ACQUISITIONS AND MERGERS

Questions 40 to 45 cover acquisitions and mergers, the subject of Part D of the BPP Study Text for Paper P4.

40 Mercury Training (6/08, amended) 45 mins

Mercury Training was established in 1999 and since that time it has developed rapidly. The directors are considering either a flotation or an outright sale of the company.

The company provides training for companies in the computer and telecommunications sectors. It offers a variety of courses ranging from short intensive courses in office software to high level risk management courses using advanced modelling techniques. Mercury employs a number of in-house experts who provide technical materials and other support for the teams that service individual client requirements. In recent years, Mercury has diversified into the financial services sector and now also provides computer simulation systems to companies for valuing acquisitions. This business now accounts for one third of the company's total revenue.

Mercury currently has 10 million, 50c shares in issue. Jupiter is one of the few competitors in Mercury's line of business. However, Jupiter is only involved in the training business. Jupiter is listed on a small company investment market and has an estimated beta of 1.5. Jupiter has 50 million shares in issue with a market price of 580c. The average beta for the financial services sector is 0.9. Average market gearing (debt to total market value) in the financial services sector is estimated at 25%.

Other summary statistics for both companies for the year ended 31 December 2007 are as follows:

	Mercury	*Jupiter*
Net assets at book value ($million)	65	45
Earnings per share (c)	100	50
Dividend per share (c)	25	25
Gearing (debt to total market value)	30%	12%
Five year historic earnings growth (annual)	12%	8%

Analysts forecast revenue growth in the training side of Mercury's business to be 6% per annum, but the financial services sector is expected to grow at just 4%.

Background information:

The equity risk premium is 3.5% and the rate of return on short-dated government stock is 4·5%.
Both companies can raise debt at 2.5% above the risk free rate.
Tax on corporate profits is 40%.

Required

(a) Estimate the cost of equity capital and the weighted average cost of capital for Mercury Training. **(8 marks)**

(b) Advise the owners of Mercury Training on a range of likely issue prices for the company. **(10 marks)**

(c) Discuss the advantages and disadvantages, to the directors of Mercury Training, of a public listing versus private equity finance as a means of disposing of their interest in the company. **(7 marks)**

(Total = 25 marks)