



INTERVIEW GUIDE 03

M&A and Accretion/ Dilution

Deal rationale, structuring, purchase accounting, process and documentation, and accretion/dilution maths with two fully worked problems.

How to use this guide

M&A questions combine strategy, accounting, process knowledge and quick maths. Do the worked problems on paper before reading the solutions.

Most questions have two layers. **What to say** is a short answer you could give in an interview. The notes underneath explain why it is right, so you can handle the follow-up.

Do not memorise answers word for word. Learn the logic, then practise saying it out loud.

01	Why companies buy companies	04
02	Structuring a deal	07
03	Merger accounting	10
04	Accretion and dilution	13
05	Restructuring and distress	19
06	Purchase accounting in detail	21
07	Deal process and documents	24
08	Public and hostile deal mechanics	28
09	Second worked problem	31
10	Quick-fire bank	34
11	Test yourself	36
12	Answers	37

A note on conventions

Worked examples use a 25% tax rate unless the question states otherwise. Where U.S. GAAP and IFRS differ in a way interviewers ask about, the guide says so. Most African markets report under IFRS; U.S. firms will expect U.S. GAAP. Say which you are assuming.

Why companies buy companies

Before the mechanics, interviewers want to know you understand the strategic logic, and why so many deals disappoint.

1.1 Why do companies make acquisitions?

What to say

To grow faster than they can organically, to enter new markets or products, to buy capabilities or technology, to consolidate an industry and gain scale, and to capture cost and revenue synergies. Financial motives also play a part, such as using excess cash or buying a company that looks undervalued.

Less flattering motives exist too: management wanting to run a bigger company, or covering for slowing organic growth. Mentioning them shows judgement.

1.2 What are the main types of merger?

Type	What it is	Typical logic
Horizontal	Two competitors combine	Scale, cost synergies, market share
Vertical	A company buys a supplier or customer	Control of the supply chain, capturing margin
Conglomerate	Unrelated businesses combine	Diversification; now much less common because investors can diversify themselves

1.3 What are synergies? Which kind is more reliable?

What to say

Synergies are the extra value created because the combined company can do things the two could not do separately. Cost synergies come from removing duplication: one headquarters, combined purchasing, merged facilities. Revenue synergies come from cross-selling, wider distribution or pricing power. Cost synergies are more reliable because they are largely within management's control; revenue synergies depend on customers.

Always ask about the cost to achieve synergies, such as severance and systems integration, and how long they take to realise.

1.4 Why do many acquisitions fail to create value?

What to say

Overpaying, usually by paying away the synergies up front; overestimating synergies; poor integration of systems and people; culture clashes and management departures; and distraction from the core business. Regulatory delays and deal costs add to the damage.

1.5 Who usually pays more, a strategic buyer or a private equity fund?

What to say

Usually the strategic buyer, because it can count on synergies that a financial buyer cannot, and it may accept a lower return. A sponsor's price is limited by its target return and how much debt it can raise. The exception is when credit is cheap or the sponsor already owns a portfolio company that can generate its own synergies with the target.

1.6 If you owned a small business and a larger company offered to buy it, how would you decide?

What to say

I would weigh the price against what I believe the business is worth on its own and to other buyers; the form of payment, since stock ties my outcome to the buyer's performance; the certainty of closing and any earn-outs; the tax consequences; what happens to my employees and customers; and whether I want to stay involved.

1.7 Name two companies you think should merge.

What to say

There is no right answer, but a strong one covers four points: the strategic logic, the specific synergies, the rough maths on whether the buyer can afford it and still create value, and the main obstacle, which is often competition regulators or culture.

Prepare one example in advance, ideally in a sector you know well. An African example, such as consolidation among payments companies or regional banks, can make your answer memorable.

Structuring a deal

2.1 How do buyers choose between paying with cash, debt or stock?

What to say

Cash on hand is usually cheapest, because the only cost is the interest it would otherwise earn. New debt is next, because interest is tax deductible. Stock is usually the most expensive, because it gives away a share of future earnings, but it avoids adding leverage and lets target shareholders share in the upside. The choice also depends on how much cash and debt capacity the buyer has, how highly its own shares are valued, and what the sellers want.

2.2 Why would a buyer pay in stock?

What to say

Because its shares are highly valued, it lacks the cash or debt capacity, the deal is very large, or the sellers want to keep exposure to the combined company. Stock consideration can also allow sellers to defer tax in some jurisdictions.

A stock deal shares risk: if the combined company underperforms, the sellers bear part of the loss. Stock deals are more common when share prices are high.

2.3 Can you buy a public company at its current share price?

What to say

Almost never. Shareholders need a control premium to sell, because the buyer gains control of the company's cash flows and strategy. Premiums vary widely but are often in the range of 20% to 40% over the undisturbed share price.

2.4 What is the difference between a stock purchase and an asset purchase? Which does each side prefer?

What to say

In a stock purchase, the buyer acquires the shares and takes on the whole company, including all its liabilities. In an asset purchase, the buyer chooses the specific assets and liabilities it takes. Sellers usually prefer stock deals: they exit cleanly and, for a corporation, avoid a second layer of tax. Buyers usually prefer asset deals: they avoid unwanted liabilities and get a stepped-up tax basis in the assets, which creates tax-deductible depreciation and amortisation.

The double tax point applies to a U.S. C corporation selling its assets and then distributing the proceeds. Tax rules on asset versus share sales differ by country, so ask. In the U.S., a 338(h)(10) or 336(e) election can give a buyer asset-deal tax treatment in a stock deal, in the right circumstances.

2.5 What is an exchange ratio?

What to say

In a stock deal, the number of acquirer shares issued for each target share: the offer price per target share divided by the acquirer's share price. A fixed exchange ratio means the value the sellers receive moves with the acquirer's share price; a fixed price means the number of shares issued adjusts.

2.6 When bidding, do you use the acquirer's WACC or the target's?

What to say

The target's, or more precisely a discount rate that reflects the risk of the target's cash flows. The buyer's own cost of capital does not change the risk of what it is buying. If the buyer is much less risky and genuinely lowers the target's financing cost, that is a synergy to value separately.

2.7 Do you focus on enterprise value or equity value in an acquisition?

What to say

Enterprise value, because the buyer is paying for the whole business and usually has to refinance or assume the debt. Equity value matters for what shareholders receive and for the share count in a stock deal.

2.8 Why use all options outstanding, not just exercisable ones, in an acquisition?

What to say

Because many equity plans accelerate vesting on a change of control, and the buyer must usually cash out or replace all outstanding awards. It depends on the plan terms, so check them.

2.9 What is a tender offer, and what defences can targets use?

What to say

A tender offer is a public offer made directly to shareholders to buy their shares at a set price, often used when the target's board does not support the deal. Defences include a shareholder rights plan, or poison pill, that dilutes a hostile buyer; seeking a friendlier bidder, a white knight; staggered boards; and golden parachutes that make changing management expensive.

Takeover rules vary sharply by country. Many markets, including South Africa, Nigeria and Kenya, have mandatory offer rules once a buyer crosses a shareholding threshold.

2.10 You buy an investment for \$100m and sell it for \$100m. How could you have made money?

What to say

Through cash received while you owned it, such as dividends. If the purchase was partly debt-funded and the business repaid that debt from its own cash flow, your equity stake grew even though the enterprise value did not change.

Merger accounting

3.1 How is goodwill calculated?

What to say

Goodwill equals the purchase price for the equity less the fair value of the target's identifiable net assets. In practice: start with the target's book equity, write assets and liabilities up or down to fair value, recognise new identifiable intangibles such as customer relationships, adjust for the related deferred taxes, and whatever purchase price is left over is goodwill.

Illustration	\$m
Equity purchase price	1,000
Less: target book equity	(400)
Less: write-up of PP&E and new intangibles	(200)
Plus: deferred tax liability on write-ups (25%)	50
Goodwill	450

The deferred tax liability arises in a stock deal, where tax bases do not step up.

3.2 What does the combined balance sheet look like?

What to say

The acquirer's balance sheet plus the target's assets and liabilities at fair value, plus new intangibles and goodwill. The target's equity is eliminated. Then reflect the financing: cash used, new debt raised, new shares issued. Transaction fees reduce the acquirer's equity, and financing fees are netted against the new debt.

3.3 Can you add up the two income statements to get the combined one?

What to say

Only as a starting point. Revenue and operating costs can be added, then adjusted for synergies. Depreciation and amortisation rise because of asset write-ups and new amortising intangibles. Interest changes with the new capital structure: more interest on new debt and less interest income on cash used. Taxes must be recalculated on the new pre-tax income. The share count changes if stock is issued.

3.4 How does an acquisition flow through the acquirer's statements?

Statement	Effect
Income statement	Target's results included from closing. Higher amortisation of acquired intangibles and depreciation of written-up assets. Higher interest expense if debt-funded; lower interest income if cash-funded. Deal fees expensed.
Cash flow	Purchase price, net of cash acquired, in investing. Debt raised or shares issued in financing.
Balance sheet	Target's assets and liabilities at fair value, new intangibles and goodwill; lower cash, higher debt, or higher equity depending on funding.

Goodwill is not amortised under IFRS or for U.S. public companies. Some older prep materials list "goodwill amortisation" as an effect; that is out of date. Acquired finite-lived intangibles are amortised.

3.5 What happens if a buyer overpays?

What to say

The excess ends up in goodwill. If the business then underperforms, the goodwill is impaired, which creates a large non-cash loss and is a public admission that the deal destroyed value.

3.6 What other accounting effects should you watch for?

- **Deferred revenue.** The target's deferred revenue is remeasured at fair value, which can reduce the revenue recognised after closing.
- **Contingent consideration.** Earn-outs are recorded at fair value at closing and later changes usually go through the income statement.
- **Inventory step-up.** Written-up inventory raises cost of goods sold in the first months after closing.
- **Target NOLs.** May be limited after a change of control; see Guide 01.

Accretion and dilution

A merger model asks one question: does the deal increase or decrease the acquirer's earnings per share? The maths is simple once the steps are fixed.

4.1 Walk me through an accretion/dilution analysis.

What to say

Start with the acquirer's and target's projected net income and add them. Add after-tax synergies. Subtract the after-tax cost of financing: interest on new debt and interest income lost on cash used. Subtract after-tax amortisation of new intangibles and depreciation on write-ups. That gives pro forma net income. Divide by the acquirer's shares plus any new shares issued to get pro forma EPS, and compare it with the acquirer's standalone EPS.

Usually done for the next one to three years. Accretion is a useful sanity check but not a measure of value: a deal can be accretive and still overpay.

THE SHORTCUT

Compare what you earn with what it costs

What you earn. The target's earnings yield at the purchase price: (target net income + after-tax synergies) ÷ purchase equity value. Without synergies, this is 1 ÷ the purchase P/E.

What it costs. The weighted after-tax cost of each funding source:

Cash: interest rate forgone × (1 – tax). Debt: interest rate × (1 – tax). Stock: the acquirer's earnings yield, 1 ÷ acquirer P/E.

If what you earn is higher than what it costs, the deal is accretive. Ignores new amortisation and fees.

4.2 In an all-stock deal, a company with a low P/E buys one with a higher P/E. Accretive or dilutive?

What to say

Dilutive, assuming no synergies. The acquirer is paying more for each dollar of the target's earnings than the market pays for its own, so it issues proportionally more shares than it adds in earnings. The reverse, a high P/E buyer and a low P/E target, is accretive.

Remember to use the purchase P/E, including the premium, not the target's trading P/E.

4.3 Company A trades at 20x earnings and Company B at 10x. Both consider buying Company C at 15x in an all-stock deal. For whom is it accretive?

What to say

Accretive for A and dilutive for B, ignoring synergies. A's cost of stock is a 5% earnings yield and C yields 6.7%. B's cost of stock is 10%, more than C's 6.7%.

4.4 A company buys a target at 10x earnings using debt at 10%. Accretive or dilutive?

What to say

Accretive. The target earns a 10% after-tax yield on the price paid, while the debt costs $10\% \times (1 - 25\%) = 7.5\%$ after tax.

Some prep materials calculate the after-tax cost as $10\% \times 20\%$. The correct form is $\text{rate} \times (1 - \text{tax rate})$.

4.5 Company A (15x P/E) buys Company B (17x P/E) with all stock. Accretive or dilutive? What if B trades at 15x? What if A uses debt at 4%?

What to say

At 17x, dilutive: B yields 5.9% but A's stock costs 6.7%. At 15x, roughly neutral, but any premium makes it dilutive. With 4% debt, accretive: even before tax, 4% is below B's 5.9% yield, and after tax it is lower still.

Assumes the deal is priced at the target's trading P/E, with no premium or synergies.

4.6 A company trading at 15x P/E buys a business with \$10m of EBITDA using 100% debt at 10%. What is the most it can pay without diluting EPS?

What to say

The target adds after-tax earnings of $(\text{EBIT} - \text{interest}) \times (1 - \text{tax})$. EPS is unchanged when interest equals EBIT, so the maximum price is $\text{EBIT} \div 10\%$. If the business has no depreciation, EBIT is \$10m and the maximum is \$100m, or 10x. With depreciation, the answer is lower. The acquirer's own P/E does not matter in an all-debt deal.

A common wrong answer divides by the after-tax cost of debt (8%) to get 12.5x. That compares a pre-tax earnings figure with an after-tax cost. Taxes apply to both the target's earnings and the interest saved, so they cancel.

Worked problems

Work each one on paper first. The shortcut check is shown after each solution.

4.7 Problem 1. Company A buys Company B at a 20% premium, funded half with new debt at 10% and half with stock. Tax rate 40%.

Company A	Company B
EPS \$2.00, P/E 25x, so share price \$50 100 shares, so net income \$200	Share price \$100, P/E 10x, so EPS \$10 20 shares, so net income \$200

Step	Result
Purchase price: $\$100 \times 1.2 \times 20$ shares	\$2,400
Debt: $\$1,200 \times 10\% \text{ interest} \times (1 - 40\%)$	\$72 after-tax cost
Stock: $\$1,200 \div \$50$	24 new shares
Pro forma net income: $\$200 + \$200 - \$72$	\$328
Pro forma shares: $100 + 24$	124
Pro forma EPS vs. \$2.00 standalone	\$2.65: +\$0.65, +32%

Shortcut. Purchase P/E is $\$2,400 \div \$200 = 12x$, an 8.3% yield. Cost: half at 6% (debt after tax) and half at 4% ($1 \div 25x = 5\%$). $8.3\% > 5\%$, so accretive.

4.8 Problem 2. Company C buys Company D for \$100 per share, funded with \$600 of new debt at 5% and the rest in stock. Tax rate 40%.

Company C	Company D
Share price \$20, EPS \$2, 50 shares Net income \$100	Share price \$75, net income \$50, EPS \$5 So 10 shares

Step	Result
Purchase price: $\$100 \times 10$ shares	\$1,000
Debt: $\$600 \times 5\% \times (1 - 40\%)$	\$18 after-tax cost
Stock: $\$400 \div \$20$	20 new shares
Pro forma net income: $\$100 + \$50 - \$18$	\$132
Pro forma shares: $50 + 20$	70
Pro forma EPS vs. \$2.00 standalone	\$1.89: -\$0.11, -5.7%

Shortcut. Purchase P/E is 20x, a 5% yield. Cost: 60% at 3% (debt after tax) plus 40% at 10% ($1 \div C$'s 10x P/E) = 5.8%. 5% < 5.8%, so dilutive. The cheap acquirer stock is the problem.

4.9 Problem 3. Company A buys Company B for a 20% premium, 50% debt at 5% and 50% stock, with \$20m of pre-tax synergies. Tax rate 40%.

Company A	Company B
Share price \$50, EPS \$2.50, net income \$100m So 40m shares and a 20x P/E	Share price \$100, EPS \$4.00, 10m shares So net income \$40m and a 25x P/E

Step	Result
Purchase price: $\$120 \times 10\text{m}$ shares	\$1,200m
Debt: $\$600\text{m} \times 5\% \times (1 - 40\%)$	\$18m after-tax cost
Stock: $\$600\text{m} \div \$50$	12m new shares
Synergies: $\$20\text{m} \times (1 - 40\%)$	\$12m
Pro forma net income: $\$100\text{m} + \$40\text{m} - \$18\text{m} + \$12\text{m}$	\$134m
Pro forma shares: $40\text{m} + 12\text{m}$	52m
Pro forma EPS vs. \$2.50 standalone	\$2.58: +\$0.08, +3.1%

The synergies make the deal. Without them, pro forma net income is \$122m and EPS is \$2.35, 6.2% dilutive. Shortcut: the 30x purchase P/E yields 3.3%, or 4.3% with synergies; financing costs $50\% \times 3\% + 50\% \times 5\% = 4.0\%$.

4.10 What factors make a deal dilutive?

What to say

A high purchase price relative to the target's earnings, a low acquirer P/E in a stock deal, expensive debt, a target with low or negative earnings, large amortisation of new intangibles, and weak or delayed synergies.

Restructuring and distress

5.1 What is a restructuring, and what is a recapitalisation?

What to say

A restructuring changes a company's debt, operations or structure, usually because it cannot meet its obligations; it can happen in or out of court. A recapitalisation changes the mix of debt and equity, either to reduce risk, by raising equity to repay debt, or to return cash, by raising debt to fund a dividend or buyback.

5.2 What are Chapter 11 and Chapter 7?

What to say

Both are U.S. bankruptcy procedures. In Chapter 11, the company keeps operating while it negotiates a plan to restructure its debts, and creditors are paid according to their priority based on the value of the reorganised business. In Chapter 7, the company is liquidated and the proceeds are paid to creditors in order of priority, usually leaving little or nothing for shareholders.

Other countries have their own regimes: South Africa's business rescue proceedings, and administration and company voluntary arrangements in Nigeria and Kenya under their newer insolvency laws, for example. The principles of priority and value-based recovery are similar.

5.3 What is DIP financing?

What to say

Debtor-in-possession financing is new money lent to a company in Chapter 11 to fund operations during the process. The court can give it priority over existing creditors, and it is often secured on the company's assets, which is why lenders are willing to provide it.

5.4 What is recovery value?

What to say

What a creditor expects to receive in a default, often expressed as a percentage of the claim. It depends on the company's value in the restructuring and the creditor's place in the priority order: secured debt first, then unsecured debt, then subordinated debt, then preferred and common equity.

Purchase accounting in detail

The adjustments that turn two sets of accounts into one. Interviewers use these to separate candidates who have built a merger model from those who have read about one.

6.1 Why does a deferred tax liability arise on a write-up?

What to say

In a stock deal, the book values of the target's assets are written up to fair value but the tax bases are not. The company will therefore record more book depreciation than tax depreciation in future, paying more tax than the book numbers imply, so a deferred tax liability is recorded for the difference at the tax rate. That liability increases goodwill, because it is part of the net assets acquired.

Example. A \$200m write-up at a 25% tax rate creates a \$50m deferred tax liability and therefore \$50m more goodwill. In an asset deal, where tax bases do step up, no such liability arises and the buyer gets deductible amortisation instead.

6.2 What is the deferred revenue haircut?

What to say

The target's deferred revenue is remeasured at fair value, which is roughly the cost of fulfilling the remaining obligation plus a normal margin, not the original contract price. That is usually less than the recorded balance, so post-close revenue is lower than the target would have reported standalone. It hits subscription and software acquisitions hardest and can make a growing target look like it is shrinking after the deal.

6.3 What is the inventory step-up, and why does it hurt early margins?

What to say

Acquired inventory is written up to fair value, roughly its selling price less costs to sell. When it is sold in the first months after closing, the higher carrying value flows through cost of goods sold, so gross margin is depressed temporarily. It is a one-off effect and is usually added back in adjusted earnings.

6.4 Which intangibles are recognised separately, and over what lives?

Intangible	Typical treatment
Customer relationships and contracts	Finite life, amortised over the expected relationship period, often 5 to 15 years
Technology and patents	Finite life, amortised over the remaining useful or legal life
Trade names and brands	Finite or indefinite; indefinite-lived brands are tested for impairment rather than amortised
In-process research and development	Capitalised as indefinite-lived until the project completes or is abandoned
Non-compete agreements	Amortised over the contractual term
Assembled workforce	Not recognised separately; it falls into goodwill

New amortisation is the main reason a deal can be dilutive on reported EPS while being accretive on cash earnings, which is why buyers often guide to both.

6.5 How are transaction fees, financing fees and earn-outs treated?

What to say

Advisory, legal and accounting fees on the acquisition are expensed as incurred, so they reduce equity rather than being capitalised into goodwill. Financing fees are capitalised against the new debt and amortised over its life as interest. Contingent consideration, an earn-out, is recorded at fair value at closing, and subsequent changes in that fair value generally run through the income statement, which can produce odd-looking gains when a target underperforms.

6.6 What is the measurement period?

What to say

A window of up to one year after closing in which the buyer can adjust provisional fair values as better information about conditions at the acquisition date emerges, with goodwill adjusted accordingly. It is not a window to revise the numbers because performance has changed since the deal.

6.7 What happens if a buyer acquires only 80% of a target?

What to say

The buyer consolidates 100% of the target's assets, liabilities, revenue and costs, and records a non-controlling interest for the 20% it does not own, measured either at fair value or at its share of net assets. Goodwill is calculated including that non-controlling interest, and the income statement shows income attributable to non-controlling interests as a deduction.

6.8 What is a bargain purchase?

What to say

An acquisition where the purchase price is below the fair value of the identifiable net assets acquired, which produces negative goodwill. The buyer must first re-examine its fair value estimates; if the shortfall survives that review, it is recognised as a gain in income. It is rare and usually indicates a distressed seller.

Deal process and documents

How a transaction actually runs, from mandate to closing. Private equity interviewers ask this because associates live in it.

7.1 Walk me through a sell-side process.

Stage	What happens
Preparation	Bank is mandated, company prepares a vendor quality of earnings report, management presentation, teaser and confidential information memorandum, and a target buyer list
Marketing	Teaser goes out, interested parties sign non-disclosure agreements and receive the CIM
First round	Buyers submit indications of interest with a price range and assumptions; the seller shortlists
Second round	Management presentations, data room access, expert calls, and confirmatory diligence workstreams
Final bids	Binding offers with a marked-up share purchase agreement and committed financing; exclusivity may be granted
Signing	Definitive agreement executed, with any conditions such as regulatory approval
Closing	Conditions satisfied, funds flow, purchase price adjusted per the mechanism agreed

7.2 What is the difference between an IOI, an LOI and an SPA?

What to say

An indication of interest is a non-binding first-round letter with a valuation range and key assumptions. A letter of intent, or term sheet, is more detailed, still largely non-binding on price but usually binding on exclusivity and confidentiality. The share purchase agreement is the binding contract: price, mechanism, representations, warranties, indemnities, conditions and covenants.

7.3 What are the key commercial terms in a purchase agreement?

Term	What it does
Purchase price mechanism	Completion accounts or locked box; see the next question
Representations and warranties	Statements of fact by the seller about the business; a breach gives the buyer a claim
Indemnities	Specific protection for known risks such as a tax exposure or litigation
Escrow or holdback	Part of the price held back to satisfy claims
Caps, baskets and survival periods	Limits on the size, threshold and duration of warranty claims
Material adverse change clause	Allows the buyer to walk if the business deteriorates severely between signing and closing; narrowly drafted and rarely successful
Earn-out	Part of the price contingent on future performance; bridges valuation gaps and creates disputes
Non-compete and non-solicit	Stops the seller competing or hiring away staff
Conditions precedent	What must happen before closing: regulatory approvals, consents, financing in some deals

Warranty and indemnity insurance has become common, particularly in sponsor-to-sponsor deals, because a private equity seller wants to distribute proceeds rather than leave money in escrow.

7.4 Explain cash-free debt-free, the working capital peg and the locked box.

What to say

Most private deals are priced on an enterprise value basis: the buyer acquires the business without its cash and without its debt, so at closing the price is adjusted by adding cash and deducting debt. A working capital peg sets a normal level of working capital, usually an average of recent months; if the business delivers less than the peg at closing, the price is reduced, and vice versa. A locked box fixes the balance sheet at an earlier date, with the seller keeping the economics up to that date and often earning interest on the price thereafter, which removes post-closing adjustment disputes.

Example. Enterprise value \$200m, cash \$10m, debt \$40m, working capital \$4m below the peg.
Equity price = \$200m + \$10m - \$40m - \$4m = \$166m.

7.5 What diligence workstreams run in parallel?

- **Commercial:** market growth, competitive position, customer interviews, pricing.
- **Financial:** quality of earnings, normalised EBITDA, working capital and net debt definitions, forecast challenge.
- **Tax:** historical exposures, structure of the acquisition, transfer pricing.
- **Legal:** corporate records, contracts, change-of-control provisions, litigation, IP, employment.
- **Operational and technical:** systems, capex needs, supply chain, environmental.
- **Insurance and, increasingly, cyber and ESG.**
- **Management assessment:** who stays, what they are paid, and who is missing.

In African deals, add title to land and assets, foreign exchange and repatriation, licence validity and local shareholding requirements. These are the items that most often delay or kill a signing.

7.6 What is a break fee, and what is a reverse break fee?

What to say

A break fee is paid by the target to the buyer if the target walks away, typically because it accepted a better offer. A reverse break fee is paid by the buyer to the target if the buyer fails to complete, most often because of a regulatory block or financing failure. Both are negotiated as a percentage of equity value and tell you which side carries the completion risk.

7.7 What is a go-shop and a fiduciary out?

What to say

A go-shop lets the target actively seek better offers for a period after signing, often with a lower break fee during that window. A fiduciary out allows the board to change its recommendation and accept a superior proposal despite having signed, because directors owe duties to shareholders. Both appear where a board wants to demonstrate it tested the market.

Public and hostile deal mechanics

8.1 What are the two ways to acquire a public company?

What to say

A one-step merger, where the boards agree, shareholders vote and the companies merge; or a tender offer, where the buyer offers to purchase shares directly from shareholders, followed by a second-step merger to acquire the rest. The tender route is faster and is the usual mechanism when the target's board is unwilling. Rules differ by market, and many jurisdictions require a mandatory offer to all shareholders once a buyer crosses a stated ownership threshold.

8.2 How does a fixed exchange ratio differ from a fixed value, and what is a collar?

What to say

With a fixed exchange ratio, the target receives a set number of acquirer shares, so the value moves with the acquirer's share price and the target shares the market risk. With a fixed value, the number of shares adjusts so the target receives a set value, and the acquirer bears the dilution risk. A collar limits the adjustment to a band: the ratio is fixed inside the band and floats outside it, which splits the risk.

Example. An offer of \$30 per target share with the acquirer at \$40 implies a 0.75 exchange ratio. If the acquirer falls to \$32, a fixed ratio leaves the target receiving \$24 of value; a fixed value raises the ratio to 0.9375 and issues more shares.

8.3 What does an activist investor do, and how does a board respond?

What to say

An activist buys a stake and pushes for change: board seats, a strategic review, a spin-off, more leverage, buybacks, or a sale. The board responds by engaging privately, by improving the plan and communicating it, by seeking support from other institutional holders, and occasionally by defending a proxy contest. For an investor, an activist stake is a potential catalyst; for a buyer, it can be a signal the company is in play.

8.4 What regulatory approvals matter?

What to say

Antitrust or competition clearance in every jurisdiction where the parties have meaningful activity, plus sector regulators in banking, insurance, telecoms, energy and defence, and foreign investment screening in some countries. Remedies such as divesting overlapping businesses can be a condition of approval. Timing is often the biggest practical issue, because a long approval period means a longer exposure to a deal break.

In Africa, transactions frequently need clearance from both national competition authorities and regional bodies such as the COMESA Competition Commission, which affects timetables.

8.5 What are appraisal or dissenters' rights?

What to say

The right of a shareholder who votes against a merger to ask a court to determine the fair value of their shares and be paid that instead of the deal price. It matters where a large holder believes the price is inadequate, and it creates a tail risk for buyers in some jurisdictions.

8.6 What is a leveraged recapitalisation as a takeover defence?

What to say

The target borrows heavily and pays a large special dividend or buys back shares, making itself less attractive by using up the debt capacity the bidder was counting on, while giving shareholders immediate value. It is effective and risky: the company is left with the leverage whether or not the bid disappears.

Second worked problem

The version interviewers use once you have proved you can do the simple case: a three-way funding mix and purchase accounting included.

9.1 Company A acquires Company T at a 25% premium, funded 40% with balance sheet cash earning 2%, 30% with new debt at 6% and 30% with stock. New intangibles of \$300m are amortised over ten years. Tax rate 25%.

Company A	Company T
Share price \$30, net income \$400m, 200m shares EPS \$2.00, so a 15x P/E	Share price \$20, 50m shares, net income \$60m EPS \$1.20

Step	Calculation	Result
Purchase price	$\$20 \times 1.25 \times 50\text{m}$	\$1,250m
Cash used	$40\% \times \$1,250\text{m}$	\$500m
New debt	$30\% \times \$1,250\text{m}$	\$375m
Stock issued	$\$375\text{m} \div \$30$	12.5m shares
Forgone interest on cash, after tax	$\$500\text{m} \times 2\% \times 0.75$	\$(7.5)m
Interest on new debt, after tax	$\$375\text{m} \times 6\% \times 0.75$	\$(16.9)m
New intangible amortisation, after tax	$\$300\text{m} \div 10 \times 0.75$	\$(22.5)m
Pro forma net income	$\$400\text{m} + \$60\text{m} - \$7.5\text{m} - \$16.9\text{m} - \$22.5\text{m}$	\$413.1m
Pro forma shares	$200\text{m} + 12.5\text{m}$	212.5m
Pro forma EPS vs. \$2.00		\$1.94: -2.8% dilutive

The lesson. Before purchase accounting, pro forma EPS is \$2.05, a 2.5% accretion. The \$22.5m of after-tax amortisation is what flips the deal to dilution. That is why acquirers emphasise cash EPS, and why the shortcut in Section 04 tells you the direction but not the answer when intangibles are large.

Check with the shortcut: the purchase P/E is $\$1,250\text{m} \div \$60\text{m} = 20.8\text{x}$, a 4.8% yield. Financing costs $40\% \times 1.5\% + 30\% \times 4.5\% + 30\% \times 6.7\% = 3.9\%$. Accretive before amortisation, dilutive after.

9.2 How would the answer change if the deal were all stock? All cash?

What to say

All stock at a 15x acquirer P/E against a 20.8x purchase P/E would be clearly dilutive, because the acquirer's stock costs 6.7% against a 4.8% target yield, before amortisation. All cash at 2% pre-tax, or 1.5% after tax, would be the most accretive funding, since the target yields 4.8% and no shares are issued, though it uses up balance sheet liquidity and raises net debt.

9.3 What would you tell the client?

What to say

That the deal is accretive on cash earnings and modestly dilutive on reported EPS, that the dilution is an accounting consequence of the intangible amortisation rather than an economic one, and that the real questions are whether the 25% premium is justified by synergies and whether the return on the \$1.25bn exceeds the cost of capital. EPS accretion is the headline; returns are the decision.

Quick-fire bank

Question	Answer
What is the difference between a merger and an acquisition?	Legally, a merger combines two entities into one; an acquisition is one buying another. Commercially the terms are used loosely, and "merger of equals" is usually a presentation choice.
Why do all-cash deals usually look more accretive?	Cash earns very little, so the forgone after-tax interest is a low cost compared with issuing equity or paying debt interest.
What happens to the share count in an all-cash deal?	It does not change, except for the acquirer's own option and award activity.
What happens to net debt if a buyer uses balance sheet cash?	Net debt rises, because cash falls while debt is unchanged.
How does an acquisition affect the buyer's leverage and rating?	Debt-funded deals raise leverage immediately while synergies arrive later, so ratings agencies focus on the path back to target leverage.
What is a reverse merger?	A private company merges into a listed shell to become public without an IPO.
What is a carve-out, and why is it harder?	Buying a division rather than a company. It needs standalone financials, transition services from the seller, and estimates of the costs the division never bore itself.
What are dis-synergies?	Costs created by a deal: duplicated systems during integration, lost customers who now buy from two competitors at once, and standalone costs in a carve-out.
What is the synergy premium?	The part of the price above standalone value that the buyer justifies with expected synergies, and therefore the part it has already paid away.

Why does the acquirer's share price often fall on announcement?	The market reads a large premium as value transferred to the target's shareholders, and doubts the synergies.
Who pays the break fee if antitrust blocks a deal?	Typically the buyer, through a reverse break fee, since regulatory risk is usually allocated to it.
Why would a seller prefer stock consideration?	To defer tax in some jurisdictions and to retain exposure to the combined company's upside.
What is an earn-out's main drawback?	It creates conflicting incentives after closing and frequent disputes about how the target's performance was measured.
What is a stub equity option?	Allowing target shareholders to roll part of their stake into the acquiring vehicle rather than cash out entirely.
Why do sponsors like corporate carve-outs?	They are often under-managed within a large group, come with cost savings that are within the sponsor's control, and attract fewer strategic bidders.
What is the first thing you check in a merger model?	That the purchase price and its funding sum correctly, and that the shares issued equal the stock consideration divided by the acquirer's price.

Test yourself

Answer each one out loud before checking. Use a 25% tax rate unless stated.

#	Question
1	An acquirer trading at 12x buys a target at 16x in an all-stock deal. Accretive or dilutive, before synergies?
2	An acquirer uses cash earning 2% to buy a target at 20x. Accretive or dilutive?
3	Acquirer: net income \$300m, 100m shares. It buys a target with \$60m of net income for \$900m in cash raised as debt at 6%. What is pro forma EPS?
4	A target is bought for \$500m equity value. Book equity is \$200m, write-ups total \$100m and there is no deferred tax. What is goodwill?
5	The acquirer's shares trade at \$40 and the offer is \$30 per target share, all in stock. What is the exchange ratio?
6	Name two reasons a strategic buyer might pay less than a private equity fund.
7	Why is a deal that is accretive to EPS not necessarily a good deal?
8	What is the after-tax cost of \$400m of debt at 7%?

Answers

#	Answer
1	Dilutive. The target yields 6.25%; the acquirer's stock costs 8.3%.
2	Accretive. The target yields 5%; the forgone interest costs $2\% \times 0.75 = 1.5\%$.
3	After-tax interest: $\$900\text{m} \times 6\% \times 0.75 = \$40.5\text{m}$. Pro forma net income: $\$300\text{m} + \$60\text{m} - \$40.5\text{m} = \$319.5\text{m}$. EPS: $\$3.195$ versus $\$3.00$, about 6.5% accretive.
4	$\$500\text{m} - (\$200\text{m} + \$100\text{m}) = \$200\text{m}$.
5	$\$30 \div \$40 = 0.75$ acquirer shares for each target share.
6	Examples: the sponsor has cheap, plentiful debt available; the sponsor already owns a company that creates synergies with the target; the strategic buyer faces regulatory risk or has limited balance sheet capacity; the strategic buyer's own shares are weak currency.
7	EPS accretion can come simply from using cheap debt or highly valued stock. The deal can still overpay relative to the target's value, earn less than the cost of capital, or add too much risk.
8	$\$400\text{m} \times 7\% \times (1 - 25\%) = \$21\text{m}$ a year, or 5.25%.

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