Corporate Restructuring: Mergers and Acquisition

(GME413F)

Prepared by

VIJAY MAHAWAR

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DECLARATION BY THE LEARNER

This is to declare that I have carried out this self-audit work myself in fulfillment of the **Trimester IV** of MBA program in General Management for Finance Major subject - **Corporate Restructuring: Mergers and Acquisitions** from Sri Sri University, Cuttack, Odisha.

The work is my original work, with due reference/credit given wherever required. This report is not been submitted to any other University/Institute for an award of any degree/diploma.

Date: 18^{6h} Nov, 2015 **Signature:**

(VIJAY MAHAWAR)

Place: Cuttack

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I. Introduction to Mergers and Acquisitions

Mergers and acquisitions continue to be highly popular form of corporate strategy, corporate finance and its development dealing with buying, selling and combining of different companies. It is one of the best processes of corporate restructuring that has gained substantial prominence in the present day corporate world. The major interests of the companies lie in having an edge over its competitors in the market. This can be accomplished either by making huge amounts of profit or by expanding their businesses. Expansion can take place internally through the introduction of new technologies, establishing new lines of products and services and enhancing the overall efficiency of the management. Through this the expansion takes place at a gradual pace but in the modern era a completely new form of external expansion has come into existence which takes place in the form of mergers, acquisitions, takeovers and amalgamations. In the present day business world, these procedures are taking place across different fields of industries including pharmaceuticals, hospitality, FMCG products, telecommunications and information technology.

In the following sections we provide an overview of the basic comparison between the finely varying terms like merger, amalgamation, acquisitions and joint ventures. Winding up with Tata Corus deal.

II. What is MERGER?

A merger is considered to be a legal consolidation of two or more companies into one entity where the separate identities of both the companies are lost with the consequences resulting into not just accumulation of assets and liabilities of different companies but gaining several other benefits. Surprisingly, the term merger is not mentioned under the

Companies Act, 1956, the Income Tax Act, 1961 (the „ITA") or any other Indian law.

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Generally, the dictionaries term merger and amalgamation as procedures that are undertaken in the business circle by companies to merge with each other to have more chances of growth and to have better access to new markets. This leaves out hardly any space for difference between the two but in reality there is a fine difference between them. **Merger** is a fusion of two or more entities and it is a process in which the identities are of all are not lost. Also the shareholders of the company being merged become shareholders of the larger company. On the other hand, **amalgamation** is blending together of two or more business entities in a fashion that both lose their identities and a new separate entity is born. Shareholders of both companies get new allotted shares that are of a new company.

Mergers may be of several types, depending on the requirements of the merging entities which are classified as follows:

Horizontal Merger: This happens between the companies which are at the same stage of industrial process and usually in the same sector as well. This is undertaken to have complete monopoly in the market by wiping out a competitor. An automobile company overtaking another of its kind can be an example of this type.

Vertical Merger: This happens when a company overtakes its suppliers i.e. a company involved at different stage of industrial process (but in the same sector). For example, when a healthcare industry buys the ambulance service providers it falls under vertical buying. This is generally undertaken to reduce the overhead costs, it leads to lower transaction costs and greater independence and self-sufficiency.

Conglomerate Merger: This takes place between companies which are involved in completely different sector of industries. The principle reason for this merger is diversification without having to incur large setup costs which mean a new industrial direction is made available to them without looking for initial funds. Also this includes utilization of financial resources and increase in the value of outstanding shares.

Congeneric Merger: These are mergers between companies engaged in the same general industry and interrelated, but having no customer-supplier relationship. A company uses this

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type of merger to reach out to customers of both the companies with similar sales and distribution channels.

III. What is ACQUISITIONS?

An acquisition is taking over of one company by another where the target company still exists as a separate entity controlled by the acquirer. In the process almost all the assets and liabilities of the acquired company then belong to the acquirer one. Further this kind of takeover can be friendly or hostile depending on how it is perceived by the members involved in the target company.

Friendly Acquisition: This involves overtake of the target company with full cooperation of both the parties during the negotiation. This is generally undertaken to take ahead some common interests of both the parties thus, also referred to as "negotiated takeover".

Hostile Acquisition: This happens when the board members of the company are either unaware about the acquisition taking place or they reject this offer but the bidder still carries on with the process forcefully.

Bailout Acquisition: This form of takeover takes place when a profit making company takes over a struggling company. This is usually done with the motive to payout less taxes by combining the profits with losses of the sick company thus it is a bailout method from the taxes on the profit margins.

Leveraged Buyouts: The acquisition of another company using borrowed money to meet the cost of acquisition. Often, the assets of the target company are used as collateral for the loans besides assets of the acquiring company. The purpose behind this is to allow companies to make large acquisitions without having to commit a handsome amount of money.

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IV. Motivation behind M&A

In a paradox to their popularity, achieving acquisition success has proven to be very difficult and has provided mixed performance to the various stakeholders involved. Results have shown that the managers of the acquirer firm report that only 56% of their acquisitions can be termed as successful when compared to the original goals set by them. Also the results suggests that following the years of an acquisition the shareholders of the acquired firm realize positive abnormal returns whereas there is a dip in returns or at most they are not statistically different from zero for the acquiring firm. Although still the overall effect of M&A transactions seems to create a net positive economic value for both the parties involved. So what is the motivation for these acquirers to come up with such acquisitions? The major thinking behind these M&A activities is the improvement in the financial health of the company overall which can be accomplished in a number of ways.

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Economy of Scale: This means that a combined company can bring down the fixed costs by removing duplicate standards in both companies while keeping the revenue stream the same leading to increase in profit margins.

Increase in Market Share: After an M&A the buyer absorbs a major competitor which leads to an increase in the market power and share.

Tax Reduction: Bailout takeover is the typical case of this where a profit making company acquires a company in loss to reduce the net taxes it has to pay.

Cross Selling: This allows two businesses from different backgrounds to come together and get customers from each other which in turn lead to increased sales revenue.

Diversification: This happens when companies look to extend their arms in some industry different from their own when they anticipate that either their industry is in a decline or other

industries can bring larger profits.

Vertical Integration: The vertical merger helps in solving the hold-up problems resulting in greater productions and sales.

The problem of externality can also be resolved with this integration as companies don‟t have to depend on outsiders for every sale.

Synergy: Corporate synergy refers to a financial benefit that a corporation expects to realize on merger with or acquisition of another corporation that offers a surplus power that enables enhanced performance and cost efficiency. Financial synergy can be gained by the combined firm in a number of ways which include cash slack, increased debt capacity, tax reduction besides marketing, revenue and management synergy.

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V. Case of Tata-Corus Deal

On 5th October 2006 the board of directors of Anglo-Dutch steelmaker Corus accepted a $7.6 billion takeover bid from Tata Steel, the Indian steel company, at 455 pence per share of Corus. The following months saw a lot of negotiations from both sides of the deal. Tata Steel's bid to acquire Corus Group was challenged by CSN, the Brazilian steel maker. Finally, on 30 January 2007, Tata Steel purchased a 100% stake in the Corus Group at 608 pence per share in an all cash deal, cumulatively valued at USD 12.04 Billion. The deal is the largest Indian takeover of a foreign company and made Tata Steel the world's fifth-largest steel group. Acquisitions, which happened before this, were:

Target	Buyer	Value($bn)	Year
Arcelor	Mittal Steel	31	2006
NKK Corp	Kawasaki Steel	14.1	2001
LNM Holdings	Ispat Intl	13.3	2004
Tata	Corus	12	2006
Krupp AG	Thyssen	8.0	1997
Dofasco	Arcelor	5.2	2005
Intl Steel	Mittal Steel	4.8	2005

Following is the list of investment advisors from both the companies:

CORUS	TATA
J P MORGAN	ABN AMRO
CAZENOVE	DEUTSCHE BANK
HSBC	STANDARD CHARTERED

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a. Synergies between the two companies

There were a lot of apparent synergies between Tata Sponge iron which was a low cost steel producer in fast developing region of the world and Corus which was a high value product manufacturer in the region of the world demanding value products. Some of the prominent synergies that could arise from the deal were as follows:

- Tata was one of the lowest cost steel producers in the world and had self-sufficiency in raw material. Corus was fighting to keep its productions costs under control and was on the look out for sources of iron ore.

- Tata had a strong retail and distribution network in India and SE Asia. This would give

the European manufacturer an in-road into the emerging Asian markets. Tata was a major supplier to the Indian auto industry and the demand for value added steel products was growing in this market. Hence there would be a powerful combination of high quality developed and low cost high growth markets.

- There would be technology transfer and cross-fertilization of R&D capabilities between the two companies that specialized in different areas of the value chain

There was a strong culture fit between the two organizations both of which highly emphasized on continuous improvement and ethics. Tata steel's Continuous Improvement Program 'Aspire'with the core values :Trusteeship,integrity,respect for individual, credibility and excellence. Corus's Continuous Improvement Program 'The Corus Way' with the core values : code of ethics, integrity, creating value in steel, customer focus, selective growth and respect for our people.

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b. Timelines

- On 20 October 2006, Tata Steel announced that it had agreed to pick up a 100% stake in the Anglo-Dutch steel maker Corus at 455 pence per share in an all cash deal, cumulatively valued at GBP 4.3 billion (USD 8.04 billion).

- On 19 November 2006, the Brazilian steel company CSN launched a counter offer for Corus at 475 pence per share, valuing it at $8.4 billion.

- On 11 December 2006, Tata preemptively upped the offer to 500 pence, which was within hours trumped by CSN's offer of 515 pence per share, valuing the deal at $9.6 Billion. The Corus board promptly recommended both the revised offers to its shareholders.

- On 11 December 2006, CSN announced a formal offer for the Company at an offer price of 515 pence per Corus Share, valuing the deal at $9.6 Billion.. The CSN Acquisition would also be implemented by way of a scheme of arrangement and is subject to a pre-

condition that either Corus Shareholders reject the Tata Scheme or the Tata Scheme is otherwise withdrawn by Corus or lapses. The Corus board promptly recommended both the revised offers to its shareholders.

- Also on 19 December 2006, UK Watchdog the Panel on Takeovers and Mergers announced that the last date for each of Tata and CSN to announce revised offers for the Company, should they wish to do so, is 30 January 2007. They also warned that it would begin an auction procedure if the two remained in competition.

- On 31 January 2007 Tata Steel won their bid for Corus after offering 608 pence per share, valuing Corus at $11.3bn

c. Final deal structure

- $3.5–3.8bn infusion from Tata Steel ($2bn as its equity contribution, $1.5–1.8bn through a bridge loan)
- $5.6bn through a LBO ($3.05bn through senior term loan, $2.6bn through high yield loan)

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Appendix I: References

1. Website: *https://en.wikipedia.org/wiki/Tata_Corus_acquisition*
2. Book: *Megers, Acquisitions & Corporate Restructuring* by *Prasad. G. Godbole*
3. Images where taken from Slideshare.

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