



Subject: Business finance 1

Chapter: Unit 4

Category: Practice question

1. CB1 April 2020 Q19

Parent is a major quoted financial services company. It has a wholly-owned subsidiary (Sub) that provides actuarial services to the other companies in the group. Sub employs 94 qualified actuaries, plus 110 support staff. These numbers include 18 senior managers who are responsible for Sub's management. Sub operates from an office space within Parent's head office.

Sub's annual running costs are approximately \$20 million, including an annual internal charge of \$2.5 million made for the use of the office space.

Sub's senior management team has held an initial meeting with Parent's Board to discuss the possibility of a management buyout of the subsidiary by its senior managers. Parent's Board has agreed, subject to the following terms:

- ☐ The senior management team would pay \$4 million for Sub.
- ☐ Sub would continue to provide all of Parent's actuarial services under contract for 4 years, at an annual fee of \$16 million. That contract would be renegotiated at the end of year 4.
- ☐ Sub would be permitted to remain in the office space for 18 months without charge but would be required to vacate the space at the end of that time.
- ☐ Sub would retain all the IT equipment and office furniture.

The senior management team could raise \$1.8 million by investing \$100,000 each from their personal savings and by remortgaging their homes. They will each take equal shares in the company and will retain 100% ownership between them.

(i) Discuss the advantages and disadvantages of this management buyout arrangement to Sub's senior management team.

(ii) Describe the advantages and disadvantages of this management buyout arrangement to Parent.

(iii) Discuss whether it would be preferable to permit Sub's other employees to buy shares in the company.

2. CB1 April 2021 Q12

Describe the difficulties in deciding whether a particular quoted company is a suitable acquisition target for a larger quoted company.

3. CB1 September 2021 Q13

A quoted company merged with a slightly smaller competitor as part of an expansion strategy, but the acquisition has failed to deliver the planned synergies.

Outline possible reasons that would explain the problems associated with this merger.

4. CB1 April 2022 Q20

S is a major quoted transportation company that operates 2,500 Heavy Goods Vehicles (HGVs), delivering goods on behalf of several hundred customers, including manufacturers and supermarkets. In addition to 5,000 drivers, S employs 300 administrative staff, most of whom are based in the company's operations centre. The operations centre uses sophisticated computer software to track the navigation systems in S's HGVs, and to schedule collections and deliveries, to maximise operating efficiencies.

S's board is considering the acquisition of G, a competing quoted transportation company that operates 1,200 HGVs and employs 2,600 drivers and 170 administrative staff. G also has a computerised operations centre that tracks HGVs and schedules collections and deliveries. G's market capitalisation is currently roughly half that of S. Confidential meetings have taken place with G's directors, who have agreed to support the bid. S will issue new shares worth 15% more than G's present market capitalisation and will exchange those for 100% of G's equity. S's board is confident that synergies will bring about a significant increase in the overall value of the merged group.

G's directors will step down after the merger, in return for a generous financial settlement. The merged group will be managed by S's existing board, whose remuneration will increase in line with the increase in the size of the merged entity.

- (i) Discuss the expectation by S's board that this merger will bring about significant synergies.
- (ii) Evaluate the proposal that G's directors should receive a generous financial settlement when they step down.
- (iii) Evaluate the proposal that S's directors should be paid more in recognition of the increase in the size of the merged entity.

5. CB1 April 2023 Q13

A quoted company, Q, has identified a takeover target in a completely different industry. Q's board believes that the market has under-priced the target company's shares.

Explain whether it would make sense for Q to proceed with this acquisition.

6. CB1 September 2023 Q15

An actuarial consulting firm, X, wishes to expand rapidly and is considering the acquisition of a slightly smaller actuarial consulting firm, Y, in order to do so. Explain the issues that should be considered with respect to the target firm before proceeding with the acquisition.

7. CB1 April 2024 Q20

Q is a quoted airline company that operates a network of intercontinental flights. Q has 100 million shares in issue and the company has a market capitalisation of \$1.1 billion.

Q's board plans to acquire 100% of L, a quoted hotel company. L owns hotels in many of the countries that are served by Q's flights. Q's directors believe that doing so will enable Q to offer holiday packages as well as flights and so will be more profitable.

L has 50 million shares in issue and the company has a market capitalisation of \$0.5 billion. Q's board plans to issue 50 million new shares and exchange one new share for each of L's existing shares.

Each of Q's directors is remunerated with a salary and a percentage of Q's annual profit.

- (i) Evaluate the planned acquisition of L as a means of creating growth for Q.
- (ii) Evaluate the agency implications for Q's shareholders of the proposal by Q's directors to acquire L.
- (iii) Discuss the possibility that L's directors will advise L's shareholders to reject Q's proposal once it has been announced.

8. Define each of the following terms:

- (i) Synergy; merger
- (ii) Horizontal merger; vertical merger; congeneric merger; conglomerate merger
- (iii) Friendly merger; hostile merger; tender offer; target company; acquiring company
- (iv) Operating merger; financial merger; equity residual method; market multiple analysis
- (v) White knight; white squire; poison pill; golden parachute

- (vi) Arbitrage
- (vii) Joint venture; corporate, or strategic, alliance
- (viii) Divestiture; spin-off; leveraged buyout (LBO); carve-out; liquidation

9. What are the different methods of achieving internal growth?

10. What are the different methods of achieving external growth?

11. When evaluating a potential target company, what factors might an acquirer consider?

12. What are the uses of cash with reference to cash budgeting?

13. How is credit policy managed?

14. How is inventory policy managed?

15. How are long term financial plans developed?

16. You are being appointed as the financial manager of a Teak wood, a large manufacturing company of wood and wooden articles. The company has massive operations in the Southeast Asia and Middle East. The owners of the company is the kingdom of Abu Dhabi. Explain in the current context what will be your objective as a financial manager and how will you achieve the same.

17. Peter Group is an Indian multinational conglomerate headquartered in Ahmedabad, India. The member companies of the group have presence in Energy, Real Estate, IT, Steel and Automotive sectors. The group has been earned global recognition for more than 20 years. Most of the businesses of the group have grown

organically in the recent times under the dynamic leadership of the Group CEO, Mr. Parker. Mr. Parker is looking to expand the business in Real Estate sector of its company RDJ Properties Ltd. by entering into a merger agreement / taking over Strange Properties Ltd.

- a. State the type of merger between RDJ Properties Ltd. and Strange Properties Ltd. Also, describe other types of mergers that Peter Group can enter into. What is the biggest risk if one of the member companies of Peter Group enters into a merger with Moon Pharma?
- b. The potential merger of Peter Group with Strange Properties Ltd. is done in order to increase competitiveness and market share whereas the merger with Moon Pharma is with an aim to achieve diversification. Explain what could be the other major motives for merger?
- c. The risk advisor of Mr. Parker has raised concerns over the idea of merger. What can be the potential problems with merger?