CHAPTER 29
Mergers and Acquisitions

Multiple Choice Questions:

I. DEFINITIONS

MERGER

a 1. The complete absorption of one company by another, wherein the acquiring firm retains its identity and the acquired firm ceases to exist as a separate entity, is called a:
- a. merger.
- b. consolidation.
- c. tender offer.
- d. spinoff.
- e. divestiture.

Difficulty level: Easy

CONSOLIDATION

b 2. A merger in which an entirely new firm is created and both the acquired and acquiring firms cease to exist is called a:
- a. divestiture.
- b. consolidation.
- c. tender offer.
- d. spinoff.
- e. conglomeration.

Difficulty level: Easy

TENDER OFFER

c 3. A public offer by one firm to directly buy the shares of another firm is called a:
- a. merger.
- b. consolidation.
- c. tender offer.
- d. spinoff.
- e. divestiture.

Difficulty level: Easy

HORIZONTAL ACQUISITION

d 4. The acquisition of a firm in the same industry as the bidder is called a _____ acquisition.
- a. conglomerate
- b. forward
- c. backward
- d. horizontal
- e. vertical

Difficulty level: Easy

VERTICAL ACQUISITION

e 5. The acquisition of a firm involved with a different production process stage than the bidder is called a _____ acquisition.
   a. conglomerate
   b. forward
   c. backward
   d. horizontal
   e. vertical

   Difficulty level: Easy

CONGLOMERATE ACQUISITION

a 6. The acquisition of a firm whose business is not related to that of the bidder is called a _____ acquisition.
   a. conglomerate
   b. forward
   c. backward
   d. horizontal
   e. vertical

   Difficulty level: Easy

PROXY CONTEST

b 7. An attempt to gain control of a firm by soliciting a sufficient number of stockholder votes to replace the current board of directors is called a:
   a. tender offer.
   b. proxy contest.
   c. going-private transaction.
   d. leveraged buyout.
   e. consolidation.

   Difficulty level: Easy

GOING-PRIVATE TRANSACTION

c 8. A business deal in which all publicly owned stock in a firm is replaced with complete equity ownership by a private group is called a:
   a. tender offer.
   b. proxy contest.
   c. going-private transaction.
   d. leveraged buyout.
   e. consolidation.

   Difficulty level: Easy

LEVERAGED BUYOUT

d 9. Going-private transactions in which a large percentage of the money used to buy the outstanding stock is borrowed is called a:
a. tender offer.
b. proxy contest.
c. merger.
d. leveraged buyout.
e. consolidation.

Difficulty level: Easy

SYNERGY

e 10. The positive incremental net gain associated with the combination of two firms through a merger or acquisition is called:
a. the agency conflict.
b. goodwill.
c. the merger cost.
d. the consolidation effect.
e. synergy.

Difficulty level: Easy

SUPERMAJORITY AMENDMENT

a 11. A change in the corporate charter making it more difficult for the firm to be acquired by increasing the percentage of shareholders that must approve a merger offer is called a:
a. supermajority amendment.
b. standstill agreement.
c. greenmail provision.
d. poison pill amendment.
e. white knight provision.

Difficulty level: Easy

STANDSTILL AGREEMENT

b 12. A contract wherein the bidding firm agrees to limit its holdings in the target firm is called a:
a. supermajority amendment.
b. standstill agreement.
c. greenmail provision.
d. poison pill amendment.
e. white knight provision.

Difficulty level: Easy

GREENMAIL

c 13. The payments made by a firm to repurchase shares of its outstanding stock from an individual investor in an attempt to eliminate a potential unfriendly takeover attempt are referred to as:
a. a golden parachute.
b. standstill payments.
c. greenmail.
d. a poison pill.
e. a white knight.

Difficulty level: Easy

POISON PILLS

d 14. A financial device designed to make unfriendly takeover attempts financially unappealing, if not impossible, is called:
a. a golden parachute.
b. a standstill agreement.
c. greenmail.
d. a poison pill.
e. a white knight.

Difficulty level: Easy

GOLDEN PARACHUTES

a 15. Generous compensation packages paid to a firm's top management in the event of a takeover are referred to as:
a. golden parachutes.
b. poison puts.
c. white knights.
d. shark repellents.
e. bear hugs.

Difficulty level: Easy

WHITE KNIGHTS

c 16. A friendly suitor that a target firm turns to as an alternative to a hostile bidder is called a:
a. golden suitor.
b. poison put.
c. white knight.
d. shark repellent.
e. crown jewel.

Difficulty level: Easy

EQUITY CARVE-OUT

b 17. The sale of stock in a wholly owned subsidiary via an initial public offering is referred to as a(n):

a. split-up.
b. equity carve-out.
c. countertender offer.
d. white knight transaction.
e. lockup transaction.

Difficulty level: Medium

SPIN-OFF

d 18. The distribution of shares in a subsidiary to existing parent company stockholders is called a(n):

a. lockup transaction.
b. bear hug.
c. equity carve-out.
d. spin-off.
e. split-up.

Difficulty level: Medium

II. CONCEPTS

ACQUISITIONS

a 19. Which of the following statements concerning acquisitions are correct?

I. Being acquired by another firm is an effective method of replacing senior management.
II. The net present value of an acquisition should have no bearing on whether or not the acquisition occurs.
III. Acquisitions are often relatively complex from an accounting and tax point of view.
IV. The value of a strategic fit is easy to estimate using discounted cash flow analysis.

a. I and III only
b. II and IV only
c. I and IV only
d. I, III, and IV only
e. I, II, III, and IV

Difficulty level: Medium

MERGER

b 20. In a merger the:

a. legal status of both the acquiring firm and the target firm is terminated.
b. acquiring firm retains its name and legal status.
c. acquiring firm acquires the assets but not the liabilities of the target firm.
d. stockholders of the target firm have little, if any, say as to whether or not the merger occurs.
e. target firm continues to exist as a subsidiary of the acquiring firm.

Difficulty level: Medium

VERTICAL ACQUISITION

d 21. When a building supply store acquires a lumber mill it is making a ______ acquisition.
- a. horizontal
- b. longitudinal
- c. conglomerate
- d. vertical
- e. complementary resources

Difficulty level: Easy

STOCK ACQUISITION

c 22. If Microsoft were to acquire U.S. Airways, the acquisition would be classified as a _____ acquisition.
- a. horizontal
- b. longitudinal
- c. conglomerate
- d. vertical
- e. complementary resources

Difficulty level: Easy

TAKEOVERS

e 23. Which of the following activities are commonly associated with takeovers?
- I. the acquisition of assets
- II. proxy contests
- III. management buyouts
- IV. leveraged buyouts
- a. I and III only
- b. II and IV only
- c. I, III, and IV only
- d. I, II, and IV only
- e. I, II, III, and IV

Difficulty level: Medium

TAXES AND ACQUISITIONS

c 24. In a tax-free acquisition, the shareholders of the target firm:
- a. receive income that is considered to be tax-exempt.
- b. gift their shares to a tax-exempt organization and therefore have no taxable gain.
- c. are viewed as having exchanged their shares.
- d. sell their shares to a qualifying entity thereby avoiding both income and capital gains taxes.
- e. sell their shares at cost thereby avoiding the capital gains tax.

Difficulty level: Medium

PURCHASE ACCOUNTING METHOD

d 25. The purchase accounting method for mergers require that:
   a. the excess of the purchase price over the fair market value of the target firm be recorded as a one-time expense on the income statement of the acquiring firm.
   b. goodwill be amortized on a yearly basis.
   c. the equity of the acquiring firm be reduced by the excess of the purchase price over the fair market value of the target firm.
   d. the assets of the target firm be recorded at their fair market value on the balance sheet of the acquiring firm.
   e. the excess amount paid for the target firm be recorded as a tangible asset on the books of the acquiring firm.

Difficulty level: Medium

SYNERGY

d 26. A proposed acquisition may create synergy by:
   I. increasing the market power of the combined firm.
   II. improving the distribution network of the acquiring firm.
   III. providing the combined firm with a strategic advantage.
   IV. reducing the utilization of the acquiring firm's assets.
   a. I and III only
   b. II and III only
   c. I and IV only
   d. I, II, and III only
   e. I, II, III, and IV

Difficulty level: Medium

ACQUISITION GAINS

c 27. Which of the following represent potential tax gains from an acquisition?
   I. a reduction in the level of debt
   II. an increase in surplus funds
   III. the use of net operating losses
   IV. an increased use of leverage
   a. I and IV only
   b. II and III only
   c. III and IV only
   d. I and III only
   e. II, III, and IV only

Difficulty level: Medium

ACQUISTION CONSIDERATIONS

c 28. When evaluating an acquisition, you should:
   a. concentrate on book values and ignore market values.
   b. focus on the total cash flows of the merged firm.
   c. apply the rate of return that is relevant to the incremental cash flows.
   d. ignore any one-time acquisition fees or transaction costs.
   e. ignore any potential changes in management.

Difficulty level: Medium

ACQUISITIONS AND EARNINGS PER SHARE

b 29 If an acquisition does not create value, then the:

a. earnings per share of the acquiring firm must be the same both before and after the acquisition.
b. earnings per share can change but the stock price of the acquiring firm should remain constant.
c. price per share of the acquiring firm should increase because of the growth of the firm.
d. earnings per share will most likely increase while the price-earnings ratio remains constant.
e. price-earnings ratio should remain constant regardless of any changes in the earnings per share.

Difficulty level: Medium

COMPLEMENTARY RESOURCES

b 30. Which one of the following combinations of firms would benefit the most through the use of complementary resources?

a. a ski resort and a travel trailer sales outlet
b. a golf resort and a ski resort
c. a hotel and a home improvement center
d. a swimming pool distributor and a kitchen designer
e. a fast food restaurant and a dry cleaner

Difficulty level: Medium

COMPLEMENTARY RESOURCES

a 31. Which one of the following is most likely a good candidate for an acquisition that could benefit from the use of complementary resources?

a. a sports arena that is home only to an indoor hockey team
b. a hotel in a busy downtown business district of a major city
c. a day care center located near a major route into the main business district of a large city
d. an amusement park located in a centralized Florida location
e. a fast food restaurant located near a major transportation hub

Difficulty level: Medium

INEFFICIENT MANAGEMENT

a 32. The shareholders of a target firm benefit the most when:

a. an acquiring firm has the better management team and replaces the target firm's managers.
b. the management of the target firm is more efficient than the management of the acquiring firm which replaces them.
c. the management of both the acquiring firm and the target firm are as equivalent as possible.
d. their current management team is kept in place even though the managers of the acquiring firm are more suited to manage the target firm's situation.
e. their management team is technologically knowledgeable yet ineffective.

Difficulty level: Medium

ACQUISITION GAINS

c 33. Which of the following represent potential gains from an acquisition?
- I. the replacement of ineffective managers
- II. lower costs per unit produced
- III. an increase in firm size so that diseconomies of scale are realized
- IV. spreading of overhead costs
- a. II and III only
- b. I and IV only
- c. I, II, and IV only
- d. I, III, and IV only
- e. I, II, III, and IV

Difficulty level: Medium

COST OF AN ACQUISITION

a 34. The value of a target firm to the acquiring firm is equal to:
- a. the value of the target firm as a separate entity plus the incremental value derived from the acquisition.
- b. the purchase cost of the target firm.
- c. the value of the merged firm minus the value of the target firm as a separate entity.
- d. the purchase cost plus the incremental value derived from the acquisition.
- e. the incremental value derived from the acquisition.

Difficulty level: Easy

CASH VERSUS STOCK ACQUISITION

c 35. Which one of the following statements is correct?
- a. If an acquisition is made with cash, then the cost of that acquisition is dependent upon the acquisition gains.
- b. Acquisitions made by exchanging shares of stock are normally taxable transactions.
- c. The management of an acquiring firm may put itself at risk of losing control of the firm if they make acquisitions using shares of stock.
- d. The stockholders of the acquiring firm will be better off when an acquisition results in losses if the acquisition was made with cash rather than with stock.
- e. Acquisitions based on legitimate business purposes are not taxable transactions regardless of the means of financing used.

Difficulty level: Medium

DEFENSIVE TACTICS

c 36. If a firm wants to take over another firm but feels the attempt to do so will be viewed as unfriendly it could decide to take a _____ approach to the acquisition.
- a. crown jewel
- b. shark repellent
- c. bear hug
- d. countertender offer
- e. lockup

Difficulty level: Medium

DIVESTITURES AND RESTRUCTURINGS

e 37. Which of the following are reasons why a firm may want to divest itself of some of its assets?
- I. to raise cash
- II. to get rid of unprofitable operations
- III. to get rid of some assets received in an acquisition
- IV. to cash in on some profitable operations
- a. I and II only
- b. I, II, and III only
- c. I, III, and IV only
- d. II, III, and IV only
- e. I, II, III, and IV

Difficulty level: Medium

DIVESTITURES AND RESTRUCTURINGS

a 38. Which one of the following statements is correct?
- a. A spin-off frequently follows an equity carve-out.
- b. A split-up frequently follows a spin-off.
- c. An equity carve-out is a specific type of acquisition.
- d. A spin-off involves an initial public offering.
- e. A divestiture means that the original firm ceases to exist.

Difficulty level: Medium

REASON FOR MERGER

a 39. In a merger or acquisition, a firm should be acquired if it:
- a. generates a positive net present value to the shareholders of an acquiring firm.
- b. is a firm in the same line of business, in which the acquirer has expertise.
- c. is a firm in a totally different line of business which will diversity the firm.
- d. pays a large dividend which will provide cash pass through to the acquiror.
- e. None of the above.

Difficulty level: Medium

SYNERGY

d 40. A reason for acquisitions is synergy. Synergy includes:
- a. revenue enhancements.
- b. cost reductions.
- c. lower taxes.
- d. All of the above.
- e. None of the above.

Difficulty level: Medium

ACQUISITION OF STOCK

b 41. One company wishes to acquire another. Which of the following forms of acquisition does not require a formal vote by the shareholders of the acquired firm?

a. Merger
b. Acquisition of stock
c. Acquisition of assets
d. Consolidation
e. All of the above require a formal vote.

Difficulty level: Medium

CONSOLIDATION

d 42. Firm A and Firm B join to create Firm AB. This is an example of:

a. a tender offer.
b. an acquisition of assets.
c. an acquisition of stock.
d. a consolidation.
e. Both B and C.

Difficulty level: Medium

HORIZONTAL MERGER

a 43. Suppose that Verizon and Sprint were to merge. Ignoring potential antitrust problems, this merger would be classified as a:

a. horizontal merger.
b. vertical merger.
c. conglomerate merger.
d. monopolistic merger.
e. None of the above.

Difficulty level: Easy

CONGLOMERATE MERGER

d 44. Suppose that General Motors has made an offer to acquire General Mills. Ignoring potential antitrust problems, this merger would be classified as a:

a. monopolistic merger.
b. horizontal merger.
c. vertical merger.
d. conglomerate merger.
e. None of the above.

Difficulty level: Easy

VERTICAL MERGER

b 45. Suppose that Exxon-Mobil acquired Schlumberger, an exploration/drilling company. Ignoring potential antitrust problems, this merger would be classified as a:

a. monopolistic merger.
b. vertical merger.
c. conglomerate merger.
d. horizontal merger.
e. None of the above.

Difficulty level: Easy

PROXY CONTEST

c 46. A dissident group solicits votes in an attempt to replace existing management. This is called a:

a. tender offer.
b. shareholder derivative action.
c. proxy contest.
d. management freeze-out.
e. shareholder's revenge.

Difficulty level: Easy

VERTICAL ACQUISITION

c 47. If the All-Star Fuel Filling Company, a chain of gasoline stations acquire the Mid-States Refining Company, a refiner of oil products, this would be an example of a:

a. conglomerate acquisition.
b. white knight.
c. vertical acquisition.
d. going-private transaction.
e. horizontal acquisition.

Difficulty level: Easy

TENDERING STOCK

d 48. Which of the following is *not* true of an acquisition of stock or tender offers?

a. No stockholder meetings need to be held.
b. No vote is required.
c. The bidding firm deals directly with the stockholders of the target firm.
d. In most cases, 100% of the stock of the target firm is tendered.
e. All of the above are true of tender offers.

Difficulty level: Medium

GOING PRIVATE

d 49. When the management and/or a small group of investors take over a firm and the shares of the firm are delisted and no longer publicly available, this action is known as a:

a. consolidation.
b. vertical acquisition.
c. proxy contest.
d. going-private transaction.
e. None of the above.

Difficulty level: Easy

REASON FOR MERGER

d 50. One of the most basic reasons for a merger is:

a. revenue enhancing in the hopes that net losses may decrease.
b. increased competition.
c. employee benefits.
d. cost reductions.
e. to keep lawyers and accountants employed.

Difficulty level: Medium

DISCOUNT RATE

c 51. Cowboy Curtiss' Cowboy Hat Company recently completed a merger. When valuing the combined firm after the merger, which of the following is an example of the type of common mistake that can occur?

a. The use of market values in valuing either the new firm.
b. The inclusion of cash flows that are incremental to the decision.
c. The use of Curtiss' discount rate when valuing the cash flows of the entire company.
d. The inclusion of all relevant transactions cost associated with the acquisition.
e. None of the above.

Difficulty level: Medium

III. PROBLEMS

GOODWILL

b 52. Turner, Inc. has $4.2 million in net working capital. The firm has fixed assets with a book value of $48.6 million and a market value of $53.4 million. Martin & Sons is buying Turner, Inc. for $60 million in cash. The acquisition will be recorded using the purchase accounting method. What is the amount of goodwill that Martin & Sons will record on its balance sheet as a result of this acquisition?

a. $0
b. $2.4 million
c. $6.6 million
d. $7.2 million
e. $11.4 million

Difficulty level: Medium

MERGER PREMIUM

a 53. Rudy's, Inc. and Blackstone, Inc. are all-equity firms. Rudy's has 1,500 shares outstanding at a market price of $22 a share. Blackstone has 2,500 shares outstanding at a price of $38 a share. Blackstone is acquiring Rudy's for $36,000 in cash. What is the merger premium per share?

a. $2.00
b. $4.25
c. $6.50
d. $8.00
e. $14.00

Difficulty level: Medium

MERGER PREMIUM

b 54. Jennifer's Boutique has 2,100 shares outstanding at a market price per share of $26. Sally's has 3,000 shares outstanding at a market price of $41 a share. Neither firm has any debt. Sally's is acquiring Jennifer's for $58,000 in cash. What is the merger premium per share?

a. $1.43
b. $1.62
c. $1.81
d. $2.04
e. $2.07

Difficulty level: Medium

VALUE OF FIRM B TO A

c 55. Jennifer's Boutique has 2,100 shares outstanding at a market price per share of $26. Sally's has 3,000 shares outstanding at a market price of $41 a share. Neither firm has any debt. Sally's is acquiring Jennifer's for $58,000 in cash. The incremental value of the acquisition is $2,500. What is the value of Jennifer's Boutique to Sally's?

a. $26,000
b. $27,600
c. $57,100
d. $58,200
e. $60,500

Difficulty level: Medium

VALUE OF FIRM B TO A

d 56. Rudy's, Inc. and Blackstone, Inc. are all-equity firms. Rudy's has 1,500 shares outstanding at a market price of $22 a share. Blackstone has 2,500 shares outstanding at a price of $38 a share. Blackstone is acquiring Rudy's for $36,000 in cash. The incremental value of the acquisition is $3,500. What is the value of Rudy's Inc. to Blackstone?

a. $30,000
b. $32,500
c. $33,000
d. $36,500
e. $39,500

Difficulty level: Medium

CASH ACQUISITION

b 57. ABC and XYZ are all-equity firms. ABC has 1,750 shares outstanding at a market price of $20 a share. XYZ has 2,500 shares outstanding at a price of $28 a share. XYZ is acquiring ABC for $36,000 in cash. The incremental value of the acquisition is $3,000. What is the net present value of acquiring ABC to XYZ?

a. $1,000
b. $2,000
c. $3,000
d. $4,000
e. $5,000

Difficulty level: Medium

CASH ACQUISITION

d 58. Firm A is acquiring Firm B for $40,000 in cash. Firm A has 2,500 shares of stock outstanding at a market value of $18 a share. Firm B has 1,500 shares of stock outstanding at a market price of $25 a share. Neither firm has any debt. The net present value of the acquisition is $2,500. What is the value of Firm A after the acquisition?

a. $40,000
b. $42,500
c. $45,000
d. $47,500
e. $50,000

Difficulty level: Medium

CASH ACQUISITION

c 59. Firm A is acquiring Firm B for $25,000 in cash. Firm A has 2,000 shares of stock outstanding at a market value of $21 a share. Firm B has 1,200 shares of stock outstanding at a market price of $17 a share. Neither firm has any debt. The net present value of the acquisition is $1,500. What is the price per share of Firm A after the acquisition?

a. $21.00
b. $21.25
c. $21.75
d. $22.00
e. $22.50

Difficulty level: Medium

CASH ACQUISITION

a 60. Alto and Solo are all-equity firms. Alto has 2,400 shares outstanding at a market price of $24 a share. Solo has 4,000 shares outstanding at a price of $17 a share. Solo is acquiring Alto for $63,000 in cash. The incremental value of the acquisition is $5,500. What is the net present value of acquiring Alto to Solo?

a. $100
b. $400
c. $1,200
d. $2,400
e. $5,500

Difficulty level: Medium

CASH ACQUISITION

c 61. Principal, Inc. is acquiring Secondary Companies for $29,000 in cash. Principal has 2,500 shares of stock outstanding at a market price of $30 a share. Secondary has 1,600 shares of stock outstanding at a market price of $15 a share. Neither firm has any debt. The net present value of the acquisition is $4,500. What is the price per share of Principal after the acquisition?

a. $30.00
b. $30.70
c. $31.80
d. $32.10
e. $32.50

Difficulty level: Medium

STOCK ACQUISITION

c 62. Winslow Co. has agreed to be acquired by Ferrier, Inc. for $25,000 worth of Ferrier stock. Ferrier currently has 1,500 shares of stock outstanding at a price of $21 a share. Winslow has 1,000 shares outstanding at a price of $22. The incremental value of the acquisition is $4,000. What is the merger premium per share?

a. $1
b. $2
c. $3
d. $4
e. $5

Difficulty level: Medium

STOCK ACQUISITION

e 63. Brite Industries has agreed to merge with Nu-Day, Inc. for $20,000 worth of Nu-Day stock. Brite has 1,200 shares of stock outstanding at a price of $15 a share. Nu-Day has 2,000 shares outstanding with a market value of $19 a share. The incremental value of the acquisition is $3,500. What is the value of Nu-Day after the merger?

a. $53,000
b. $54,250
c. $56,000
d. $57,750
e. $59,500

Difficulty level: Medium

STOCK ACQUISITION

a 64. Goodday & Sons is being acquired by Baker, Inc. for $19,000 worth of Baker stock. Baker has 1,500 shares of stock outstanding at a price of $25 a share. Goodday has 1,000 shares outstanding with a market value of $16 a share. The incremental value of the acquisition is $2,000. How many new shares of stock will be issued to complete this acquisition?

a. 760.0 shares
b. 840.0 shares
c. 960.0 shares
d. 1,187.5 shares
e. 1,312.5 shares

Difficulty level: Medium

STOCK ACQUISITION

e 65. Holiday & Sons is being acquired by Miller's, Inc. for $20,000 worth of Miller's stock. Miller has 1,300 shares of stock outstanding at a price of $20 a share. Holiday has 1,000 shares outstanding with a market value of $18 a share. The incremental value of the acquisition is $2,000. What is the total number of shares in the new firm?

a. 1,000 shares
b. 1,300 shares
c. 1,500 shares
d. 2,000 shares
e. 2,300 shares

Difficulty level: Medium

STOCK ACQUISITION

d 66. Firm A is being acquired by Firm B for $24,000 worth of Firm B stock. The incremental value of the acquisition is $3,500. Firm A has 1,500 shares of stock outstanding at a price of $15 a share. Firm B has 1,200 shares of stock outstanding at a price of $30 a share. What is the value per share of Firm B after the acquisition?

a. $17.50
b. $24.00
c. $30.00
d. $31.00
e. $35.00

Difficulty level: Medium

STOCK ACQUISITION

b 67. Firm X is being acquired by Firm Y for $35,000 worth of Firm Y stock. The incremental value of the acquisition is $2,500. Firm X has 2,000 shares of stock outstanding at a price of $16 a share. Firm Y has 1,200 shares of stock outstanding at a price of $40 a share. What is the actual cost of the acquisition using company stock?

a. $34,750
b. $34,789
c. $35,000
d. $35,289
e. $35,500

Difficulty level: Challenge

STOCK ACQUISITION

c 68. Firm Q is being acquired by Firm S for $30,000 worth of Firm S stock. The incremental value of the acquisition is $2,000. Firm Q has 1,900 shares of stock outstanding at a price of $15 a share. Firm S has 1,500 shares of stock outstanding at a price of $40 a share. What is the net present value of the acquisition given that the actual cost of the acquisition using company stock is $30,167?

a. $167
b. $225
c. $333
d. $425
e. $433

Difficulty level: Challenge

EARNINGS AND VALUATION

d 69. The Sligo Co. is planning on merging with the Thorton Co. Sligo will pay Thorton's stockholders the current value of their stock in shares of Sligo. Sligo currently has 2,300 shares of stock outstanding at a market price of $20 a share. Thorton has 1,800 shares outstanding at a price of $15 a share. How many shares of stock will be outstanding in the merged firm?

a. 1,800 shares
b. 2,300 shares
c. 2,750 shares
d. 3,650 shares
e. 4,100 shares

Difficulty level: Medium

EARNINGS AND VALUATION

b 70. Firm A is planning on merging with Firm B. Firm A will pay Firm B's stockholders the current value of their stock in shares of Firm A. Firm A currently has 2,300 shares of stock outstanding at a market price of $20 a share. Firm B has 1,800 shares outstanding at a price of $15 a share. The after-merger earnings will be $6,500. What will the earnings per share be after the merger?

a. $1.67
b. $1.78
c. $1.83
d. $1.87
e. $1.92

Difficulty level: Medium

EARNINGS AND VALUATION

a 71. Firm A is planning on merging with Firm B. Firm A will pay Firm B's stockholders the current value of their stock in shares of Firm A. Firm A currently has 2,300 shares of stock outstanding at a market price of $20 a share. Firm B has 1,800 shares outstanding at a price of $15 a share. What is the value of the merged firm?

a. $73,000
b. $75,000
c. $76,667
d. $77,778
e. $78,000

Difficulty level: Medium

EARNINGS AND VALUATION

d 72. Firm A is planning on merging with Firm B. Firm A will pay Firm B's stockholders the current value of their stock in shares of Firm A. Firm A currently has 2,300 shares of stock outstanding at a market price of $20 a share. Firm B has 1,800 shares outstanding at a price of $15 a share. What is the value per share of the merged firm?

a. $19.00
b. $19.18
c. $19.44
d. $20.00
e. $20.33

Difficulty level: Challenge

SYNERGY

b 73. Firm V was worth $450 and Firm A had a market value of $375. Firm V acquired Firm A for $425 because they thought the combination of the new Firm VA was worth $925. What is the synergy from the merger of Firm V and Firm A?

a. $50
b. $100
c. $475
d. $500
e. None of the above.

Difficulty level: Easy

NPV OF MERGER

b 74. Firm V was worth $450 and Firm A had a market value of $375. Firm V acquired Firm A for $425 because they thought the combination of the new Firm VA was worth $925. What is the NPV from the merger of Firm V and Firm A?

a. $0
b. $50
c. $425
d. $450
e. None of the above.

Difficulty level: Medium

IV. ESSAYS

MERGER GAINS

75. The empirical evidence strongly indicates that the stockholders of the target firm realize large wealth gains as a result of a takeover bid but the stockholders in the acquiring firm gain little, if anything. Although there exists no definitive answer as to why this is the case, several possible explanations have been proposed. List and explain three of these possible explanations for the minimal returns to the acquiring firm's stockholders.

    Size differentials, competition in the takeover market, lack of achieving merger gains, management goals other than the best interests of the shareholders, and early announcements of corporate acquisition intent are all presented as possible explanations in the textbook.

FORMS OF ACQUISITION

76. Describe the three basic legal procedures that one firm can use to acquire another and briefly discuss the advantages and disadvantages of each.

    The three forms are merger, acquisition of stock, and acquisition of assets. A merger has the advantage that it is legally simple and therefore low cost but it has the disadvantage that it must be approved by the shareholders of both firms. Acquisition by stock requires no shareholder meetings and management of the target firm can be bypassed. However, it can be a costly form of acquisition and minority shareholders may hold out, thereby raising the cost of the purchase. An acquisition of assets requires the vote of the target firm's shareholders. However, it can become quite costly to transfer title to all of the assets.

MANAGEMENT INTENT

77. Sometimes the management of a target firm fights a takeover attempt even when that attempt appears to be in the best interest of the shareholders. Why would management take this stance?

    Often, the management of the target firm is replaced after an acquisition. If management believes this may be the case, they may fight the takeover attempt in an effort to maintain their current positions. In other cases, management may fight the attempt if they feel that by doing so, they may increase the amount paid by the acquiring firm.

POISON PILLS

78. Defensive merger tactics are designed to thwart unwanted takeovers and mergers. Do such activities work to the advantage of stockholders all of the time? Are these types of activities ethical? Who do you think benefits most from these activities?

    Good answers will acknowledge that defensive tactics "insulate" existing management from the vagaries of the marketplace and may allow ineffective management to remain in charge. Obviously, defensive maneuvers do not always act in the best interest of shareholders and many students will argue that management benefits most from these activities. The ethics debate about these issues is always an interesting one.

SOLUTIONS TO TEST BANK PROBLEMS

Chapter 29

52. Goodwill = $60m – ($4.2m + $53.4m) = $2.4m
53. Merger premium per share = ($36,000 ÷ 1,500) – $22 = $2
54. Merger premium per share = ($58,000 ÷ 2,100) – $26 = $1.62
55. Value of Jennifer's to Sally's = (2,100 × $26) + $2,500 = $57,100
56. Value of Rudy's to Blackstone = (1,500 × $22) + $3,500 = $36,500
57. NPV = (1,750 × $20) + $3,000 – $36,000 = $2,000
58. Value of A = (2,500 × $18) + $2,500 = $47,500
59. Price per share of A = [(2,000 × $21) + $1,500] ÷ 2,000 = $21.75
60. NPV = (2,400 × $24) + $5,500 – $63,000 = $100
61. Price per share = [(2,500 × $30) + $4,500] ÷ 2,500 = $31.80
62. Merger premium per share = ($25,000 ÷ 1,000) – $22 = $3
63. Value after merger = (1,200 × $15) + (2,000 × $19) + $3,500 = $59,500
64. Number of shares issued = $19,000 ÷ $25 = 760 shares
65. Total number of shares = 1,300 + ($20,000 ÷ $20) = 2,300 shares
66. Value per share = [(1,200 × $30) + (1,500 × $15) + $3,500] ÷ [1,200 + ($24,000 ÷ $30)] = $62,000 ÷ 2,000 = $31.00
67. Number of shares issued = $35,000 ÷ $40 = 875 shares; Value per share after merger = [(1,200 × $40) + (2,000 × $16) + $2,500] ÷ [1,200 + 875] = $82,500 ÷ 2,075 = $39.75904; Actual cost of acquisition = 875 × $39.75904 = $34,789.16 = $34,789
68. Net present value = [(1,900 × $15) + $2,000] – $30,167 = $30,500 – $30,167 = $333
69. Number of shares = 2,300 + (1,800 × $15 ÷ $20) = 3,650 shares
70. Number of shares = 2,300 + (1,800 × $15 ÷ $20) = 3,650; Earnings per share = $6,500 ÷ 3,650 = $1.78
71. Value of merged firm = (2,300 × $20) + (1,800 × $15) = $73,000
72. Value per share = [(2,300 × $20) + (1,800 × $15)] ÷ [2,300 + (1,800 × $15 ÷ $20)] = $73,000 ÷ 3,650 = $20
73. Merger premium = $925 - ($450 + $375) = $100
74. Net Present Value = $925 - $450 - $375 - ($425-$375) = $50