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08MBAFM323

Third Semester MBA Degree Examination, May/June 2010
Mergers, Acquisitions and Corporate Restructuring

Time: 3 hrs. Max. Marks:100

Note: *1.Answer any FOUR full questions from Q.No.1 to Q.No.7.*
2.Question No.8 is compulsory.

1 a. What do you mean by split off? **(03 Marks)**

b. The particulars of Alpha and Beta are as follows:

Particulars	Alpha	Beta
Profit (Rs. In Cr.)	100	75
No. of shares (Crore)	20	25
EPS (Rs.)	5	3
P/E multiple	30	10
Market prices (Rs.)	150	30

Alpha proposes to acquire Beta and gives its shares in exchange of the shares of Beta. Evaluate the proposal with appropriate figures. **(07 Marks)**

c. Apex Ltd. is evaluating an investment proposal to manufacture trucks for Horizon Ltd. The project will require an initial investment of Rs.10 lakhs in plant and equipment. This initial investment will be depreciated strait line down to a salvage value of Rs.2 lakhs, at the end of 8 years. The project will generate revenues of Rs.3 lakhs and will incur operating expenses of Rs.1 lakh in the first year. These revenues and expenses are expected to grow at around 5% a year over the remaining 7 years of the project. The marginal tax rate for the company is 36%. Estimate the free cash flows to the firm. Also, verify the effect of depreciation on the net present value of the project (Assume the cost of capital at 10%). **(10 Marks)**

2 a. What is meant by synergy of a merger? **(03 Marks)**

b. Alpha India Ltd. is trying to buy Beta India Ltd. Beta India Ltd. is a small biotechnology firm that develops products that are licensed to major pharmaceutical firms. The development costs are expected to generate negative cash flows of Rs.10 lakhs during the first year of the forecast period. Licensing fee is expected to generate positive cash flows of Rs.5, 10, 15 and 20 lakhs during 2-5 years respectively. Due to the emergence of competitive products cash flows are expected to grow annually at a modest 5% after the fifth year. The discount rate for the first five years is estimated to be 15% and then drop to 8% beyond the fifth year. Calculate the value of the firms. **(07 Marks)**

c. Firm X has purchased firm Y. Firm Y had the base year earnings as Rs.2,00,000. At the time of the merger, its shareholders received initial payments of Rs.50,000 shares of the firm X. The market value of the firm X's share is Rs.25 per share and the P/E ratio is 8. The projected post merger earnings of firm Y for the next 3 years are Rs.236000, Rs.285000 and Rs.310000. Assume that there are no changes in the share price and the P/E ratio of firm X. Determine the number of shares required to be issued to the shareholders of company during these years. **(10 Marks)**

3 a. How to determine return on equity? (03 Marks)

b. What are the steps in discounted cash flow valuations? (07 Marks)

c. ABC Ltd. has declared dividend during the past five years as follows:

Year	2001	2002	2003	2004	2005
Rate of dividend (%)	12	14	18	21	24

The average rate of return prevailing in the same industry is 15%. Calculate the value per share of Rs.10 of ABC Ltd. based on the dividend yield method. (10 Marks)

4 a. What do you understand by capital structure and business value? (03 Marks)

b. ABC Ltd. is intending to acquire substantial share in Z Ltd. to acquire control in the company. The beta factor of Z. Ltd. shares is 1.60 and its current market price is Rs.190. The company is consistently paying a dividend of Rs.46 p.a. The risk free market rate of interest is 12% and the rate of return expected on such securities in the market is 18%. You are required to value the share of Z Ltd. (07 Marks)

c. XYZ Ltd. is intending to acquire ABC Ltd. (by merger). The following information is available in respect of the companies:

Particulars	XYZ Ltd.	ABC Ltd.
No. of equity shares	5,00,000	3,00,000
Earnings after tax (Rs.)	25,00,000	9,00,000
Market value per share (Rs.)	21	14

i) What is the present EPS of both companies?

ii) If the proposal merger takes place, what would be the new earning per share for XYZ Ltd? (assuming that the merger takes place by exchange of equity shares and the exchange ratio is based on the current market prices.)

iii) What should be exchange ratio, if ABC Ltd. wants to ensure the same earnings to members as before the merger? (10 Marks)

5 a. Calculate the market price of ABC Ltd's shares under Walter's model. Earnings per share = Rs.4, Dividend per share = Rs. 2.50, Cost of capital = 16%, Internal rate of return = 18%. (03 Marks)

b. Alpha Ltd. operates in the pharma industry. The firm is expected to pass through two phases of growth i) initial high growth and ii) a stable growth period. The tax rate for the firm is 40%. The following parameters are available for the firm:

	Initial Growth phase	Stable Growth phase
Return on assets	25%	18%
Debts equity ratio	1	1
Interest rate on debt	12%	10%
Payout ratio	24%	?
Growth rate	?	10%

Estimate the growth rate of revenues for the firm in the critical growth phase. (07 Marks)

c. BART is a large company operating in the cement industry. Given its large size it is unlikely that the firm will grow at a rate faster than the economy in the long term. The free cash flow to the firm in 2004 was Rs.4 per share. The following additional information for the year 2005 is available:

Earning per share = Rs.4.5 | Capital expenditure per share = Rs.4.15
Depreciation per share = Rs.3.30 | Cange in working capital/share = Re.1
Debt financing ratio = 30%

The earnings, capital expenditure, depreciation and working capital are all expected to grow at 6% a year. The beta of the stock is 1.1. The treasury bill rate is 7%. Estimate the value per share using the free cash flow to equity method. (Assume the market premium to be 6%) **(10 Marks)**

6 a. The Treasury bill is being traded at 4.5%. Assume that three different factors are considered. The following additional information is available as

	Factor 1	Factor 2	Factor 3
Risk Premium	4%	4.5%	3%
Beta	1.25	0.95	1.15

Estimate the cost of equity. **(03 Marks)**

b. What is the function of due diligence? **(07 Marks)**

c. What are the reasons for failure of M & A? **(10 Marks)**

7 a. ABC Ltd. a listed company in BSE, which has 50,000 outstanding shares, has made an offer to repurchase 18% of its shares through an open market operation. The shares are being quoted at Rs.84. ABC Ltd. offered Rs.92 for each share sold by the shareholders. 25% of the outstanding shares were offered by the shareholders for the buyback. Estimate the value of the remaining shares after the repurchase. **(03 Marks)**

b. Why do companies form strategic alliances? **(07 Marks)**

c. What are the key issues in the joint ventures? **(10 Marks)**

8 Case Study:

Raymond Inc., a leader in the development and manufacture of household products in India, reported EBIT of Rs.1200 lakhs in 2004, prior to depreciation of Rs.350 lakhs. The capital expenditure in 2004 amounted to Rs.420 lakhs and working capital was 10% of revenues (which were Rs.13000 lakhs). The firm has outstanding debt, yielding a pre-tax interest rate of 8%. The tax rate for the firm is 40% and the treasury bill rate is 7%. The most recent beta for the firm is 1.10. The debt equity ratio of the firm was 50%.

The firm expects revenues, earnings, capital expenditure and depreciation to grow at 9.5% a year from 2005-09, after which the growth rate is expected to drop by 4% (capital spending will offset depreciation in the steady state period). The company also plans to lower its debt/equity ratio to 25% for the steady state resulting in the pre tax interest rate drop to 7.5%. The annual market premium of the firm is 6%.

a. Calculate free cash flow and PV of free cash flow. **(07 Marks)**
b. Estimate the value of the firm. **(07 Marks)**
c. Provide your comments. **(06 Marks)**

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