

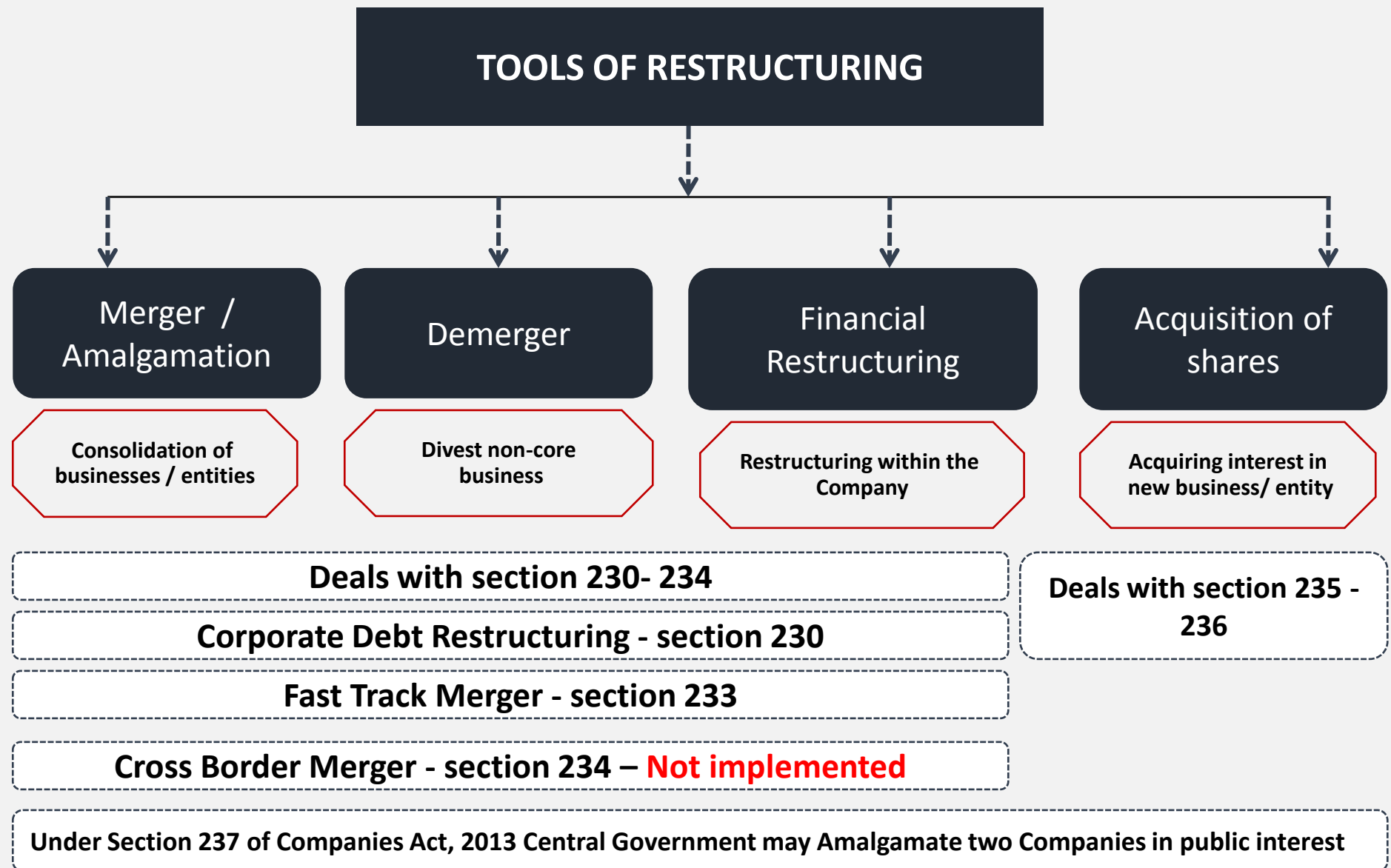
Mergers & Acquisitions

Pavan Kumar Vijay

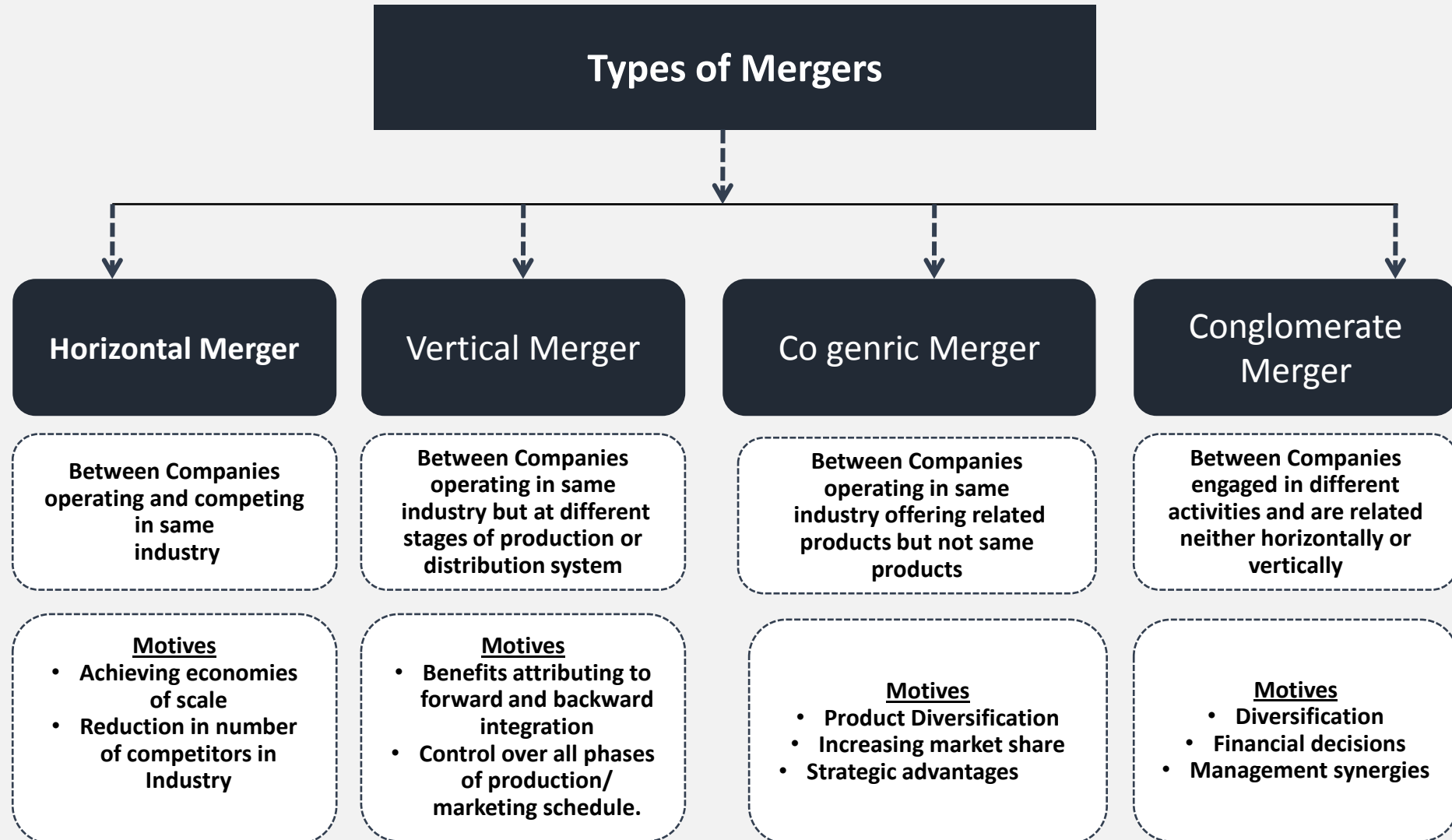


Overview of M&A in Companies Act, 2013

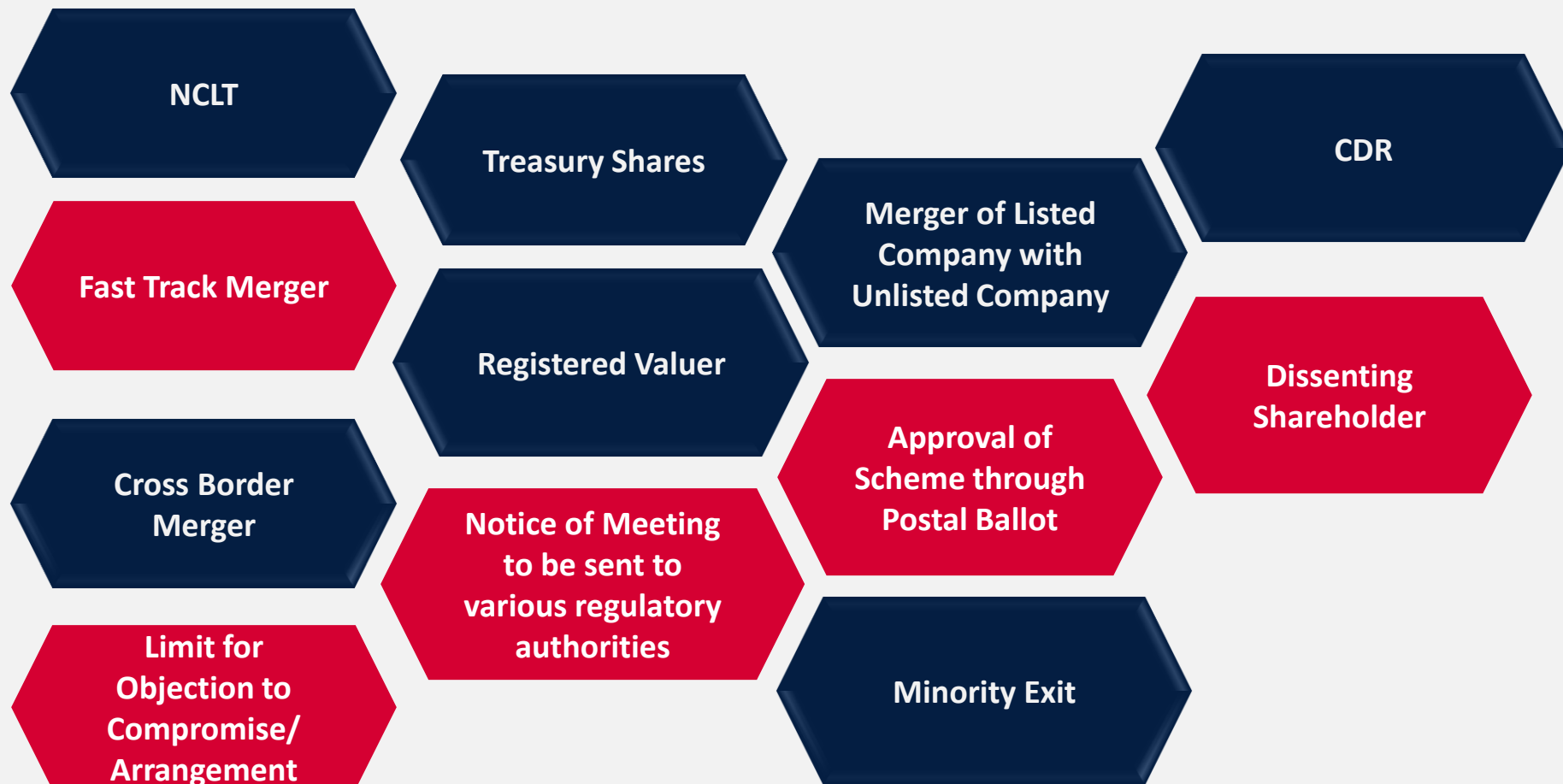
Re-Organization Provisions as per Companies Act, 2013



Types of Mergers



Pragmatic reforms of M&A



Motives and Benefits

Motives

Economies of large
scale business

Elimination of
competition

Desire to enjoy
monopoly power

Adoption of
modern
technology

Resolving technical
and managerial
talent shortage

Benefits

Greater Value
Integration

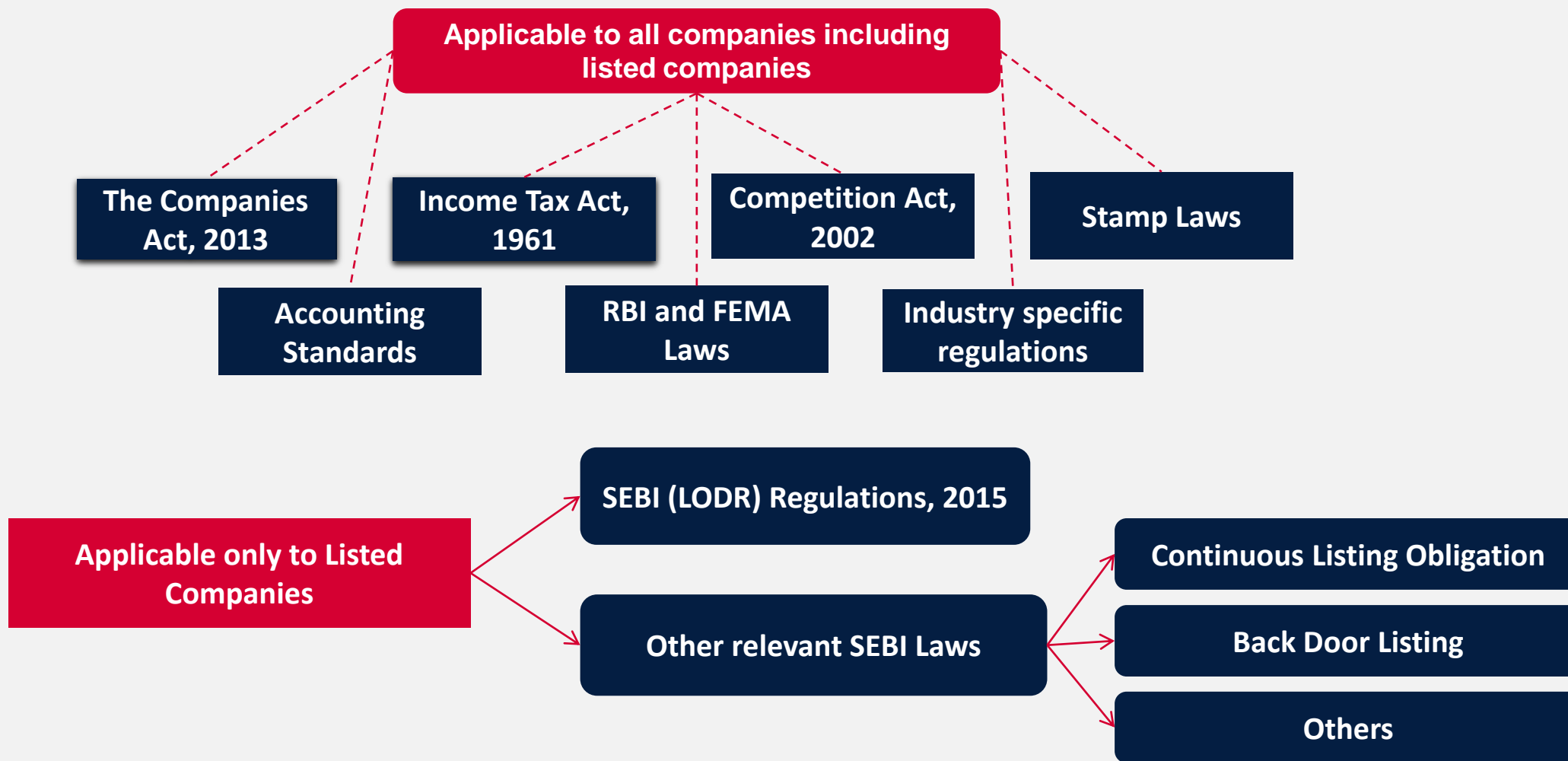
Gaining Cost
Efficiency

Increasing Market
Share

Gaining higher
competitiveness

Synergy benefits

Regulatory framework of M&A





Merger

Merger Process under Companies Act, 2013

Considering proposal for Merger and Amalgamation by BOD's of Companies



Finalisation of Scheme of Amalgamation, Valuation and Fairness Opinion



Recommendation on Scheme and Valuation report by the Audit committee



Approval of the Scheme and Valuation Report by Board of Directors of the Companies



Filing of Scheme, Valuation report and Fairness Opinion with the designated Stock Exchanges for SEBI approval, if Co. is listed

Uploading of Scheme, Valuation report and Fairness Opinion on website of the Co.



Filing of Application to NCLT (Disclosure through affidavit if reduction of share capital is the part of scheme)



On direction of NCLT, Notice of meeting and copy of Valuation report has to be sent to Shareholders, Creditors and CG, IT, SEBI, ROC, OL, respective stock exchange

(* Notice shall also provide an option to vote through postal ballot)

Notice also includes the effect of scheme on KMP's, Creditors, Promoters, Non promoters members and also disclose interest of Directors, denture holders

Merger Process under Companies Act, 2013

Convening of Shareholders and Creditors Meetings for approval of Scheme and discussion on the representation given by regulatory authorities – decision reported to NCLT

If creditors having atleast 90% value agree and confirm by way of affidavit to the scheme, then NCLT may dispense creditors meeting.

Notice to Regional Director and Official Liquidator and submission of their NOC with NCLT

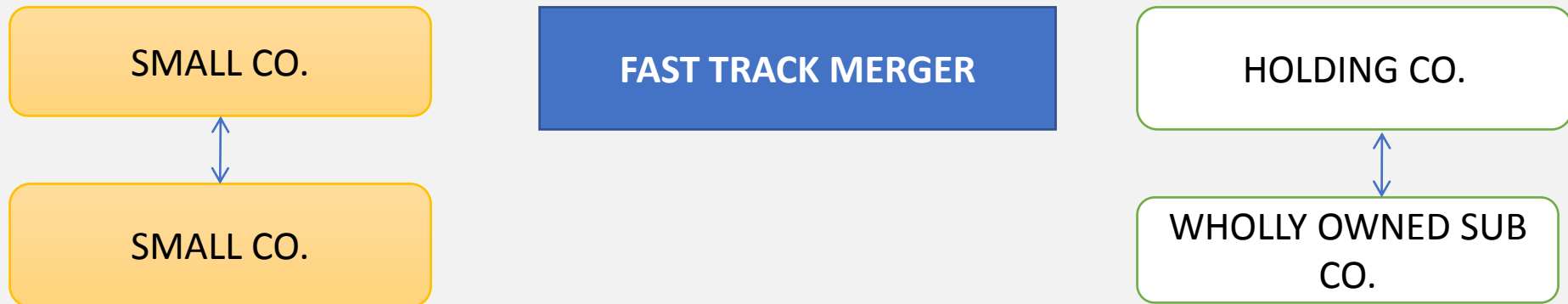
Final Hearing by NCLT

Obtaining NCLT Order and filing with Registrar of Companies

NCLT may provide exit opportunity to the dissenting shareholders

Post Merger compliances

Fast Track Merger



Small Company means Company other than PUBLIC CO. having PAID Up CAPITAL not more than Rs. 50 Lakh and TURNOVER not more than Rs. 2 Crores. *(Govt. can raise the limits)*

Not applicable to Holding -Subsidiary Co., Charitable Co. & Co. Governed by Special Acts

Central Government has the power to sanction the scheme, no requirement to approach NCLT

Fast Track Merger Process under Companies Act, 2013

Considering proposal for Merger and Amalgamation by BOD's of Companies



Finalisation of Scheme of Amalgamation



Approval of the Scheme by Board of Directors of the Companies



Notice of Proposed Scheme would be given to ROC, OL and any other person affected through scheme for their objections and suggestions



Filing of Declaration of solvency with the Registrar of Companies (RoC) along with the Scheme of Arrangement



Issue of notice by Transferor and Transferee Company for convening the meeting of the members and creditors and notice



Meeting of the shareholders and Creditors of the Company for scheme approval with requisite majority



Filing the copy of Scheme along with the result of each meeting with the Central Government by the Transferee Company

Fast Track Merger Process under Companies Act, 2013

Filing a copy of scheme and Notice of Objection and Suggestion to :- ROC and OL



ROC and official liquidator to provide their No Objection or suggestion on the scheme to Central Government within thirty days of receipt.



Central Government to consider the objection and suggestion of ROC and OL and if central government is of the opinion that scheme is in the public interest or in the interest of creditors, the Central Government shall issue a confirmation order.



Central Government may refer the scheme to NCLT for considering the scheme under Section 232 of the Companies Act, 2013 as a normal merger.



File copy of the order with the Registrar of the Companies in e Form INC 28

Fast Track Merger (Cont.)

Applicability

- ❖ Scheme of merger between holding company and its wholly-owned subsidiary company; or
 - ❖ Between two or more small companies (*not applicable for listed companies*).
-

Features

- ❖ Section 233 of Companies Act, 2013 provide for the fast paced merger mechanism for the class of companies mentioned above ;
 - ❖ Requirement to go to NCLT for sanctioning of scheme of arrangement has been done away with;
 - ❖ Objections only from Registrar and Official Liquidator (and from no other authority/regulator) are invited as envisaged in the provisions;
 - ❖ if opined to be against public interest, NCLT may order merger in normal course, that is, through NCLT route;
 - ❖ Equally applicable to Demergers and other schemes of arrangement.
-

Impact Analysis of Fast Track Merger

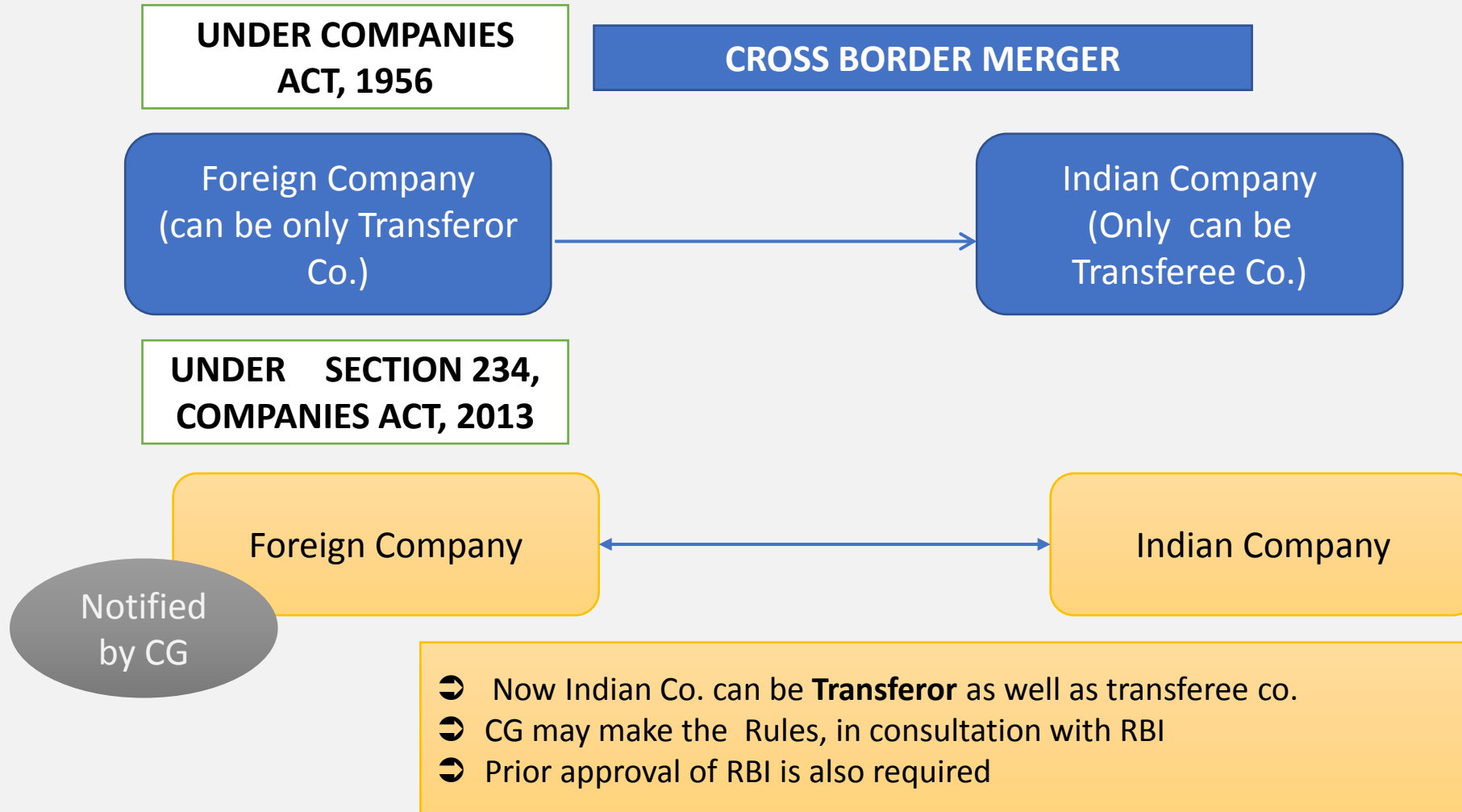


- ✦ Encourage corporate restructurings for small and group companies
- ✦ Will result in faster disposal of the matters
- ✦ Only relevant cases would go to NCLT
- ✦ No need of separate RBI / IT approval
- ✦ Provisions of valuation by Registered Valuer are not specified



- ✦ Approval required from majority of each class of Creditors holding 90% in value, may be difficult especially from trade creditors
- ✦ There is no clarity on which person to be considered as affected by the scheme for giving the notice
- ✦ No clarity, what shall be impact of objections, if any

Cross Border Merger



Impact Analysis of Cross Border Merger



- Flexibility for company structuring overseas
- Cross Border restructuring will increase
- Opportunity for Indian companies to form corporate strategies on a global scale



- Scope of inbound mergers may get restricted to notified jurisdictions

Minority Exit Opportunity

ACQUISITION U/S 235 / 236

Where acquirer becomes registered holder of 90% or more of the issued shares due to scheme or contract involving transfer of shares or by virtue of an amalgamation, shares exchange, Conversion of Securities, then Acquirer have to buy the minority shares as per following formula for price determination :-

➤ IN CASE OF LISTED COMPANY

- ❖ Price as per SEBI Regulations; *[It implies that through Merger a person may go beyond 75%]*
- ❖ Registered valuer to provide valuation report to the Board of Directors of the company justifying the methodology of arriving at such price

➤ IN CASE OF UNLISTED CO. (INCLUDING PVT)

- ❖ The highest price paid by the acquirer, person or group of persons for acquisition during last twelve months;
- ❖ fair price of shares of the company to be determined by the registered valuer after taking into account valuation parameters

Impact Analysis of Minority Exit



Provides an exit option to minority shareholders in unlisted companies as well .

Issues:

- Inconsistency between Companies Act, 2013 and SEBI delisting regulations which provide that purchase price for minority shareholders should be determined as per reverse book building
- Duty is casted but No right to Squeeze out provided for acquirer

Merger of listed company with unlisted company

- On merger of listed company with unlisted company, the transferee company shall remain an unlisted company until it becomes a listed company
- Provision for an exit route for shareholders of the Transferor Company
- Payment of value of shares and other benefits in accordance with pre-determined price formula or as per prescribed valuation

Impact Analysis of Merger of listed company with unlisted company



- Streamlined the entire process of merger
- Dissenting shareholder will get exit opportunity

Issue: Inconsistency between Companies Act, 2013 and SEBI Delisting Regulations



Single Window Clearance

When a scheme envisages various incidental proposals as an integral part of the scheme, the procedures prescribed under the Companies Act, need not be separately undertaken.

Single Window Clearance

Change of name of the amalgamated company to the name of amalgamating company

Change of Registered Office of the transferee company

Reduction of Share capital

Conversion of status of a company (Private Limited to Public Limited and vice-versa)

Sanction of a Scheme without power to amalgamate in the memorandum of association

Increase in authorised Share Capital post amalgamation

Change of object clause through the Scheme



Merger Tax Laws

When its Amalgamation within the meaning of Income Tax Act

- ➔ **Carry forward and set off of accumulated loss and unabsorbed depreciation allowance**
- ➔ **Capital Gains Tax Exemption**
- ➔ **Amortisation of Preliminary Expenses**
- ➔ **Capital Expenditure on Scientific Research**
- ➔ **Expenditure on Acquisition of Patent Right or Copyright**
- ➔ **Expenditure on Amalgamation**
- ➔ **Expenditure on know-how**
- ➔ **Expenditure for obtaining Licence to Operate Telecommunication Services**



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Demerger

Demerger



The Companies Act, 2013 provides for the reference to the concept of 'de-merger' in the following sections—

- (a) Section 230/232 – as a scheme of compromise, arrangement or reconstruction ; a scheme involving a division, wherein the undertaking, property and liabilities of the company in respect of which the compromise or arrangement is proposed are to be divided among and transferred to two or more companies each of which is either an existing company or a new company; and
- (b) Section 180(1)(a) – sale, lease or otherwise dispose of –
 - the whole of the undertaking of the company; or
 - substantially the whole of the undertaking of the company; or
 - if the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking.

Types

- **Partial Demerger** - one of the undertakings or a part of the undertaking or a department or a division of an existing company is separated and transferred to one or more new company/companies
- **Complete Demerger** - In the first case, i.e. in the case of partial demerger, the existing company also continues to maintain its separate legal identity and the new company, a separate legal identity, carries on the separated or spun off business and undertaking of the existing company.

Demerger Tax Laws

When its Demerger within the meaning of Income Tax Act

- ⇒ Capital gains tax not attracted [Section 47(vib)]
- ⇒ Tax concession to a foreign demerged company [Section 47(vic)]
- ⇒ Carry forward and set off of business losses and unabsorbed depreciation of the demerged company [Section 72A(4) & (5)]
- ⇒ Deduction available under section 80-1A(12) or 80-1B(12)
- ⇒ Amortisation of expenditure in case of demerger [Section 35DD]
- ⇒ Treatment of bad debts [Section 36(1)(vii)]



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Financial Restructuring

Reduction of Share Capital

Modes of reduction of share capital

Reducing or extinguishing the liability of members in respect of uncalled or unpaid capital

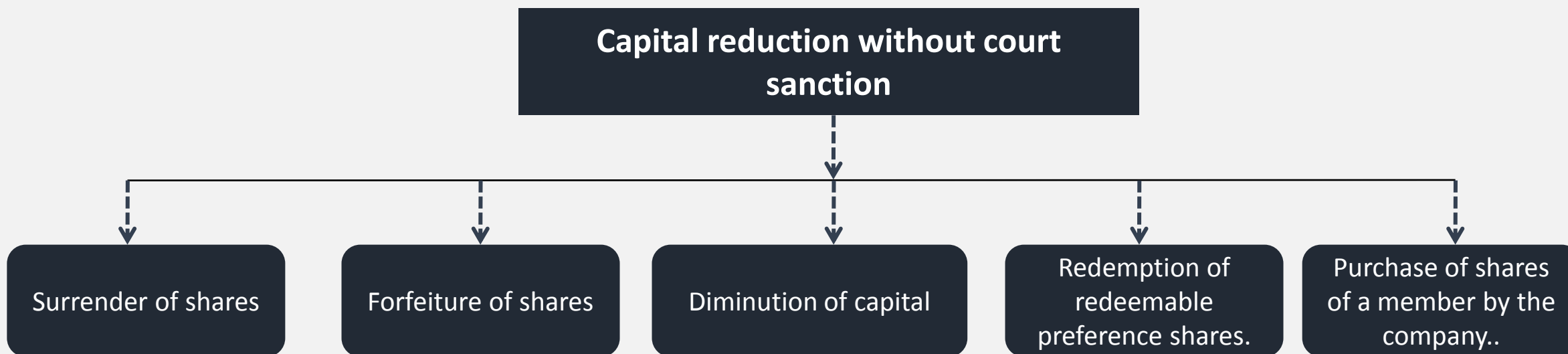
Paying off or returning paid-up capital not wanted for the purposes of the company

Paying off the paid-up capital on the conditions that it may be called up again so that the liability is not extinguished;

By following a combination of any of the preceding methods

By writing off or canceling the capital which has been lost or is under represented by the available assets

Reduction of Share Capital



Reduction of Share Capital

Reasons

- ➔ Trading Losses
- ➔ heavy capital expenses and assets of reduced or doubtful value
- ➔ To write off unrecognized expenditure
- ➔ To maintain debt-equity ratio
- ➔ For raising fresh finance.



Judicial Pronouncements



Judicial Pronouncements



Principal Bench NCLT while interpreting new Company Law provisions refuses to dispense with shareholders meetings in an amalgamation

[JVA Trading Pvt. Ltd. and C&S Electric Limited]



Approval by Shareholders or creditors present and voting (simple majority in number and three-fourth in value)

[Re Maknam Investments Ltd. (1995) 6 SCL 93 Cal; Re Mafatlal Industries Ltd. (1995) 84 Comp Cas 230 (Guj)]



Even Companies having different business objects can amalgamate.

[Re: PMP Auto Inds Ltd. (1994) 80 Comp Cas 291 (Bom); Re: EITA India Ltd. (ibid); Re: Mcleod Russel (India) Ltd. (1997) 13 SCL 126(Cal)]



Judicial Pronouncements



Increase in authorized capital due to clubbing on account of amalgamation does not require the payment of registration fee or the stamp duty again.

[Jaypee Cement Limited v. Jayprakash Industries Limited [2004] 2 Comp LJ 105 (All) / [2004] XXXIV CS LW 50]



Insufficient authorized capital on appointed date is not a ground of rejection. Company can increase its authorized capital after sanctioning of the scheme.

[Re: Mahavir Weaves Pvt. Ltd. (1985) 83 Comp. Cas 180]



A *bona fide* scheme can be sanctioned even if an order of winding-up has been made and a liquidator has been appointed.

[In Meghal Homes Private Limited v. Shreeniwas Girmikk Samiti and others (2007) 78 SCL 482 (SC)]



Role of SEBI in Mergers & Demergers.. Cont.

Review & give Observation on Scheme before filing with NCLT:

- ➡ Scheme should be in consonance with SEBI Regulations
- ➡ Scheme should not be against the interest of minority shareholders
- ➡ Valuations should be fair to the shareholders of Listed Company
- ➡ No undue advantage to the Promoters or KMPs
- ➡ Proper disclosure of all the facts to shareholders to take informed decision
- ➡ In case promoters' holding is increasing in Scheme, it is to be approved by Non-promoters through Postal Ballot

Role of SEBI

**Regulation 37 of SEBI (LODR)
Regulations, 2015**

Review & Give Observation on Scheme before filing
with NCLT

Grant exemption from Rule 19(2)(b) of SCRR for listing
of Resulting Company in case of demerger

SEBI Latest Development

Fast Track Merger in true sense

Exemption from filing with SEBI
and its observations thereof

Merger of Wholly-owned subsidiary with Parent
Company


Where Unlisted Company is
being merged with Listed
Company

Disclosure of material Information by the unlisted
company as per the format of abridged format

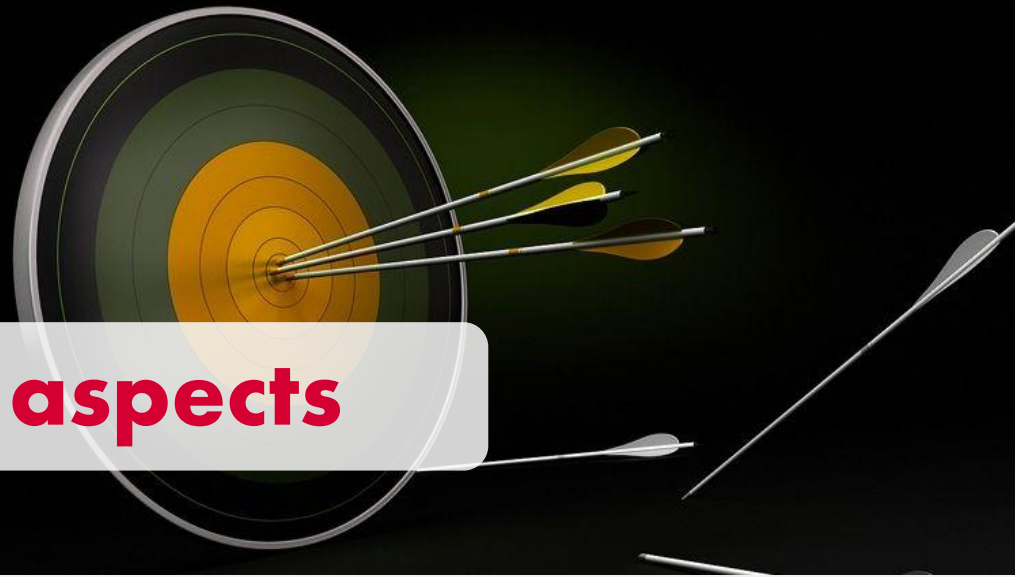
Allowed only if listed company is listed on Stock
Exchange having nationwide trading terminal



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STAMP DUTY



Stamp Duty aspects

Stamp Duty is leviable :

- ✓ On the execution of an instrument (not on transactions)
- ✓ Only on Instruments mentioned in the Schedules
- ✓ At the rate prescribed in the Schedule by the particular State Government

Whether order of the Court for amalgamation is an instrument of conveyance under the Stamp Act or not?



Stamp duty aspects



Constitution of India

Power of Union
Government to
prescribe rates

Entry 91 - bills of exchange, cheque, promissory notes, bills of lading, letters of credit, Policies of Insurance, Transfer of Shares, Debentures, Proxies and Receipts

Power of State
Government to
prescribe rates

Entry 63- Stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.

Concurrent list

Stamp Duty aspects – Judicial Pronouncements



Court order is an instrument of conveyance citing inter-vivos transfer

[Hindustan Lever Vs. State of Maharashtra (2004) 1 CLJ 148 (SC)]



States can levy stamp duty on High Court's order considering it as instrument on the number of shares issued plus consideration and not on gross value of assets transferred.

[Li Taka Pharmaceuticals v. State of Maharashtra (Bombay High Court)]

Stamp Duty aspects – A Judicial Pronouncement at Odds

Chief Controlling Revenue Authority v. Reliance Industries Limited

HC order is an instrument and not the scheme; stamp duty is payable on each order of Jurisdictional HC where companies have RO in different states – No rebate allowed



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Diligence is the
mother of good luck.

Benjamin Franklin

Why Due Diligence is Important for M&A....??

- ➔ To **investigate** into the **Affairs of Business** as a prudent business person
- ➔ To confirm all material facts related to the Business
- ➔ To assess the Risks and Opportunities of a proposed transaction.
- ➔ To reduce the Risk of post-transaction unpleasant surprises
- ➔ To confirm that the business is what it appears.

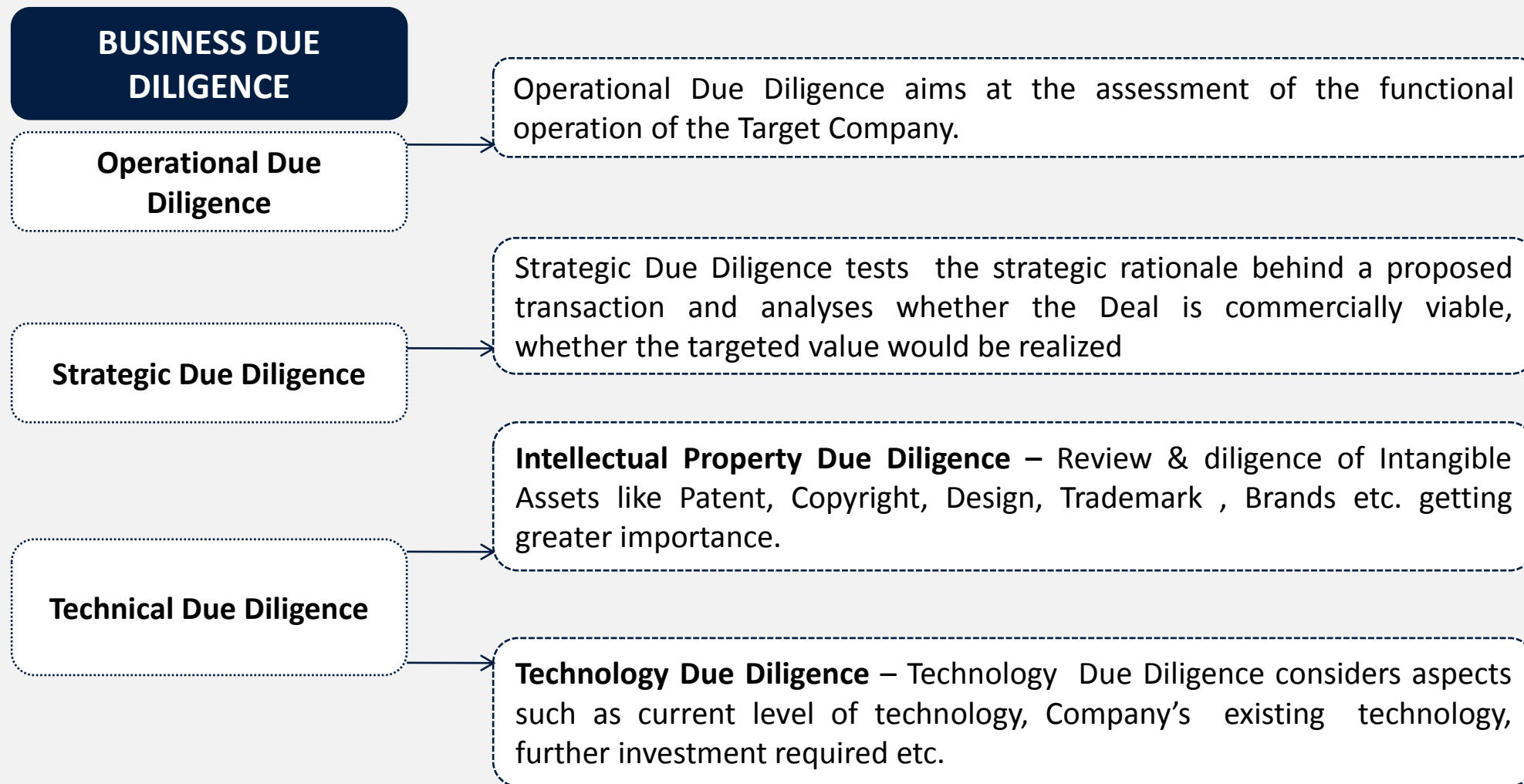
Why Due Diligence is Important for M&A....??

- ➔ To Create a Trust between two Unrelated Parties
- ➔ To **identify potential deal killers** defects in the target and avoid a bad business transaction.
- ➔ To verify that the transaction complies with investment or acquisition criteria.
- ➔ To **Investigate & Evaluate** a Business Opportunity
- ➔ It Involves an analysis carried out **before acquiring a controlling interest** in a company

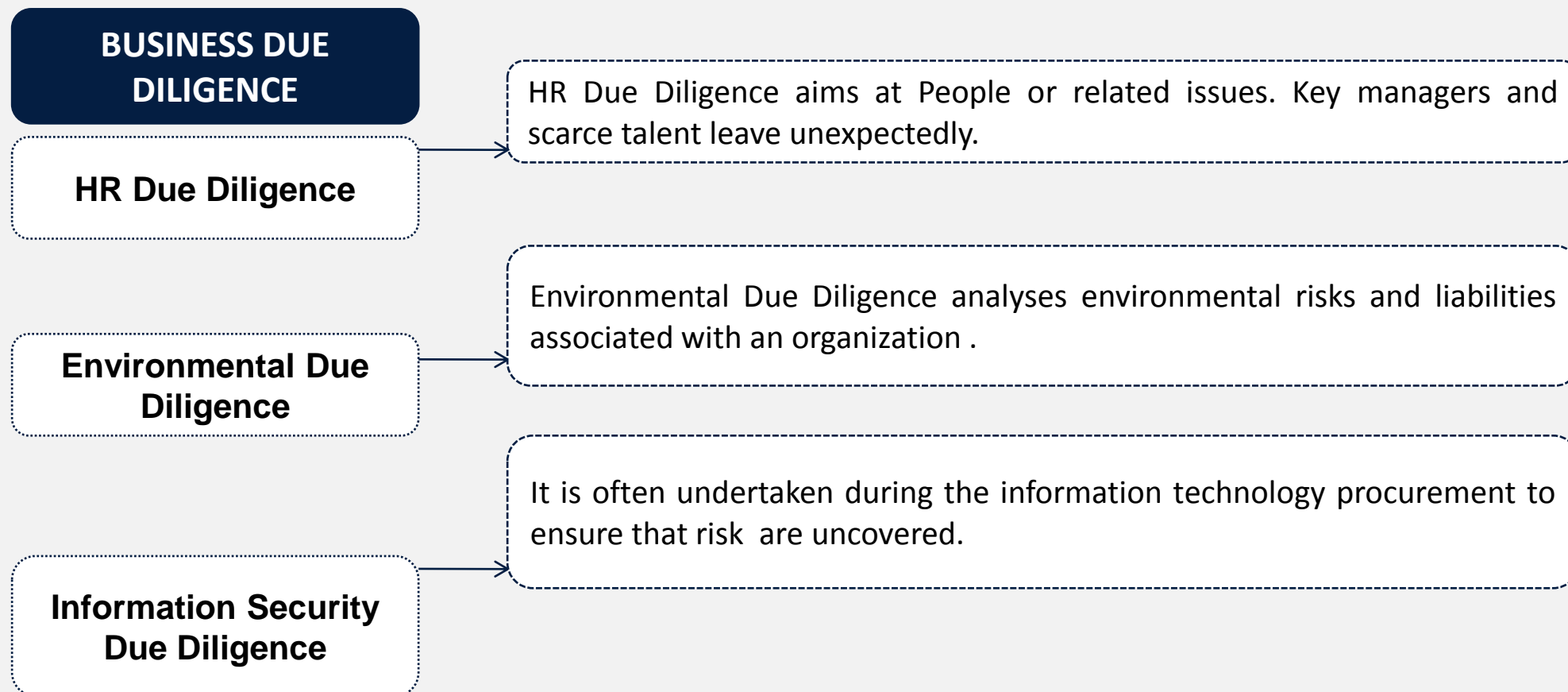


TYPES OF DUE DILIGENCE OVERVIEWS

Types of Due Diligence Overviews Cont..



Types of Due Diligence Overviews Cont..



Types of Due Diligence Overviews Cont..

Legal Due Diligence

A Legal Due Diligence covers the Legal Aspects of Business Transaction liabilities of the Target Company, potential legal pitfalls and other related issues. Legal Due Diligence covers intra-corporate and intercorporate transactions.



Financial Due Diligence

Financial Due Diligence includes review of accounting policies , review of internal audit procedure, quality and sustainability of earning and cash flow, condition and value of Assets, potential liabilities and tax implication on Deal Structure.

Common Diligence Issues in India

Inappropriate revenue recognition	Inadequate reserves and reversal of reserves including inventory	Improper cutoff and rollover impact;
Unsophisticated financial reporting system	Charge backs, rebates and returns	Issues for representation and warranties from the buyer
Improper cutoff and rollover impact;	Related party transactions – stand alone issues	Financial & Restrictive Covenants in agreements / legal documents
Implications of Regulations, Taxes & Duties – based on deal structure		

CASE STUDY



Some Practical cases



When Dai-Ichi bank of Japan merged with Nippon Kangyo to form the then biggest bank in the world called Dai-Ichi Kangyo, the two company executives found even the definition of the word, 'loan' differed between the banks!



They had to put out a 200-word glossary explaining the meaning of various banking terms before they could even start!

Some Practical cases Cont...

DAI ICHI AND RANBAXY DEAL

Daiichi Sankyo paid \$4.6 B for 63% of Ranbaxy A YEAR LATER IT WROTE DOWN the value of the acquisition by \$3.6 B.

REASON: They did not know the depth and extent of Ranbaxy's woes and full details of the **Food and Drug Administration (FDA) investigation** into Ranbaxy. In fact in 2009 FDA had shut down reviews of all pending or future drug applications from Ranbaxy's Panta Sahib plant. The first-to-file atorvastatin (Generic for Lipitor world's largest selling drug) was the greatest attraction for Dai Ichi and that was fraught with many problems.

DAI ICHI HAVE MADE INADQUATE DUE DILIGENCE STAGE AND RESULT THEY EARN HUGE LOSS.

Some Practical cases Cont...

HCL AND AXON DEAL

Infosys and HCL bid for Axon in Sep 08, HCL countered Infosys bid of 600 pence with an aggressive offer of 650 pence;

INFOSYS WITHDREW AND HCL TOOK IT OVER

NOTE: HCL did make the acquisition work by doing all the right things –main one –by eating the ego!

They reverse merged HCL teams into AXON as AXON was a high performance team and they were better than HCL –thus HCL Axon was born.

HCL DURING HR DUE DILIGENCE UNDERSTOOD THE FACTS THAT AXON TEAM HAS HUGE POTENTIAL AND DEAL CREATE SYNERGEY FOR HCL-AXON.

The goal of DUE DILIGENCE should be

DEAL MAKING

not

KILLING...



VALUATION



M&A Valuation –An Overview



M&A is primarily driven with motive of achieving Inorganic growth and Synergy i.e. the potential additional value gain from combining two firms, either from operational or financial sources.

However, certain studies have shown that most – but not all – M&A fail to deliver value and bridge the price-value gap

One of the reasons is that the aggressive acquirers in consultation with eager advisors result in pushing up the acquisition price; Resultantly, the value often get transferred from acquirer's shareholders to target company's shareholders;

Valuation for Mergers

APPLICABLE LAW FOR VALUATION FOR MERGERS

Companies Act, 2013 [Section 230-232]

Fairness Opinion [Regulation 37 of the LODR]

SEBI Notification
[CIR/CFD/CMD/16/2015], dated
30th November, 2015

Under SEBI Notification, Valuation by independent chartered account mandatory other than those specifically exempted. "Valuation Report from an Independent Chartered Accountant" is not required in cases :

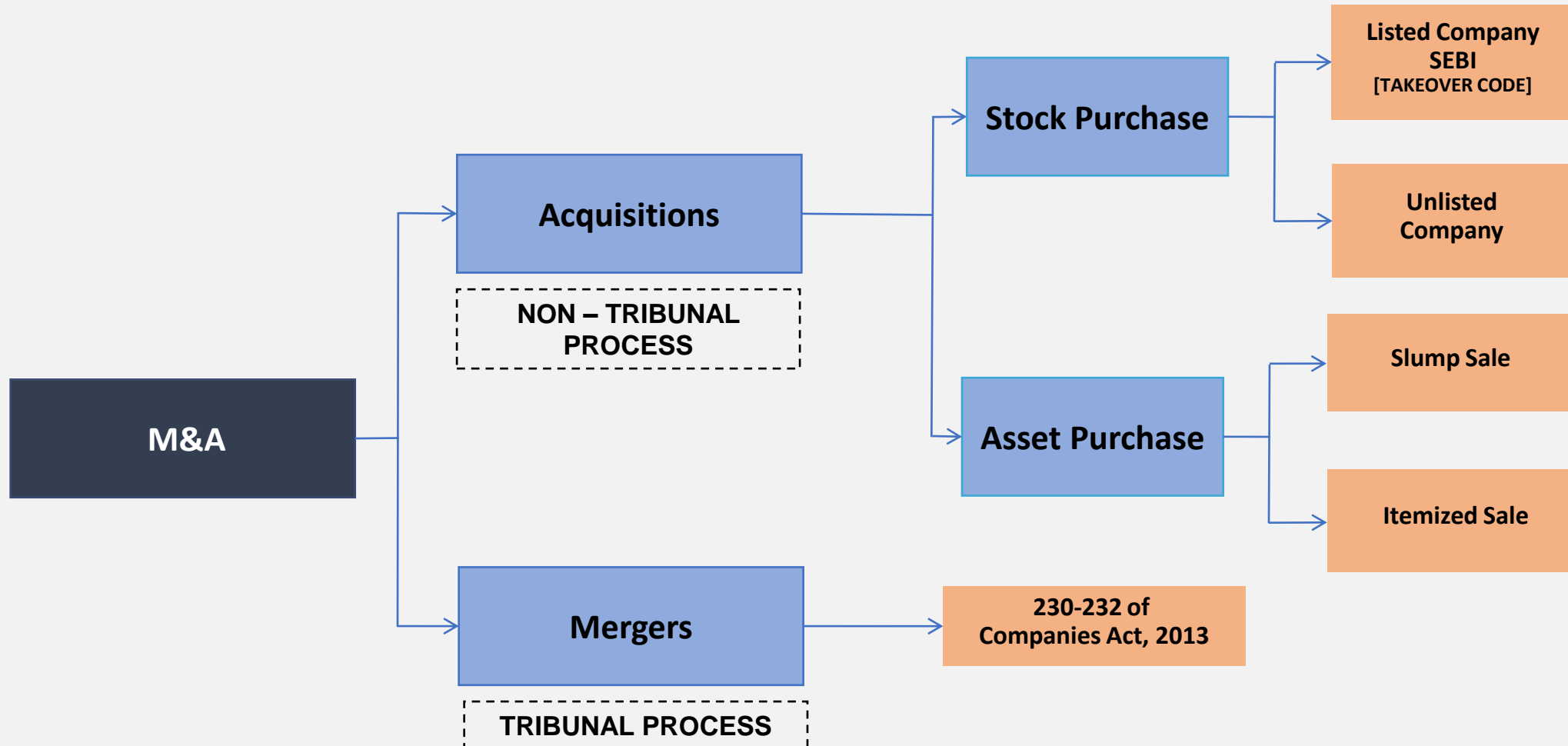
- where there is no change in proportion of shareholding of any of the existing shareholders of the listed entity in the resultant company the shareholding pattern of the listed company / resultant company
- Where no new shareholder is being allotted equity shares of the resultant company



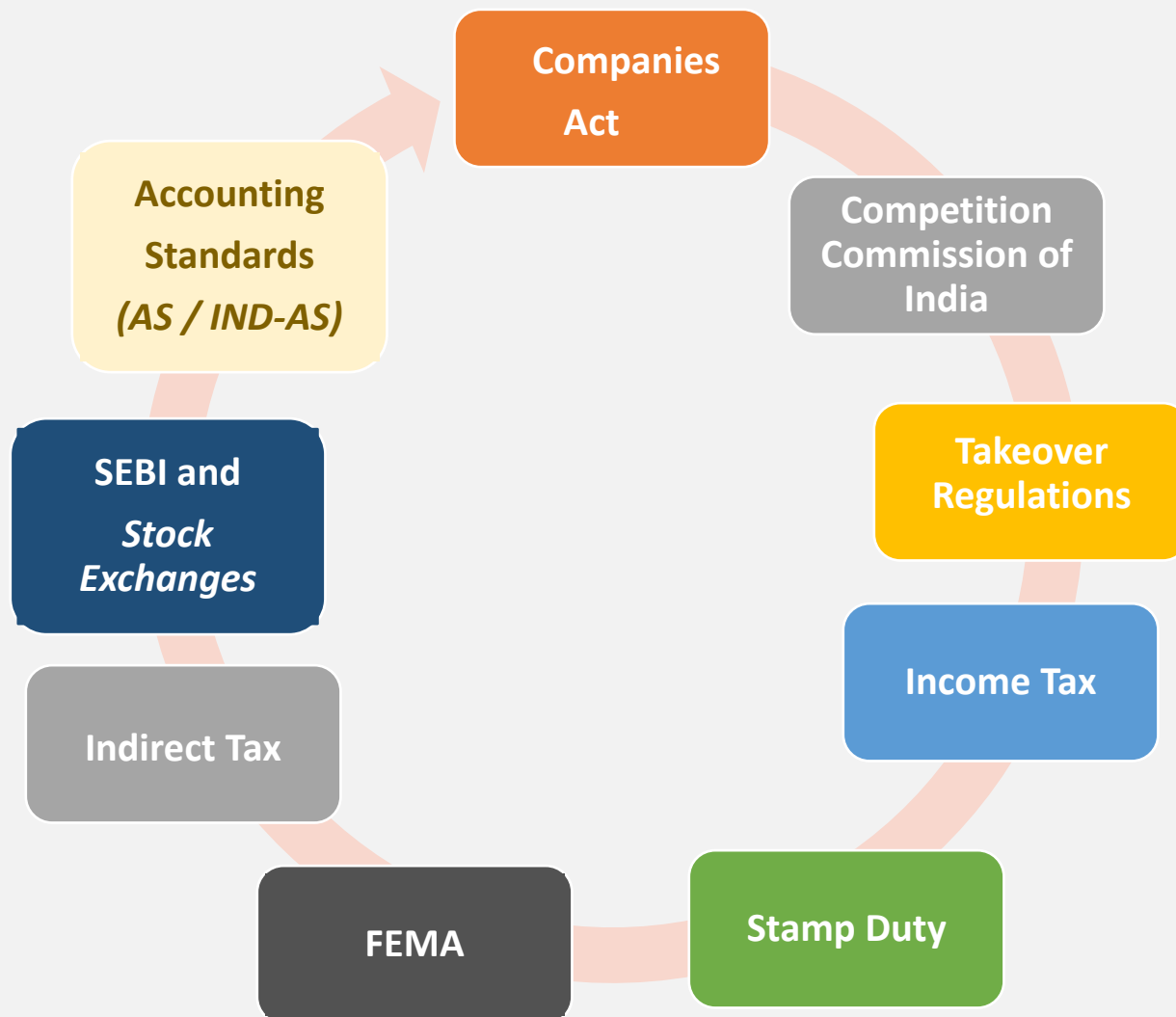
In terms with provisions of Companies Act, 2013, till the time provisions of registered valuer is notified, Valuation certificate shall be needed from a SEBI registered Merchant Banker or a Chartered Accountant with atleast 10 years of experience



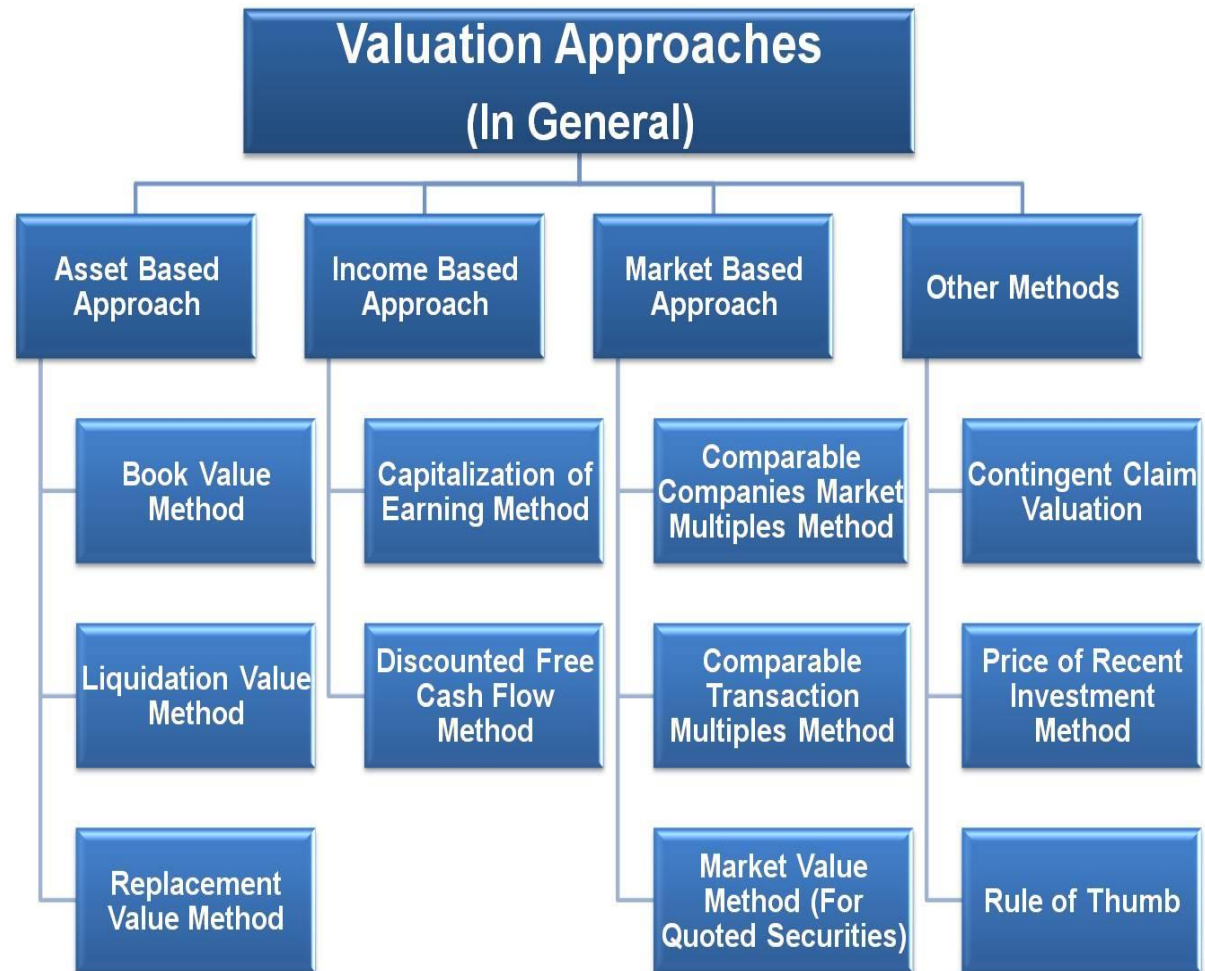
M&A - Situations & Valuation



Snapshot of Indian Laws impacting Valuation



Broad Approaches to Valuation



Applicability of a particular approach depends upon

On whose behalf? – one buyer vs another buyer, buyer vs seller;

For what purpose? – independent strategic acquisition, group company consolidation, cross border transaction

When? – distress situation, industry downturn, boom etc

Fair Value in M&A ?

Fair Value is “The price at which an entity would change hands between a willing buyer and willing seller, neither being under compulsion to buy or sell and both having reasonable knowledge of all relevant facts.”

- ☒ Valuing Acquisition Targets on Standalone basis and Valuing them with Synergy
- ☒ Distress Sale Vs. Desperate Buy
- ☒ Empirical Evidence
- ☒ Control Premiums and Minority Discounts
- ☒ Comparable Transaction Multiples (CTM) and Price of Recent Investments (PORI)
- ☒ Competitive Positioning and Risk in Corporate Acquisitions
- ☒ Valuation of Intangible Assets and Purchase Price Allocation (PPA)

Swap Ratio Valuation



In case of a merger valuation, the emphasis is on arriving at the relative values of the shares of the merging companies to facilitate determination of the swap ratio

⇒ Hence, the purpose is not to arrive at absolute values of the shares of the companies



The key issue to be addressed is that of fairness to all shareholders

⇒ This is particularly important where the shareholding pattern and shareholders vary between the two companies



There are established legal precedence for merger valuation methodologies

⇒ Valuer's role is to incorporate case specific factors and use appropriate methodologies so as to determine a fair ratio. Usually, best to give weight ages to valuation by all methods

⇒ Market price method and Earnings methods dominate.

Impact

If the exchange ratio is set too high, there will be a transfer of wealth from the bidding firm's stockholders to the target firm's stockholders.

If the exchange ratio is set too low, there will be transfer of wealth from the target firm to the bidding firm's stockholders.

Control Premium and Takeover Bid

“BEAUTY LIES IN THE EYES OF THE BEHOLDER;
VALUATION IN THOSE OF THE BUYERS”

- ✓ An investor seeking to acquire control of a company is typically willing to pay more than the current market price of the company. **Control premium** is an amount that a buyer is usually willing to pay over the fair market value of a publicly traded company to acquire controlling stake in a company.
- ✓ Control can be direct (shareholding or Authority to appoint Board) or indirect (veto power, casting vote etc)
- ✓ Research has shown that the control premium in India has widely ranged from 30-50% in the past few years having median of 40%.

Recent Transactions (2016)	Control Premium
Microsoft acquires LinkedIn	50%
Oracle acquires NetSuite	19%
Verizon acquires Fleetmatics Group	40%



LATEST NEWS

SEBI Latest Developments

Where shares are proposed to be issued to a selected group of persons pursuant to a scheme of arrangement

Valuation as per SEBI (ICDR) Regulations

As per pricing for Preferential Issues

Valuation – Judicial Pronouncements



Mathematical precision is not the criterion for adjudging the fair exchange ratio

Hindustan Lever Employees' Union
v. Hindustan Lever Ltd



Absence of Valuation Report- No legal or factual impediment to grant sanction to the scheme of amalgamation

Shreya's India (P) Ltd. v. Samrat
Industries (P) Ltd.



It is fair to use combination of three well known methods - asset value, yield value & market value

Hindustan Lever Employees' Union
Vs. HLL



Exchange Ratio not disturbed by Courts unless objected and found grossly unfair"

Miheer H. Mafatlal Vs. Mafatlal
Industries/ Dinesh v. Lakhani Vs.
Parke-Davis (India) Ltd.



Valuation job must be entrusted to people who know the Company rather than giving to outsiders who will start from scratch

Consolidated Coffee V/s Arun
Kumar Agrawal



That is what learning is.
You suddenly
understand something
you've understood
all your life,
but in a new way.

Doris Lessing



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