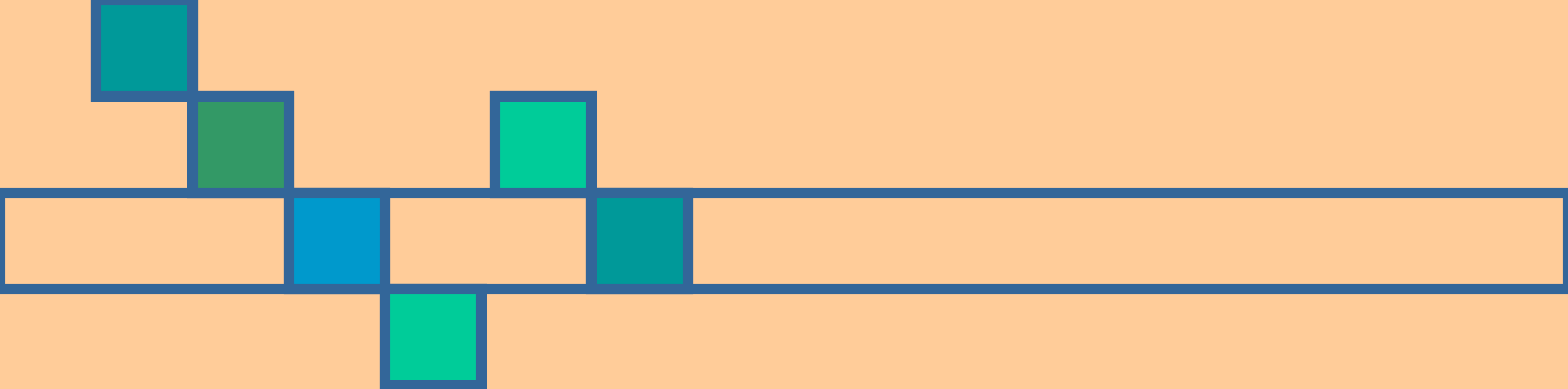


Mergers, Acquisitions, Financial and Corporate Restructuring



Ram Kumar Kakani



The views expressed herein
are personal



Introducing ...

Bonus, Large Stock Dividends, Small Stock Dividends, Stock Splits, Reverse Stock Splits, Buy Back, Stock Repurchase, Merger, Acquisition, Synergy, Economies of Scale & Scope, Pure-play, Conglomerate, Takeover, Consolidation, Tender Offer, Open Offer, Strategic Alliance, Joint Venture, Divestiture, Liquidation, Sell-off, Spin-off, Equity Carve out, White Knight, Poison Pill, Going Private, Boot Strapping, Leveraged Buy-out, Management Buy-out, Creeping Acquisition,

Merger versus Consolidation

■ Merger

- One firm is acquired by another
- Acquiring firm retains name and acquired firm ceases to exist
- Advantage – legally simple
- Disadvantage – must be approved by stockholders of both firms

■ Consolidation

- Entirely new firm is created from combination of existing firms

Acquisitions

- A firm can be acquired by purchasing voting shares of the firm's stock
- Tender offer – public offer to buy shares
- Stock acquisition
 - No stockholder vote required
 - Can deal directly with stockholders, even if management is unfriendly
 - May be delayed if some target shareholders hold out for more money – complete absorption requires a merger
- Classifications
 - Horizontal – both firms are in the same industry
 - Vertical – firms are different stages of the production process
 - Conglomerate – firms are unrelated

Takeovers

- Control of a firm transfers from one group to another
- Possible forms
 - Acquisition
 - Merger or consolidation
 - Acquisition of stock
 - Acquisition of assets
 - Proxy contest
 - Going private

Financial Restructuring

- Bonus: Bajaj Auto, WIPRO
- Stock Split: Zee Telefilms, Infosys, Elgi Equipments
- Buy Back: Kesoram Industries (market – successful)
- Buy Back: Reliance Industries (market – failed)
- Buy Back: Manugraph Industries (tender – successful)
- Buy Back: Bajaj Auto (tender – failed)
- Creeping Acquisition: Videocon International (failed),
Bombay Dyeing (successful)
- Coming Soon ... Reverse Stock Split

TABLE 25.1

Accounting for
Acquisitions: Purchase
(in Millions)

Firm A		Firm B	
Working capital	\$ 4	Working capital	\$ 2
Fixed assets	16	Fixed assets	8
Total	<u>\$20</u>	Total	<u>\$10</u>
Equity	\$20	Equity	\$10
Total	<u>\$20</u>	Total	<u>\$10</u>

Firm AB	
Working capital	\$ 6
Fixed assets	30
Goodwill	2
Total	<u>\$38</u>
Debt	\$18
Equity	20
Total	<u>\$38</u>

The market value of the fixed assets of Firm B is \$14 million. Firm A pays \$18 million for Firm B by issuing debt.

TABLE 25.2

Accounting for
Acquisitions: Pooling of
Interests (in Millions)

Firm A		Firm B					
Working capital	\$ 4	Equity	\$20	Working capital	\$ 2	Equity	\$10
Fixed assets	<u>16</u>			Fixed assets	<u>8</u>		
Total	<u>\$20</u>	Total	<u>\$20</u>	Total	<u>\$10</u>	Total	<u>\$10</u>

Firm AB			
Working capital	\$ 6	Equity	\$30
Fixed assets	<u>24</u>		
Total	<u>\$30</u>	Total	<u>\$30</u>

Accounting for Acquisitions

■ Pooling of interests accounting no longer allowed

■ Purchase Accounting

- Assets of acquired firm must be reported at fair market value
- Goodwill is created – difference between purchase price and estimated fair market value of net assets
- Goodwill no longer has to be amortized – assets are essentially marked-to-market annually and goodwill is adjusted and treated as an expense if the market value of the assets has decreased

Story of a Indian Business Group

K. K. Bangur Group

- In 1995-96, Graphite Vicarb + Carbon Corp → Carbon Everflow
- In 2001-02, Carbon Investments is merged in Carbon Everflow
- Also, Graphite India is being merged into Carbon Everflow
- But, they will be known by something starting with Graphite ...
- Why?
- Possible case of Boot Strapping

Which company should be merged (or amalgamated) into another?

Graphite India							
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap	
1.21	19.16	15.87	28.00	1.76	265	34	
Carbon Everflow							
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap	
1.25	10.47	8.38	20.00	2.39	145	25	

All figures are for last year (March 2001) and assumed to continue

When Carbon Everflow is merged into Graphite India

Graphite India							
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap	
1.21	19.16	15.87	28.00	1.76	265	34	
Carbon Everflow							
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap	
1.25	10.47	8.38	20.00	2.39	145	25	
Merge Carbon Everflow into Graphite India							
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap	
2.10	29.63	14.11	24.83	1.76	410	52	

When Graphite India is merged into Carbon Everflow

Graphite India						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
1.21	19.16	15.87	28.00	1.76	265	34
Carbon Everflow						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
1.25	10.47	8.38	20.00	2.39	145	25
Merge Graphite India with Carbon Everflow						
Share Capital	PAT	EPS	MP	P/E ratio	Sales	MarketCap
2.94	29.63	10.08	24.09	2.39	410	71

Bootstrap Game

- In a bootstrap game acquiring firm has a high P/E ratio
 - Selling firm has a low P/E ratio
- After merger, acquiring firm has a short-term EPS rise
- But, the acquirer has a slower than normal growth (in EPS) due to share dilution
- What could be the other reasons for Carbon Everflow merging into Graphite India?
- In reality, if markets are efficient then what will happen?

Financing Mergers

Cash

- Indian Oil bought IBP with cash
- India Cements bought Raasi Cement with cash
- Simplicity, preciseness, no control rights to front party

Exchange of Shares

- Target shareholders maintain an interest in the new firm, to the acquirer there is no cash outflow needed
- Carbon Everflow and Graphite India
- HLL and BBLIL

Story of a Multinational

- Two firms both competed for same raw material
- Had large scale marketing of household products
- Involved similar distribution channels
- Operated in > 40 countries in 1920s, Guess (?)
- Dutch Company: Unie Margarine, British Soapmaker: Lever Brothers ... married/merged ... Unilever happens
- Even, in India ... post-liberalization
- Till 1993-94, HLL + Lipton + Brooke Bond + Ponds + Goodricke; After 1993-94 HLL added TOMCO, Vashishti Detergents, Lakme, Modern Foods, Kwality Icecreams to itself and divested some businesses such as leather/animal products

Why engage in Corporate Restructuring?

- Sales enhancement and operating economies (Modi Cements – GACL, HLL)
- Improved Management (Modern Foods – HLL, BALCO – Sterlite)
- Information Effect (Bombay Dyeing – Bajoria, Jaiprakash – Bela Cements, Raymond – Cement)
- Wealth Transfer (C K Birla, P&G, Colgate)
- Tax Reasons (Narmada Cement – L&T)
- Leverage gains (J K Corp)
- Hubris Hypothesis (Rajaratnam)
- Managements Personal Agenda (Pfizer, P&G, Tata)

How do we evaluate a deal?

- Always recalculate things using NPV
- Also, look for any real options that exist
- Also, take a new expected rate of return (depending on the new risk profile of the company)
- Take the deal costs also into account

Restructuring in Cement Sector

- Raasi Cements forms a subsidiary Shri Vishnu Cements
- Shri Vishnu nearly fails
- Shri Vishnu is forced to take a financial restructuring package by Lenders i.e., domestic financial institutions incl. ICICI
- India Cements – Raasi Cements
- India Cements – Shri Vishnu Cements
- Shri Vishnu Cements – Italia Cement (failed)
- Shri Vishnu Cements – Zuari Industries

Restructuring in Cement ...

- Nihon Nirmaan – a White Cement Elephant
- Narmada Cements – L&T
- Modi Cement – Gujarat Ambuja Cements
- DHL Cement – Gujarat Ambuja Cements
- CCI plants are lapped up by India Cements, Birla Cements, etc.
- Smaller players (Deccan, DCL, Snehalata, etc.) are also being sold off or becoming bankrupt
- Lafarge enters through TISCO and Raymond
- ACC – Gujarat Ambuja Cements
- L&T – Grasim Cements

Business Standard

New Delhi, Feb. 25, 2002: Sidharth Shriram-promoted Siel Ltd has sold its 5,000-tcd (tonnes crushed per day) Titawi sugar complex in Uttar Pradesh to Sir Shadi Lal Enterprises Ltd. The transaction is worth Rs 56.50 crore, in addition to the market value of the working capital. ... Lazard India brokered the deal on behalf of Siel.

SIEL is a diversified firm

- Interests in sugar, chemicals, financial services (holds stake in Siel financial services), engineering (holds stake in Jay Engineering works).
- Also holds stake in Honda Siel Cars Ltd., Daikin Shriram Airconditioning Ltd.
- Titawi sugar unit is profitable and zero leveraged → was done to cut down the debt levels of the company
- Will be left with one sugar unit in Mawana

Year 1996

<i>Company Name</i>	<i>Details</i>
Gujarat Lyka Organic	Takeover by Sun Pharma
Khatau group split	Merge Khatau and Mahendra Khatau groups
M J Pharma	Takeover by Sun Pharma
Modi Stone	Merged with another group company Modi Rubber
Piramal Healthcare	Merged with Nicholar Piramal
Powmex Steel	Acquired by GKW (BD Bangur Co.)
SAE (India)	Takeover by F co. from RPG group
Saptarishi Agro Inds.	Acquired by Tata group
Spic Fine Chemicals	Acquired by Henkel from SPIC group
UB Petro Products	Takeover from UB group by SPIC (now known as SPIC Organics)
Vorin Labs	Takeover by Ranbaxy group

Source: Prof. Sushil Khanna, IIM Calcutta

Year 1997

<i>Company Name</i>	<i>Details</i>
Aruna Sugars Finance	Acquired by India Cements from Aruna Sugars group
Asian Cables	Merged with RPG Telecom
Best & Crompton	Mallya (UB) sells stake to Polysindo Indonesia
BFL Software	Changed hands from Bangur Group to a professional NRI
Crossland Research Lab	Merged with Ranbaxy labs
DCM Toyota/DCM Daewoo Motors	Acquired by Daewoo Corp. Korea
Kirloskar Cummins	Cummins acquires controlling stake from Kirloskar
Maharashtra Glass	Acquired by Grindwell Norton/Saint Gobin from Atul Glass group
Modi Cement	Acquired by Gujarat Ambuja Cement from Modi alkalies group
Nagarjuna Steel	Merged with Pennar Steels
Rama Fertilisers	Merged with Rama Petrochem
SRF Finance	GE Caps acquires from SRF (DCM group)
Tamilnadu Dhadha Pharma	Merged with Sun Pharma
Upcom Cables	Merged with RPG Telecom

Source: Prof. Sushil Khanna, IIM Calcutta

Year 1998

<i>Company Name</i>	<i>Details</i>
Anagram Finance	Changed hands from Lalbhai group to ICICI
Dharani Cements	Acquired by Grasim Inds
ITC Classic Finance	Changed hands from ITC group to ICICI
Merind	Acquired by Wockhardt group from Tata group
Orissa Synthetics	Acquired by Reliance from JK Corp (a division of)
Pentasia Chemicals	Merged with Asian Paints
Raasi Cements	Acquired by India Cements
Shree Digvijay Cement	Acquired by Grasim Inds
Tulsipur Sugar	Acquired by Balrampur Chini Mills
Visaka Cements	Acquired by India Cements

Source: Prof. Sushil Khanna, IIM Calcutta

What are the broad trends?

- Many business groups are merging their affiliate concerns into one (example – K K Bangur)
- Sectors being liberalized are seeing a lot of M&A activity (example – financial services, cement, pharmaceuticals)
- Sectors that are having very attractive features or are of strategic importance are seeing a lot of foreign investment (ex – Advertising, Cola, FMCG, Consumer Durables, Retail Petrochemicals, Telecom, Banking, Insurance, etc.)

Why Restructuring happens?

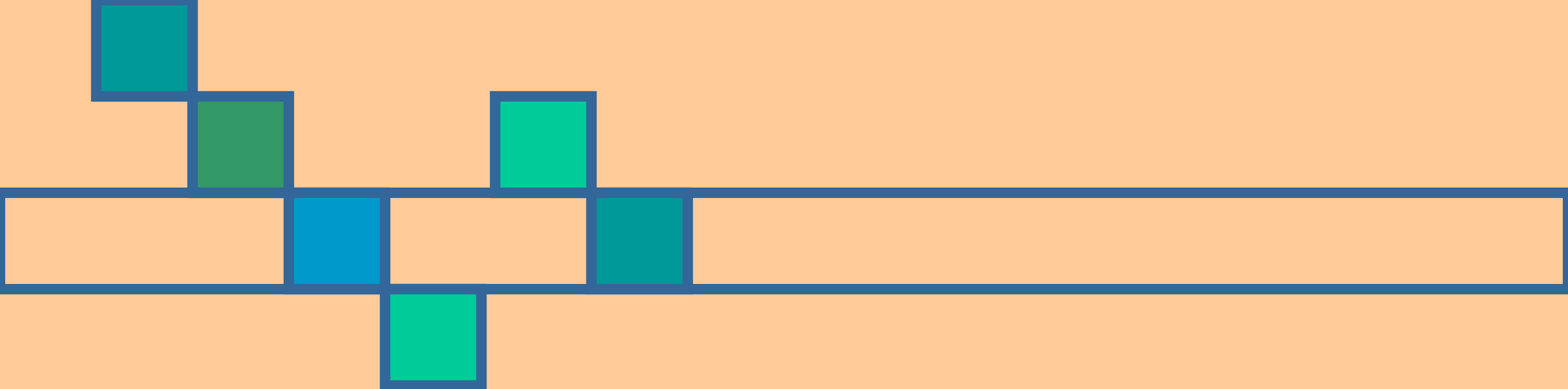
- Environmental conditions and major shareholders priorities
- Why have more than 70% of Mergers & Acquisitions related to local companies being sold out to foreign ones?



Corporate Control and
Governance



Ram Kumar Kakani



The views expressed herein
are personal



FINANCIAL FOCUS

- ↪ 19th & 20th Century
- ↪ Company legislation
- ↪ Bottom line driven
- ↪ Destroy communities
- ↪ Create communities

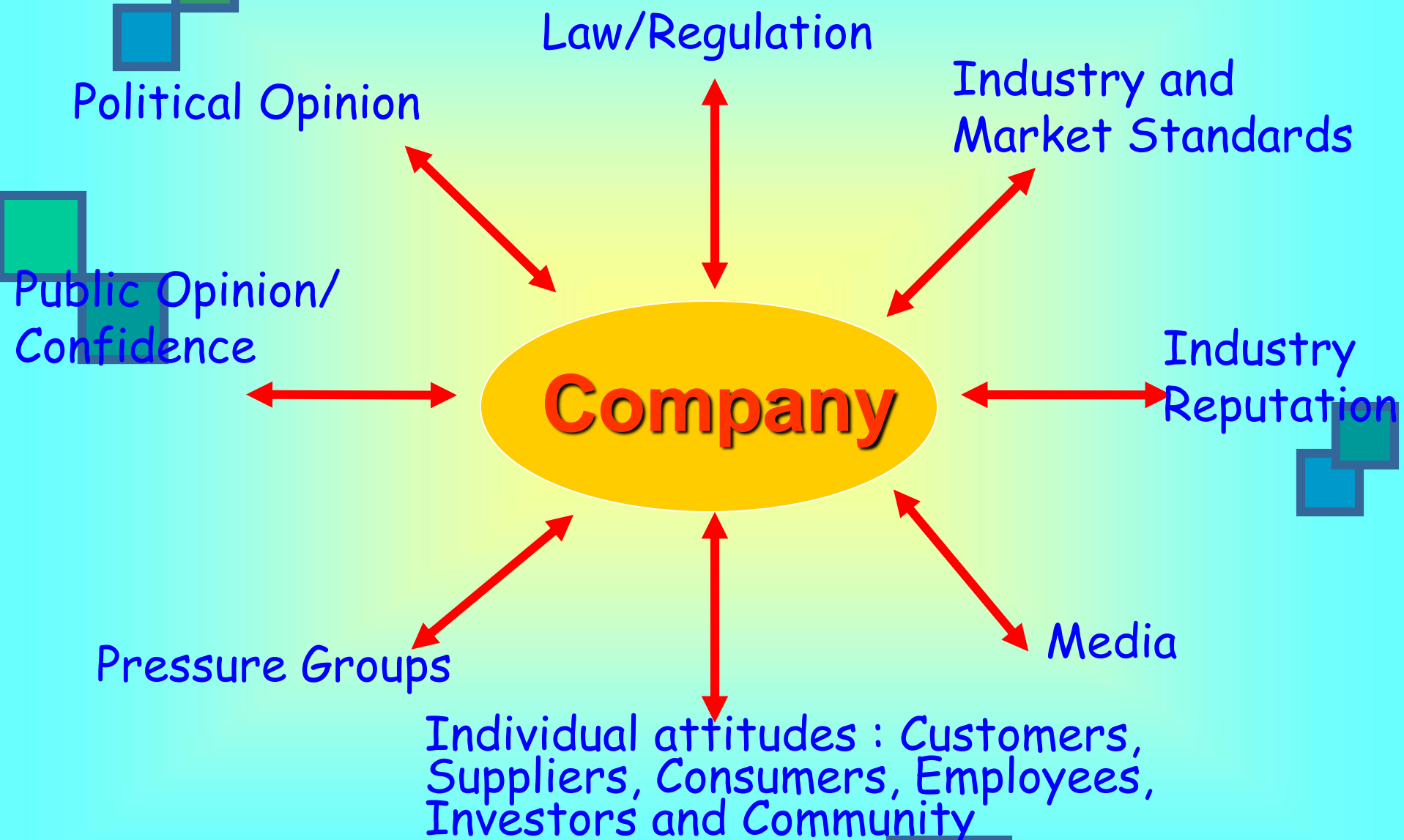


Power of Multinationals

- ↪ Open world economy - W.T.O.
- ↪ Only 25 Countries GDP > GM
- ↪ Denmark 25th - 5.2m
- ↪ GM supports 9 million people
- ↪ Shell > 40% of Holland market cap
- ↪ Wallenberg holds a major chunk of Sweden (> 64%)
- ↪ Main source of tax revenue
- ↪ Economic and political power

Source: www.corpgov.org (2001)

Licence to operate



Can we in 21st Century?

- ↪ Have shareholder dominance
- ↪ Exclude other stakeholders
- ↪ Have financial measurements only

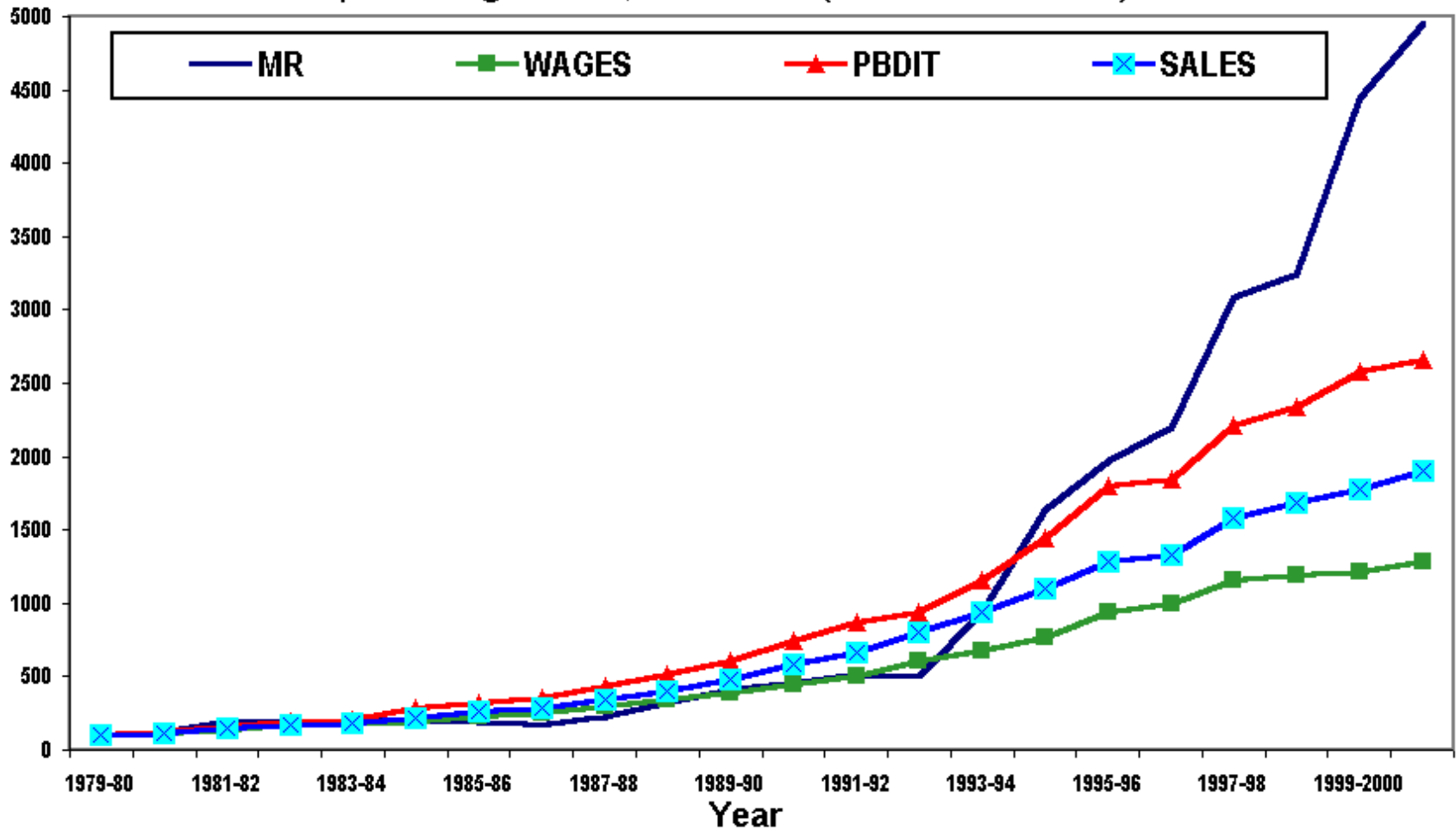
We need in 21st Century?

- ↪ measurements for sustained business success
- ↪ Responsibility towards stakeholders
- ↪ Accountability to shareholders
- ↪ Transparency

Why engage in Restructuring?

- Corporate Governance is taking into account all stakeholders interest ...
- In other words ... not to misuse powers given by some others is the essence of corporate governance
- Example ...
- Wealth Transfer (C K Birla, P&G, Colgate)
and/or
- Managements Personal Agenda (Pfizer, Tata)

Growth of Managerial Remuneration, Employee Wages, Operating Profit, & Sales (Base 1979-80)



Source: Ram Kumar Kakani & Pranabesh Ray, Managerial Remuneration: The Ballooning Issue, XLRI Working Paper, XLRI Jamshedpur: India, 2002

Governance: Indian Context

- ❖ Governance is different from Western Countries
- ❖ Ownership pattern is itself different
- ❖ 5 categories of owners –
 1. Indian Promoter(s)/Owner(s)
 2. Foreign Investor(s)
 3. Domestic Institutional Investor(s)
 4. Other Big Investor(s) incl. Private Mutual Funds
 5. Retail Investor(s) OR Public Shareholding

Indian Context

- ❖ Broadly 4 types of firms –
 1. Foreign Owned
 2. State Owned
 3. Indian Business Group Controlled
 4. Private Indian (non-business group)
- ❖ Big Questions:

‘Does Ownership Pattern Influence Corporate Governance of a Firm’

'Does Ownership Pattern Influence Shareholder Value of a Firm'

Table 1

Category	Mean Holdings	Remarks
1. Indian Promoter(s)/ Owner(s) holding	37%	It also presents the indirect stake by owners i.e., the interest held by owner(s) in their firms by way of crossholdings.
2. Foreign Investor(s)	15%	This figure also includes the stake held by Foreign Institutional Investors.
3. Domestic Institutional Investor(s)	14%	This figure includes holdings of UTI, LIC, SBI, GIC, and IDBI, and their mutual funds.
4. Retail Investor(s)	27%	Also known as Public Shareholding.
5. Other(s)	07%	This figure also includes the interests of Private Mutual Funds
Total	100%	

Period: FY 2001

Monitor(s)

- Owner-Manager(s)

Agency Theory Vs Reputational Theory

- Foreign Institutional Investors & Private Mutual Funds

Formal Authority, Social Influence, Ruthless, Expertise to capture property rights

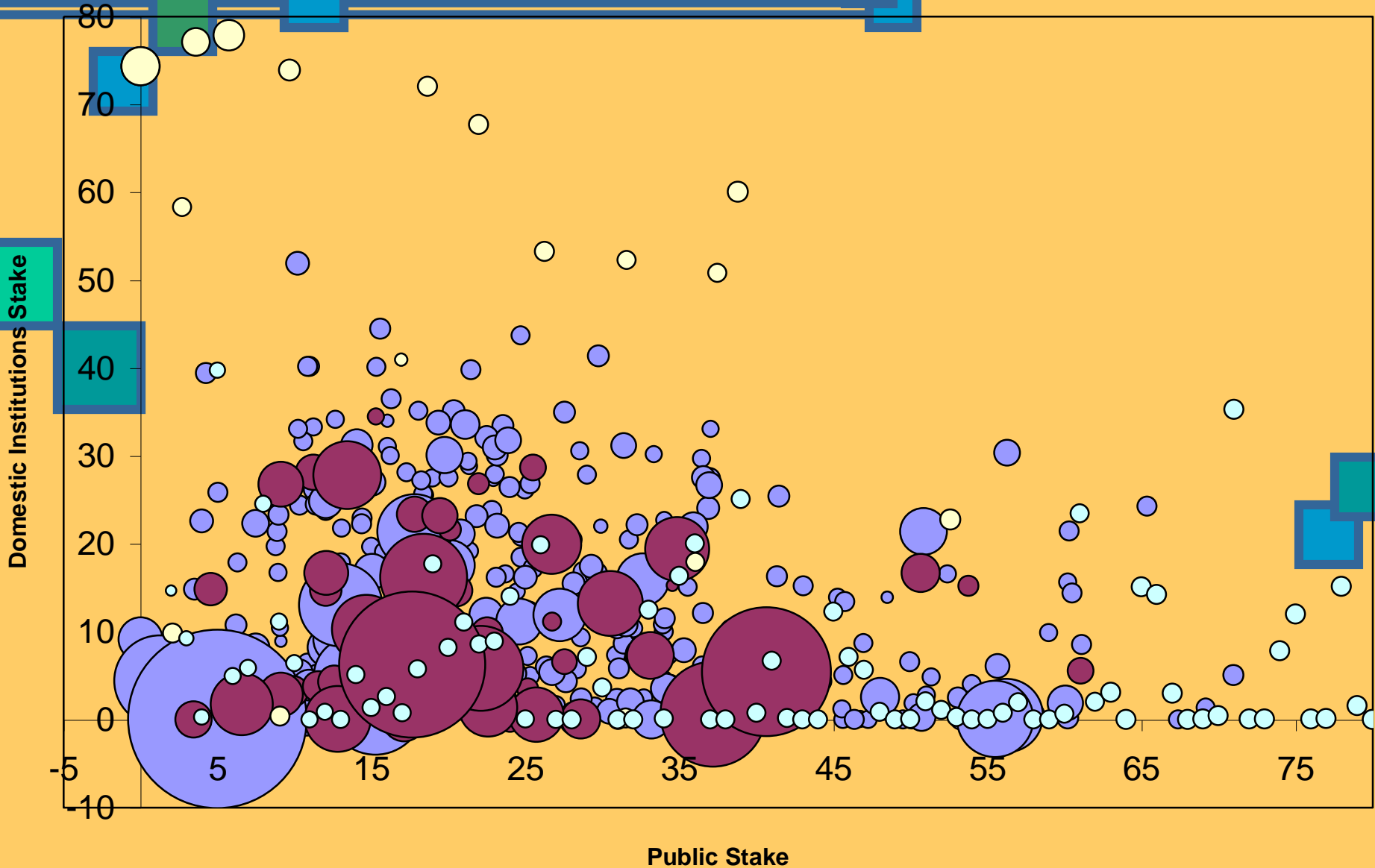
- Domestic Institutional Investors

Political pressures, economic factors, & legal issues

- Retail Investors

Lack Capability, No Incentives, Low Awareness, Poor Corporate Governance Norms

How Corporate India Performed?



● Business Group


● Foreign Owned (MNC)

○ State Owned

○ Private Indian



Results ...

- Foreign firms performed well, but
 - Private Indian firms performance was bad
 - State-Owned firms did not perform well, but ...
 - Performance of Indian Business Group Affiliates has been varied
- 

Possible Reasons ...

- Retail shareholders are usually very small and dispersed.
- Foreign Investors are operating in non-capital intensive value generating sectors
- Whereas, DIIS were investing in value destroying sectors.
- Another reason is, DIIS own equity due to subscription of devolved public/rights issues, underwritten IPOs, conversion of debt-to-equity in distressed companies.

Corporate Governance

An AGM of Grasim Industries, was held in a remote location. Of its 13 directors, just one showed up, while only a handful of the company's 300,000 minority shareholders attended. And they were employees who were unlikely to hold management accountable.

- Rahul Bajaj epitomized the problem. He said at a seminar on corporate governance in 1996 that:
- “All of us know what boards and managements should do, but are doing what we should not do. We have done things that are questionable – legal but questionable. Why should we need a committee to tell us what to do?”

Corporate Governance

■ Strategy Guru Prof. K. R. S. Murthy, Ex-Director, IIM Bangalore summarizes the governance questions in Asia as

- Why do business leaders do things they know should not be done?
- What are the pressures or fears that force them to do so?
- How can they be helped to be more integral to their own beings?
- How can the board of directors play a more useful role?

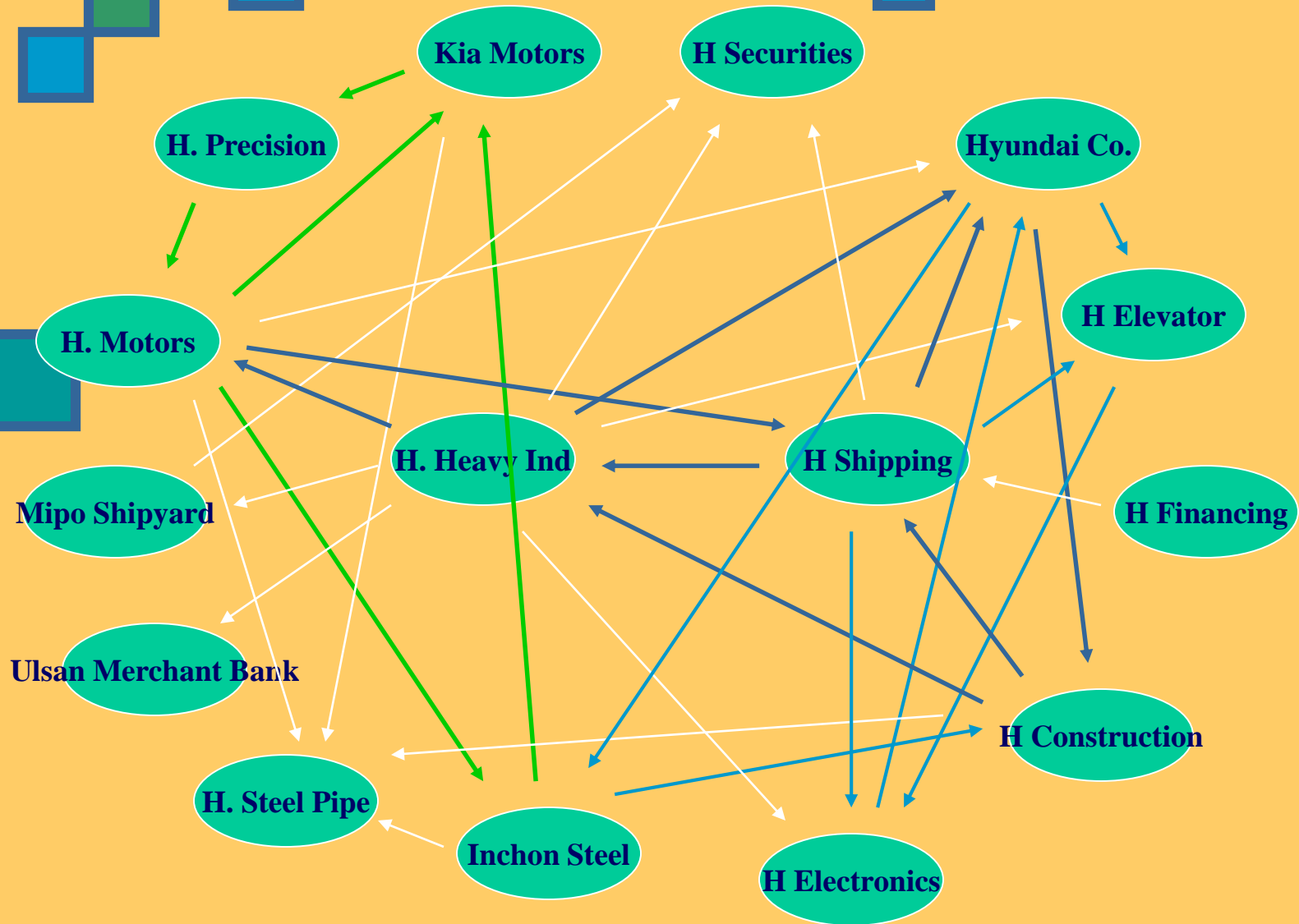
New Regulations

- Presentation of consolidated financial statements
- Presentation of segmental financial statements
- Stricter disclosure requirements be put in place
- Include outside (non-executive) representatives directors in the board representing minority (public) interests
- Audit Committee
- Remuneration and Nominations Committee
- Shareholders/Investors Grievance Committee

New Regulations

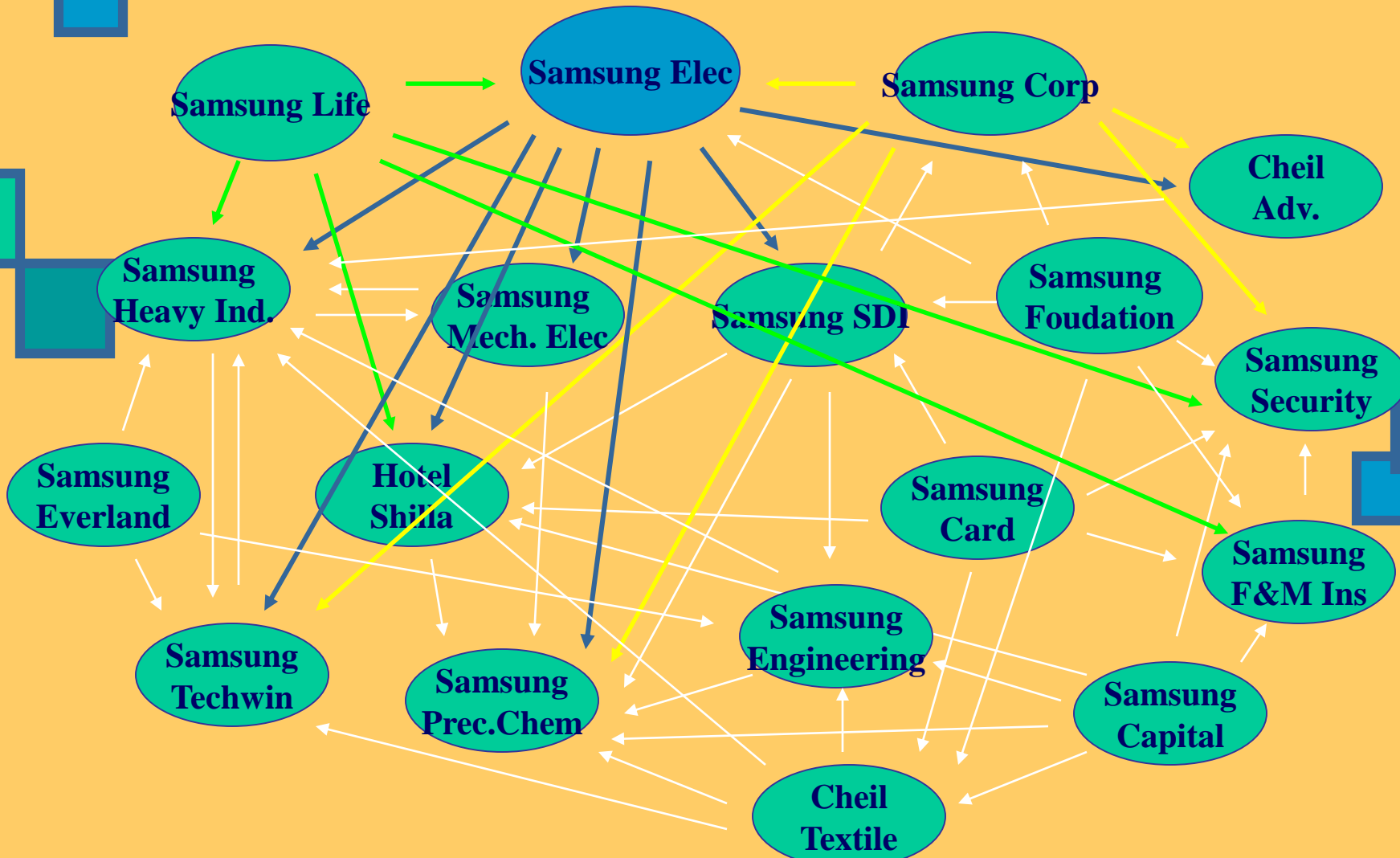
- Integrated supervision agency be established
- More regulation on related party transactions
- Stricter liability on accountant
- Improved accounting standards
- Duty of directors in legal codes
- Mandatory compliance officer
- Liability of controlling shareholder
- Cross debt guarantee prohibited
- Cross share ownership prohibited
- Strengthen minority shareholder rights
- Remove hostile takeover barriers
- Corporate Governance guidelines, etc be publicized

Circular Equity Ownership: Hyundai Group



Source: Hasung Jang, Korea University

Pyramidal Equity Ownership: Samsung Group



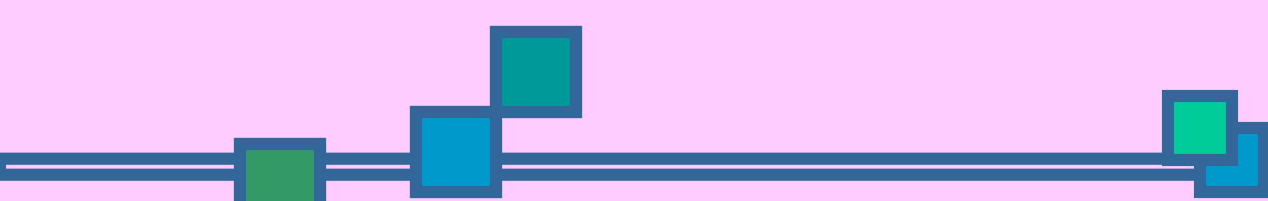

Source: Hasung Jang, Korea University

Some more ways to evade

- Off balance sheet transaction
- Off shore paper company operation
- Issue cheap equity/debt with warrants to promoters
- Hidden debt guarantees

Financial Management II

- How much of FM did we cover in FM2?
- In the area of Finance - what more needs to be done?
- Can we have our major area as Finance?
- Our focus was on connecting text book to practical aspects through ... Take Home Assignments, Question Papers, etc.
- Why was this course tailored so differently? ... albeit in such a non-student friendly way
- Say, in terms of, question paper, rigor, toughness, pressure
- Everyone has a way of interpreting the Goal ... help student
- Evaluation Fairness? Feedback Time? Value Addition?
- How will be our grading? What is my feedback of this batch?

- 
- I take back all the prejudice against any person(s) or communities conveyed during the teaching?
 - I apologize if anyone is hurt/upset by the same ... it was to drive home the point
 - In fact, business communities and marwari's do add lot of value to the society with their entrepreneurial spirit
 - Feedback for improving the course and its delivery are welcome
 - Assignments getting more than 22.5 marks could be given to me (for record/circulation)
- 

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to
Prof. N. Krishna Rao
for introducing me to Financial Management
And
to
My School Teachers, Professors, Parents who
added value to me and to all others who helped/
blessed/ wished me ...**

**You may also think of doing something for the
underprivileged or the unfortunate ...**