Practice Questions – Mergers and Acquisitions

1. Penn Corp. is analyzing the possible acquisition of Teller Company. Both firms have no debt. Penn believes the acquisition will increase its total after tax annual cash flows by $2.4 million indefinitely. The current market value of Teller is $58 million, and that of Penn is $107 million. The appropriate discount rate for the incremental cash flows is 10 percent. Penn is trying to decide whether it should offer 40 percent of its stock or $73 million in cash to Teller's shareholders.

    a. What is the cost of each alternative?

    b. What is the NPV of each alternative?

    c. Which alternative should Penn choose?

2. Fly-By-Night Couriers is analyzing the possible acquisition of Flash-in-the-Pan Restaurants. Neither firm has debt. The forecasts of Fly-By Night show that the purchase would increase its annual after tax cash flow by $450,000 indefinitely. The current market value of Flash-in-the-Pan is $14 million. The current market value of Fly-By-Night is $31 million. The appropriate discount rate for the incremental cash flows is 8 percent. Fly-By-Night is trying to decide whether it should offer 35 percent of its stock or $18.5 million in cash to Flash-in-the-Pan.

    a. What is the synergy from the merger?

    b. What is the value of Flash-in-the-Pan to Fly-By-Night?

    c. What is the cost to Fly-By-Night of each alternative?

    d. What is the NPV to Fly-By-Night of each alternative?

    e. Which alternative should Fly-By-Night use?

3. Harrods PLC has a market value of £200 million and 9 million shares outstanding. Selfridge Department Store has a market value of £70 million and 8 million shares outstanding. Harrods is contemplating acquiring Selfridge. Harrods' CFO concludes that the combined firm with synergy will be worth £300 million, and Selfridge can be acquired at a premium of £10 million.

    a. If Harrods offers 2.5 million shares of its stock in exchange for the 8 million shares of Selfridge, what will the stock price of Harrods be after the acquisition?

    b. What exchange ratio between the two stocks would make the value of a stock offer equivalent to a cash offer of £90 million?

4. Consider the following premerger information about Firm X and Firm Y

	Firm X	Firm Y
Total earnings	$74,000	$19,000
Shares outstanding	30,000	20,000
Per-share values:		
Market	$ 53	$ 16
Book	$ 17	$ 6

Assume that Firm X acquires Firm Y by paying cash for all the shares outstanding at a merger premium of $5 per share. Assuming that neither firm has any debt before or after the merger, construct the post merger balance sheet for Firm X assuming the use of

a. Pooling of interests accounting methods and

b. Purchase accounting methods.

5. Assume that the following balance sheets are stated at book value. Construct a postmerger balance sheet assuming that Meat Co. purchases Loaf, Inc., and the pooling of interests method of accounting is used.

Meat Co.			
Current assets	$ 9,000	Current liabilities	$ 5,800
Net fixed assets	32,000	Long-term debt	9,300
		Equity	25,900
Total	$41,000	Total	$41,000

Loaf, Inc.			
Current assets	$ 3,600	Current liabilities	$ 1,800
Net fixed assets	6,500	Long-term debt	2,100
		Equity	6,200
Total	$10,100	Total	$10,100

6. In the previous problem, suppose the fair market value of Loaf's fixed assets is $12,500 versus the $6,500 book value shown. Meat pays $19,000 for Loaf and raises the needed funds through an issue of long-term debt. Construct the postmerger balance sheet now, assuming that the purchase method of accounting is used.

7. Foxy News, Inc., is considering making an offer to purchase Pulitzer Publications. The vice president of finance has collected the following information

	Foxy	Pulitzer
Price–earnings ratio	15.5	11.5
Shares outstanding	1,200,000	500,000
Earnings	$3,600,000	$680,000
Dividends	810,000	310,000

Foxy also knows that securities analysts expect the earnings and dividends of Pulitzer to grow at a constant rate of 5 percent each year. Foxy management believes that the acquisition of Pulitzer will provide the firm with some economies of scale that will increase this growth rate to 7 percent per year.

a. What is the value of Pulitzer to Foxy?

b. What would Foxy's gain be from this acquisition?

c. If Foxy were to offer $18 in cash for each share of Pulitzer, what would the NPV of the acquisition be?

d. What's the most Foxy should be willing to pay in cash per share for the stock of Pulitzer?

e. If Foxy were to offer 200,000 of its shares in exchange for the outstanding stock of Pulitzer, what would the NPV be?

f. Should the acquisition be attempted? If so, should it be as in (c) or as in (e)?

g. Foxy's outside financial consultants think that the 7 percent growth rate is too optimistic and a 6 percent rate is more realistic. How does this change your previous answers?