Introducing …

Synergy, Economies of Scale & Scope, Pure-play, Conglomerate, Takeover, Consolidation, Tender Offer, Open Offer, Strategic Alliance, Joint Venture, Divestiture, Liquidation, Sell-off, Spin-off, Equity Carve out, White Knight, Poison Pill, Going Private, Boot Strapping, Leveraged Buy-out, Management Buy-out, Creeping Acquisition,

Merger versus Consolidation

- Merger
  - One firm is acquired by another
  - Acquiring firm retains name and acquired firm ceases to exist
  - Advantage – legally simple
  - Disadvantage – must be approved by stockholders of both firms
- Consolidation
  - Entirely new firm is created from combination of existing firms

Acquisitions

- A firm can be acquired by purchasing voting shares of the firm's stock
- Tender offer – public offer to buy shares
- Stock acquisition
  - No stockholder vote required
  - Can deal directly with stockholders, even if management is unfriendly
  - May be delayed if some target shareholders hold out for more money – complete absorption requires a merger
- Classifications
  - Horizontal – both firms are in the same industry
  - Vertical – firms are different stages of the production process
  - Conglomerate – firms are unrelated

Takeovers

- Control of a firm transfers from one group to another
- Possible forms
  - Acquisition
    - Merger or consolidation
    - Acquisition of stock
    - Acquisition of assets
  - Proxy contest
  - Going private

TABLE 25.1

Accounting for Acquisitions: Purchase (in Millions)

Firm A				Firm B			
Working capital	$ 4	Equity	$20	Working capital	$ 2	Equity	$10
Fixed assets	16			Fixed assets	8		
Total	$20	Total	$20	Total	$10	Total	$10

Firm AB

Working capital	$ 6	Debt	$18
Fixed assets	30	Equity	20
Goodwill	2		
Total	$38	Total	$38

The market value of the fixed assets of Firm B is $14 million. Firm A pays $18 million for Firm B by issuing debt.

Accounting for Acquisitions

- Purchase Accounting
  - Assets of acquired firm must be reported at fair market value
  - Goodwill is created – difference between purchase price and estimated fair market value of net assets
  - Goodwill no longer has to be amortized – assets are essentially marked-to-market annually and goodwill is adjusted and treated as an expense if the market value of the assets has decreased

Bootstrapping by Bangur Group

- K. K. Bangur Group
- In 1995-96, Graphite Vicarb + Carbon Corp → Carbon Everflow
- In 2001-02, Carbon Investments is merged in Carbon Everflow
- Also, Graphite India is being merged into Carbon Everflow
- But, they will be known by something starting with Graphite …
- Why?
- Possible case of Boot Strapping

Which company should be merged (or amalgamated) into another?

Graphite India						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
1.21	19.16	15.87	28.00	1.76	265	34
Carbon Everflow						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
1.25	10.47	8.38	20.00	2.39	145	25

All figures are for last year and assumed to continue

When Carbon Everflow is merged into Graphite India

Graphite India						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
1.21	19.16	15.87	28.00	1.76	265	34
Carbon Everflow						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
1.25	10.47	8.38	20.00	2.39	145	25
Merge Carbon Everflow into Graphite India						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
2.10	29.63	14.11	24.83	1.76	410	52

When Graphite India is merged into Carbon Everflow

Graphite India						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
1.21	19.16	15.87	28.00	1.76	265	34
Carbon Everflow						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
1.25	10.47	8.38	20.00	2.39	145	25
Merge Graphite India with Carbon Everflow						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
2.94	29.63	10.08	24.09	2.39	410	71

Bootstrap Game

- In a bootstrap game acquiring firm has a high P/E ratio

→ Selling firm has a low P/E ratio

- After merger, acquiring firm has a short-term EPS rise
- But, the acquirer has a slower than normal growth (in EPS) due to share dilution
- What could be the other reasons for Carbon Everflow merging into Graphite India?
- In reality, if markets are efficient then what will happen?

Financing Mergers

Cash

- Indian Oil bought IBP with cash
- India Cements bought Raasi Cement with cash
- Simplicity, preciseness, no control rights to front party

Exchange of Shares

- Target shareholders maintain an interest in the new firm, to the acquirer there is no cash outflow needed
- Carbon Everflow and Graphite India
- HLL and BBLIL

How do we evaluate a deal?

- Always recalculate things using NPV
- Also, look for any real options that exist
- Also, take a new expected rate of return (depending on the new risk profile of the company)
- Take the deal costs also into account

What are the broad trends?

- Many business groups are merging their affiliate concerns into one (example – K K Bangur)
- Sectors being liberalized are seeing a lot of M&A activity (example – financial services, cement, pharmaceuticals)
- Sectors that are having very attractive features or are of strategic importance are seeing a lot of foreign investment (ex – Advertising, Cola, FMCG, Consumer Durables, Retail Petrochemicals, Telecom, Banking, Insurance, etc.)