
| 5% debentures | 1,50,000 | Patterns and drawings | 2,500 |
| Sundry creditors | 20,000 | Stock in trade | 1,06,000 |
| | | Sundry Debtors | 45,000 |
| | | Investments | 5,000 |
| | | Cash at bank | 36,500 |
| Total | 5,20,000 | | 5,20,000 |

Close the books of W Co. ltd by passing the necessary Journal entries. (15 Marks)

8 CASE STUDY:

The following information is given about the two firms X and Y:

| | Firm X | Firm Y |
|--------------------------|--------------|-------------|
| Market price for share | Rs. 60 | Rs. 20 |
| Number of shares | 6,00,000 | 2,00,000 |
| Market value of the firm | Rs. 360 lakh | Rs. 40 lakh |

Firm X intends to acquire Firm Y. The market price per share of Y has increased by Rs. 4 because of rumours that Y might get a favourable merger offer. Firm X assumes that by combining the two firms is will save in costs by Rs. 20 lakh. Firm X has two options.

1. Pay Rs. 70 lakh cash for Firm Y.
2. Offer 1,25,000 shares instead of Rs 70 lakh to the shareholders of Y ltd.

Calculate :

- a. The cost of cash offer if Y's market price reflects only its value as a separate entity.
- b. Cost of cash offer if Y's market price reflects the value of the merger announcement.
- c. Apparent cost of the stock offer.
- d. True cost of the stock offer. (20 Marks)

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Third Semester MBA Degree Examination, Dec.08/Jan.09

Mergers, Acquisitions and Corporate Restructuring

Time: 3 hrs.

Max. Marks: 100

Note: 1. Answer any FOUR questions from Q.1 to Q.7. Question No.8 is compulsory.

2. Write explanatory notes for any assumptions made.

3. Present value tables are to be allowed and provided.

- 1 a. What are Split up's? (03 Marks)
b. What is Due Diligence? Who is required to undertake it? (07 Marks)
c. Explain various reasons for Corporate Restructuring. (10 Marks)

- 2 a. What is comparable company approach? (03 Marks)
b. Rahul International is keen on reporting EPS of Rs. 3.50 after acquiring Overseas Corporation. The following financial data is available:-

| Particulars | Rahul International | Overseas Corporation |
|------------------------|---------------------|----------------------|
| Earnings per share | Rs. 2.50 | Rs. 2.50 |
| Market price per share | Rs. 28 | Rs. 18 |
| P/E Ratio | 8 | 4 |
| No. of shares | 1,50,000 | 1,50,000 |

There is no gain from merger. What exchange ratio will raise the post merger EPS of Rahul International to Rs. 3.50. (07 Marks)

- c. Briefly explain the differential efficiency and inefficient management theory of mergers. (10 Marks)
- 3 a. What are agency problems? (03 Marks)
b. Briefly explain various types of synergies. (07 Marks)
c. What are the benefits of pure diversification? (10 Marks)
- 4 a. What is master limited partnership? (03 Marks)
b. Who are the participants in a acquisition process? What sort of service do they provide? (07 Marks)
c. The free cash flow of a firm is projected to grow at a compound annual average rate of 35% for the next 5 years. Growth is then expected to slow down to a normal 5% annual growth rate. The current years cash flow to the firm is Rs. 4,00,000. The firm's cost of capital during the high growth period is 18% and 12% beyond the fifth year, as growth stabilizes. Calculate the value of the firm. (10 Marks)
- 5 a. What is cultural shock in merger? (03 Marks)
b. Briefly explain the concessions available to a firm when they merge under the Income Tax Act of 1961. (07 Marks)
c. Explain various preventive anti-takeover defense measures undertaken by firms in case of hostile takeover. (10 Marks)
- 6 a. What is Pooling of interest method in case of mergers? (03 Marks)
b. The relevant financial details of two firms just prior to merger announcement are as follows:

| | Day ltd. | Night ltd. |
|--------------------------|---------------|---------------|
| Market price per share | Rs.65 | Rs.30 |
| No. of shares | 8,00,000 | 5,00,000 |
| Market value of the firm | Rs.520,00,000 | Rs.150,00,000 |

.....contd

The merger is expected to bring gains which have a present value of Rs.120,00,000. Day Ltd offers 2,46,000 shares in exchange for 5,00,000 shares to the shareholders of firm Night Ltd. Assuming that the market value of two firms just before the merger announcement are equal to their present values as separate entities, calculate the NPV to Day Ltd and Night Ltd respectively. (07 Marks)

c. Explain the 5 steps to be taken care off before an acquisition is undertaken. (10 Marks)

7 a. What is hubris hypothesis? (05 Marks)

b. The following is the Balance sheet of D Ltd on 31-12-00

| LIABILITIES | Rs. | ASSETS | Rs. |
|----------------------------|-----------------|-------------------|-----------------|
| Capital shares of 100 each | 4,00,000 | Building | 1,70,000 |
| General reserve | 50,000 | Plant & Machinery | 4,00,000 |
| Profit and Loss a/c | 5,600 | Investments | 50,600 |
| 5% Debentures | 2,50,000 | Debtors | 1,40,500 |
| Creditors | 1,28,700 | Stock | 80,700 |
| Proposed dividend | 24,000 | Cash at bank | 16,500 |
| | <u>8,58,300</u> | | <u>8,58,300</u> |

D Ltd was absorbed by N Ltd on the following terms and conditions:-

N Ltd to assume:

- 1) Assume all the liabilities and to acquire all assets except Investments which were sold by D Ltd for Rs.45,000
- 2) Discharge the debenture debt at a discount of 5% by issue of 7% debentures in N Ltd.
- 3) Issue to shares of Rs.60 each in N Ltd at Rs.65 per share and to pay Rs.2 in cash to the shareholders of D Ltd in exchange for one share in D Ltd.
- 4) Pay the absorption cost of Rs.1,500.

D Ltd sold in the open market one fourth of the shares received from N Ltd at the average rate of Rs.63 per share. Pass the journal entries to record the above transactions in the books of D Ltd. (15 Marks)

8 CASE STUDY:

(20 Marks)

Consider two firms that operate independently and have the following data:-

| Particulars | (Rs. in million.) | |
|----------------------|-------------------|-------------|
| | Metro Ltd | Regency Ltd |
| Reserves | 6,000 | 3,000 |
| Cost of goods sold | 3,500 | 1,800 |
| EBIT | 2,500 | 1,200 |
| Expected growth rate | 5% | 7% |
| Cost of capital | 8% | 9% |

Both the firms are in a steady state with capital spending offset by depreciation. Both the firms have an effective tax rate of 40% and are financed by equity only.

Scenario 1:- Assume that combining of the two firms will create economies of scale that will reduce the cost of goods sold to 48% of reserves.

Scenario 2:- Assume that as a consequence of the merger the combined form is expected to increase its future growth to 7% while the cost of goods sold is 60% and do not come down to 48%.

Scenario 1 and 2 are mutually exclusive. You are required to:-

- a. Compute the value of both the firms as separate units.
- b. Compute the value of both the firms together if there were absolutely no synergy at all from merger.
- c. Compute the cost of capital and the expected growth rate for the combined entity.
- d. Compute the value of synergy in Scenario 1 and Scenario 2.

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Third Semester MBA Degree Examination, June-July 2009

Mergers, Acquisition and Corporate Restructuring

Time: 3 hrs.

Max. Marks:100

Note: Answer any FOUR questions from Q.1 to Q.7
Question No.8 is compulsory.

- 1 a. What are the different types of mergers? (03 Marks)
b. Explain why mergers and Acquisitions often fail? (07 Marks)
c. What are the strategic drivers of Mergers and Acquisition? (10 Marks)
- 2 a. Explain agency cost. (03 Marks)
b. Discuss the financial perspective of Conglomerate diversification. (07 Marks)
c. Explain i) Efficiency theories ii) Information and signaling. (10 Marks)
- 3 a. Write a note on hostile takeover with an example. (03 Marks)
b. What are the different types of swaps? (07 Marks)
c. Write a note on the following: (10 Marks)
i) Buyback ii) Joint ventures.
- 4 a. What is an ESOP? (03 Marks)
b. What is LBO? What are the different types of LBO? (07 Marks)
c. Write short notes on the following: (10 Marks)
i) Spin off ii) Split up iii) Divestitures iv) Equity carve out v) Poison pill.
- 5 a. Explain bootstrapping. (03 Marks)
b. Describe the five stages in the Merger and Acquisition process. (07 Marks)
c. Explain briefly the various types of takeover defenses (10 Marks)
- 6 a. Explain the SEBI guidelines with respect to the minimum offer price. (03 Marks)
b. Discuss the cultural and political perspective of post merger integration. (07 Marks)
c. The following are the abridged balance sheet of P Ltd and S Ltd as on 31st March, 2006.

| Liabilities | P Ltd | | S Ltd | | Assets | |
|---|--------------|--|-------------|--|----------------|--------------|
| | Rs. in 1000 | | Rs. in 1000 | | Rs. in 1000 | |
| Equity share capital (Rs.10 each) | 8000 | | 3000 | | Fixed Assets | 11000 |
| 10% Preference capital (Rs.100 each) | | | 1000 | | Current Assets | 4000 |
| General Reserve | 4610 | | 980 | | | |
| Statutory Reserve | 390 | | 125 | | | |
| Profit and Loss A/C. | 563 | | 355 | | | |
| 12% Debentures | | | 250 | | | |
| Current liabilities | 1437 | | 990 | | | |
| | 15000 | | 6700 | | | |
| | | | | | | 15000 |
| | | | | | | 6700 |

On 1st April, 2006, P Ltd takes over S Ltd on the following terms:

- i) P Ltd will issue 350000 equity shares of Rs.10 each at par to the equity shareholders of S Ltd.
- ii) P Ltd will issue 11000 10% preference share of Rs.100 each at par to the preference shareholders of S Ltd.
- iii) The debentures of S Ltd will be converted into an equal member of 12.5% debentures of same denomination.

You are informed that the statutory reserves of S Ltd are to be maintained for two more years. You are required to show the balance sheet of P Ltd immediately after the above mentioned scheme of amalgamation has been implemented assuming that the amalgamation is in the nature of merger. (10 Marks)

- 7 a. Y Ltd is considering the acquisition of X Ltd with stock. Relevant financial information is as follows:

| | Y | X |
|--------------------------------|-----------|-----------|
| Present earnings (in thousand) | Rs. 4,000 | Rs. 1,000 |
| Common shares (in thousand) | Rs. 2,000 | Rs. 800 |
| Earning per share | Rs. 2 | Rs. 1.25 |
| Price/earnings ratio | 12 | 8 |

Y Ltd plans to offer a premium of 20 percent over the market price of X Ltd.

- i) What is the ratio of exchange of stock? ii) How many new shares will be issued? (03 Marks)
- b. GFC is taking over TPC. The shareholders of TPC would receive 0.8 shares of GFC for each share held by them. The relevant data for two companies are as follows:

| | GFC | TPC |
|--------------------------------|------|------|
| Net sales (Rs in crore) | 335 | 118 |
| Profit after tax (Rs in crore) | 58 | 12 |
| No. of shares (Crore) | 12 | 3 |
| EPS (Rs) | 4.83 | 4 |
| Market value per share | 30 | 20 |
| Price earnings ratio | 6.21 | 5.00 |

For the combined company (after merger) you are required to calculate i) EPS ii) P/E ratio iii) market value per share iv) number of shares v) Total market capitalization. (07 Marks)

- c. XYZ company is acquiring PQR company. XYZ will pay 0.5 of its shares to the shareholders of PQR for each share held by them. The data for the two companies are as given below:

| | XYZ | PQR |
|-------------------------------|-----|-------|
| Profit after tax (Rs in lakh) | 150 | 30 |
| No. of shares (lakhs) | 25 | 8 |
| EPS (Rs) | 6 | 3.75 |
| Market price of share (Rs) | 78 | 33.75 |
| P E ratio | 13 | 9 |

Calculate the earnings per share of the surviving firm after merger. If the ratio falls to 12 after the merger, what is the premium received by the share holders of PQR (using the surviving firm's new price)? Is the merger beneficial for XYZ shareholders? (10 Marks)

8 Case Study :

The following are the details of two potential merger candidates, Northrop and Grumman in 2006:

| | Northrop | Grumman |
|------------------------|----------------|----------------|
| Revenues | \$4400 | \$3125 |
| Cost of goods sold | 87.5% | 89% |
| Depreciation | \$200 | \$74 |
| Tax rate | 35% | 35% |
| Working capital | 10% of revenue | 10% of revenue |
| Market value of equity | \$2000 | \$1300 |
| Outstanding debt | \$160 | \$250 |

Both firms are expected to grow 5% a year in perpetuity. Capital spending is expected to be offset by depreciation. The beta for both the firms is 1 and both firms are rated BBB, with an interest rate on their debt of 8.5%. The risk free rate is 7% and the market risk premium is 5.5%. As a result of merger, the combined firm is expected to have a cost of goods sold of only 86% of total revenues.

- Estimate the value of Grumman, operating independently.
- Estimate the value of Northrop, operating independently.
- Estimate the value of combined firm with no synergy.
- Estimate the value of combined firm with synergy.
- How much is the operating synergy worth?

(20 Marks)

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Third Semester MBA Degree Examination, Dec.09/Jan.10
Mergers, Acquisitions and Corporate Restructuring

Time: 3 hrs.

Max. Marks:100

Note: 1. Answer any FOUR full questions from the Q.No.1 to 7.
2. Question No. 8 is compulsory.

- 1 a. Mention any three different ways of measuring success of mergers and acquisitions. (03 Marks)
b. Briefly explain the characteristics of horizontal mergers. (07 Marks)
c. Explain the arguments against conglomerates. (10 Marks)
- 2 a. Mention different types of corporate refocusing. (03 Marks)
b. What are the alternatives to vertical integration? Briefly explain any one. (07 Marks)
c. What is leveraged buyouts (LBO)? What kind of targets make good LBOs? (10 Marks)
- 3 a. Mention any three factors that determine choice of financing method in acquisition. (03 Marks)
b. Distinguish between friendly takeovers and hostile takeovers. (07 Marks)
c. Karnataka – Tours Ltd is considering merger to achieve more favourable growth. The company has decided to acquire Indian Overseas Travellers Ltd. Karnataka – Tours Ltd offers Rs.10,00,000 for Rs.6,00,000 of Indian Overseas Travellers Ltd's stock at book value. Indian Overseas Travellers Ltd has Rs.200,000 debt.
Calculate goodwill that may arise if Karnataka – Tours Ltd has Rs.20,00,000 equity and Rs.5,00,000 debt itself.
Prepare a combined balance sheet under
i) Purchase method
ii) Pooling of interest method. (10 Marks)
- 4 a. Specify any three differences between mergers and holding company technique for combination. (03 Marks)
b. Briefly explain earn-outs as an approach to merger financing. (05 Marks)
c. Mega Retailers Ltd plans to acquire Agro Logistics Ltd as a strategy. Details of financial data before merger are as follows:
Number of outstanding shares: Market price per share:
Mega Retailers Ltd : 30 million Mega Retailers Ltd Rs.100/- per share
Agro Logistics Ltd : 20 million Agro Logistics Ltd Rs.40 per share.
It is expected that, merger of above companies results in gains having present value of Rs.300 million.
Exchange ratio agreed between the companies is 1.00.
i) Calculate the value of merger for Mega Retailers Ltd. (12 Marks)
ii) Provide your comment.
- 5 a. What is equity carve – out? (03 Marks)
b. Write a note on recent mergers in India. (07 Marks)
c. Specify various theories of merger and explain any one in detail. (10 Marks)

Important Note : 1. On completing your answers, compulsorily draw diagonal cross lines on the remaining blank pages.
2. Any revealing of identification, appeal to evaluator and /or equations written eg. 42+8 = 50, will be treated as malpractice.

- 6 a. Mention any six post merger problems. (03 Marks)
 b. Explain the basis on which exchange ratio is determined in practice. (05 Marks)
 c. U and I softwares Ltd and Linda IT Ltd provide the following financial data:

| | U and I Ltd | Linda IT Ltd |
|---------------------------------|-------------|--------------|
| EAT (Rs in lakh) | 25 | 3 |
| Net sales (Rs in lakh) | 400.00 | 60.00 |
| Number of shares | 800,000 | 300,000 |
| EPS Rs | 3 | 1 |
| DPS Rs | 2 | 1 |
| Market capitalization (Rs lakh) | 500.00 | 60.00 |

U and I softwares Ltd planned to acquire Linda IT Ltd.

Required:

- i) Calculate premerger market value per share for both the companies.
 ii) Calculate post merger EPS market value per share and price earnings ratio if share holders of Linda IT Ltd are offered a share of Rs.60 or Rs.40 in a share exchange for merger.
 iii) Calculate U and I software Ltd's EPS if Linda IT Ltd's share holders are offered Rs.150, 14% convertible bond for each two shares held in Linda IT Ltd. (12 Marks)
- 7 a. What is Master Limited Partnership (MLP)? (03 Marks)
 b. Write a note on mergers as capital budgeting decisions. (07 Marks)
 c. Explain the main provisions under SEBI takeover code. (10 Marks)

8 CASE STUDY

During 1960s and 1970s with the spread of large out-of-town super markets, retailers were big enough to invest on information technology and also gained power over manufacturers, who tended to have superior information about customers (ie. Manufacturers).

Super markets discovered their own brands to compete with established ones of the manufacturers. In Europe large mergers further empowered the steady accrual of buyer power.

Wal-Mart of US acquired Asda of the UK. Similarly in France, Carrefour and Promodes merged. Experts judged that further consolidation through mergers would result in an industry, dominated by five/six global groups in a few years.

Responding to this challenge from retailers, with mergers of their own, the Unilever group acquired Slim fast foods and Ben and Jerry's homemade and bestfoods in the US, the last for \$20 bn in 2000. The objective of this acquisition was to build up strong global brands that would withstand the retailers' cut-throat competition. Manufacturers also aimed to reduce costs and improve their profit margins.

Besides, manufacturers also tried strategies like, offering services that required use of their products directly to consumers, like Unilever introduced home cleaning and laundry service in UK.

Proctor and Gamble started its online beauty care business, allowing women to design their own beauty products and order them from home. In India, Hindustan Lever Ltd has introduced direct to home sales of Pureit.

While the retailers were behaving like manufacturers, the latter were emulating the former.

Questions:

- a. Bring out sources of manufacturers competitive advantage in the above case.
 b. How mergers help the retailers like Wal-Mart to gain competitive advantage? (Refer case above)
 c. Before merger movement, what was the retail industry's competitive structure?
 d. Briefly explain the financial advantages of mergers to both retail and manufacturing industries. (20 Marks)

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10

Third Semester MBA Degree Examination, Dec.09-Jan.10 Mergers, Acquisitions and Corporate Restructuring

Time: 3 hrs.

Max. Marks:100

- Note: 1. Answer any FOUR full questions form Q.No.1 to Q.No.7.
Question No. 8 is compulsory.
2. Use of Scientific calculators to be permitted.
3. Present value tables to be allowed.**

- 1
 - a. Distinguish between a friendly takeover and a hostile takeover. Is a "tender offer" same as a hostile takeover? (03 Marks)
 - b. What are the compelling reasons for mergers? Briefly explain atleast three such reasons out of various reasons. (07 Marks)
 - c. Explain the following in the context of a merger :
 - i) Horizontal merger
 - ii) Vertical merger
 - iii) Conglomerate merger. (10 Marks)
- 2
 - a. Briefly explain the meaning of valuation of goodwill using super profits method. (03 Marks)
 - b. What are the various synergies that are possible from a merger? (07 Marks)
 - c. Co. B is being absorbed by A, on a share exchange basis. Relevant financial data are as under.

| | A. Ltd | B. Ltd |
|----------------------------|--------|--------|
| PAT, Rs lakhs | 56 | 21 |
| No of equity shares, lakhs | 10 | 8.40 |
| EPS, Rs /share | 5.60 | 2.50 |
| PER, no of times | 12.50 | 7.50 |

Determine premerger market value / share of each company and maximum exchange ratio A Ltd can offer without dilution of its EPS and MV/share. (10 Marks)

- 3
 - a. An Acquisition is basically a NPV decision. Do you agree? How? (03 Marks)
 - b. What do you mean by LBO? What is the immediate financial risk faced by a LBO after restructuring? (07 Marks)
 - c. Co E Ltd is considering acquisition of F Ltd. following data are available for both.

| | Co E Ltd | Co F Ltd |
|---------------------|------------|----------|
| PAT, Rs | 2,00,000/- | 60,000 |
| No of equity shares | 40,000 | 10,000 |
| MV / share, Rs | 15/- | 12/- |
| EPS, Rs / share | 5/- | 6/- |

- i) If merger goes through by way of exchange of equity shares when exchange ratio is based on current market value of equity , what will be the new EPS for Co E?
 - ii) Company F Ltd wants to make sure that earnings available to its share holders will not be diluted due to merger. What should be the exchange ratio in this case? (10 Marks)

- 4
 - a. What is a due diligence process in the context of a merger? (03 Marks)
 - b. Explain the following concepts in the context of valuation of a company :
 - i) Book value
 - ii) Market value
 - iii) Appraised value
 - iv) Replacement value
 - v) Liquidation value. (07 Marks)
 - c. TP Ltd has identified the following incremental benefits and costs associated with a target over a 10 year period (all in Rs).

| Year | Cash flows before taxes (CFBT) | Depreciation | Investments |
|--------|--------------------------------|--------------|-------------|
| 1 | 80,000/- | 20,000/- | 1,50,000/- |
| 2 | 80,000/- | 50,000/- | 1,00,000/- |
| 3 | 1,35,000/- | 50,000/- | 50,000/- |
| 4 | 1,90,000/- | 50,000/- | Nil |
| 5 | 1,95,000/- | 50,000/- | Nil |
| 6 - 10 | 2,00,000/- | 20,000/- | Nil |

- i) Given TP Co's tax rate of 40%, calculate present value of after tax cash flows (CFAT) at 15% required rate of return over a 10 year period resulting from this acquisition.
- ii) Value of TP Ltd is Rs 24 lakhs before merger, while that of target is Rs 10 lakhs per merger. Market value / share of TP Ltd is Rs 50/- and required rate of return is 15%. Calculate NPV for both cash financed and stock financed acquisition, if TP Co. Ltd expects paying a premium of 15% above current market value of target.

Note : - PVF, SF, 15% (years 1 – 10 ave) 0.870, 0.756, 0.658, 0.572, 0.497, 0.432, 0.376, 0.327, 0.284, 0.247 respectively. (10 Marks)

- 5 a. What are the advantages and disadvantages of usage of equity only as a means of financing an acquisition? (03 Marks)
- b. Explain the following terms in the context of a takeover or acquisition : i) Street swap ii) Alliance iii) Staggered Board iv) Poisson pill v) Green mail vi) Crown jewel vii) White knight / Squire. (07 Marks)
- c. XYZ Ltd is considering a merger with ABC Ltd. Shares of XYZ Ltd are currently traded at Rs 25/- each, has 2 lakh shares outstanding and a PAT of Rs 4 lakhs. ABC Ltd has 1 lakh shares outstanding, its current market value is Rs 12.50 per share and a PAT of Rs 1 lakhs. Merger will be affected through a stock swap. ABC has agreed to a plan where XYZ will offer current market value of ABC's shares.
- i) What are the pre merger EPs and PER of both companies?
- ii) If ABC's PER is 8 times, what is its current market price? What is the exchange ratio? What will be post merger EPS of XYZ Ltd?
- iii) What must be the exchange ratio for XYZ Ltd, so that its pre merger and post merger EPS will be the same? (10 Marks)

- 6 a. Explain the meaning of "pooling of interest and purchasing of interest" in case of a merger. (03 Marks)
- b. Briefly highlight taxation aspects as applicable to both amalgamated co and amalgamating co under IT Act 1961. (07 Marks)
- c. Co. A is planning to acquire B. Relevant financial details (pre merger) are as under :

| Particulars | Co. A | Co. B |
|---------------------|-------|-------|
| MV/ share Rs | 75/- | 30/- |
| No. of shares lakhs | 10 | 5 |
| MV, Co, Rs lakhs | 750 | 150 |

This merger is expected to bring in gains with a present value of Rs 150 lakhs. Co A offers 2,50,000 shares in exchange of 5 lakh shares to share holders of B. You are required to calculate : i) True cost of acquiring B by A ii) NPV of merger to B. State if you have made any assumptions. (10 Marks)

- 7 a. Explain the meanings of negotiated or friendly acquisition, open market acquisition and a bail out offer. (05 Marks)

- b. XYZ Ltd is considering purchase of Y Ltd. XYZ Ltd has 3 lakh shares outstanding with a market price of Rs 30/- per share where as Y Ltd has 2 lakh shares outstanding each selling at Rs 20/- per share. EPS are Rs 4/- and Rs 2.25 per share (XYZ and Y Ltd respectively). Managements of both companies are discussing two proposals for exchanging shares as
- i) In proportion to relative EPS of these Co's ii) 0.5 XYZ : 1 Y (0.5 : 1). You are required to compute : I) EPS, post merger, both alternative II) Share impact on EPS for share holders of two Co's under both alternatives. (15 Marks)

8 Compulsory Case Study :

Balance sheet of XYZ Ltd as on 31 – 3, current year in Rs lakhs ; is as under.

| Equity, 10 lakh shares Rs 20/- FV | Rs 200 lakhs | Net plant | Rs 250 lakhs |
|---|--------------|-----------|--------------|
| 13% debentures | 100 | Fixtures | 5 |
| Reserves and surplus | 50 | Stock | 90 |
| Creditors and other current liabilities | 30 | Debtors | 25 |
| | | Bank | 10 |
| Total | 380 | Total | 380 |

Other information :

- i) This company is to be absorbed by ABC Ltd as on above date. Consideration for absorption is discharge of debentures at a premium of 10%, taking over liability in respect of sundry creditors and payment of Rs 14/- in cash and one share of Rs 10/- in ABC Ltd at a market price of Rs 16/- per share, in exchange of one share of XYZ Ltd. Also cost of dissolution of Rs 10 lakhs is to be borne by purchasing company.
- ii) Expected incremental annual free cash flows to the firm (FCFF) from this acquisition over a 5 year period is

| Year | 1 | 2 | 3 | 4 | 5 |
|--------------|-----|-----|-----|-----|----|
| CF, Rs lakhs | 100 | 135 | 175 | 200 | 80 |

- iii) FCFF is expected to be constant after 5 years.
 iv) Cost of capital relevant to this decision is 14%.

Required :

- a. Comment on financial soundness of this merger by determining NPV.
 b. Determine minimum cash flows required from target for this acquisition at 14% cost of capital (when NPV becomes zero). In both cases, assume no salvage for current assets or fixed assets except cash which is recovered in full.

Please note : PVF., SF, (1-6) are at 14% are as under :

0.8771, 0.7695, 0.6749, 0.5920, 0.5193, 0.4555 respectively.

(20 Marks)

- 3 a. How to determine return on equity? (03 Marks)
- b. What are the steps in discounted cash flow valuations? (07 Marks)
- c. ABC Ltd. has declared dividend during the past five years as follows:

| Year | 2001 | 2002 | 2003 | 2004 | 2005 |
|----------------------|------|------|------|------|------|
| Rate of dividend (%) | 12 | 14 | 18 | 21 | 24 |

The average rate of return prevailing in the same industry is 15%. Calculate the value per share of Rs.10 of ABC Ltd. based on the dividend yield method. (10 Marks)

- 4 a. What do you understand by capital structure and business value? (03 Marks)
- b. ABC Ltd. is intending to acquire substantial share in Z Ltd. to acquire control in the company. The beta factor of Z. Ltd. shares is 1.60 and its current market price is Rs.190. The company is consistently paying a dividend of Rs.46 p.a. The risk free market rate of interest is 12% and the rate of return expected on such securities in the market is 18%. You are required to value the share of Z Ltd. (07 Marks)
- c. XYZ Ltd. is intending to acquire ABC Ltd. (by merger). The following information is available in respect of the companies:

| Particulars | XYZ Ltd. | ABC Ltd. |
|------------------------------|-----------|----------|
| No. of equity shares | 5,00,000 | 3,00,000 |
| Earnings after tax (Rs.) | 25,00,000 | 9,00,000 |
| Market value per share (Rs.) | 21 | 14 |

- i) What is the present EPS of both companies?
- ii) If the proposal merger takes place, what would be the new earning per share for XYZ Ltd? (assuming that the merger takes place by exchange of equity shares and the exchange ratio is based on the current market prices.)
- iii) What should be exchange ratio, if ABC Ltd. wants to ensure the same earnings to members as before the merger? (10 Marks)
- 5 a. Calculate the market price of ABC Ltd's shares under Walter's model. Earnings per share = Rs.4, Dividend per share = Rs. 2.50, Cost of capital = 16%, Internal rate of return = 18%. (03 Marks)

- b. Alpha Ltd. operates in the pharma industry. The firm is expected to pass through two phases of growth i) initial high growth and ii) a stable growth period. The tax rate for the firm is 40%. The following parameters are available for the firm:

| | Initial Growth phase | Stable Growth phase |
|-----------------------|----------------------|---------------------|
| Return on assets | 25% | 18% |
| Debts equity ratio | 1 | 1 |
| Interest rate on debt | 12% | 10% |
| Payout ratio | 24% | ? |
| Growth rate | ? | 10% |

Estimate the growth rate of revenues for the firm in the critical growth phase. (07 Marks)

- 13
2
2
- c. BART is a large company operating in the cement industry. Given its large size it is unlikely that the firm will grow at a rate faster than the economy in the long term. The free cash flow to the firm in 2004 was Rs.4 per share. The following additional information for the year 2005 is available:

Earning per share = Rs.4.5
 Depreciation per share = Rs.3.30
 Debt financing ratio = 30%

Capital expenditure per share = Rs.4.15
 Change in working capital/share = Re.1

The earnings, capital expenditure, depreciation and working capital are all expected to grow at 6% a year. The beta of the stock is 1.1. The treasury bill rate is 7%. Estimate the value per share using the free cash flow to equity method. (Assume the market premium to be 6%)
 (10 Marks)

- 6 a. The Treasury bill is being traded at 4.5%. Assume that three different factors are considered. The following additional information is available as

| | Factor 1 | Factor 2 | Factor 3 |
|--------------|----------|----------|----------|
| Risk Premium | 4% | 4.5% | 3% |
| Beta | 1.25 | 0.95 | 1.15 |

Estimate the cost of equity. (03 Marks)

- b. What is the function of due diligence? (07 Marks)
- c. What are the reasons for failure of M & A? (10 Marks)
- 7 a. ABC Ltd. a listed company in BSE, which has 50,000 outstanding shares, has made an offer to repurchase 18% of its shares through an open market operation. The shares are being quoted at Rs.84. ABC Ltd. offered Rs.92 for each share sold by the shareholders. 25% of the outstanding shares were offered by the shareholders for the buyback. Estimate the value of the remaining shares after the repurchase. (03 Marks)
- b. Why do companies form strategic alliances? (07 Marks)
- c. What are the key issues in the joint ventures? (10 Marks)

8 Case Study:

Raymond Inc., a leader in the development and manufacture of household products in India, reported EBIT of Rs.1200 lakhs in 2004, prior to depreciation of Rs.350 lakhs. The capital expenditure in 2004 amounted to Rs.420 lakhs and working capital was 10% of revenues (which were Rs.13000 lakhs). The firm has outstanding debt, yielding a pre-tax interest rate of 8%. The tax rate for the firm is 40% and the treasury bill rate is 7%. The most recent beta for the firm is 1.10. The debt equity ratio of the firm was 50%.

The firm expects revenues, earnings, capital expenditure and depreciation to grow at 9.5% a year from 2005-09, after which the growth rate is expected to drop by 4% (capital spending will offset depreciation in the steady state period). The company also plans to lower its debt/equity ratio to 25% for the steady state resulting in the pre tax interest rate drop to 7.5%. The annual market premium of the firm is 6%.

- a. Calculate free cash flow and PV of free cash flow. (07 Marks)
- b. Estimate the value of the firm. (07 Marks)
- c. Provide your comments. (06 Marks)
