Mergers & Acquisitions | Preview

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Drivers for M&A

M&A Drivers

- Achieve economies of scale / synergies
- Exit non-core businesses
- Overcome threat / competition
- Grow inorganically
- Tax efficiency
- Re-direct capital to core competencies
- Enhance shareholder value
- Global restructuring

Laws impacting M&A

Newton redefined: Every action has a tax and regulatory reaction

SEBI / SE Listing Requirements

Taxes

Industry specific laws

Companies Act

Laws affecting M&A

Accounting Standards / GAAP

Competition Act

Stamp Duty

FDI & Exchange Control

Acquisition structuring | M&A Tools

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M&A Tools

M&A

Activity	Tools
Consolidation / hive off	• Merger • Demerger
Acquisitions	• Business Purchase • Share Purchase

Merger | Concept

- Merger involves transfer of all assets and liabilities of amalgamating company to the amalgamated company

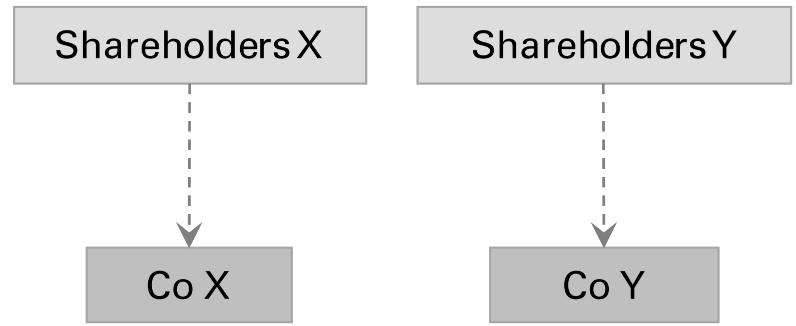
Benefits

- Synergy achieved
- Increased Net worth facilitates ease in future fund raising
- Tax Neutral

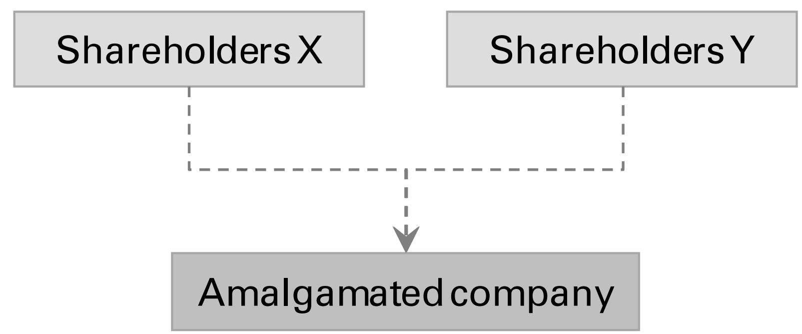
Key aspects

- Mode of consideration?
  - Equity/ preference/ Debentures
- Continuity of tax losses
- Applicability of Section 79
- Continuity of tax benefits
- Tax break on Goodwill
- Stamp duty

Pre-merger scenario



Post-merger scenario



Demerger | Concept

- De-merger involves transfer of all assets/ liabilities of identified business from one company to another
- In consideration, resulting company to issue shares to shareholders of demerged company)

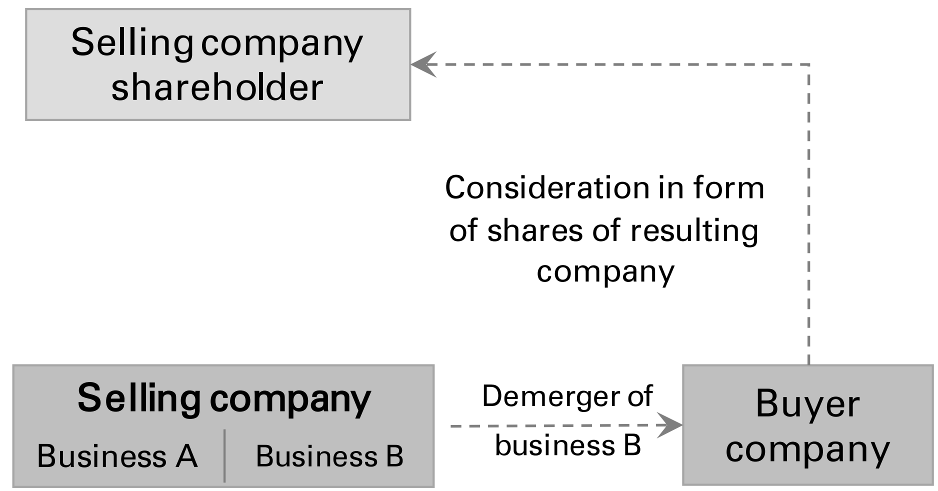
Benefits

- Creation of structure amenable to fund raise
- Unlock shareholders value
- Tax Neutral

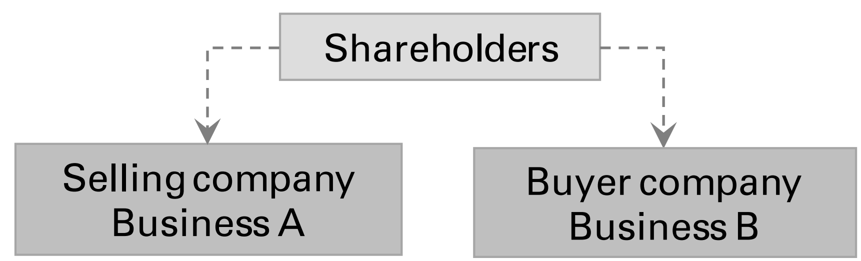
Key aspects

- What constitutes an ‘undertaking’?
- Whether consideration can be mix of equity shares and/or preference shares?
- Transfer at book value?
- Continuity of tax losses
- Cost split of shares

Transaction



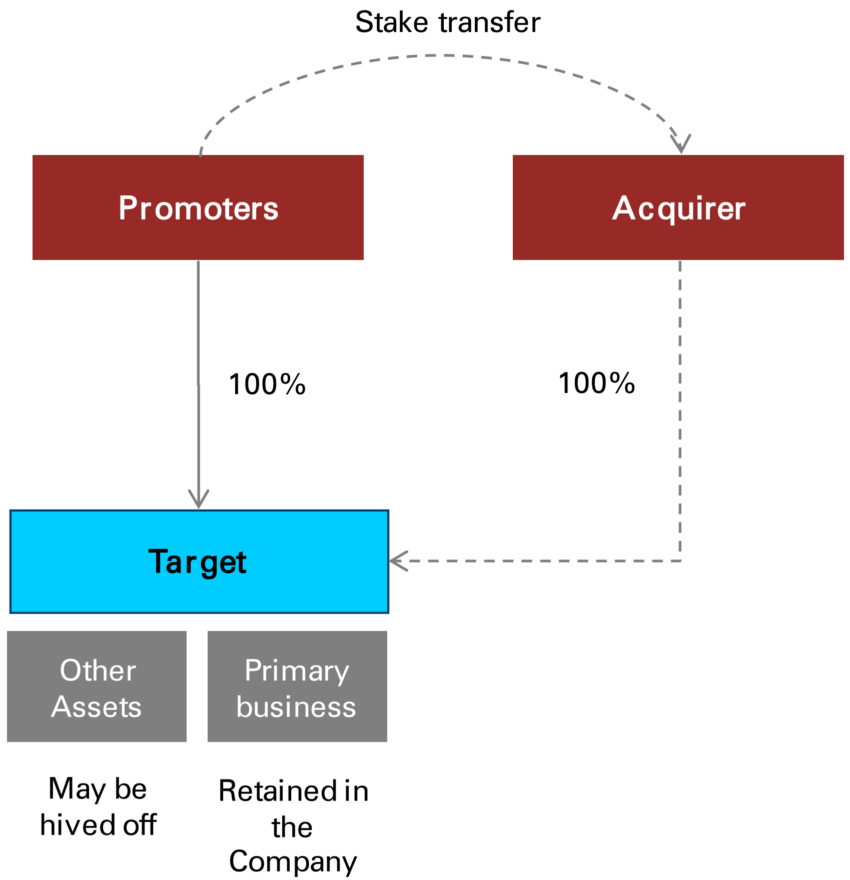
Post demerger scenario



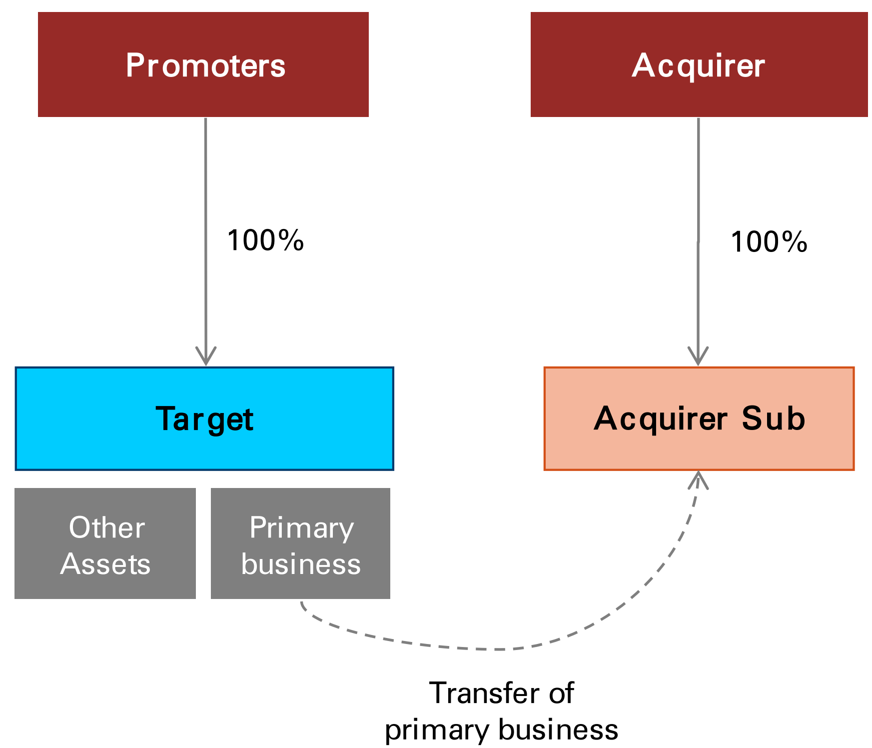
Share deal vis-à-vis Asset deal | Concept

Acquisition of a stake in the Target could be effected through the following options

Option 1 – Share deal



Option 2 – Asset deal

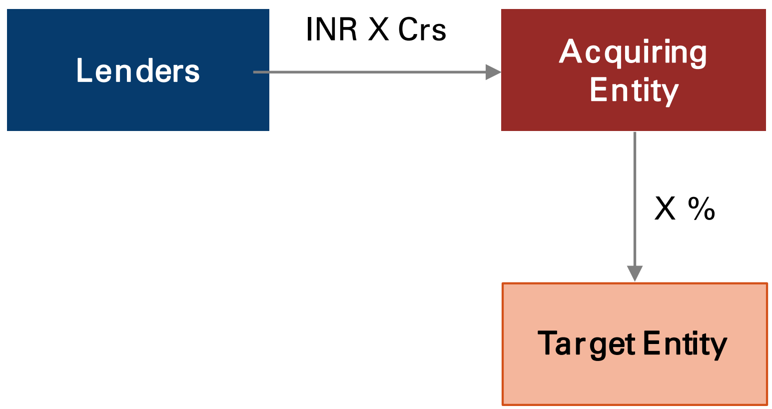


Share deal vis-a-vis Asset deal | Key tax differentiators

Parameters	Share deal	Asset deal
Tax treatment of purchase consideration	• Classified as 'investment' - No depreciation / deduction available • Consideration deductible as 'cost of acquisition' from future capital gains	• Depreciation available on stepped up cost • Possible to allocate consideration to intangibles
Tax break on interest on borrowed funds for acquisition	• Not available	• Available
Tax benefits of Target	• Ordinarily continues with Target	• Debatable whether moves to Buyer
Carry forward of tax losses	• Impact on losses due to change of shareholding to be analyzed	• Tax losses do not move
Past tax liabilities	• Buyer assumes primary responsibility for past tax liabilities	• Buyer may assume secondary liability for a limited period (ie Acquirer would be held liable only if the Target defaults in settling past tax liabilities)
Stamp duty	• Relatively low cost	• Higher cost

M&A | Acquisition Financing

Typical Structure



Key Considerations

- Consolidated leverage
- Cashflows – Loan servicing ability
- LBO structure
- Tax break through merger
- Asset purchase

Who can Fund

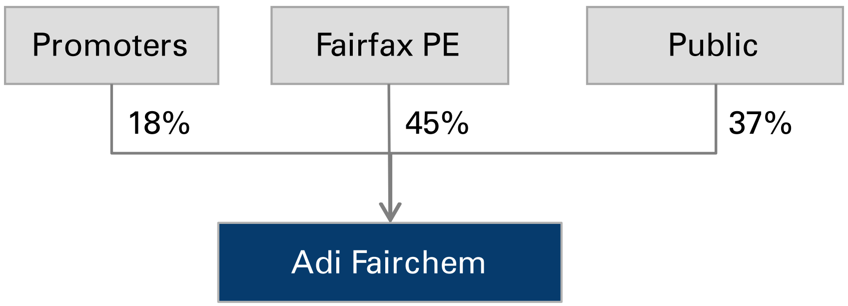
Domestic Banks	Indian banks are not allowed to fund acquisition of shares. They can fund for asset purchase on slump sale basis
Foreign Banks	Invest through the FPI vehicle and is a preferred option for Foreign owned and Controlled (FOCC) companies who cannot raise domestic debt for acquisitions
Mutual Funds	Mutual Funds used to be active participants earlier but with new regulatory guidelines, they need to have at least 4.0x cover for deals where primary security is shares of acquirer / target
NBFCs	With restrictions on Domestic Banks and Mutual Funds; NBFCs have become active participants in Acquisition Financing deals (except for FOCC cases)
Credit Funds	While they can participate in these kind of trades, they become less attractive considering they are high yield investors

Case Studies

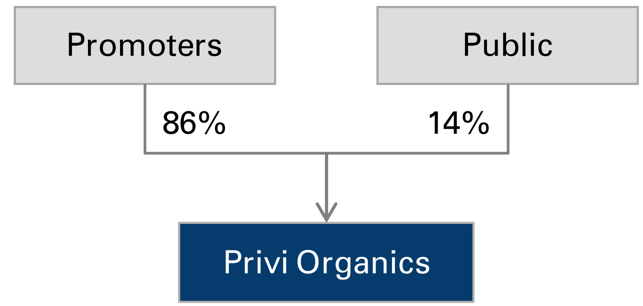
Case Study 1 | Adi Fairchem – Privi Organics

Current Structure and Transaction

Adi Fairchem Shareholding



Privy Organics Shareholding



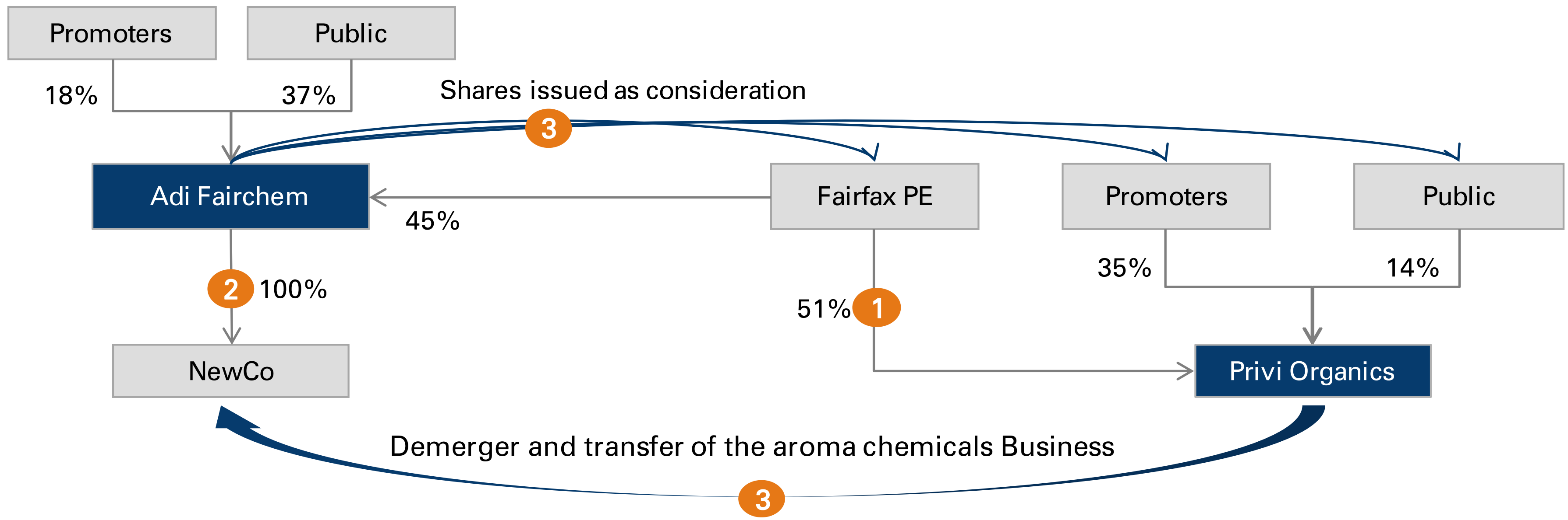
Fairfax PE was to acquire majority stake in Privi Organics and consolidate the two businesses

Key Parameters / Constraints

- Share issuance on consolidation likely to breach MPS norms – consideration to be structured
- Target Promoter declassification to be achieved from SEBI perspective
- Tax treaty benefits for Fairfax PE to lapse post 31 March 2017
- Consolidation of businesses post acquisition – Management to be kept separate
- Consolidation to be achieved in a Tax & Regulatory efficient manner
- Shift from High Court to NCLT

Case Study 1 | Adi Fairchem – Privi Organics

Implemented Structure



Deal Mechanics

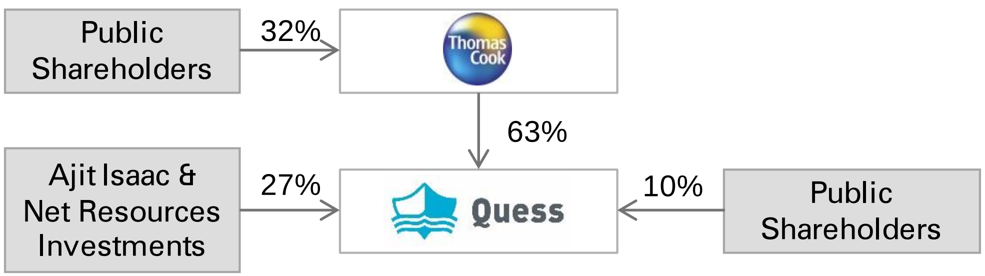
1. Fairfax invested 51% in Privi Organics prior to the demerger scheme
2. A wholly owned subsidiary ('NewCo') was incorporated under Adi Fairchem
3. Entire Aroma Chemicals business of Privi Organics was demerged and transferred to NewCo
4. In consideration of the demerger, equity shares of Adi were issued to the shareholders of Privi to the extent of 75% and balance consideration was issued in the form of CCPS
5. Post demerger and share issuance, Target promoter declassification process initiated

Case Study 2 | Quess – MIS

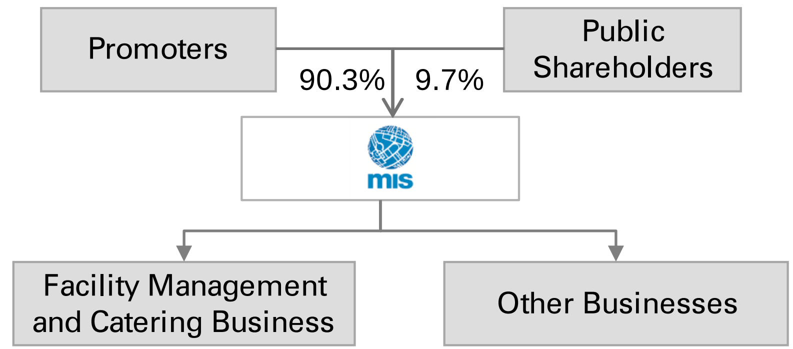
1/2

Current Structure

Quess Shareholding



MIS Shareholding



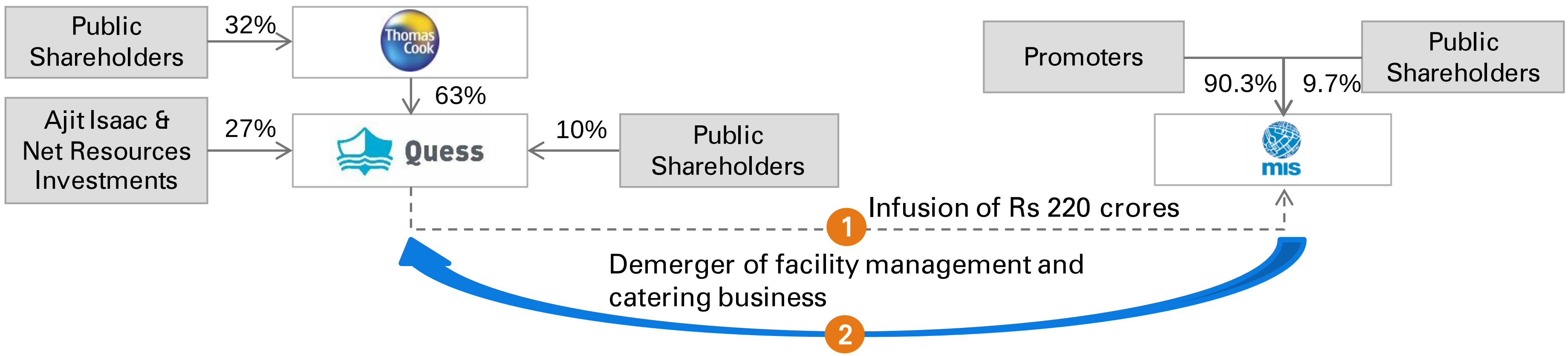
Quess wanted to acquire the Facility Management and Catering (FMC) business of MIS for INR XX Crs with consideration to be split between cash and share swap

Key Parameters / Constraints

- Acquisition of only the FMS division of MIS
- Equity valuation of Transferred Undertaking of MIS – Approx Rs 650 crores of which primary infusion needed in MIS to the tune of Rs 220 crores to repay a debt and balance consideration to be discharged by way of shares of Quess to MIS shareholders
- Valuation of Quess to consider the infusion while determining share swap
- Acquisition to be done in a tax & regulatory efficient manner

Case Study 2 | Quess – MIS

Implemented Structure



Deal Mechanics

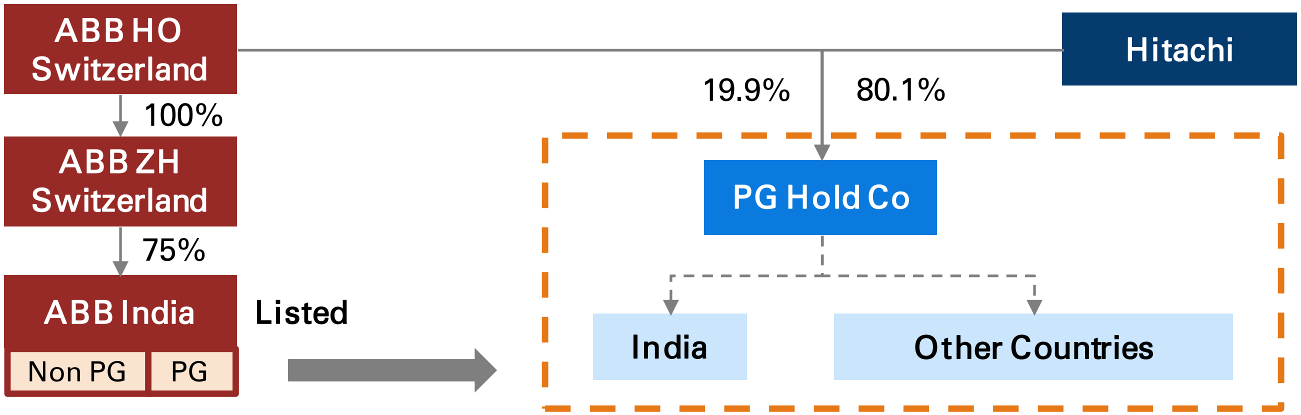
1. Quess to infuse **Rs 220 crores** into MIS by subscribing to Compulsorily Convertible Preference Shares **(‘CCPS’)** of MIS for securing an interest in the Transferred Undertaking, development of the same and facilitating the demerger of the same businesses
2. Subsequent to infusion, Quess and MIS entered into a Scheme of Arrangement under Section 230 to 232 of Companies Act, 2013 to **demerge** the Transferred Undertaking from MIS into Quess
   - In consideration for the said demerger, Quess issued approx 7.15 mn equity shares to the MIS shareholders
   - CCPS infused by Quess into MIS to be cancelled on demerger

Key Considerations

- Step 1 : Money infused used to settle the lender in MIS – Choice of instrument was the key
- Step 2 : Money infused as CCPS in MIS by Quess considered while valuing MIS for share swap purposes. Also, CCPS to be cancelled on demerger.

Case Study 3 | Global Sale of ABB's Powergrid business to Hitachi

Current Structure and Proposed Structure



- Hitachi was acquiring the global Powergrids business of ABB for $11bn
- This business was present in 57 countries worldwide and involved 2 entities in India
- India is the only listed entity in the entire group other than ABB ZH

PG business in ABB India to be carved out under PG Hold Co

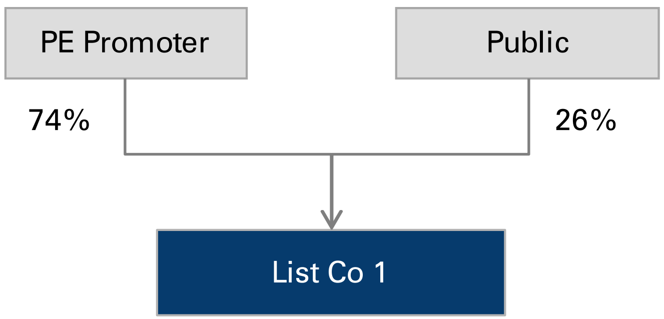
Key Parameters / Aspects

- Carve out of PG business from ABB India to be achieved in a tax and regulatory efficient manner
- Timing of Open offer trigger – when to make Public Announcement
- Direct v Deemed Direct v Indirect Open offer
- Determination of Open offer price
- Structure the transfer of PG business entity under PG Hold Co
- Does the aforesaid transfer trigger another open offer?

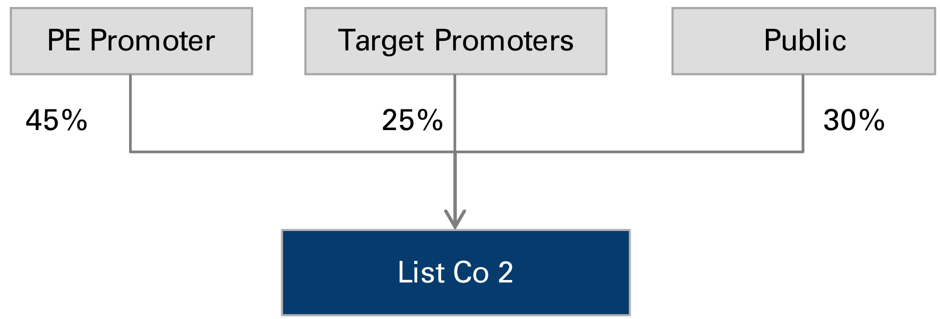
Case Study 4 | Listed Company Acquisition [Ongoing]

Current Structure

ListCo 1 (Acquirer)



ListCo 2 (Target)



List Co 1 to acquire List Co 2 and consolidate businesses alongwith giving exit to Target PE investors

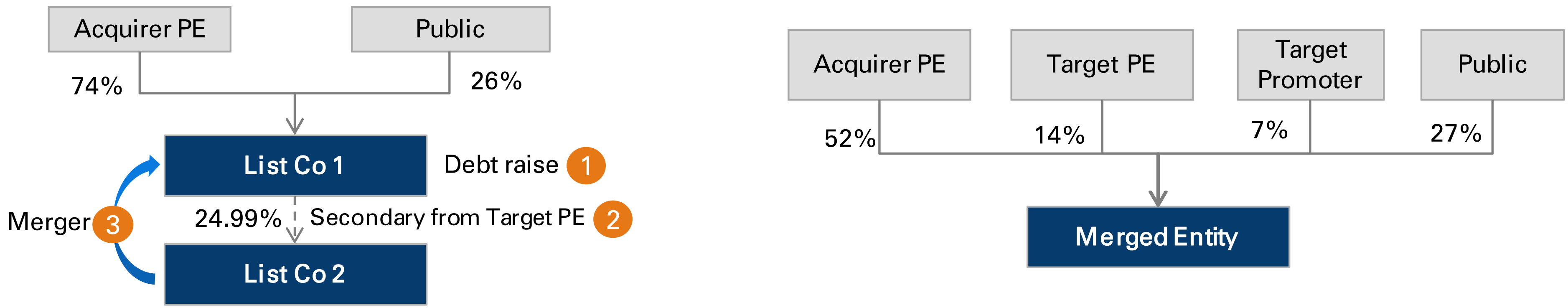
Key Parameters / Constraints

- Target PE to be given cash exit – Who to acquire (Acquirer PE or List Co 1)
- Consolidation of businesses to be achieved
- Avoid open offer trigger
- Ensure MPS compliance on consolidation – Likely to cross 75%
- Avoid structure which entails majority of minority approval
- Acquisition debt

Case Study 4 | Listed Company Acquisition [Ongoing]

Resultant Structure

Pre Merger Shareholding Structure | **Post Merger Shareholding Structure**



Deal Mechanics

1. List Co 1 to raise acquisition debt to acquire shares of List Co 2
2. List Co 1 to acquire less than 25% in List Co 2 from PE Promoter
3. Merger of List Co 2 with List Co 1. Consideration to be in the form of RPS restricted to the tune of 25% and balance being equity shares

Key Considerations

- Step 1 : Acquisition debt can be raised through FPIs only since List Co 1 is FOCC
- Step 2 : Ensures that open offer is not triggered since shares bought are below the threshold for triggering open offer
- Step 3 : Advisable to limit RPS in merger to 25% from tax perspective. Also, RPS can only be issued to residents

Case Study 5 | Reliance – Future Deal [Ongoing]

Deal Details

Deal Description

- Reliance group plans to acquire the logistics & warehousing (LWU) and retail & wholesale (RWU) businesses housed in various Future group companies (Big Bazaar, Brand Factory, Hometown, Central, eZone, etc.) for ~Rs 25000 Cr
- Future group has to consolidate the LWU and RWU businesses housed in various group companies in Future Enterprises (FEL)
- Reliance group proposes to acquire a minority interest in the remaining businesses (manufacturing of FMCG / apparels, investments, etc.)
- Deal consideration includes borrowings and current liabilities which will be taken over by Reliance Group as part of the deal

Deal Mechanics

Step 1 **Internal restructuring by Future group**

- Amalgamation of Future Retail, Future Consumer, Future Lifestyle Fashions, Future Market Networks, Future Supply Chain with FEL

Step 2 **Acquisition of Target Business (Slump sale) for Rs 5,650 Cr**

- Transfer of LWU from FEL to Reliance Retail Ventures Ltd (RRVL)
- Transfer of RWU from FEL to WOS of RRVL

Step 3 **Investment by RRVL WOS in remaining business of FEL**

- Preferential Allotment through mix of equity shares (1,200 Cr) and warrants (1,600 Cr) in aggregate up to 13.14% of equity share capital of FEL

What Went Wrong

- In Aug 2019, Amazon had bought 49% in Future Coupons, a promoter group entity which holds 9.8% in Future Retail Ltd (FRL) for Rs 1,500 Cr (~4.8% indirect stake in FRL)
- After the announcement of RIL - Future group deal in Aug 2020, Amazon filed an arbitration petition with Singapore International Arbitration Centre (SIAC) in Oct 2020 claiming that Future Group breached certain conditions of the contract agreed in 2019 including a “non-compete” clause and “right of first refusal” (RoFR) clause
- The legal battle between Amazon and Future Group over the deal with Reliance has been going on for seven months now and next hearing at Supreme Court is on 4th May 2021

Future group has already received CCI and SEBI approval and is now waiting for Supreme Court clearance on the ongoing litigation with Amazon before applying for NCLT and shareholder approval

Thank you

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