K. J. SOMAIYA INSTITUTE OF MANAGEMENT STUDIES AND RESEARCH

Program: PGDM & MMS - Elective, Trimester VI (Batch 2017-2019)

Subject: Mergers and Acquisitions
(End Term examination)

Maximum Marks: 50 Time : 3 Hours Date: 15/04/2019

Notes:
1. Question No. 1 is compulsory. (20 marks)
2. Answer any 3 question from Question 2 to Question 7 (10 marks each)

Q1) Case Study
The Gucci - LVMH Battle
The case gives a detailed account of the dispute between two of the world's leading luxury good companies, Gucci and LVMH. The case examines how Gucci managed to thwart the takeover efforts of its rival LVMH.

The Poison Pill
In March 1999, a $ 3 billion stock deal was announced between luxury goods major Gucci N V and the Pinault-Printemps-Redoute (PPR) group of France.

The news of PPR acquiring a 40% stake in Gucci came as a surprise for Bernard Arnault (Arnault), Chairman of the Moet Hennessy Louis Vuitton (LVMH) group, who had been trying to acquire Gucci through open market stock acquisitions. Gucci announced that it would issue more shares if LVMH tried to further increase its stake in the group. Gucci President Domenico De Sole (De Sole) said that he had the support of Gucci staff, suppliers and independent shareholders to keep LVMH off the board. Earlier, Gucci had approved an employee stock option scheme (ESOP) to counter LVMH's acquisition tactics. Not only did LVMH remain powerless in Gucci despite spending $ 1.4 billion, but its share prices also began sliding on the Paris stock market.

LVMH charged that the sole purpose of Gucci's move was to deprive LVMH of its voting rights. The same day PPR announced its deal with Gucci, it paid $ 1 billion for Sanofi Beaute, the French owner of brands like Yves Saint Laurent cosmetics and perfumes. This was another setback for LVMH as Arnault had been trying to acquire Sanofi.

As a result of these deals, overnight the Gucci/PPR combination became a major competitor for LVMH. LVMH now made a full takeover bid for Gucci at $ 81 a share, $ 6 more than what PPR had paid. At the same time, it dragged Gucci to the court to annul the deal with PPR and replace its board with an independent overseer. The Gucci-LVMH battle took the global fashion industry by surprise. More so, because in 1994, it was Arnault himself, who had turned down an offer to buy Gucci for $ 400 million. However, in just five years the same man had spent $ 1.4 billion in building up a 34% stake in Gucci. A media report said, "How a $ 400 million reject became a highly desirable $ 8 billion company is one of the greatest comeback stories in the fashion business."

Background note

Gucci's history goes back to 1923, when Gucci started selling expensive leather goods in

Florence, Italy. By 2001, the Gucci Group had emerged as one of the world's leading multi-brand luxury goods companies.
The company designed, produced and distributed high-quality personal luxury goods, including ready to wear garments, handbags, luggage, small leather goods, shoes, timepieces, jewellery, ties and scarves, perfume, cosmetics and skincare products. Some of its important brands were Gucci, Yves Saint Laurent, Sergio Rossi and Boucheron. The group directly operated stores in major markets throughout the world and also sold their products through franchise stores, duty-free boutiques and leading department and specialty stores. De Sole had joined Gucci in 1982 and quickly moved up the ranks, becoming the President of Gucci US. In the early 1980s, around 50% of the company's stock was owned by an Arab company, Investcorp.

During the 1970s and 1980s, the Gucci label was seen on almost every imaginable product: scotch, leatherwear, key chains, watches, T-shirts, etc. Also, the company was spending more than $ 4 million a year to combat a flood of fake Gucci merchandise In 1990, Gucci hired Tom Ford (Ford), an actor-model with a degree in interior architecture and some experience in fashion design for its designing needs. By 1993, Gucci was on the verge of bankruptcy. In 1994, it was reported that the company was offered to Arnault for $ 400 million, but he backed off at the last minute. Investcorp then bought the remaining 50% stake in a desperate effort to recoup its investment. De Sole and Ford then began working towards cancelling Gucci's numerous licensing agreements and went on to build its image as a premier luxury brand. Though initially De Sole had reservations regarding Ford's competence, over the years, Ford emerged as the single most important factor behind Gucci's success.

The battle for Gucci
LVMH had begun stalking Gucci since the beginning of January 1999 by acquiring more than 5% of its shares. By the end of January 1999, LVMH's stake in Gucci had increased to 34%.
On January 27th, 1999, Arnault arranged a meeting with De Sole, at which he proposed that, since he was now one of Gucci's largest shareholders, he be allowed to name a director to its board. De Sole however believed that Arnault's people should not be put on the Gucci board, since they were from the rival fashion house Louis Vuitton. De Sole could not afford to let them have access to inside information regarding store space, publicity, and designers. De Sole alleged that Arnault was plotting a 'creeping takeover' by gradually buying enough shares to dominate Gucci's board. De Sole then asked Arnault to buy the remaining shares.

The Battle ends
In July 2001, followers of the Gucci-LVMH tussle were surprised to see media reports that claimed that the battle was over. LVMH had agreed to sell its 20% stake in Gucci to PPR for $ 2 billion under a condition that PPR forfeit voting rights on this stake.

PPR bought the LVMH stake at $ 94 per share, raising its stake in Gucci to 53.2%. As a first step, PPR was to buy half of LVMH's 20% stake for $ 975 million. Then, Gucci was to pay a special dividend of $ 7 per share to all shareholders except PPR in November 2001. Next, PPR was to launch a full public offer for all Gucci shares at $ 101.50 per share in March 2004.

PPR, Gucci and LVMH also agreed to release all outstanding claims and withdraw all pending litigation. PPR was planning to finance the deal by issuing equity and convertible bonds. Media reports revealed that the deal was struck at the behest of Dutch investigators, who urged the three parties to reach an agreement without seeking legal intervention.

i) Briefly explain the history of Gucci.
ii) Explain the Gucci/PPR combination. How did it impact LVMH and what actions did LVMH take?
iii) What strategy did LVMH adopt to acquire Gucci in 1999? Explain the different types of hostile takeover.
iv) How did the Gucci-LVMH tussle finally end?
v) Explain the terms:- i) Killer bees ii) Poison pill iii) Parachutes iv) White Knight v) Crown Jewels

Q2) Bharat Heavy Electricals Ltd BHEL, a public sector company was established in the year 1964. It is the largest engineering and manufacturing enterprise in India in the energy related and infrastructure sector. BHEL caters to following sectors of Indian economy:- Power generation and Transmission, Transportation, Renewable energy, Defence. In March 1992, BHEL was a 100% government owned company. However the company felt that the scope of strategic alliance with foreign companies had increased. It was anticipated that the government of India would **partially disinvest its stake.** The valuation of the company was done as on March 31, 1992. The inputs for valuation were taken from **the five year plan** developed by BHEL from the year 1992-93 to 1996-97. Therefore the **explicit forecast period was set at five years.** However the company did not have any projections for the period thereafter. The following information was provided for the 5 years:-

- Revenue for 5 years (Rs in crores) 3350, 3700, 4200, 5000, 6000 respectively from 1992-93 to 1996-97
- EBDIT would be 12% of the Revenue
- Depreciation would be 3.12% of the Revenue
- EBIT would be 8.88% of the Revenue
- The tax rate would be 45% for the year 1992-1993
- Thereafter it would decline by 5% each for two years and stabilise at 35% beyond two years
- Change (Increase) in working capital (Rs in crores) 103, 135, 153, 182, 219 respectively from 1992-93 to 1996-97
- No capital expenditure is expected to be incurred
- The Weighted Average Cost of Capital (WACC) is estimated at 12.5%
- The terminal value at the end of 5 years was estimated as a multiple (12X) of the free cash flow for year 5
- On March 31, 1992, BHEL had a total debt of Rs. 775 crore
- It was assumed that the book value of debt was a good proxy for its market value
- As on March 31, 1992, BHEL had 24 crore shares outstanding of Rs 10 each

Find the Enterprise Value based on DCF Valuation method. Also find the Value of Equity and Value per share.

Q3) SASKEN COMMUNICATION TECHNOLOGIES was set up in 1989, headquartered in Bangalore is a leading provider of telecommunication software solutions and services to network equipment manufacturers and semiconductor companies around the world. It has presently 1350 employees. SASKEN is an unlisted public company. It plans to issue stock options to its employees in April 2004. **It wants to ascertain the value of its equity shares to structure its ESOP using Relative Valuation Method.** For SASKEN, the EPS is Rs 5.60, Book Value per share is Rs 38.40 and Sales per share Rs 54.70
SASKEN is considering 2 companies for comparison viz HUGHES SOFTWARES & SUBEX

SYSTEMS. For HUGHES, the EPS is Rs 22.30, Book Value per share is Rs 99.20 and Sales per share Rs 102.40. The market price per share is Rs 570. For SUBEX, the EPS is Rs 23.40, Book Value per share is Rs 87.10 and Sales per share Rs 114.10. The market price per share is Rs 280. **Determine the Value per share of SASKEN using the Equity Multiples P/E, P/B and P/S. (Formulas not needed)**

Q4) The Balance Sheet of ST ltd and SM ltd as on 31st March 2018 is as follows :-

Liabilities	ST ltd.	SM ltd	Assets .	ST ltd	SM ltd
Equity Share capital (shares of Rs. 10 each)	15,00,000	12,00,000	Fixed Assets (Net)	14,00,000	7,50,000
Reserves	9,50,000	1,00,000	Debtors	3,00,000	5,00,000
10% Debentures		2,00,000	Stock	4,20,000	4,70,000
Creditors	4,70,000	3,20,000	Bank	8,00,000	1,00,000
TOTAL	**29,20,000**	**18,20,000**	**TOTAL**	**29,20,000**	**18,20,000**

ST ltd agreed to absorb SM ltd as on 31st March 2018 on the following terms :-
i) ST ltd agreed to pay off 10% Debentures of SM ltd
ii) ST ltd to revalue its Fixed Assets at Rs 19,50,000 to be incorporated in the books.
iii) Shares of both companies to be valued on net asset basis after considering Rs 5,00,000 towards value of Goodwill of SM ltd
iv) The cost of absorption of Rs 30,000 are met by ST ltd
Prepare Balance Sheet after absorption, making necessary adjustments. Show working notes.

Q5) a) What are the approaches to Brand Valuation? Explain them.

b) What is Leveraged Buy out and Management Buy out? What are the advantages and disadvantages of LBO? Explain the difference between Management buy out and Leveraged buy out

Q6) a) Define Corporate Restructuring. What are the main forms of corporate restructuring. Explain any two in detail

b) Explain BCG Matrix and strategy prescriptions using the BCG Matrix for M&A

Q7) MCQ
i) The main benefit of a reverse merger:
a) lower susceptibility to market conditions
b) becoming a public company at a considerably less cost
c) possibility of quoting a higher price for the shares later
d) all of these

ii) Bas, CEO of Ignacio Auto & Body Shop, a Lower Manhattan-based automobile repair shop, is seeking to grow his business. Bas' main competitor Alvaro's Awesome Autos, is based in upper Manhattan. After a long day of due diligence and negotiation they agree that if they combine their businesses they'll enjoy significant synergies. How would you best describe the combination of the businesses?
a) Geographic expansion

b) Merger
c) Reverse Merger
d) All of the above

iii) What is a bear hug letter?
a) A letter from the target to the acquiror outlining all of the positive effects that would result from an acquisition between the two companies and threatening a hostile takeover
b) A letter from the target to the acquiror outlining all of the negative effects that would result from an acquisition between the two companies
c) A letter from the acquiror to the target outlining all of the positive effects that would result from an acquisition between the two companies and threatening a hostile takeover
d) A letter from the acquiror to the target outlining all of the negative effects that would result from an acquisition between the two companies

iv) A tender offer is
a) a goodwill gesture by a "white knight."
b) a would-be acquirer's friendly takeover attempt
c) a would-be acquirer's offer to buy stock directly from shareholders
d) viewed as sexual harassment when it occurs in the workplace

v) The merger of an oil refinery by a chain of gasoline stations is an example of :
a) Horizontal merger
b) Vertical merger
c) Conglomerate merger
d) None of these

vi) Contracts given to key executives that can be used as an anti-takeover measure by a firm to discourage unwanted takeover attempt
a) shark repellents
b) Poison put
c) Golden Parachute
d) All of these

vii) Which of the following activities is/are not associated with spin-off
a) Creation of a new legal entity
b) Distribution of shares to a portion of existing shareholders in a subsidiary in exchange for parent company stock
c) Distribution of shares on *pro rata* basis to existing shareholders of the parent company
d) Separation of control

viii) Michael Porter believes the significant synergy corporations gain through mergers and acquisitions is
a) Tax savings
b) Brand Enhancement
c) Product Extensions
d) Human Capital

ix) What is Enterprise Value
a) Enterprise value is calculated as minority interest and preferred shares, minus total cash and cash equivalents

b) Enterprise value is calculated as market cap plus debt, minority interest less preferred shares, minus total cash and cash equivalents
c) Enterprise value is calculated as market cap plus debt, minority interest and preferred shares
d) Enterprise value is calculated as market cap plus debt

x) Suppose that the market price of Company X is $45 per share and that of Company Y is $30. If X offers three-fourths a share of common stock for each share of Y, the ratio of exchange of market prices would be
a) 0.667
b) 1.0
c) 1.125
d) 1.5

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