CMR
INSTITUTE OF
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Internal Assesment Test - II

Sub:	Mergers Acquisitions and Corporate Restructuring							Code:
Date:	08.06.2021	Duration:	90 mins	Max Marks:	50	Sem:	II	Branch:

Mar

Part A - Answer Any Two Full Questions (16*02=32 Marks)

1 (a) What is swap ratio [03

A swap ratio is a ratio at which an acquiring company will offer its own shares in exchange for the target company's shares during a merger or acquisition. When two companies merge or when one company acquires another, the transaction does not have to be an outright purchase of the target company's shares with cash. It can involve a stock conversion, which is basically an exchange rate, described through the swap ratio.

(b) Explain the different methods of determining the purchase consideration. [0

There are different methods of purchase consideration depending upon the terms and conditions settled between the transferor company.

Net asset method: under this method the net asset value is calculated by deducting all the liabilities taken over by the transferee company from the entire asset taken by the transferee company. The value of the assets and liabilities is not that appear in the balance sheet but it is that which is decided between the two companies.

2) Net payment method: in this case purchase consideration is calculated by adding all the payments made by the transferee company to the shareholders of the transferor company. Payment can be in the form of cash, shares or debentures.

3) Lump sum method: this is the case when Transferee Company agrees to pay Transferor Company a fixed sum of money. Like xyz limited agrees to pay abc ltd 25 lakh. This is lump sum method.

4) Intrinsic value or share exchange method: in this method to calculate purchase consideration following method is used:

Net asset available to the equity shareholders/ number of equity shares

(c) On 31st March the Balance sheet of M stood as follows [0

Liabilities	Rs	Assets	Rs
Share capital for Rs 10 each	500,000	Machinery	70,000
Provision for Creditors	110,000	Inventory	315,000
		Debtors	105,000

		Cash in bank	20,000
		P/L	100,000
Total	**610,000**	**Total**	**610,000**

On this date, L Ltd took over the business of M Ltd for Rs 400,000 , payable in the form of its equity shares of Rs 10 each at par. Show the necessary ledger accounts in the books of M LTd

1(c) L. Ltd: -> Transferee
M Ltd. -> Transferor

Journal entries in the books of M Ltd.

			Dr.	
1)	Realisation a/c	Dr.	5,10,000	
	To Machinery a/c			70,000
	To Inventory a/c			3,15,000
	To Debtors a/c			1,05,000
	To cash in Bank a/c			20,000
	[Being assets taken over].			
2)	Provision for creditors	Dr.	1,10,000	
	To Realisation a/c.			1,10,000
	[Being liabilities discharged]			
3)	L Ltd. a/c	Dr.	4,00,000	
	To Realisation a/c.			4,00,000
	[Being purchase consideration due].			
4)	Shares of L Ltd. a/c	Dr.	4,00,000	
	To L Ltd. a/c			4,00,000
	[Being shares of L Ltd. Recd.]			
5)	Equity shares capital a/c	Dr.	5,00,000	
	To Equity shareholders a/c.			5,00,000
	[Being allotment of eq. share holders].			

6). Equity shareholders a/c Dr. 1,00,000
To P/L a/c 1,00,000
[Being transfer of P/L a/c]

7) Equity shareholders of M Ltd. a/c Dr. 4,00,000
To Share of L Ltd. a/c 4,00,000
[Being L Ltd. alloted shares to M Ltd.]

Ledger a/c

Realisation a/c

Dr. Particulars	Amt		Cr.
To Machinery a/c	70,000	By provision for Creditors	1,15,000
To Debtors a/c.	105,000	By L Ltd.	4,00,000
To Inventory a/c.	315,000		
To Cash in Bank.	20,000		
	5,10,000		5,10,000

Equity shareholders a/c.

Dr.			Cr.
To P/L a/c	100,000	By Eq. capital a/c	5,00,000
To L Ltd. a/c.	400,000		
	500,000		500,000

2 (a) What is Business Valuation its importance [03

2 (a) Business Valuation:

It refers to the cashflows one expects from the business post deal, but much also depends on the bargaining power of the acquirer and the target.

Business valuation centres around 3 foundational concepts:

a) Going Concern value
b) Liquidation value.
c) Market value.

Importance of Business valuation:

* It determines the economic values of business
* It can be used to determine the fair value of a business for a variety of reasons, including sale value, establishing partner ownership, taxation etc.
* Owners will often turn to professional business evaluators for an objective estimate of the value of the business.

(b)Distinguish methods of pooling interest methods and purchase methods [07

Differences

2(b)

Pooling of Interest method	Purchase method
(1) This method is used in the case of amalgamation in the nature of merger.	This method is used in case of amalgamation in the nature of purchase.
(2) This method provides investors with less information.	More information is provided to investors.
(3) This method does not record any required assets and liabs. that are not previously recorded in the books of transferor Co'.	This method reveals all hidden assets & liabs of the transferor Co' by recording at fair value in the books of the transferee Co'.
(4) Under this method, no amalgamation adjustment is opened in the books of transferee Co'.	Under this method, amalgamation adjustment need to be opened in the books of transferee Co' for carry forward of any statutory reserve.
(5) Any differences b/w purchase consideration and value of assets & liabs taken over must be adjusted against "General Reserve".	Any differences b/w purchase consideration and value of assets & liabs taken over must be treated as goodwill or capital reserves.
(6) All assets, liabilities, reserves and surplus of the Transferor Co' are incorporated in the financial statements of the transferee Co' at book value.	Only assets taken over from the transferor Co' are incorporated in the financial statements of the transferee either at book value or agreed value.

(c)The following is the balance sheet of A Ltd as on 31st March 2017, [10

Liabilities	Rs	Assets	Rs
Equity Share capital: of Rs 10 each fully paid	150,000	Fixed assets	32,50,000
General Reserve	900,000	Investments	600,000
Preference share capital	750,000	Current assets	500,000
15% Debentures	700,000		
Current liabilities	500,000		

Calculate purchase consideration under the following conditions using Net asset method

a) Discharge debentures at a premium of 12% debenture of X Ltd.
b) Fixed Assets above 15% of the book value
c) Investments at par value@ 10% Premium
d) Current assets at a discount of 12%
e) Current assets at a book value**.**

2(c) Total assets taken over.

Fixed assets → 32,50,000 + 15% 32,50,000 + 4,87,500	37,37,500
Investments → 6,00,000 + 10% 6,00,000 + 60,000	6,60,000
Current assets → 5,00,000 − 12% 5,00,000 − 60,000	4,40,000
Total assets (A)	48,37,500

Total liabilities taken

Current liabilities →	5,00,000
15% debenture at 12% premium 7,00,000 + 12% 7,00,000 + 84,000	7,84,000
Total liabilities (B)	12,84,000

purchase consideration = A − B.
(Net Asset method) = 48,37,500 − 12,84,000
= $\boxed{\text{Rs. } 35,53,500}$

3 (a) What is called as intrinsic value of share. [03

Intrinsic value is the anticipated or calculated value of a company, stock, currency or product determined through fundamental analysis. It includes tangible and intangible factors. Intrinsic value is also called the real value and may or may not be the same as the current market value. It is also referred to as the price a rational investor is willing to pay for an investment, given its level of risk.

(b) What are the different methods of financing mergers [07

Exchanging Stocks
Debt Acquisition
Paying in Cash
Initial Public Offerings
Issuance of Bonds
Loans

(c)What are the conditions to satisfy an amalgamation to be as the nature of merger, also differentiate amalgamation in nature of merger with amalgamation in nature of purchase. [10

Open with

Amalgamations in The nature of merger

Amalgamations in The nature of merger, it should satisfy. all the following conditions

1). Transfer of all assets & liabilities.
2. Purchase Consideration in Equity shares
3). Same business (Transferor and Transferee)
4. Recording of assets & liabilities at book values.
5. Equity shareholders holding 90% of equity shares are same in both the co's.

Difference.

Amalgamation in the nature of merger	Amalgamation in the nature of purchase
1. Transfer all assets & liabilities	2. There is no need to transfer all assets & liabilities
2. Purchase Consideration is discharged wholly by issue of Equity shares.	P.C need not be ~~issued~~ discharged by issue of equity shares
3. The business of Transferor and Transferee should be in same line of business.	The business of both parties need not be same.

Amalgamation in the nature of merger	Amalgamation in the nature of purchase
4. The assets & liabilities taken over are recorded at their existing carrying amount except where the adjustment is required.	The assets & liabilities taken over are recorded at their existing carrying amount or on the basis of their fair values.
5. The balance of P/L should be aggregated with the corresponding balance of transferee Co' or transferred to General Reserve.	The balance of P/L A/c ~~bor~~ is identified and not recorded at all.

Part B - Compulsory (01*08=08 marks)

4

(a) PQ Ltd wants to acquire MN Ltd by exchanging its 1.6 shares for every share of MN Ltd. It anticipates to maintain the existing P/ E ratio subsequent to merger also. The relevant financial data are furnished below: [10

Particulars	PQ Ltd	MN Ltd
EAT (Rs)	15,00,000	450,000
No. of equity shares outstanding	300,000	75,000
Market price per share (Rs)	35	40

A) What is the exchange ratio based on market price
B) What is the pre merger and P/E ratio for each company?
C) What will the P/E ratio used in acquiring MN Ltd
D) What is the EPS of PQ Ltd after acquisition?
E) What is the expected market price per share of the merger firm?

4 (a) PQ Ltd. → Acquired firm.
MN Ltd. → Target firm.

A) Exchange ratio based on Market price:

For every 1 share of MN Ltd. — 1.6 shares are offered by PQ Ltd
75,000 — x

$75{,}000 \times 1.6 = x$
$\boxed{1{,}20{,}000 \text{ shares}}$ exchanged from PQ Ltd to MN Ltd.

B) pre-merger EPS:

PQ Ltd -	MN Ltd.
$\frac{\text{EAT}}{\text{No. of shares o/s}} = \frac{15{,}00{,}000}{3{,}00{,}000}$	$= \frac{4{,}50{,}000}{75{,}000}$
$= \boxed{₹2.5}$	$= \boxed{₹6.}$

P/E ratio = $\frac{\text{MPS}}{\text{EPS}}$

PQ Ltd $= \frac{35}{5} = \boxed{7 \text{ times}}$

MN Ltd $= \frac{40}{6} = \boxed{6.6 \text{ times}}$

C) P/E ratio used in acquiring MN Ltd is $\boxed{7 \text{ times}}$

D) EPS of PQ Ltd. after acquisition:

$$= \frac{EAT}{\text{No. of eq. shares o/s}}$$

$$= \frac{15,00,000 + 4,50,000}{3,00,000 + 1,20,000}$$

$$= \frac{19,50,000}{4,20,000}$$

$$= \boxed{Rs. 4.64}$$

E) Expected MPS of PQ firm:

Post EPS of merged firm × P/E ratio

$= 4.64 \times 7$

$= \boxed{Rs. 32.48}$

Course Outcomes		PO1	PO2	PO3	PO4	PO5	PO6	PO7
CO1:	Understand Corporate and merger acquisition activity							
CO2:	Analyse M & A deals that took place in the past							
CO3:	Understand the synergies of M &A							
CO4:	Compute the valuation associated with M & A	1a, 1b. 1c, 3a, 3b	2a, 2b				2c, 3c, 4c	
CO5:	Understand the human and cultural aspect of M &A							

Cognitive level	KEYWORDS
L1	List, define, tell, describe, identify, show, label, collect, examine, tabulate, quote, name, who, when, where, etc.
L2	summarize, describe, interpret, contrast, predict, associate, distinguish, estimate, differentiate, discuss, extend
L3	Apply, demonstrate, calculate, complete, illustrate, show, solve, examine, modify, relate, change, classify, experiment, discover.
L4	Analyze, separate, order, explain, connect, classify, arrange, divide, compare, select, explain, infer.
L5	Assess, decide, rank, grade, test, measure, recommend, convince, select, judge, explain, discriminate, support, conclude, compare, summarize.

PO1 - *Knowledge application; PO2 - Analytical and logical thinking; PO3 - Team work; PO4 - Leadership; PO5 - life-long learning; PO6 - Analyze and practice aspects of business;* PO7- *Personal and Societal growth*;