

MAFA : CA FINAL

**DEDICATED TO :
ASHIM JAANA SIR**

PREPARED BY : SUNIL KUMAR M. R

CA Final (2nd Group Pending)

Email : suniludde@gmail.com

Mobile : 9902601142

BANGALORE

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Every effort is taken to avoid errors and omissions.

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MERGER & ACQUISITION

Meaning of Merger

Merger	Refers to a combination of 2/ more companies into one company
Types of Merger	Absorption Consolidation
Absorption	One company, acquires another company
Consolidation	Two / more companies, combined to form a New company

Requirements of Merger

Purchasing Company	Company which acquires other Co., is known as Purchasing Co.
Vendor Company	Company which is acquired by othe co., is known as vendor Co.

Purpose / Main theme of Merger

<u>Benefit of Merger, or Overall BOM</u>	A merger cannot be successful unless there is a gain. Overall gain expected to arise from merger is known as BOM
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<u>Requirements of BOM</u>	Value of Purchasing Company (Pre Merger) Value of Purchasing Company (Post Merger) Value of selling Company
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$$\text{Benefit of merger} = PV_{AB} - (PV_A + PV_B)$$

PV_{AB}	Value of the merged firm
PV_A	Value of purchasing company before merger
PV_B	Value of vendor company before merger.

So, where there is Benefit, there is cost

Cost of Merger (Applicable only to Purchasing Company)

Reason	A merger cannot, be successful unless both the negotiating parties Shareholders of Purchasing company Shareholders of Selling Company, Benefits from Merger
Therefore	The consideration is set above the premerger value of Selling Co.

Merger Acquisition

Gain allocated	The excess consideration over premerger value of the vendor is the merger gain allocated to the vendor
	The part of merger gain allocated to the vendor company is called COM to Purchasing Company

Cost of Merger, depends upon Mode of Payment

Consideration paid in Cash

COM =	Cash paid to vendor company	-	PV_B
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Consideration paid in Kind

$$COM = \alpha \cdot PV_{AB} - PV_B$$

Alpha = Degree of holding by shareholders
of the vendor company

$$\text{Degree of Holding} = \frac{\text{No. of shares to be issued to the vendor company}}{\text{Total no. of shares of the merged company}}$$

$$\begin{array}{lcl} \text{Total no.} & & \text{Existing no. of shares of} \\ \text{of shares} & = & \text{purchasing co.} \\ \text{Of} & & \text{before merger} \\ \text{Merged co.} & + & \\ & & \text{No. of shares to be issued to the} \\ & & \text{vendor company} \end{array}$$

When there is both BOM & COM, there will be NOM

Net Benefit of Merger

Net present value of merger

Net gain of merger

Net gain of merger to purchasing company

$$\text{Net gain of merger to purchasing company} = \text{Total benefit of merger} - \text{Benefit to be enjoyed by the vendor company (Cost of merger to the purchasing company)}$$

This can also be found by adapting the formula of cost of merger to the purchasing company

$$\text{Net gain of merger to purchasing company} = \text{Alpha} * \text{PV}_{AB} - \text{PV}_A$$

Merger Acquisition

Benefit of Merger to Selling company

Benefit of merger to vendor company	=	Cost of merger to the purchasing Co.
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Basic Summary

With Respect to P.Co. BOM
 COM
 NOM

With Respect to S.Co. BOM

Final Summary

Merger revolves around 3 points

BOM	<i>Depends on Value</i>
COM	<i>Depends on Value & Consideration</i>
NOM	<i>Depends on BOM & COM</i>

But these, BOM, COM, & NOM, revolves around 3 points

Value
Consideration

BOM BENEFIT OF MERGER

BOM = $PV_{PS} - [PV_P + PV_S]$
BOM = Cost savings
BOM = COM + NOM

COM COST OF MERGER

COM = Cash Paid - PV_S
COM = $\text{Alpha} * PV_{PS} - PV_S$
COM = BOM - NOM

NOM NET BENEFIT OF MERGER

NOM = BOM - COM
NOM = $\text{Alpha} * PV_{PS} - PV_P$

VALUE

Value = MPS * No. of Shares
Value = PV of Future Cash Flow

Cash flow is Infinite (With applying the below formula, the Cash flow will be a year less)

$$\frac{D (1 + g)}{K - g} \quad \text{or} \quad \frac{D}{K}$$

Behind Every Successful MAN,
there are lot of unsuccessful years.

Mobile : 9902601142

Merger Acquisition

CONSIDERATION

Cash payment	Cash paid / Payable
<u>Payment in Kind</u>	<u>Shares Issued</u>
Based on	Exchange Ratio / Stock Swap
Exchange Ratio ;	Calculation based on EPS MPS PE Ratio Net Asset Basis

EPS : Earning Per Share

EPS =	EA 2 ESH (profit) / No. of Shares
EA 2 ESH (profit) =	EPS * No. of Shares
No. of Shares =	EA 2 ESH / EPS
EPS =	MPS / PE Ratio

MPS : Market Price Per share

MPS =	PE Ratio * EPS
Market Capitalisation	MPS * No. of Shares

PE RATIO : Price Earning Ratio

PE Ratio =	MPS / EPS
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BASIC UNDERSTANDING

	Operating Income
Less : Operating Expenses	
	EBIT : Operating Profit
Less : Interest	
	EBT
Less : Tax	
	EAT
Less : Preference Dividend	
	EA 2 ESH
Less : Transfer to Reserve	
	NEA 2 ESH

IMPORTANT POINTS

Synergy Gain	Increase in Profit If no Synergy Gain, After & Before same profit
Free Float	Total Capital - Promoters Holding

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Mobile : 9902601142

Merger Acquisition

Important Observations

Purchasing Co.	Concerned with, MAXIMUM EXCHANGE RATIO
Selling Co.	Concerned with, MINIMUM EXCHANGE RATIO
Assumption	Before and after merger, MPS to be same, and not less

Very Important

If Some value (SV), is to be same, : Before & After the merger

$$\text{Then} = \frac{\text{SV of Selling co.}}{\text{SV of Purchasing Co.}}$$

The formula remains same, whether they ask the SV to be same
for Purchasing co.
For selling co.

Also, while computing by longer method, then also, the SV of
Purchasing co. only to be considered, and not of
selling co.

Ex : EPS of P.co = 5

 EPS of S.co = 6

 Then consider Eps of P.co. = 5, and not of S.co.

Face Value & Book Value

Face Value	E.S.Capital / No. of E.Shares
Book Value	E.S.Capital + Res & Sur / No. of E. Shares Net worth / No. of shares Assets - Liabilities / No. of shares

Compare the gain / loss before and after merger

By way of EPS	
By way of MPS	This is better

Merger Acquisition

Important points

Exchange ratio
(Interpretation) P:Q
Purchasing co. : Selling co.
For every Q share of Selling co., Purchasing co. shall issue P shares

Exchange ratio
(computation) $\frac{\text{Base of vendor co.}}{\text{Base of Purchasing co.}} = P$

∴ For every share of Selling co., purchasing co. shall issue P shares

Minimum / Maximum exchange ratio

Maximum exchange ratio
MPS assumed to be same before and after merger
MPS of Purchasing co.

Minimum Exchange ratio
MPS assumed to be same before and after merger
MPS of selling co.
PE ratio given wrt purchasing co.
So multiply the PE ratio of Purchasing co. by Variable(x)

Attractiveness of merger proposal

Can be found out wrt EPS / MPS
comparison to be made, wrt after and before merger