Overview on Mergers and Acquisitions

Chapter Objectives

- Discuss the form of mergers and acquisitions.
- Highlight the real motives of mergers and acquisitions.
- Illustrate the methodology for evaluating mergers and acquisitions.
- Focus on the considerations that are important in the mergers and acquisitions negotiations.
- Understand the implications and evaluation of the leveraged buyouts.

Introduction

- Corporate restructuring includes mergers and acquisitions (M&As), amalgamation, takeovers, spin-offs, leveraged buy-outs, buyback of shares, capital reorganisation etc.
- M&As are the most popular means of corporate restructuring or business combinations.

MERGER

- **It involves combination of all the assets, liabilities, loans, and businesses (on a going concern basis) of two (or more) companies such that one of them survives.”**

Types of Business Combination

- **Merger or Amalgamation**
  - Merger or amalgamation may take two forms:
    - ***Absorption*** is a combination of two or more companies into an existing company.
    - ***Consolidation*** is a combination of two or more companies into a new company.
  - In merger, there is complete amalgamation of the assets and liabilities as well as shareholders' interests and businesses of the merging companies. There is yet another mode of merger. Here one company may purchase another company without giving proportionate ownership to the shareholders' of the acquired company or without continuing the business of the acquired company.

Example

ILLUSTRATION 2.01 A Limited has a paid-up equity capital of Rs 10 crore consisting of 1 crore shares of face value of Rs 10 each. B Limited has a paid-up equity capital of Rs 50 crore consisting of 5 crore shares of face value of Rs 10 each. A Limited is proposed to be merged with B Limited, wherein based on the relative valuation of both the companies, shareholders of A will be given, two shares of B Limited for every five shares of A Limited held by them. Upon the merger being carried out, the following things will happen:

(a) Shareholders of A Limited will get 40 lakh shares of face value of Rs 10 each of B Limited in exchange of shares of A Limited.

(b) Shares of A Limited will get cancelled since A Limited will cease to exist through a legal process called 'dissolution without winding up'.

(c) All the assets and liabilities of A Limited will be transferred to B Limited.

(d) Balance sheet of B limited will have equity capital of Rs 54 crore and will include assets and liabilities of both A Limited and B Limited.

(e) Business of A Limited will be conducted under the name of B Limited along with the erstwhile business of B Limited.

(f) All rights exercisable by A Limited against the third parties will now be exercisable by B Limited against them and vice-versa.

In short, A Limited will cease to exist and B Limited will survive carrying on the businesses of both A Limited and B Limited.

This is called a merger.

Types of Business Combination

- **Forms of Merger:**
  - ***Horizontal merger***
  - ***Vertical merger***
  - ***Conglomerate merger***
- **Acquisition** may be defined as an act of acquiring effective control over assets or management of a company by another company without any combination of businesses or companies. A **substantial acquisition** occurs when an acquiring firm acquires substantial quantity of shares or voting rights of the target company.

Types of Business Combination

- ***Takeover*** – The term takeover is understood to connote hostility. When an acquisition is a ‘forced’ or ‘unwilling’ acquisition, it is called a takeover.
- A holding company is a company that holds more than half of the nominal value of the equity capital of another company, called a **subsidiary company**, or controls the composition of its Board of Directors. Both holding and subsidiary companies retain their separate legal entities and maintain their separate books of accounts.

Acquisition

- Acquisition is an attempt or a process by which a company or an individual or a group of individuals acquires control over another company called 'target company'.
- Acquiring control over a company means acquiring the right to control its management and policy decisions.
- It also means the right to appoint (and remove) majority of the directors of a company.
- In acquisition, the target company's identity remains intact.

Ways to acquire a control over a company (a target company):

By acquiring ,i.e. purchasing a substantial percentage of the voting capital of the target company.

By acquiring voting rights of the target company through power of attorney or through a proxy voting arrangement.

By acquiring control over an investment or holding company, whether listed or unlisted, that in turn holds controlling interest in the target company.

By simply acquiring management control through a formal or informal understanding or agreement with the existing person (s) in control of the target company.

- **Some of the significant acquisitions in Indian context in recent past :**

Acquisition of Corus by Tata Steel
Acquisition of Novelis by Hindalco
Acquisition of Spice Communication by Idea Cellular
Acquisition of Ranbaxy by Daiichi Sankyo
Acquisition of Hutchison Essar by Vodafone
Acquisition of Sahara Airlines by Jet Airways
Acquisition of Deccan Airways by Kingfisher Airlines

Motives of Mergers and Acquisitions

- **Mergers and Acquisition are intended to:**
  - Limit competition.
  - Utilise under-utilised market power.
  - Overcome the problem of slow growth and profitability in one's own industry.
  - Achieve diversification.
  - Gain economies of scale and increase income with proportionately less investment.
  - Establish a transnational bridgehead without excessive start-up costs to gain access to a foreign market.

Motives and Benefits of Mergers and Acquisitions

- Utilise under-utilised resources–human and physical and managerial skills.
- Displace existing management.
- Circumvent government regulations.
- Reap speculative gains attendant upon new security issue or change in P/E ratio.
- Create an image of aggressiveness and strategic opportunism, empire building and to amass vast economic powers of the company.

Benefits of Mergers and Acquisitions

- **The most common advantages of M&A are:**
  - **Accelerated Growth**
  - **Enhanced Profitability**
    - ***Economies of scale***
    - ***Operating economies***
    - ***Synergy***
  - **Diversification of Risk**

Benefits of Mergers and Acquisitions

- **Reduction in Tax Liability**
- **Financial Benefits**
  - ***Financing constraint***
  - ***Surplus cash***
  - ***Debt capacity***
  - ***Financing cost***
- **Increased Market Power**

Analysis of Mergers and Acquisitions

- There are three important steps involved in the analysis of mergers or acquisitions:
  - Planning
  - Search and screening
  - Financial evaluation

Factors Influencing the Earnings Growth

- The important factors influencing the earnings growth of the acquiring firm in future are:
  - The price–earnings ratios of the acquiring and the acquired companies.
  - The ratio of share exchanged by the acquiring company for one share of the acquired company.
  - The pre-merger earnings growth rates of acquiring and the acquired companies.
  - The level of profit after tax of the merging companies.
  - The weighted average of the earnings growth rates of the merging companies.

Leveraged Buy-outs

- A **leveraged buy-out** (LBO) is an acquisition of a company in which the acquisition is substantially financed through debt. When the managers buy their company from its owners employing debt, the leveraged buy-out is called **management buy-out** (MBO).
- The following firms are generally the targets for LBOs:
  - High growth, high market share firms
  - High profit potential firms
  - High liquidity and high debt capacity firms
  - Low operating risk firms
- The evaluation of LBO transactions involves the same analysis as for mergers and acquisitions. The DCF approach is used to value an LBO.

Tender Offer and Hostile Takeover

- A **tender offer** is a formal offer to purchase a given number of a company's shares at a specific price.
- Tender offer can be used in two situations.
  - First, the acquiring company may directly approach the target company for its takeover. If the target company does not agree, then the acquiring company may directly approach the shareholders by means of a tender offer.
  - Second, the tender offer may be used without any negotiations, and it may be tantamount to a **hostile takeover.**

Regulation of Mergers and Takeovers in India

- **In India, mergers and acquisitions are regulated through:**
  - The provision of the Companies Act, 1956,
  - The Monopolies and Restrictive Trade Practice (MRTP) Act, 1969,
  - The Foreign Exchange Regulation Act (FERA), 1973,
  - The Income Tax Act, 1961, and
  - The Securities and Controls (Regulations) Act, 1956.
    - The Securities and Exchange Board of India (SEBI) has issued guidelines to regulate mergers, acquisitions and takeovers.

Regulation of Mergers and Takeovers in India

- **Legal Measures against Takeovers**
- **Refusal to Register the Transfer of Shares:**
  - a legal requirement relating to the transfer of shares have not be complied with; or
  - the transfer is in contravention of the law; or
  - the transfer is prohibited by a court order; or
  - the transfer is not in the interests of the company and the public.
- **Protection of Minority Shareholders' Interests**
- **SEBI Guidelines for Takeovers:**
  - ***Disclosure of share acquisition/holding***
  - ***Public announcement and open offer***
    - ***Offer price***
    - ***Disclosure***
    - ***Offer document***

Legal Procedures

- ***Permission for merger***
- ***Information to the stock exchange***
- ***Approval of board of directors***
- ***Application in the High Court***
- ***Shareholders' and creditors' meetings***
- ***Sanction by the High Court***
- ***Filing of the Court order***
- ***Transfer of assets and liabilities***
- ***Payment by cash or securities***

REFERENCES

- Financial Management, Ninth Edition © I M Pandey.,Vikas Publishing House Pvt. Ltd.