



CA - FINAL

SFM
STRATEGIC FINANCIAL
MANAGEMENT

MERGER & ACQUISITION

By GAURAV JAINN

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68 Marks
(AIR/CA/CS 20th)

May 2015



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AIR 1

Roll No. 130814

88 Marks

Nov. 2014



Anish Gupta

AIR 22

Roll No. 188172

68 Marks

Nov. 2015



Payal Bansal

AIR 27

Roll No. 137808

70 Marks

May 2014



Pravesh Khandelwal

AI 2nd Highest

Roll No. 125761

85 Marks

May 2017



Naman Jain

Roll No. 133759

94 Marks

Nov. 2013



Nishant Gupta

AIR 17

Roll No. 162871

77 Marks

Nov. 2014



Keshav Goel

AIR 18

Roll No. 132485

83 Marks

May 2016



Harsh Garg

AIR 17

Roll No. 408489

74 Marks

May 2016



Kunal Somani

AIR 14

Roll No. 438272

88 Marks

May 2016



Prashu Goyal

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81 Marks

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Divy Sethi
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Rashika Jain
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Niklesh Agarwal
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Scoring **71** Marks in SFM



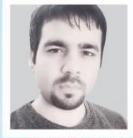
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Kapil Manchanda
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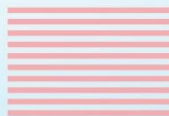
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Scoring **94** Marks in SFM

Many congratulations to my shining Star **Naman Jain**
for scoring **94** marks (Roll No. 133759 NRO 0336585) in CA Final SFM



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Vibhor Gupta
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Aakash Gupta
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Shubham Bansal
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Shishir Agarwal
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Mergers, Acquisition & Corporate Restructuring

LOS 1 : Introduction

Merger & Acquisition

MERGER (A + B = A)
ACQUISITION (Stake Buyout)
AMALGAMATION (A + B = C)

Reasons for Merger & Acquisition

- ❖ Economies of Scale
- ❖ Efficiency Improvement
- ❖ Power of Market Share – Reduced Competition
- ❖ Tax Consideration
- ❖ Combining resources that are complementary.

LOS 2 : Share Exchange Ratio/ Swap Ratio

Swap Ratio may be defined as No. of equity shares issued by Acquiring Company to Target Company for every one share held by Target Company.

Methods of Calculating the Swap Ratio:

1. **On the basis of MPS** $\text{Swap Ratio} = \frac{\text{MPS of Target Company}}{\text{MPS of Acquiring Company}}$
2. **On the basis of EPS** $\text{Swap Ratio} = \frac{\text{EPS of Target Company}}{\text{EPS of Acquiring Company}}$
3. **On the basis of NAV per Share** $\text{Swap Ratio} = \frac{\text{NAV of Target Company}}{\text{NAV of Acquiring Company}}$
4. **On the basis of Book Value per share** $\text{Swap Ratio} = \frac{\text{BVPS of Target Company}}{\text{BVPS of Acquiring Company}}$
5. **On the basis of P/E Ratio** $\text{Swap Ratio} = \frac{\text{P/E Ratio of Target Company}}{\text{P/E Ratio of Acquiring Company}}$

Note:

$$\text{EPS} = \frac{\text{Earning available to Equity Shareholder}}{\text{Total number of equity shares}}$$

$$\text{NAV} = \frac{\text{Total Assets} - \text{Total External Liability}}{\text{Total number of equity shares}}$$

$$\text{P / E Ratio} = \frac{\text{Market Price per Share}}{\text{Earning Price per Share}}$$

Negative SWAP Ratio

$$\text{Swap Ratio} = \frac{\text{Acquiring Co.}}{\text{Target Co.}}$$

$$\text{e.g. Swap Ratio} = \frac{\text{NPA of Acquiring Co.}}{\text{NPA of Target Co.}}$$

LOS 3 : Some Basic Concepts**1. Total Number of Equity Shares after Merger**

$$\text{Number of Shares}_{A+B} = N_A + N_B \times ER$$

2. EPS after Merger or EPS_{A+B} or EPS of a Merged Firm/ Combined Firm

$$\text{EPS}_{A+B} = \left[\frac{E_A + E_B + \text{Synergy Gain}}{N_A + N_B \times ER} \right]$$

3. MPS after Merger or MPS_{A+B} or MPS of a Merged Firm**Alternative 1: If P/E Ratio is given**

$$\text{MPS}_{A+B} = \text{EPS}_{A+B} \times \text{P/E}_{A+B}$$

Alternative 2: If P/E Ratio is not given

$$\text{MPS}_{A+B} = \left[\frac{\text{Total MV after Merger}}{\text{Total No. of Equity Shares after Merger}} \right]$$

Or

$$\text{MPS}_{A+B} = \left[\frac{\text{MV}_A + \text{MV}_B + \text{Synergy Gain}}{N_A + N_B \times ER} \right]$$

Note:

- ❖ Answer by both alternative will be different.
- ❖ Alternative 1 should be preferred whenever any hint regarding P/E after merger is given in question.

4. Market Value of Merged Firm or MV_{A+B}**Alternative 1:**

$$\text{MV}_{A+B} = \text{MPS}_{A+B} \times [N_A + N_B \times ER]$$

Alternative 2:

$$\text{MV}_{A+B} = \text{MV}_A + \text{MV}_B + \text{Synergy}$$

Note:

- ❖ Answer by both alternative will be different.
- ❖ Alternative 1 should be preferred

5. Equivalent EPS of Target Co. in Merged Firm

$$\text{Equivalent EPS of Target Co. in Merged Firm} = \text{EPS}_{A+B} \times \text{ER}$$

6. Equivalent MPS of Target Co. in Merged Firm

$$\text{Equivalent MPS of Target Co. in Merged Firm} = \text{MPS}_{A+B} \times \text{ER}$$

LOS 4 : Gain or Loss

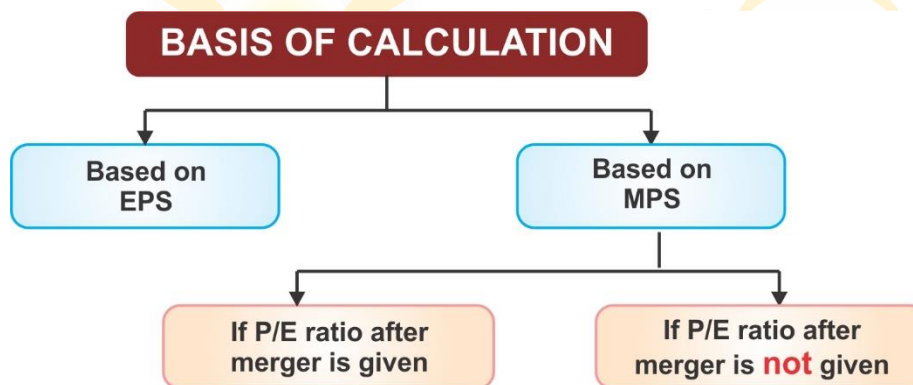
- ❖ Merger may result into Gain/Loss for acquiring company & target Company.
- ❖ On the basis of EPS/MPS/Market Value (MV)

	A Ltd.	B Ltd.
MPS / EPS / MV after Merger	XXX	XXX
MPS / EPS / MV before Merger	XXX	XXX
Gain/ Loss	XXX	XXX

LOS 5 : Maximum Exchange Ratio and Minimum Exchange Ratio

A= Acquiring Company → will try to keep exchange ratio as low as possible. Hence, we calculate maximum ER for acquiring company.

B= Target Company → will try to keep exchange ratio as high as possible. Hence, we calculate minimum ER for Target Company.



Case 1: On the basis of EPS:

a) Maximum Exchange ratio for A Ltd.

EPS before Merger = EPS after Merger

$$\text{EPS}_A = \text{EPS}_{A+B}$$

$$\text{EPS}_A = \frac{E_A + E_B + \text{Synergy Gain}}{N_A + N_B \times \text{Exchange Ratio (ER)}}$$

↓
Solve for ER

b) Minimum Exchange ratio for B Ltd.

EPS before Merger = Equivalent EPS after Merger

$$EPS_B = EPS_{A+B} \times ER$$

$$ESP_B = \left[\frac{E_A + E_B + \text{Synergy Gain}}{N_A + N_B \times \text{Exchange Ratio}} \right] \times ER$$

Solve for ER

Case 2: On the basis of MPS (If P/E Ratio after merge is given i.e. P/E_(A+B) is given)

a) Maximum Exchange ratio for A Ltd.

MPS before Merger = MPS after Merger

$$MPS_A = MPS_{A+B}$$

$$MPS_A = EPS_{A+B} \times P/E_{(A+B)}$$

$$MPS_A = \left[\frac{E_A + E_B + \text{Synergy Gain}}{N_A + N_B \times \text{Exchange Ratio}} \right] \times P/E_{(A+B)}$$

Solve for ER

b) Minimum Exchange ratio for B Ltd.

MPS before Merger = Equivalent MPS after Merger

$$MPS_B = MPS_{A+B} \times ER$$

$$MPS_B = [EPS_{A+B} \times P/E_{(A+B)}] \times ER$$

$$MPS_B = \left[\frac{E_A + E_B + \text{Synergy Gain}}{N_A + N_B \times \text{Exchange Ratio}} \right] \times P/E_{(A+B)} \times ER$$

Solve for ER

Case 3: On the basis of MPS (If P/E Ratio after merge is not given):

a) Maximum Exchange ratio for A Ltd.

MPS before merger = MPS after merger

$$MPS_A = MPS_{A+B}$$

$$MPS_A = \frac{MV_A + MV_B + \text{Synergy Gain}}{N_A + N_B \times \text{Exchange Ratio (ER)}}$$

Solve for ER

b) Minimum Exchange ratio for B Ltd.

MPS before merger = Equivalent MPS after merger

$$MPS_B = MPS_{A+B} \times ER$$

$$MPS_B = \left[\frac{MV_A + MV_B + \text{Synergy Gain}}{N_A + N_B \times \text{Exchange Ratio (ER)}} \right] \times ER$$

Solve for ER

The Future of Finance starts with you

LOS 6 : Calculation of % of Holding in New Company

$$\text{For A Ltd.} = \frac{\text{Total Number of shares of A Ltd.}}{\text{Total Number of share of A Ltd.} + \text{Total Number of Shares issued to B Ltd.}}$$

$$\text{For B Ltd.} = \frac{\text{Total Number of Shares issued to B Ltd}}{\text{Total Number of share of A Ltd.} + \text{Total Number of Shares issued to B Ltd.}}$$

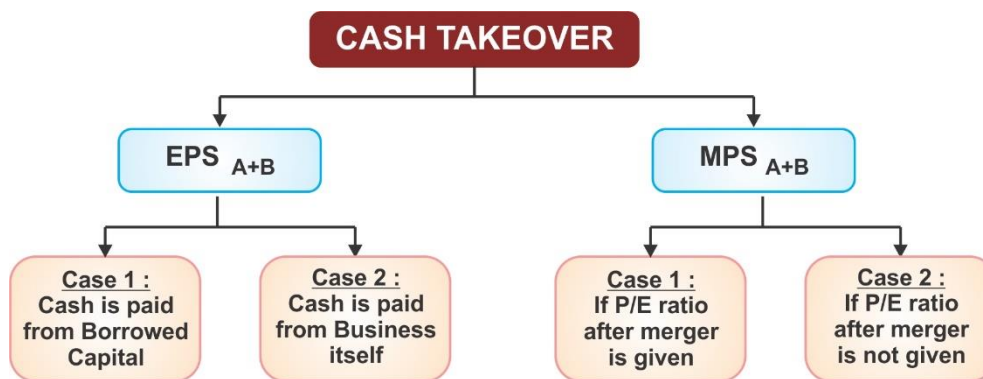
LOS 7 : Free Float Market Capitalization (Value)

- ❖ "Free Float" means shares which are freely available or freely tradable in the market. Shares held by promoters are not freely tradable in the market. These shares are subject to certain restrictions as placed by SEBI.
- ❖ A Firm's market float is the total value of the shares that are actually available to the investing public and excludes the value of shares held by controlling shareholders because they are unlikely to sell their shares.
- ❖ Sensex and Nifty is based on Free-Float market Capitalization.

Free Float Mkt Capitalization = Free float No. of equity shares x MPS

$$\left(\begin{array}{c} \text{Total No. of Equity Shares} \\ (-) \\ \text{Promoters Holding / Management Holding / Govt.} \\ \text{Holding / Strategic Holding} \end{array} \right) \times \text{MPS}$$

LOS 8 : Calculatio of EPS_{A+B} and MPS_{A+B} in case of CASH TAKEOVER



1. EPS_{A+B} in case of cash take-over & cash is paid out of borrowed money

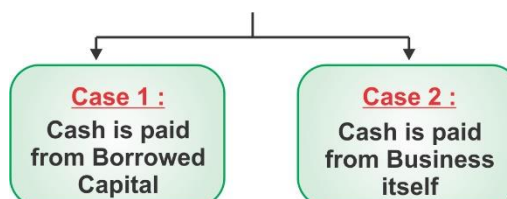
$$\text{EPS}_{A+B} = \left[\frac{E_A + E_B + \text{Synergy Gain} - \text{Interest} (1 - \text{tax})}{N_A} \right]$$

2. EPS_{A+B} in case of cash take-over & money is arranged from Business itself

$$\text{EPS}_{A+B} = \left[\frac{E_A + E_B + \text{Synergy Gain} - \text{Cash Paid} \times \text{Opportunity cost of interest}}{N_A} \right]$$

3. MPS_{A+B} (If P/E ratio after merger is given)

$$= \text{EPS}_{A+B} \times \text{P/E}_{A+B}$$



4. MPS_{A+B} (If P/E ratio after merger is NOT given)

$$\text{MPS}_{A+B} = \left[\frac{MV_A + MV_B + \text{Synergy Gain} - \text{Cash Paid}}{N_A} \right]$$

LOS 9 : Purchase Price Premium

$$\text{Purchase Price Premium} = \frac{\text{Offer Price to target Co.} - \text{MPS of target Co. before Merger}}{\text{MPS of target Co. before Merger}}$$

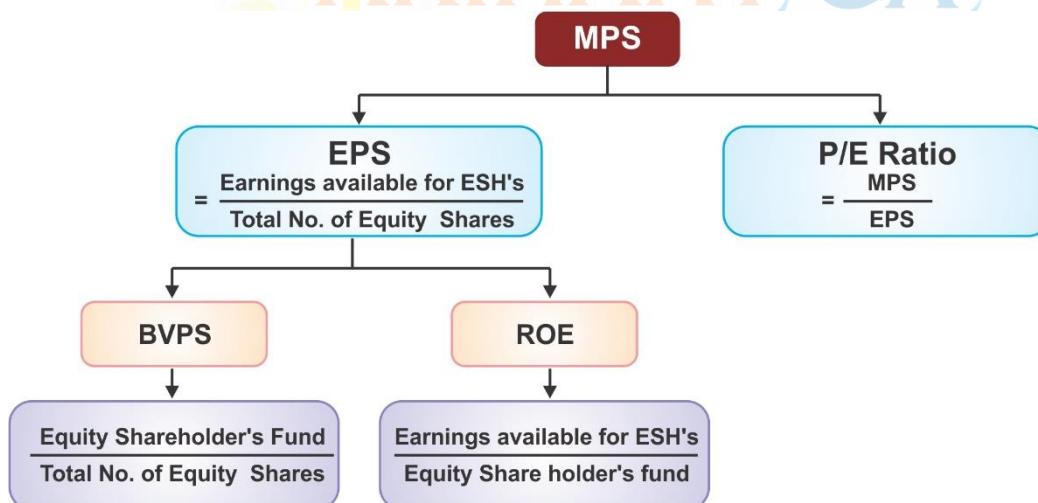
LOS 10 : Purchase Consideration / Cost of Acquisition

❖ PC = Net Payment made by Acquiring Co. to Target Co.

Calculation of PC/ COA	
Market Value of Equity Shares Issued by A Ltd. to B Ltd.	XXX
(+) Debentures, Preference shares Capital Issued by A Ltd. to B Ltd.	XXX
(+) Current Liability paid or Taken over	XXX
(+) Any other expenses incurred	XXX
(-) Cash in hand or Bank	XXX
(-) Sale of any other asset not required in business	XXX
Cost of Acquisition / Purchase Consideration	XXX

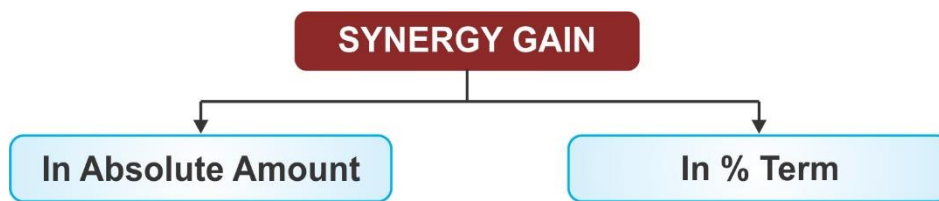
Note:

- ❖ Cash and current Liabilities must be taken, even if question is Silent.
- ❖ Sale of any other asset not required should be taken only if clear indication in the Question.

LOS 11 : Components of MPS**LOS 12 : Maximum MPS & Minimum MPS**

$$\text{Minimum MPS offered by A Ltd. To B Ltd.} = \frac{\text{Value of Equity of B Ltd.}}{\text{No. of Equity Shares of B Ltd.}}$$

$$\text{Maximum MPS offered by A Ltd. To B Ltd.} = \frac{\text{Value of Equity of B Ltd.} + \text{Value of Synergy}}{\text{No. of Equity Shares of B Ltd.}}$$

LOS 13 : Calculation of EPS A+B when Synergy Gain is Given in Question**1. EPS_{A+B} when Synergy Gain is Expressed in %**

$$ESP_{A+B} = \left[\frac{(E_A + E_B) (1 + \text{Synergy Gain})}{N_A + N_B \times ER} \right]$$

2. EPS_{A+B} when Synergy Gain is Expressed in Absolute Amount

$$ESP_{A+B} = \left[\frac{E_A + E_B + \text{Synergy Gain}}{N_A + N_B \times ER} \right]$$

Note:

If question is silent regarding Synergy Gain, assume it to be NIL.

Synergy Gain – In terms of Earnings & Market Value

Synergy means extra – benefit/ advantage.

1. Synergy In terms of Earnings

$$\text{Synergy} = E_{A+B} - (E_A + E_B)$$

2. Synergy In terms of Market Value

$$\text{Synergy} = MV_{A+B} - (MV_A + MV_B)$$

LOS 14 : True Cost & True Benefit of Merger

Case 1: When Merger is Financed by Cash	Case 2: When Merger is Financed by Stock
For Acquiring company (A Ltd.)	For Acquiring company (A Ltd.)
Cost to A Ltd. = Cash paid to B Ltd. – $MV_{B \text{ Ltd.}}$ received	Cost to A Ltd. = $MV_{A+B} \times \% \text{ Holding of B Ltd.}$ – $MV_{B \text{ Ltd.}}$ received
Benefit of Merger (Synergy Gain) = $MV_{A+B} - (MV_{A \text{ Ltd.}} + MV_{B \text{ Ltd.}})$	Benefit of Merger (Synergy Gain) = $MV_{A+B} - (MV_{A \text{ Ltd.}} + MV_{B \text{ Ltd.}})$
Net Benefit (NPV) = Benefit – Cost	Net Benefit (NPV) = Benefit – Cost
For Target Company (B Ltd.)	For Target Company (B Ltd.)
Benefit (Net Benefit) = Cash Received – $MV_{B \text{ Ltd.}}$ sacrificed	Benefit (Net Benefit) = $MV_{A+B} \times \% \text{ Holding of B Ltd.}$ – $MV_{B \text{ Ltd.}}$ sacrificed

Note:

Cost of A Ltd. = Benefit for B Ltd.



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