



# Unlocking value through M&A

**7 July 2018**



**Baroda Branch of  
Western India Regional Council of  
The Institute of Chartered Accountants of India**

**K C Mehta & Co.**

Chartered Accountants

---

# Agenda

## Topic

1. Rationale for M&A – buy side & sell side
2. Types of M&A
3. M&A process
4. Structuring possibilities
5. Valuation
6. Due diligence
7. Key deal considerations – buy side & sell side
8. Tax and regulatory considerations
9. M&A in times of Insolvency and Bankruptcy
10. Post deal integration

## Rationale for M&A

### **Sell Side**

- **When does M&A activity start??**
  - **How to get the best value?**
- **Gradual divestment/Succession planning**
- **Complete sale – when does this work?**
- **Dilution for Strategic Investment/Joint Venture**
- **Hiving off non-core, non-productive or inefficient line of business**
- **Hiving off the core/growing business**
- **Insolvency and bankruptcy**
- **Tax restructuring**

### Identification of potential Sell Side

- **High growth**
- **Excellent market prospects**
- **WC problems**
- **Declining revenue**
- **High Debt**
- **Promoter strength**

## Rationale for M&A

### Buy Side

- **Tools – Capital and IP**
- **IP can be technology, restrictive rights, customers, know-how, etc.**

Identification of potential buy-side

- **Funding**
  - **Debt Equity Ratio or Debt Service Coverage Ratio**
  - **Investments**
- **Other Financial factors**
  - **Slow growth**
  - **Market shrinkage (e.g. Auto)**

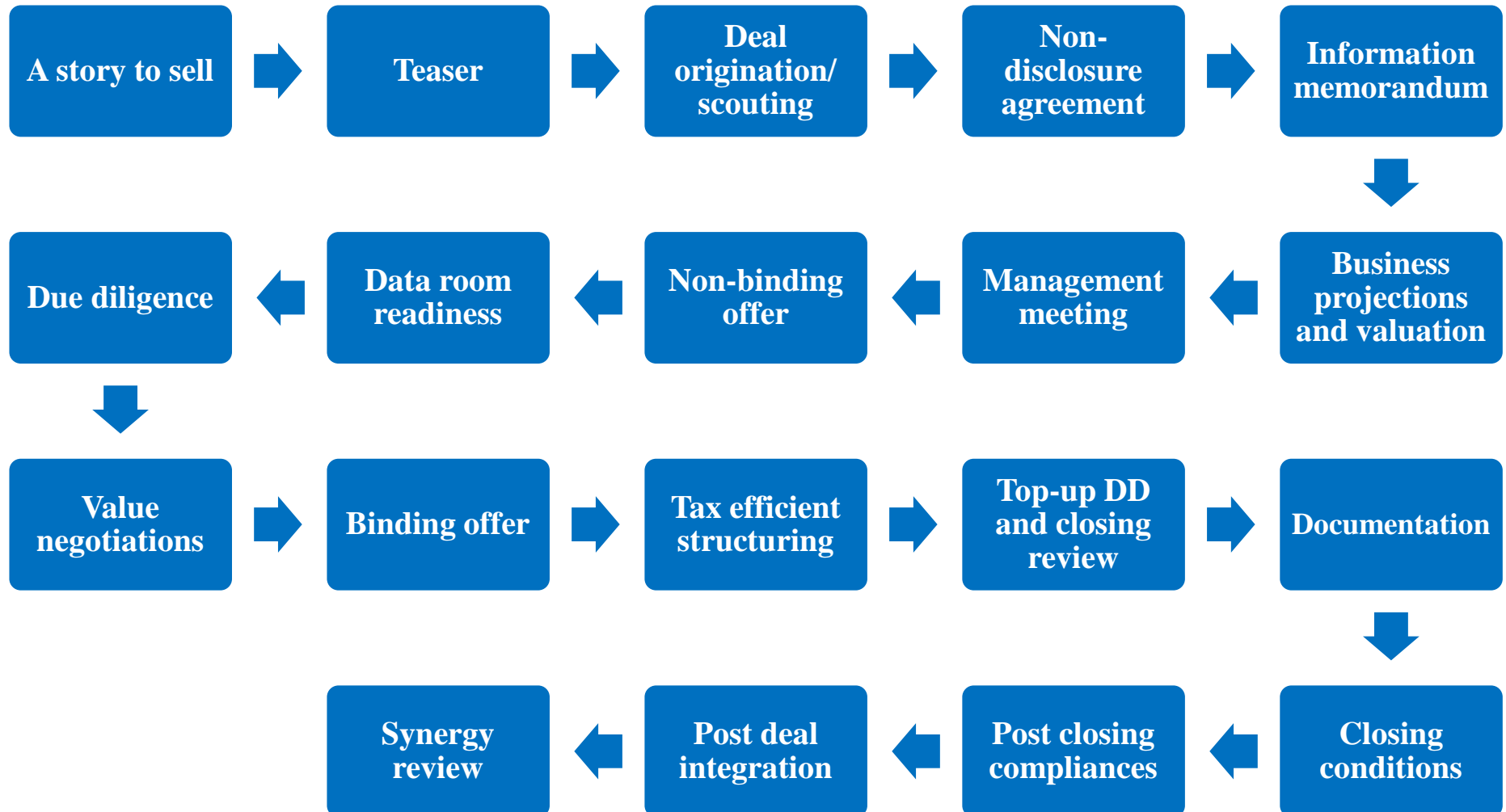
### – Non financial factors

- **Next generation looking to get in**
- **Vertical integration**
- **Elimination of competition**
- **Acquisition of human capital**

## Types of M&A

- **Share acquisition**
- **Merger**
- **Demerger**
- **Slump sale**
- **Asset sale**
- **Capital reduction and share buy-back**
- **Management buy-outs**
- **Family settlement and wealth restructuring**

# M&A process



## Structuring possibilities

- **What it takes for a Joint Venture to actually be a Joint Venture?**
- **Protection to Minority shareholders *Tag/Put/Pre-emptive***
- **Majority too requires protection *Drag/Call/ROFR***
- **Variations to Drag/Tag *Floor/Lock in/***
- **Getting out! *Texas/Mexican shootout/Arbitration***
- **Gradual acquisition using calls**
- **Using options to evaluate opportunity**

- 
- **Choice of Consideration/Valuation**  
*Fixed/Earnout/Shares(convertible,options)/Royalty/Guaranteed cashflows*

- 
- **Choice of Vehicle *L/P/C***
  - **Choice of Transaction *SPA/BTA/Scheme/Mix***
  - **Reps & Warranties and Indemnification**

# Valuation

## **Income approach**

- **Discounted cash flow method**
- **Capitalised earnings method**

## **Market approach**

- **Comparable listed companies' multiple**
- **Comparable transactions' multiple**

## **Cost approach**

- **Net asset value (replacement cost)**
- **Liquidation value (net realisable value)**

## **Valuation Drivers**

- **EBITDA computation**
  - non operating items, non-recurring items, non-sustainable items, etc.
- **Relevant period for EBITDA**
- **Historical growth in earnings?**

- **Earning potential**

- **Customers**

- **Strength of customers**
- **Customer mix**
- **Number of customers**

- **DLOM**

- **Size of the Target**
- **Company Status (Listed, public, private)**
- **Stake involved**
- **Shareholder rights**

- **Other important qualitative aspects**

- **Strong management or promoter driven?**
- **Financial information**
- **Compliances (or lack of it)**
- **Environmental aspects**



## Due diligence

### **Identify value adjustments and deal breakers**

- **Financial and tax due diligence**
  - **Red flags due diligence / Vendor initiated due diligence**
  - **Financial analysis of trends in revenue, margins, capex and working capital**
  - **Equity bridge: quality of earnings, net debt and working capital**
- **Commercial due diligence**
  - **Review of financial projections**
  - **Market assessment and competitor benchmarking**
  - **Interviews with customers and suppliers**
- **IT, HR and Operational due diligence**
  - **Identify process gaps in SOPs**
- **Legal and secretarial due diligence**
- **Investigation and forensic review**

## Key deal considerations

### **Sell side**

- **Getting ready for a sale**
- **Identifying potential buyers – customers, suppliers, competitors, private equity**
- **Selling at the top – preserving value**
- **Tax efficient structuring of the deal**
- **Evaluate the buyer's financial capability**
- **Transition support and continued employment of promoters**
- **Value negotiations (examples)**
  - **Royalty payments in lieu of goodwill**
  - **Carve out land/building from the deal and lease out to the buyer**

## Key deal considerations

### Buy Side

- **Fitment of deal rationale vis-à-vis the Target**
- **Value negotiations based on due diligence**
- **Continuity of brand/tradename**
- **Deferred and contingent consideration (earn-outs)**
- **Structuring through financial instruments – options, convertible instruments, etc.**
- **Indemnities and warranties in definitive agreements**
- **Acquisition financing**
  - **cash neutral**
  - **qualified institutional placement and preferential allotment (listed co)**
  - **private equity (unlisted co)**
  - **issue of NCDs (debt)**
  - **NBFCs and ARCs**

## Tax and regulatory considerations

### Structuring

- Structuring indemnity *Litigation*
- Choice of Vehicle *Unincoprtd./LLP/Company*
- Choice of Transaction  
*SPA/BTA/Scheme/Royalty/NC Fees/Earnout*

### Other Tax considerations

- Taxability of dividend
- Repatriation options  
*Dividend/BB/CR/Conversion/Scheme*
- Tax Losses
- NR Taxation *SPV, DTAA, Compliances, TP*
- MAT
- GAAR
- Deemed selling cost
- Recipient based tax

- Taxation of indirect share transfer
- POEM

### Other Laws

- SEBI
  - Takeover code
  - Insider information
  - Buyback rules
  - Preferential allotment
  - Schemes
- FEMA
  - Investment options
  - ECB
  - Compliances
- Companies Act
- LLP Act/Competition Law/Stamp Duty/GST

## M&A in times of Insolvency and Bankruptcy

### **Mechanism under IBC**

- **CDR, SDR, S4A, JLF withdrawn by RBI**
- **180 days (+90 days) for completion of Corporate Insolvency Resolution Process**
- **Insolvency professional (IP) takes over the management**
- **IP verifies claims from financial and operational creditors**
- **IP constitutes committee of creditors (CoC)**
- **Resolution applicants/bidders submit resolution plans**
- **Resolution plans are vetted by IP and approved by CoC and NCLT**
- **Winning bidder gets majority stake against repayment to lenders subject to haircut!**
- **Lenders may also get part of their debt converted to equity**

### **Tax considerations post IBC**

- **Sec 115JB allows set off of brought forward loss and unabsorbed depreciation**
- **Sec 79 not to apply in case of carry forward and set off of past losses**

## Post deal integration

### **First and foremost, agree the integration timeline!**

- **accounting for M&A including purchase price allocation**
- **carve-out financial statements**
- **conditions subsequent per the definitive agreements**
- **change in Board composition and authorised signatories**
- **transfer of tangible and intangible assets including intellectual properties**
- **change in contractual terms with customers, suppliers, lenders, etc.**
- **HR integration, employee retention/severance and employee benefit plans**
- **MIS, ERP and process level control integration**
- **transfer pricing policies and inter-company agreements**

### **Synergy review**

- **ongoing monitoring of financial and operational KPIs**
- **change in effective tax rate**

---

## Q&A – Open house

### **Chinmay Naik**

E: [chinmay.naik@kcmehta.com](mailto:chinmay.naik@kcmehta.com)

M: 99254 46820

### **Suril Mehta**

E: [suril.mehta@kcmehta.com](mailto:suril.mehta@kcmehta.com)

M: 85111 85339