

Internal Assessment Test - I

Sub:	Merger , Acquisitions and Corporate Restructuring						Code:	18MB	
Date	4/5/21	Duration:	90 mins	Max Marks:	50	Sem:	I	Branch:	MBA

**Part A: (Answer any 2 full questions)**

1 (a) What is demerger, list some examples

Marks [03] CO

A demerger meaning is termed as the transfer of business undertakings to other company. Therefore, the company who receives the undertakings is called the resulting company. While the source company who transfers it is known as the demerged company.

Ex: Hero Honda, got splitted from Hero, and now only Honda operates.

WIPRO IT division in the 1980s

(b) Discuss types of synergies of Merger?

[07] CO

Detailed discussion on

Financial synergy

Managerial synergy

Operating synergy

(c) Explain the various theories of merger?

[10] CO

**Differential efficiency theory:**

According to this theory, if the firm A acquires firm B, and if the management of firm A is more efficient than firm B, the efficiency of firm B is brought to the level of firm A.

This theory also implies that some firms operate below their potential and as a result have below average level of efficiency.

Such firms are more vulnerable to acquisitions by other most efficient firms in the same industry.

This is because firms with greater efficiency would be able to identify firms with good potential but operating lower efficiency.

**Inefficient Management theory:**

This is similar to the concept of managerial efficiency but it is different, inefficient management means that the management of one company simply is not performing upto its potential

Inefficient management theory simply represents that is incompetent in the complete sense.

### Hubris motivation hypothesis:

Hubris hypothesis implies that managers look for acquisitions of firms for their own potential motive and that the economic gains are not only the motives for acquisitions

This theory is particularly evident in case of competitive tender offer to acquire a target. The urge to win the game often results in the winners curse refers to the ironic hypothesis that states that the firm which overestimates the value of the target mostly wins the context.

2a) What is due Diligence?

[03] CO

**Due diligence** is an investigation, audit, or review performed to confirm facts or details of a matter under consideration. In the financial world, **due diligence** requires an examination of financial records before entering into a proposed transaction with another party.

(b) Firm X is considering the acquisition of Firm Y. The relevant information is as follows. Firm X [07] CO has the total market value of Rs 25 crore. Firm Y has a total market value of Rs 15 crore. The value of A past merger is expected to be Rs 43 Crore due to synergy. Firm X will have to pay Rs 16.5 crore to firm Y. What is the net gain to firm X.

2 (b). X → acquiring firm  
Y → Target firm.

$$V_X = ₹ 25 \text{ cr.}$$
$$V_Y = ₹ 15 \text{ cr.}$$
$$V_{XY} = ₹ 43 \text{ cr.}$$

purchase consideration = ₹ 16.5 cr.

Net gain = ?

$$V_{XY} = V_{XY} - (V_X + V_Y)$$
$$= 43 - (25 + 15)$$
$$= 43 - 40$$
$$V_{XY}' = ₹ 3 \text{ cr.}$$
$$\text{Net gain} = V_{XY}' - \text{Cost of merger}$$
$$= 3 \text{ cr.} - 1.5 \text{ cr.}$$
$$= ₹ 1.5 \text{ cr.}$$
$$\text{Cost of merger} = \text{Cash paid} - V_Y$$
$$= 16.5 - 15$$
$$= ₹ 1.5 \text{ cr.}$$

c) Explain the 5 stage model of merger process

[10] CO

#### Stage 1: Corporate strategy evolution

The goal of M & A is to achieve corporate and business strategic objectives. The corporate strategy aims to achieve ways to optimise the portfolio of businesses that a firm has and how that portfolio can be modified in the interest of the shareholders.

The business strategy aims to enhance the firm's competitive positioning on a sustainable basis in its chosen markets. Both the objectives can be met by M & A but is only one of several alternatives including, for instance, strategic alliances, outsourcing, organic growth, etc.

### Stage 2: Organising for acquisition

It is important to understand the decision process of acquisition because it has a bearing not only on the quality of the decision and its value creation logic but also on the ultimate success of the post-merger integration.

### Stage 3: Deal structuring and negotiation

The result of the processes described in Stages 1 and 2 is the specific target selection. Once the selection has been made by the firm, the merger transaction has to be negotiated or a takeover bid to be made. The deal-making takes place in this stage.

### Stage 4: Post-acquisition integration

The objective of this important stage is to make the merged organisation operational so that the strategic value expectations can be delivered which drove the merger in the first place.

Integration of two organisations is not just about making changes in the organisational structure and instituting a new hierarchy of authority. It involves the integration of processes, systems, strategies, reporting systems, etc.

Above all, it also involves integrating people and changing the organisational culture of the merging firms, possibly to develop a new hybrid culture.

Integration of organisations may require a change in the mindset and behaviour of the people. It is, therefore, necessary to address cultural issues during the integration process.

### Stage 5: Post-acquisition audit and organisational learning

Companies trying to grow through acquisitions need to develop acquisition-making as a core competence and excel in it.

Companies possessing the right growth strategy through acquisition and the necessary organisational capabilities to manage their acquisitions efficiently and effectively can sustain their competitive advantage far longer and create sustained value for their shareholders

3 (a) What are the motives behind mergers and Acquisition



[03] CO

(b) Explain the various types of due diligence?

[07] CO

**Due Diligence**

Due diligence is an audit or investigation conducted by the company of the potential product or investment being planned by it. Due diligence reviews all financial records. It is a final precaution measure undertaken before entering into an agreement with another party.

**Types Of Due Diligence**

- Legal Due Diligence
- Tax Due Diligence
- Process Centered
- Operational Due Diligence
- Intellectual Property Due Diligence
- Commercial Due Diligence
- Information Technology Due Diligence
- Human resources Due Diligence

c) Discuss different types of mergers with examples

[10] CO

4 Types of Mergers and Acquisitions



**Horizontal**

Companies with similar products or services come together with the main goal to expand their offerings or markets.



**Vertical**

Companies in the same industry join their forces to improve logistics, consolidate staff or reduce time to market their offerings.



**Conglomerate**

Companies in different industries join their forces with a goal to broaden their range of services and products.



**Concentric**

Companies share customer bases but provide different services and do not have a mutual relationship.

**Part B (Compulsory Question)**

**[10]marks**

4 X Ltd wishes to acquire Y LTD. The financial details are as follows:

Liabilities	X Ltd	Y Ltd	Assets	X Ltd	Y Ltd
10% Debentures	100,000	100,000	Fixed assets	600,000	250,000
P &L A/c	150,000	100,000	Current assets	350,000	210,000
Share Premium A/c	-	10,000			
Equity share @ Rs 100 each	500,000	250,000			
Preference share	200,000	-			
<b>Total</b>	<b>950,000</b>	<b>460,000</b>	<b>Total</b>	<b>950,000</b>	<b>460,000</b>

**Additional information:**

a) Annual profit available to equity shareholders after tax and preference dividend is as follows:  
 X LTD: Rs 150,000    Y Ltd: Rs 80,000

b) MPS per equity share:  
 X Ltd: Rs 200        Y Ltd: Rs 250

Calculate share exchange ratio based on : a) NAV    b) EPS c) MPS

Part-2.

4. X → Acquiring firm  
Y → Target firm.

a) NAV      b) EPS      c) Mps.

$$a) \text{ NAV} = \frac{\text{Net worth}}{\text{No. of eq. shares o/s}}$$

Net worth:

	X	Y
Total assets	9,50,000	4,60,000
(-) pref. shares	2,00,000	-
(-) 10% Debt	1,00,000	1,00,000
<u>Net worth</u>	<u>6,50,000</u>	<u>3,60,000</u>

No. of eq. shares o/s:

$$X \text{ Ltd.} = \frac{5,00,000}{100} = \underline{5000}$$

$$Y \text{ Ltd.} = \frac{2,50,000}{100} = \underline{2500}$$

$$\text{NAV (X Ltd.)} = \frac{6,50,000}{5000} = \underline{Rs. 130}$$

$$\text{NAV (Y Ltd.)} = \frac{3,60,000}{2500} = \underline{Rs. 144}$$

$$\text{NAV exchange} = 144 = 1.11$$

$\therefore$  No. of shares issued by X Ltd. to Y Ltd.  
 $1.11 \times 2500 = 2775$  shares

$$b) \text{EPS} = \frac{\text{EAT}}{\text{No. of eq. shares of X}}$$

$$\text{EPS (X Ltd.)} = \frac{150,000}{5000} = 30 \text{ / share}$$

$$\text{EPS (Y Ltd.)} = \frac{80,000}{2500} = 32 \text{ / share}$$

$$\text{EPS exchange ratio} = \frac{\text{EPS of target firm}}{\text{EPS of acquiring firm}}$$

$$\text{EPS} = \frac{32}{30} = 1.06$$

$\therefore$  No. of shares issued by X Ltd. to Y Ltd.  
 $1.06 \times 2500 = 2650$  shares

$$c) \text{MPS exchange ratio} = \frac{\text{MPS of target firm}}{\text{MPS of acquiring firm}}$$

$$= \frac{250}{200}$$

$$= 1.25$$

$\therefore$  No. of shares issued by X Ltd. to Y Ltd.  
 $1.25 \times 2500 = 3125$  shares

Compare:

a) NAV  $\rightarrow$  2775 shares

b) EPS  $\rightarrow$  2650 shares

c) MPS  $\rightarrow$  3125 shares

X Ltd. should prefer EPS method in acquiring Y Ltd.

