

Sigra Co is a listed company producing confectionary products which it sells around the world. It wants to acquire Dentro Co, an unlisted company producing high quality, luxury chocolates. Sigra Co proposes to pay for the acquisition using one of the following three methods:

Method 1

A cash offer of \$5•00 per Dentro Co share; or

Method 2

An offer of three of its shares for two of Dentro Co's shares; or

Method 3

An offer of a 2% coupon bond in exchange for 16 Dentro Co's shares. The bond will be redeemed in three years at its par value of \$100.

Extracts from the latest financial statements of both companies are as follows:

	Sigra Co \$'000	Dentro Co \$'000
Sales revenue	44210	4680
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Profit before tax	6190	780
Taxation	(1240)	(155)
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Profit after tax	4950	625
Dividends	(2700)	(275)
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Retained earnings for the year	2250	350
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Non-current assets	22450	3350
Current assets	3450	247
Non-current liabilities	9700	873
Current liabilities	3600	436
Share capital (40c per share)	4400	500
Reserves	8200	1788

Sigra Co's current share price is \$3•60 per share and it has estimated that Dentro Co's price to earnings ratio is 12•5% higher than Sigra Co's current price to earnings ratio. Sigra Co's non-current liabilities include a 6% bond redeemable in three years at par which is currently trading at \$104 per \$100 par value.

Sigra Co estimates that it could achieve synergy savings of 30% of Dentro Co's estimated equity value by eliminating duplicated administrative functions, selling excess non-current assets and through reducing the workforce numbers, if the acquisition were successful.

Required:

Estimate the percentage gain on a Dentro Co share under each of the above three payment methods. Comment on the answers obtained. (16 marks)

Examiners Report

Part (a) of question three required candidates to calculate the percentage gain on a target company's share price using three different acquisition methods and to comment on the results. With the cash offer, a significant number of candidates failed to calculate the earnings per share of the acquiring or target companies correctly.

With the share-for-share offer many responses did not account for the synergies created. The majority of candidates were not able to calculate the value of the bond offer. A small minority of the candidates did not give the gains as percentages, but as amounts, although percentages were specifically asked for.

It was surprising that many candidates failed to get many marks for this question especially when a similar question had been set in a recent P4 examination. It could be that candidates did not expect the same topic to be examined again so soon and decided not to study this area.

Candidates should bear in mind that any topic area from the entire P4 syllabus can be tested in an examination. Recent examination of a topic area does not preclude it from being tested again soon after.