

Q1. What do you mean by Exchange Ratio?

Answer : ER means the number of shares the acquiring firm is willing to give in exchange for one share of the target firm.

Acquirer exchanges its own shares for shares of the target company **according to a pre-determined ratio** decided in merger negotiations.

Q2. What are the bases on which the exchange ratio is commonly determined in practice? Critically evaluate them.

Answer : In an all-stock deal, only two things is important.

1. The percentage holding of the two companies in the new company post merger.

2. The acquisition premium paid by the acquiring firm to the target firm. The Acquisition premium in a pure stock deal is the *amount paid over and above the fundamental value of the target firm as finally accepted & then calculated* . This premium has to be justified by the synergy gains in the merger.

As a rule, the acquisition premium must be less than the synergy gains expected in the deal

In a pure stock deal , the acquisition premium may be determined using equation- 1 below

AP = (MPS of acquirer x ER) minus (MPS of Target)

However, one has to understand that the final acquisition premium to be paid by the acquirer is the negotiated value agreeable to both parties and may be above or lower fundamental value

Now, both the percentage holding and the acquisition premium are dependent on the exchange ratio negotiated between the firms in an all –stock deal.

Hence, the financial due diligence will determine the acquisition premium and the percentage holding before announcing the merger.

The holding of the acquirer firm in the new company post merger = $m / m + nx$
AND

The holding of the target firm in the new company post merger = $nx / m + nx$

Note : m refers to number of shares in the acquiring firm & n is the number of shares in the target firm and X is the exchange ratio.

Bases for determining ER/SR : The commonly used bases for establishing the ER/SR are:

1. Market value per share (MVPS)
2. Book value per share (BVPS)
3. Earnings per share (EPS)
4. Discounted cash flow value per share (DCF Value)

1. DCF Value per share : **DCF Value per share = Firm value using the DCF method -- Debt value / Number of Equity shares. The DCF value approach is ideally suited when fairly credible business plans and cash flow projections are available for a period of 5-10 years for the merging companies**

2. **EPS:** While EPS reflect *prima facie* the earning power, there are some problems in an exchange ratio based solely on the current earnings per share of the merging companies because it fails to take into account the following :

- (a) The difference in the growth rate of earnings of the two companies.
- (b) The differential risks associated with the earnings of the two companies.
- (c) The gains in earnings arising out of merger

If the shareholders want to protect the earnings per share (EPS) ,then the ER would be determined as follows:

ER= EPS of the target/ EPS of the acquirer

3.MVPS : When the shares of the acquiring firm and the target firm are actively traded in a competitive market , market prices have considerable merit. They reflect current earnings, growth prospects, and risk characteristics . But, when trading volume in competitive market is very low , market price , however ,may not be very reliable and, in the extreme case , market prices may not be existent if the shares are not traded.

Another problem with market prices is that they may be manipulated by those who have a vested interest

If the shareholders of acquiring firm want to protect the share price , then the ER would be determined by equation :

ER = MPS of target firm/ MPS of acquiring firm.

Now, when MPS in above equation is not the '*fair value*' but an overvalued share value of the target firm, then ER may increase, creating value loss for acquiring firm shareholders.

Hence, the acquirer will like to find the fundamental value (FV) of the target firm's share which can be determined as follows :

FV of share of target firm = FV of target firm/ number of outstanding shares of target firm

Therefore, **ER = FVPS of Target Firm / MPS of Acquirer Firm**

4. BVPS: The use of this method is not recommended because of the following main reasons:

(a) BV is influenced by accounting policies which reflect subjective judgements

(b) BV do not reflect changes in purchasing power of money

(c) BV often are highly different from true economic value

Q.1 (c) : What are the key methods of valuation of business that may be used in connection with a business combination decision? Explain them.

Answer : Different valuation techniques will be used depending on industry segment, type of company, stage of company's growth, structure of deal proposed, strategic plans for the target, private or public status and such other considerations,. Several methods are typically used to provide a range of valuations, after which the parties often rationalize the choice of analysis that supports their intended objective

The key methods are :

1. Market Based Method :

Comparable Company Market Multiple uses the valuation ratio of a publicly traded company and applies that ratio to the company being valued. The valuation ratio typically expresses the valuation as a function of a measure of financial performance (e.g. Revenue, EBITDA, EBIT, Earnings per Share or Book Value).

A comparable analysis valuation takes two companies with similar metrics and calculates the valuation multiples to compare them. The methodology often includes the creation of benchmarks. This method looks at comparables e.g. compares actual sales of similar businesses within a meaningful timeframe. It provides a helpful metric when comparing companies with differing profit levels but similar margins, products, markets and competition,

EBIT (Earnings Before Interest & Tax) measures a company's financial performance as it can be compared with similar companies, the price/earnings ratio (P/E ratio) is the company's value divided by its after tax profits . To establish the company's value based on price earnings, the valuator must multiply its after-tax profit by an appropriate multiple. Note that any debt should be subtracted and any surplus cash added to calculate the company's equity value, Market Price per Share : The current stock price is generally viewed as one of the best valuation metrics because markets are considered somewhat efficient. Suppose ABC Ltd. engaged in manufacturing cement is currently producing a NOPAT of Rs. 500 million and is to be valued for acquisition purpose. Looking at the valuation of similar cement companies in the industry of same size, it is found that the companies which have comparable cement plants are trading in the market at 6 times their NOPAT. So, as a first approximation we may put a value of Rs. 3000 million to ABC Ltd.

In this example we looked at the market value with NOPAT multiple

Financial analysts consider different multiples for business valuation like

- ✓ Market value- NOPAT Multiple
- ✓ Market value to PAT
- ✓ Market value - Sales Multiple
- ✓ Market Value – EBDIT Multiple
- ✓ Market value- Book value Multiple
- ✓ Market Value to EPS

The perspectives provided by the market multiples are very useful.

To reject them would be to ignore relevant evidence

Income Based Method : This method focuses on expected future cash flows. The discounted cash flow (DCF) approach estimates a company's value on its expected future cash flows. With a DCF analysis, cash flow projections form the basis for the organisation's valuation. The DCF method expresses the present value of the business as a function of its future cash earnings capacity. This methodology works on the premise that the value of a business is measured in terms of future cash flow streams, discounted to the present time at an appropriate discount rate.

The value of the firm is arrived at by estimating the Free Cash Flows (FCF) to Firm after all operating expenses, taxes, working capital and capital expenditure is met.

The Perpetuity value of a business is computed after the business has stabilised. The FCF is then discounted with Weighted Average cost of capital (WACC). Adjustments for Debt and Cash as on Valuation date is then made to the Enterprise Value (EV) to arrive at the Equity Value for Shareholders.

The DCF Method of firm valuation involve three basic steps :

Step -1 : Define the present value (PV) of the free cash flow from the purchase i.e. FCF multiplied by discount rate

The FCF from a purchase is the cash flow generated by it after providing for additional investments required for its operations. It is expressed as : NOPAT – Net Investment in operating capital (OC) (OC = NFA + NCA) **OR**

$FCF = EBIT (1-T) + \text{Non-cash items like Depreciation} -- \text{Changes in working Capital} --- \text{Changes in capital expenditures}$

Step-2 : Establish the Terminal value first and then discount it to present value (PV). Terminal Value can be determined under three different situations as under

(i) When TV is likely to grow at a constant rate

$$TV = FCF \text{ at the end of Horizon Period } \times (1+g) / k-g$$

(ii) When TV is likely to decline at a constant rate

$$TV = FCF \text{ at the end of the Horizon Period } \times (1- g) / k + g$$

(iii) When TV is likely to be constant till infinity

$$TV = FCF / k$$

Here, k represents discount rate / capitalization rate which is generally taken as the weighted average cost of capital

And PV of TV = TV as calculated in above situations multiplied by discount rate

Step-3 : Add the present value of FCF derived in step -1 and Present Value of Terminal Value derived in step 2 to get the total value of purchase

3. Discount Rate or Capitalization Rate (Given the target firm's target capital structure) is the weighted Average Cost of Capital (WACC)

$$WACC (K) = k(e) \times w_1 + k(d) \times w_2 + k(p) \times w_3$$

Note : In the above formula it is assumed that the capital structure of the firm comprises of equity capital (e), Debt capital (d) & Preferential share capital (p)

3. Asset Based Method : A company's balance sheet is a logical starting point when it comes to estimating value. But many items might require adjustments to bring them in line with the current market value. Also, some items like intangible assets won't appear on the balance sheet and must be added.

The asset based method views the business as a set of assets and liabilities that are used as building blocks of a business value. The difference in the value of these assets and liabilities on a book value basis, or realizable value basis or replacement cost basis is the business value. However, the Net Asset Value reflected in books do not usually include intangible assets and earning potential of the business and are also impacted by accounting policies which may be discretionary at times. Thus, Net asset Value is not perceived as a true indicator of the business value. However, it is used to evaluate the entry barrier that exists in a business and is considered viable for mature companies and also for property and investment companies having strong asset base. For Calculating the Adjusted Net asset Value , the valuer should factor in the fair value of the all assets (tangible plus intangible)

Q2 (a) How is goodwill treated in Purchase Method of Accounting ?

Answer : **Goodwill is defined as an identifiable non-monetary assets having no physical substance .** Goodwill represents the future economic benefits arising from such assets acquired in a business combination that are not individually identified and separately recognised.

Goodwill is measured as the difference between the purchase consideration paid including payment for Non-Controlling Interest (NCI) AND the acquisition–date fair value of identifiable net assets acquired

Q 2 (b) Following is the financial details of X Ltd. and Y Ltd.

Particulars	X Ltd	Y Ltd
EPS	Rs4	Rs4
MPS	Rs 80	Rs.60
Number of shares	1,00,000	80,000

The merger of X Ltd. with Y Ltd. will result into a synergy of 6%. What ER will result into a post merger EPS of Rs.5 for Y Ltd.

Solution :

Total Earnings of KP Ltd = EPS x Number of shares

$$= 4 \times 1,00,000 = \text{Rs. } 4,00,000$$

Total Earnings of G Ltd = EPS x Number of shares

$$= 4 \times 80,000 = \text{Rs. } 3,20,000$$

$$\text{Total Earnings of KP + G} = 4 \text{ L} + 3.2\text{L} = 7.2 \text{ L}$$

$$\text{Total Earnings after considering synergy gain of 6\%} = \text{Rs. } 7.2 \text{ L} \times 1.06 = \text{Rs. } 7,63,200$$

Now, It is expected that post merger EPS at Rs.5

(EPS = PAT of combined Firm/ Number of shares in combined Firm)

Therefore,

$$\text{Rs. } 5 = \text{Rs. } 7.632 \text{ lakh} / (1 \text{ lakh shares} + \text{ER} \times 0.8 \text{ Lakh shares})$$

$$7.632 / 5 \text{ lakh} = 1 \text{ lakh shares} + \text{ER} \times 0.8 \text{ Lakh shares}$$

$$1.5264 - 1 = ER \times 0.8$$

$$0.5264 = ER \times 0.8$$

$$\mathbf{ER = 0.658}$$

Q2 (c) Explain the “ Pooling of interest method’ and the ‘ Purchase method’ of accounting for amalgamation .

Answer : Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

1. All the assets, liabilities and reserves of the transferor company become, after amalgamation , the assets, liabilities and reserves of the transferee company.

2. **Assets, Liabilities & Reserve are recorded at their book values** i.e. No adjustment is intended to be made to the book values of the assets and liabilities of transferor company when they are incorporated in the financial statements of the transferee company **except to ensure uniformity of accounting policies.**

3. Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein , immediately before the amalgamation by the transferee company or its subsidiaries or their nominees) becomes equity shareholders of the transferee company by virtue of amalgamation

4..The consideration for amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is **discharged by the transferee company wholly by the equity shares in the transferee company, except that cash may be paid in respect of fractional shares.**

5.Impact on transactions : The difference (excess amount paid) between purchase consideration and share capital of transferor company is treated as capital loss and adjusted in capital reserve and in case capital reserve is insufficient then adjusted to revenue reserve or profit and loss account

6. Pooling of interest method is used for accounting effect.

7 .Type of transaction : Equity shareholders of transferor company who become members of the transferee company are given only equity shares in the transferee company.

8. There is no revaluation of assets or creation of goodwill.

Purchase Method :

An amalgamation should be considered to be an amalgamation in the nature of purchase *when any one or more of the conditions specified for amalgamation in the nature of merger is not satisfied (as discussed above)*

In this type of amalgamation, one company acquires another company and equity shareholders of the combining entities **do not continue to have proportionate shares in the equity of the combined entity** i.e. Holding of shares in the combined company depends upon swap ratio determined in negotiations during Deal Process.

Points of distinction	Pooling of interest Method	Purchase method
Applicable	This is applicable to mergers	This method is used in acquisitions and/or takeovers
Shareholder's interest	Shareholder's interest in the amalgamated company will be proportionate to their interest in the combining company	Shareholders of the transferor/ vendor company normally do not have proportionate share in the equity of the transferee /purchaser company
Impact on assets & liabilities	Assets, Liabilities and all reserves are taken over	Here, Assets and Liabilities are taken over

Valuation of assets & liabilities	No adjustment is made to the book values of assets and liabilities of the transferor./vendor company. When they are included in the financial statements of the transferee/ purchaser company except to ensure uniformity in accounting policies.	Revaluation of assets and liabilities of the transferor/vendor company is made by the transferee / purchase company while incorporating the items in the books of the transferee/ purchaser company
Transfer of shareholding	At least 90% equity shareholders of transferor (VENDOR) company become shareholders of transferee company (Shareholders of transferor (VENDOR) company may not become shareholders of

Time perspective	This method seems to backward looking in the sense agreed that all accounts are taken at book values in the books of the purchasing company.	Here, the perspective seems to be present as assets and liabilities are taken over at or fair value on the acquisition date . Goodwill may arise out of the deal but may not be amortised.
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	BUYER)	transferee company (BUYER)
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Q3. (a) How friendly takeover is different from hostile takeover?

Answer : Take over is a transaction or series of transactions whereby a person or individual or a group of individuals or a company acquires control over the assets of a company , either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company. In case of companies whose shares are widely held by public , the takeover may be affected by :

1. By agreement between the acquirer and the controllers of the acquired company (target company)
2. By purchase of shares on the stock exchange
3. By means of a takeover bid

Takeovers are broadly classified into two categories :

1. Friendly or (Negotiated)
2. Hostile or (Open Market) Takeover .

A takeover takes place usually by acquisition or purchase from the shareholders of a company their shares at a specified price to the extent of at least controlling interest in order to gain control of that company. A company may acquire shares of an unlisted company through what is called the acquisition under section 235 and 236 of the companies act, 2013.

Where the shares of a company are widely held by the general public , the takeover involves the process as set out in the SEBI (Substantial Acquisitions of Shares and takeover) Regulations, 2011.

1.Friendly Takeover : When everything (purchase consideration, mode of payment and other parameters) results on **cordial negotiations** between two or more companies in the takeover process, it is generally termed friendly takeover. The target's board of directors generally has to approve the takeover . Sometimes, the bidder's board must also give its approval. Finally, an affirmative vote by the shareholders is needed. Of course, not all takeovers are

friendly. The target's management may resist the merger, in which case the acquirer must decide whether to pursue the merger and, if so, what tactics to use.

Facing resistance, the acquirer may begin by purchasing some of the target's stock in secret. This position is often called a *toehold*. Examples : (a) HINDALCO took over INDAL by acquiring 54% stake in INDAL from its overseas parent Alcan. Alcan decided to exit from INDAL on its own. Later on, INDAL was merged with HINDALCO.

2.Hostile Takeover : When a company takes over another company even though the management of the target company is not interested in it. It is known as a Hostile Takeover. The acquiring company makes the tender offer/bid directly to the shareholders of the target company. The tender offer is made to buy shares at a premium above the current market price.

Conditions of tender/bid may be :

(a) The acquirer will purchase all the shares that are tendered- that is, turned in to the acquirer

(b) The acquirer will purchase all the shares up to, say 50% of the number of shares outstanding. If more shares are tendered, prorating will occur. i.e. Stockholder is allowed to sell one share for every two shares tendered.

(c) The acquirer may also say that it will accept the tendered shares only if a minimum number of shares have been tendered under the tender offer.

In a hostile takeover, the acquiring company attempts to get control of the management without the knowledge and consent of the existing management. ***The term hostile is used because the economic power of the acquiring company is demonstrated.*** Examples : (i) Takeover of Ashok Leyland by Hinduja Group (NRI) (ii) Rassi cements takeover by India cements in 1998. (iii) Mittal steels owned by L N Mittal (Headquartered at London) acquisition of Arcelor (French Company)

Q3 (b) What are the defences available to the target firm to prevent hostile takeover ? Critically examine any one of such defence.

Answer :

A firm becomes a prime takeover target when the value of its shares does not fully reflect the potential value of business. **Before discussing available defence strategies, one must understand the warning signals of potential takeover targets.** There are some signs that tell that the hunt for a company's acquisition has begun and a raider is about to launch its attack.

(a) There are situations in which the stock price of the target company is below the current market value of its assets. This situation makes a firm particularly attractive to an acquirer without considering the ongoing value of the underlying business.

(b) Some companies hold cash and marketable securities. These companies are particularly valuable to acquisitions since that cash will be available to the acquiring company and used to pay for acquisition.

(c) The number of small transactions in shares of the company has increased considerably.

(d) Other companies in the same industry have been attacked by raiders

(e) Unsolicited offers to sell the shares in company have been received during the last few months.

Following are the defences available to the target firm to prevent hostile takeover :

- ✓ **Divestiture** : In a divestiture the target company divests or spin-offs some of its businesses in the form of an independent subsidiary company. Thus, it reduces the attractiveness of the existing business to acquirer. This is technically called as selling the '*crown jewels*'. In this strategy, a particular aspect of the target firm which has been highly attractive to the raider is made un available to the raider after takeover. The attractive aspect may be a profitable division, or a brand or patent etc.
- ✓ **Amalgamating Group Companies:** In this tactic, two or more companies promoted by the same group are amalgamated to form a larger company. The larger company is thus less vulnerable to a takeover and can avoid anti –takeover.

- ✓ **White Knight** : In this strategy, the targeted firm invites another company called as white knight to make counter offer for its shares. White knight may bid at a price equal to or greater than the hostile tender offer. In other words, in this strategy , the company facing an unfriendly takeover might arrange to be acquired by a friendly suitor who White might be favoured simply because it is willing to pay a higher purchase price. Alternatively, it might promise not to lay off employees, fire managers or sell off divisions.

A white squire is another variant of white knight where it does not take full control of the target company. Instead, the target sells a block of stock to a white squire who is considered friendly and who will vote her or his shares with the target's management. Other conditions may be imposed such as requirement of the white squire to vote for management , a standstill agreement that the white squire can not acquire more of the target's shares for a specified period of live and a destruction on the sale of that block of stock

- ✓ **Poison Pills** : The tactics used by a company to make itself unattractive to a potential bidder is called 'poison pill'. . For Example, the company may issue substantial amount of FCDs to its existing shareholders *to be converted into equity shares with voting rights at a future date when it faces a takeover threat*. Hence, the task of the bidder would become difficult since the number of shares to have voting control of the company will substantially increase.

Another strategy , under this tactics is that the target company may allot equity shares and/or convertible securities on a preferential basis to the promoter group so that its equity stake is enhanced.

Types of Poison Pills :

(a) **People Pill** : In this strategy, management/ key managerial personnel of the target company threatens that in the event of a takeover, the entire management team will resign. This is useful if the company has good management team and talents. ; losing talents/ team of management could seriously harm the company and make the bidder think twice.

(b) Poison Puts : In this strategy, a debt is issued with a put options exercisable only in the event of hostile takeover. Debt is issued to show liquidity crisis or financial distress of the firm to the raider.

(c) Brand Pills : In this strategy , rules are made for not allowing the acquirer to use brand name of the target company after takeover e.g. If any one acquires TATA Companies , the acquirer can not use TATA Brand name post acquisition. Thus, it may become unattractive to the raider

- ✓ **Packman Strategy :** This strategy is based on the premise that offense is sometimes better than defence. In this strategy, target company makes a counter offer on the raider company as a response to the raider's tender offer on the target.
- ✓ **Litigation :** Bringing administrative claims or court proceedings against the raider is regarded as one of the most common anti –takeover measures. A target company should search for finding a leeway under provisions of any regulatory , securities laws or other laws.

Court action can considerably lengthen the period of time needed to complete the takeover and reduce its chances of success by increasing the cost of litigation and by allowing time for the target to solicit competing bids or put up defence.

The target may sue for a temporary injunction to prohibit the bidder from purchasing any additional shares of the target's stock until the court has an opportunity to rule on the case.

Q3. (C) What are the problems of Post- Merger Integration (PMI) ? How can integration be achieved?

Answer : Post Merger Integration (PMI) is the complex process of combining and reorganizing the two or more business entities to realize synergies that motivated the mergers or acquisitions. The process of combining the merging firms has critical implications for assets, resources , people , and roles. Hence integration planning is one of the most important areas of a merger or an acquisition that needs to be addressed before the final transaction.

The problems of PMI includes :

Lack of effective PMI Planning : Planning is one of the most important exercise that will determine success or failure of M&A. However, research literature indicates towards lack of integration planning as an important cause for failure of M&A.

Lack of attention to people issues : Often acquirers focus almost entirely on financial and operational data.

Not performing an effective human resource due diligence could lead to loss of executives/ talented people soon after the deal announcement. In fact, by making human due diligence a vital part of the whole exercise , acquirers can identify the differences in decision making processes and culture, address HR issues, and avoid attrition

Lack of timely competency assessment and mapping of the Target company's operations and determination of the optimal mix of staff and organizational structure :

Executive of the acquisition team should identify key managerial talent prior to the deal closure and lock them in with monetary incentives immediately after the deal closure. Moreover, prior to closing the deal , functional integration teams (Finance team, Marketing team ,R & D team, and so on) work to identify key talent; human resources works with the integration teams to identify and recreate financial and non – financial drivers of key talent retention. *For Example, Pfizer , a reputed MNC in Pharmaceutical business conducted a rapid competency assessment and mapping of the Target company's operations and determine the optimal mix of staff and organizational structure (After the acquisition in 2001) . In 2001, Pfizer acquired Warner-Lambert, which combined two of the pharmaceutical industry's fastest-growing companies. The acquisition created the world's most valuable and fastest-growing pharmaceutical company.*

Cultural Integration issues : The issues of Cultural Integration need to be addressed simultaneously if not well before the issues of financial , operational and legal integration are considered.

A good example of cultural incompatibility is Daimler – Chrysler merger. The post merger phase highlighted the difficulty of trying to integrate two very different cultures. Even though in the beginning, Daimler –Benz and Chrysler

both expressed the commitment to working together and sharing work practices and product development methods. This commitment did not materialize, a phenomenon exemplified by the Daimler management's unwillingness to use Chrysler parts in Mercedes cars.

Training & Development issues : Training is an important part for the achievement of successful integration. In many cases, HR professionals are left out of the merger process because they are considered ill-equipped to deal with the merger. In many cases, senior managers are often reluctant to involve HR professionals in the merger process because they do not believe that HR possess the skills required to contribute effectively to the merger process. Hence, both senior and middle level managers normally need considerable training and development to handle the demands of the new and big organization

Power Politics : Power struggles can be a major obstacle to the success of M&A Integration Process. Clashes between the management of the two companies, as well as clashes within a company's own management can lead to the demise of a merger. Not only do power struggles distract management from focusing on business issues, but managers also tend to place their own self-interests above those of the business, and often make decisions that will benefit them at the expense of the rest of the organization.

PMI problems are company specific issues as well apart from common issues as discussed above like

Managers of companies **that merge to addresses overcapacity** in the industry must decide how to rationalize resources, including human capital, in order to become more efficient.

A merger **that is supposed to provide geographic expansion** would need to have several local units, with executives managing each unit. Here, retention of key executives would be the key issue. Likewise, product or market extensions and industry convergences would have different integration issues.

Hence, PMI problems can be put as under :

1. Employee Engagement
2. The cultural shift

3. Technology Integration
4. Synergy implementation
5. Customer Engagement
6. Communication Challenges
7. Senior management issues : Oftentimes, post-merger integrations will involve changes in employee positions and job duties, including the introduction of new management and high-level executives. Without proper planning, this can cause costly setbacks to your post-merger integration process as employees scramble to adapt to their new role or management style. In order to keep employees engaged and working collectively towards a common goal, it's vital to take the time to identify the right KPIs to keep tabs on employee on goings and post-merger integration milestones.

A typical M&A has several sources of risk because of which the transaction may fail. Understanding them would suggest areas that need top executives attention. The best organizations identify and manage the most important risks inherent in M&A. They pay careful attention to key areas of business performance, employee perceptions and expectations , and other HR issues.

Integration can be achieved if the key risks in PMI are resolved in a time bound manner :

- ✓ **Cultural Alignment:** This is the most important driver of success in a merger. A merger is likely to be successful only if the cultures of the merging companies are compatible. Every company has its own set of practices , beliefs , and values . Since organizations are complex systems of people, technologies, and processes , no real progress is possible if executives of the two organisations are warring on systems and processes.
- ✓ **Attractiveness of Market :** M&A are often aimed at addressing market opportunities that have not been adequately addressed by either of the companies. If the market turns out to be unattractive after the merger e.g. due to changes in governmental regulations or misjudgement on the part of concerned executives the deal is not likely to result in significant synergy.
- ✓ **Quality of Target Company's Management Team:** Jamie Dimon, CEO of JP Morgan Chase opined “ I would rather have a first –rate execution and second-rate strategy any time than a brilliant idea and

mediocre management .” It is now well documented that strategies more often fail because they are not well executed.

- ✓ **Talent retention** : Much of the forecasted synergy can be realized only if the organization is able to retain the most talented employees.
- ✓ **Customer Retention** : it is far easier to retain existing customers than find new ones. An integration plan must address how the new organization would serve its customers.
- ✓ **Revenue Synergy assumptions** : All estimates for a target valuation are based on assumptions, and assumptions can go wrong. For this reason, it is necessary that executives from all functional areas are involved in the estimation process. More importantly, everyone must know the assumptions made. Downsize surprises can be costly.
- ✓ **Supply Chain Management** : A sound PMI plan must address supply chain issues before the merger. For instance, the acquisition of Corus Group by Tata steel was aimed at manufacturing in UK and Netherlands and selling through out the world. Obviously, this opened up various supply chain issues for Tata Steel . Tata steel addressed this by setting up Shipping Companies.

Therefore, essential things to include in PMI plan includes :

- 1.Integration Roadmap:** An analysis and outline of the current business state alongside future goals and objectives to ensure all parties are aligned on how to effectively drive post-merger integration success.
- 2. Change Management Roadmap:** A plan to prepare, equip and support the employees, customers and company culture in order to ensure project outcomes, timelines and budgets are kept on track. This also includes an outline of any changes to new systems and processes and the impacts they have on your business and stakeholders.
- 3. Risk Management Roadmap:** Developing a plan for the global, state and local compliance regulations of business must adhere to in order to maintain an effective and secure control environment to safe
- 4. IT Implementation Roadmap:** Fostering alignment of IT systems with a focus on eliminating redundancies, optimizing efficiency and building long-term capabilities. This roadmap should also include a plan for

driving successful communication, process enhancement and customer success.

Q4. Y Ltd. intends to acquire A Ltd. The Balance Sheet of A Ltd. is as under :

Liabilities	Rs.	Assets	Rs.
Equity 33,000 shares @ 10 each	3,30,000	Plant & Machinery	6,00,000
Retained Earnings	1,60,000	Sundry Debtors	30,000
Sundry creditors	2,50,000	Inventories	90,000
		Cash	20,000
Total Rs.	7,40,000	Total Rs.	7,40,000

The shareholders of A Ltd. are entitled to get one share in Y Ltd. for every three shares. The shares of company Y will be issued at a market price of Rs. 20 each . The expected benefits from acquisition will amount to Rs. 1,80,000 p.a. for next 5 years. If the firm's cost of capital is 12 percent , do you think the merger will create synergy?

Note: PVIF @12 % = 3.6048

Solution :

Step-1 Computing cost of merger i.e. cash outflows (COF)

Equity (11,000 shares @ 20 each)	= Rs. 2,20,000
Payment of creditors	= Rs. 2,50,000
Less : available cash balance of ABC Ltd.	= (-) Rs. 20,000
Total COF	= Rs . 4,50,000

Step-2 : Computing discounted Cash inflows over 5 years

Years	CF(After Tax)	PV Factor @12%	DCF Value
1-5	Rs. 1,80,000	3.6048	Rs. 648,864

$$\begin{aligned}\text{NPV} &= \text{DCF} - \text{Cost of merger} \\ &= \text{Rs. } 6,48,864 - \text{Rs. } 4,50,000 \\ &= \text{Rs. } 1,98,864\end{aligned}$$

Yes, the merger will create Synergy because NPV of merger is positive.