*Figure 25.4: Valuing an Acquisition*

| Component | Valuation Guidelines | Should you pay? |
|---|---|---|
| Synergy | *Value the combined firm with synergy built in*. This value may include<br>a. a higher growth rate in revenues: *growth synergy*<br>b. higher margins, because of *economies of scale*<br>c. lower taxes, because of tax benefits: *tax synergy*<br>d. lower cost of debt: *financing synergy*<br>e. higher debt ratio because of lower risk: *debt capacity*<br>*Subtract the value of the target firm (with control premium) + value of the bidding firm (pre-acquisition). This is the value of the synergy*. | *Which firm is indispensable for synergy?*<br>- If it is the target, you should be willing to pay up to thevalue of synergy.<br>- If it is the bidder, you should not. |
| Control Premium | Value the company as if optimally managed. This will usually mean altering investment, financing and dividend policy:<br>Investment Policy: Earn higher returns on projects and divest unproductive projects.<br>Financing Policy: Move to a better financing structure; eg. optimal capital structure<br>Dividend Policy: Return cash for which the firm has no need.<br>Practically,<br>1. Look at industry averages for optimal (if lazy)<br>2. Do a full-fledged corporate financial analysis | If motive is control or in a stand-alone valuation, this is the maximium you should pay. |
| Status Quo Valuation | Value the company as is, with existing inputs for investment, financing and dividend policy. | If motive is undervaluation, the status quo value is the maximum you should pay. |