Roll No. ____________________

(Do not write anything on question paper except Roll No.)
[This paper consists of FOUR Pages]

Jagan Institute of Management Studies

End-Term Examination, December, 2016 – January, 2017
Trimester V – PGDM (IB)/PGDM (RM) 2015-17

Corporate Mergers, Acquisition & Restructuring

ET_IB/RM_CMAR_3012

Time: 3 Hrs. *M. Marks: 70*

INSTRUCTIONS: Attempt any FIVE questions including Q8 which is compulsory.

Q 1 Eastern Petrochemicals Ltd. (EPL) is contemplating with the introduction of upstream in the value chain. With that idea the company is considering the acquisition of Kalna Refineries Ltd. (KRL) in a stock-for-stock transaction. According to the deal, the stockholders of KRL would receive Rs. 119.2 for each stock. The synergistic benefits, which would enhance the earnings of the merged entity by 5%, are expected from this acquisition. EPL thinks that their price-earnings ratio would increase by 10% after the acquisition. The following information is available for the companies:

	EPL	KRL
Earnings (Rs. in lakhs)	35.00	10.15
Number of shares	11,00,000	2,00,000
Market price per share (Rs.)	74.5	89.6

You are **required** to compute:

a) The purchase price premium.
b) The purchase price premium.
c) The number of new shares issued by EPL.
d) Post-merger EPS of the EPL.
e) Post-merger share price of the EPL.
f) Post-merger equity ownership distribution. **13**

Q 2 Kiya Automobile India Ltd. (KAIL), a new Indian outfit of Korean auto major Kiya Motors, is planning to acquire Raheja Motors Ltd. (RML), a known name in the field of automobile servicing. RML has its presence in almost all the district headquarters of India. The recent financial details of the two companies are as follows:

	KAIL	RML
Profit after Tax (Rs. in lakhs)	3300	720
Market price per share (Face value Rs. 10)	300	72
P/E Ratio	24	15
Projected growth rates (% p.a.)	8	4

Among the consultants, two equally probable views with regard to the prospect of this acquisition are being expressed. The views are:

i) There is no synergy due to the merger.

ii) There is an increase in earnings of the merged entity by 5% due to synergy.

Based on the information furnished above, you are **required** to:

a) Calculate the maximum exchange ratio from KAIL's point of view.

b) Considering no synergy, compute the dilution in EPS of KAIL when exchange ratio is 0.55 and also show when the dilution would be wiped off. [Detail computations should form part of your answer.] **13**

Q 3 Efficiency theories hold that mergers and other forms of asset redeployment have potential for social benefits. They generally involve improving the performances of incumbent management or achieving a form of synergy. With respect to this, explain the various efficiency theories of merger and their significance. **13**

Q 4 Srujan Healthcare Private Ltd. (SHPL), which provides pharmacy management and drug therapy to nursing homes in various Indian cities, reported earnings per share of Rs. 8.5 in last year on revenues per share of Rs.125.0. It had negligible net capital expenditures, but had to maintain working capital at 40% of revenues. Revenues and earnings are expected to grow 20% a year for next five years from current year, after which the growth rate is expected to decline linearly over three years to 5%. This growth rate is expected to continue for the rest of the life of the company. The firm has debt ratio of 15%, which it intends to maintain in the future. The stocks of similar companies listed in Indian stock exchanges have a beta of 1.10. These companies maintain a debt-equity ratio of 50% and investors expect a return of 13.6% from these stocks. No abnormal activities are foreseen in this industry. It is expected that sensitivity of the market returns and returns from this stock is going to remain unchanged for the period of analysis. The treasury bond rate is 7% and the corporate tax is applicable at 35%.

One young analyst argues that SHPL can create growth by giving easier credit terms to its clients.

You are **required** to estimate the value per share, using the free cash flow to equity model. **13**

Q 5 Karan Rajouri Limited (KRL), a household product manufacturer, reported earnings per share of Rs.3.20 during last year and paid dividends per share of Rs.1.7. The firm reported depreciation of Rs.315 lakh and capital expenditures of Rs.475 lakh. There were 160 lakh shares outstanding, trading at Rs.51 per share. The net capital

expenditures is expected to grow same as the earnings. The working capital needs are negligible. KRL had debt outstanding of Rs.16 crore and intends to maintain its current financing mix to finance future investment needs. The firm is in a steady state, and earnings are expected to grow 7% a year. The stock has a beta of 1.05 and treasury bond rate is 6.25%. The risk premium expected from the market portfolio is 5.5%.

You are **required** to

a) Estimate the value per share, using the dividend discount model.

b) Estimate the value per share using FCFE model.

c) Explain why the estimates of the value per share are different in (a) and (b).

d) Explain which one you would suggest to use as benchmark for comparison to the market price. **13**

Q 6 "*A Takeover can either be friendly or hostile. When the management of the target company does not support such acquisition and the acquirer uses unfavorable tactics with an intention to buy a significant stake in the target company without informing the incumbent management, is said to have indulged into a hostile takeover*."

In order to resist such takeover, the target company's management and board of directors may adopt several anti-takeover tactics. Discuss any five. **13**

Q 7 "*Strategic alliances can increase market share, reduce competition, improve expertise, and open the door to new funding opportunities – but not all strategic alliances are created equal. The truth is that sometimes a strategic alliance can cause more harm than good if the partner company has different goals, gets more than it gives, or otherwise fails to live up to its side of the deal.*"

What are the various challenges and questions to be asked by firms to themselves before entering into strategic alliance? **13**

Q 8 Read the case and answer the questions that follow:

In today's globalized economy, it is becoming evident that the current ways of doing business are not good enough to stay competitive in tomorrow's market; organizations have to invent new ways of competing. In a world of continuous redefinition of industry boundaries and commingling of technologies, businesses have to strive for "opportunity share" in future markets. Suffice it to say that what is needed today is strategic clarity based on established principles. Strategic decisions such as divestments, new product launches, acquisitions, consolidations, etc., though in vogue for long, have

become more relevant today than in the past, for creating additional space for the existing firms to claim additional pie in the "opportunity share". Mergers and Acquisitions have, thus, become universal tools to attain greater market share, acquire additional brands, cannibalize competing brands, realize improved infrastructure, create new synergies, capitalize on efficiencies and economies of scale, globalize in shorter span of time, etc.'

As a natural corollary to the underlying logic of mergers, the stakeholders of business firms do expect positive outflows from mergers and acquisitions. They are indeed resorted to with the expectations that merger results in certain benefits.

They remain mere wishful thinking till they become reality and historical data reveals that many mergers have failed in producing the anticipated benefits. What is, therefore, needed here is to know why the majority of mergers failed in delivering what is expected of them, so that we could use that knowledge as a checklist while evaluating new mergers.

All the hype that usually surrounds the pre-merger phase suddenly dissipates once the merged entity becomes a reality and problems surface. It perhaps ever remains an enigma as to why and how the much sought after merger suddenly threatens the very proponents of merger with unforeseen challenges. The empirical studies/findings carried out on companies such as Sun Pharmaceuticals, Wockhardt, Nicholas Piramal, Ranbaxy, etc., reveal that the synergy theory does not hold good in the merger and acquisition scenario of India. It is, however, very difficult to precisely define what makes a merger to fail since its complex nature makes it impossible to fix a single answer fitting all situations.

Questions:

a) According to the case, stakeholders of business firms resort to mergers with the expectations that merger results in certain benefits. What would be the possible expectations of stakeholders of business firms from mergers? **9**

b) According to the case, there is a need to know why the majority of mergers failed in delivering what is expected of them, so that we could use that knowledge as a checklist while evaluating new mergers. What would the management do the possible mistakes, which lead to the failure of mergers? **9**

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