Synergies to be tested

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B contemplates to launch a mixed offer on A, 60% paid in cash and 40% paid in kind ie by shares to be issued by B. The useful financial information is presented hereafter:

		A	B
Net income (M€)		100	200
Number of shares (million)		4	5
EPS before the deal (€)		25,00	40,00
Sector's P/E		35	20
Valuation (M€)		3500	4000
Share price (€)		875	800
Payment (M€)			
Cash	60%	2100	
Shares	40%	1400	
Cost of debt		2,00%	
Corporate tax rate		25%	

Calculate the bidder's EPS accretion / dilution rate and assess the required synergies to get a 5% EPS accretion.

Payment (M€)		
Cash	60%	2100
Shares	40%	1400
Cost of debt		2,00%
Corporate tax rate		25%
After tax cost of debt		1,50%
After tax interests on acquisition debt (M€)		31,5
Payment in shares to be issued by B (M€)		1400
Value of a B share (€)		800
Number of shares to be issued by B (million)		1,75
Number of B shares (million)		
Before the deal		5
To be issued		1,75
After the deal		6,75
Net income of B after the deal (M€)		268,5
EPS of BE after the deal (€)		39,78
B's EPS accretion / dilution		-0,6%

In order to get a 5% EPS accretion, the bidder's EPS after the deal has to reach :

$$BPA\ before\ .\ (1 + 5\%) = 40\ .\ 1{,}05 = 42\ €$$

The BPA after the deal is based on the *stand alone* net income (before taking synergies into account) to be increased by x.

Then:

$$\frac{268{,}5 + x}{6{,}75} = 42$$

and:

$$x = 42\ .\ 6{,}75 - 268{,}5 = 15\ M€$$

Finally, the required pre-tax synergies are worth:

$$\frac{15}{1 - 25\%} = 20\ M€$$

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