

 **Mergers and Acquisitions**

**Mergers & Acquisitions**

* Refer to the aspect of corporate finance dealing with purchase, sale, or combination of two business entities that can add strategic value to a company in a given industry and grow rapidly without having to grow organically.

|  |  |
| --- | --- |
| **Mergers** | **Acquisitions** |
| Refer to the acquirer absorbing the entire target company. | Refer to the acquirer buying only a part of target company |
| Involve purchase of controlling stock | Involve purchase of assets or a distinct business segment (e.g., subsidiary) |
| Both the acquirer and target lose their respective identities after merger (e.g., Glaxo Smithkline) | The acquirer and/or target retain their identity after merger. (Mahindra Satyam) |
| It is generally friendly in nature | It can be a hostile take-over |

**Transaction Structure - Amalgamation into an Existing Company**

 **S1**

 **S2**

 **Co. 2**

**Co. 1**

#### Issue shares

**Transfer Assets & Liabilities**

* Co. 1: Amalgamating Company; Ceases to Exist
* Co. 2: Amalgamated Company
* Co. 2 receives all of Co. 1’s assets and liabilities
* S1: Shareholders of Co. 1 receive shares in Co. 2 and maybe other benefits like debentures, cash
* Co. 2 will now have S1 and S2 as its shareholders
* Case in Example – Merger of Reliance Petroleum into Reliance Industries Limited

 **S1 S2**

**Co. 2**

###### Two firms in the same industry combine Typically the competitors

**Motivation: To achieve**

* Industry consolidation to exploit economies of

scale, size and / or scope

* Entry into a new geography
* Enhance product / services portfolio

###### Examples

* P&G acquiring Gillette
* Acquisition of equity stake in IBP by IOCL
* Bharat Forge’s acquisition of CDP (Germany)
* S&P’s stake in CRISIL

#### Industry 1

Firm 2

Firm 5

Firm 4

Firm 1

Firm 3

**Which Industries / Sectors will typically see Horizontal Integration? Why???**

**Buying your supplier**

**Backward Integration**

**Buying your customer**

**Forward Integration**

**Internalization of crucial forward or backward activities**

**Vertical Integration**

**Two firms across the vertically integrated industries combine**

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**Industry 2**

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Firm 3

Firm 4

**Industry 1**

Firm 1

Firm 2

Firm 5

Firm 3

Firm 4

**Producer / Manufacturer**

**Customers of finished goods**

**Supply Chain**

**Motivation: To achieve**

* Control of a forward or backward activity in supply chain

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**Raw Material**

**Supplier**

* Secure Raw Materials

**Examples**

* Indian Rayon’s acquisition of Madura Garments
* IBM’s acquisition of Daksh

###### Combination of two firms in uncorrelated business

**Motivation: To achieve**

* Diversification by combining uncorrelated assets and income streams
* To reduce business risks

###### Examples

* L&T’s attempted acquisition of Satyam
	1. **Synergy (Economies of scope/scale)**
	2. **Achieve rapid growth (inorganic)**
	3. **Increased market power**

**(reduced competition)**

* 1. **Diversification**
	2. **Access to unique**

**competencies**

* 1. **Empire building by managers**
	2. **Tax benefits 8. Bootstrapping EPS**

**9. International expansion**

Size

Time

|  |  |  |  |
| --- | --- | --- | --- |
| **Industry stage** | **Characteristics** | **Motivations** | **Type of M&A** |
| Pioneer | * Uncertainty of product acceptance
* High capital requirements, low margins
 | * Access to larger/mature firm’s capital
* Gain management expertise
 | * Horizontal
* Conglomerate
 |
| Rapid growth | * High profit margins
* Increasing revenues and profits
* Less competition
 | * Access to capital
* Capacity expansion
 | * Horizontal
* Conglomerate
 |
| Mature growth | * Increasing competition
* Less scope for supernormal growth
 | * Operational efficiencies
* Synergies (economies of scale/scope)
 | * Horizontal
* Vertical
 |
| Stabilization | * Reduced growth potential due to high competition
* Capacity constraints
 | * Economies of scale
* Management efficiency
 | * Horizontal
 |
| Decline | * Change in consumer tastes
* Excess capacity/declining margins
 | * Operational efficiencies
* New growth opportunities
* survival
 | * Horizontal
* Vertical
* Conglomerate
 |

|  |  |  |
| --- | --- | --- |
| **Metric** | **Stock purchase** | **Asset purchase** |
| Payment to party | Made directly to target’s shareholders in exchange for their shares | Made directly to the company |
| Approval | Majority shareholder approval required | Unless asset sale is a substantial portion, no shareholder approval necessary |
| Taxes | No tax expense incurred by company, but shareholders pay capital gains tax | Target company has to pay capital gains tax |
| Liabilities of target | Acquiring firm assumes target’s liabilities | Usually the liabilities are avoided by acquirer in the transaction. |

|  |  |  |
| --- | --- | --- |
| **Metric** | **Stock offering** | **Cash offering** |
| Meaning | Target’s shareholders receive proportion of acquirer’s common stock in exchange for their target’s holding | Acquirer pays an agreed amount of cash for target company stock |
| Risk in the merged entity | * Part of the risk (and reward) is borne by target’s shareholders.
* Lower confidence in synergies by acquirer.
 | * Risk is entirely borne by acquirer
* Higher confidence in synergies
 |
| Relative valuations | Stock offer is a signal that acquirer’s shares may be overvalued |  |
| Capital structure impact | Decreases leverage as issuance of new stock dilutes ownership for existing shareholders | Increases leverage, especially if acquirer borrows money to pay target’s shareholders. |

**Friendly offer:**

* Refer to the acquisition of a target company that is willing to be taken over.
* Usually, the target will accommodate overtures and provide access to confidential information to facilitate the scoping

and due diligence processes.

* Normally the process is started voluntarily by target company but can be initiated by friendly overture by acquirer seeking better information to value target.

Confidentiality

agreement

Main due

diligence

Ratified

Final sale agreement

Sign letter of intent

Approach target

Information memorandum

**Friendly Acquisition**

**Both parties have opportunity to structure deal to their mutual satisfaction:**

* Taxation Issues (stock offer instead of cash offer)
* Asset purchase rather than stock purchase
* Earn outs

## Friendly Vs Hostile offer (Cont…)

**Hostile offer:**

* A takeover in which the target has no desire to be acquired and actively rebuffs the acquirer and refuses to provide any confidential information.
* The acquirer usually has already accumulated an interest in the target (15% of the outstanding shares) and this preemptive investment indicates the strength of resolve of the acquirer.

**Hostile Acquisition**

**Beachhead:** slowly acquire

toehold by open market purchase of target’s shares

Acquire 15% stock through open

market purchase over longer period

File statement with SEBI

without attracting attention

Make a tender offer to bring

ownership percentage to the desired level.

**Acquirer’s tactics:**

* Bear hug: acquirer submits merger proposal directly to target’s board of directors
* Tender offer: acquirer offers to buy shares directly from target’s shareholders
* Proxy battle: acquirer seeks control over target by having target’s shareholders approve a new board of directors chosen by acquirer. If successful, the new board may then replace target’s management and execute a

friendly merger.

## Understanding M&A Process - Typical Steps & Timelines

 **Fortnights**

 **10 11**

**2**

**3**

**4**

**6**

**7**

**9**

**5**

**1**

**8**

**Preliminary Preparation and Shortlisting of Buyers**

**Signing of Non Disclosure Agreement**

**Dispatch of Info Pack to selected Buyers**

**Management Meetings, discussion on Info Pack and Business Model**

**Receipt of Preliminary Bid**

**Shortlist 2-3 Potential Buyers**

**Buyer Due Diligence, Data room**

**Receipt of Final Bid**

**Shortlist Final Buyer and provide exclusivity**

**Activity**

**Key external point**

**Key decision point**

**Confirmatory due diligence and Final Negotiations**

**Finalize transaction documents**

**Closure**

**Phase I Phase II Phase III**

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Financial Modeling



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