Mergers, Acquisitions and Corporate Restructuring

Prof. Chandra Sekhar Mishra
Vindo Gupta School of Management
Indian Institute of Technology, Kharagpur

Lecture - 08
Takeover Tactics and Anti-Takeover Defenses – 2

Hello friends, welcome to another session on the mergers, acquisition and corporate structuring. In the last two sessions we talked about takeover tactics and anti-taker defenses adaptable different companies so their acquiring company or the target company. We will continue with that those particular concepts in this session also. This is going to last session on this particular topic that is takeover tactics and anti-takeover defenses.

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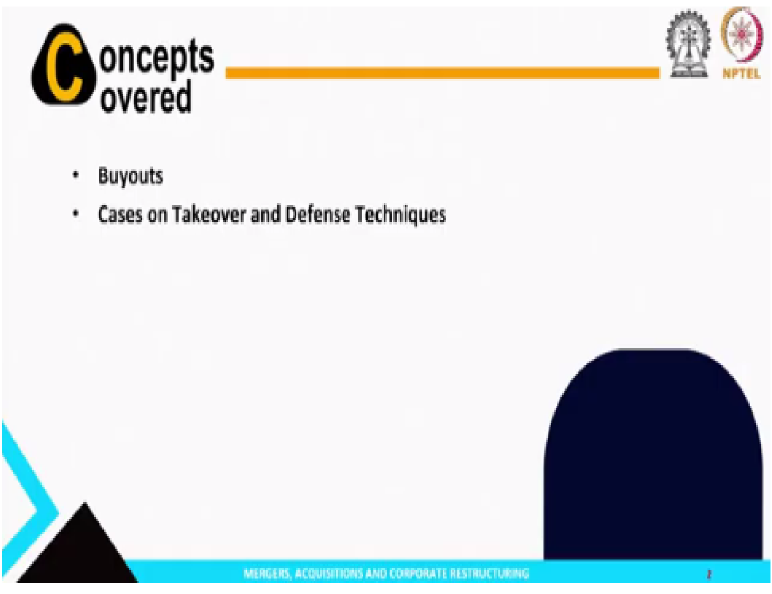

And this is the outline for this session. We will talk about something called buyouts different types of buyouts, we also discuss two cases of takeover and defense and where how these companies have adopted multiple takeover techniques or defense techniques for that matter.

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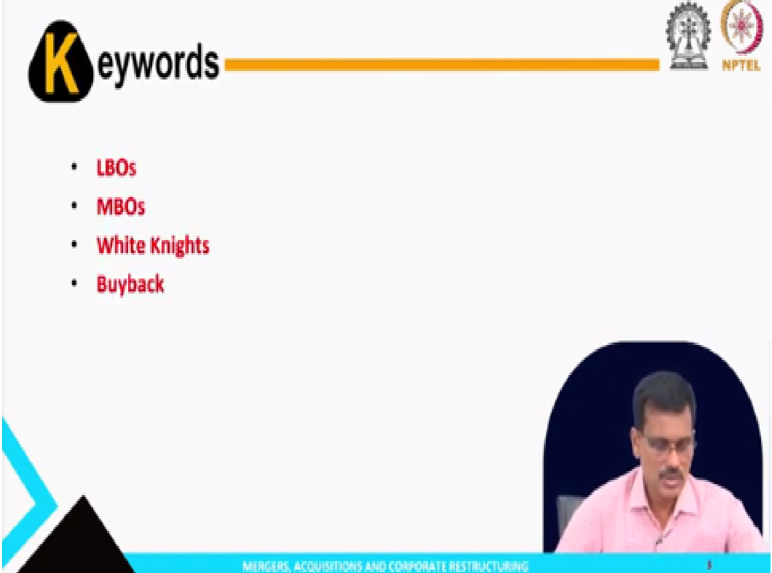

So, coming to the keywords, we are going to talk about leverage bios called LBOs, we have to talk about management bios, we are going to talk about how white knights play a role in the takeover defense technique. And we will talk about how buy back is also used by the company as a takeover or anti-takeover attempt a defense for that matter. So, that is something we will discussed.

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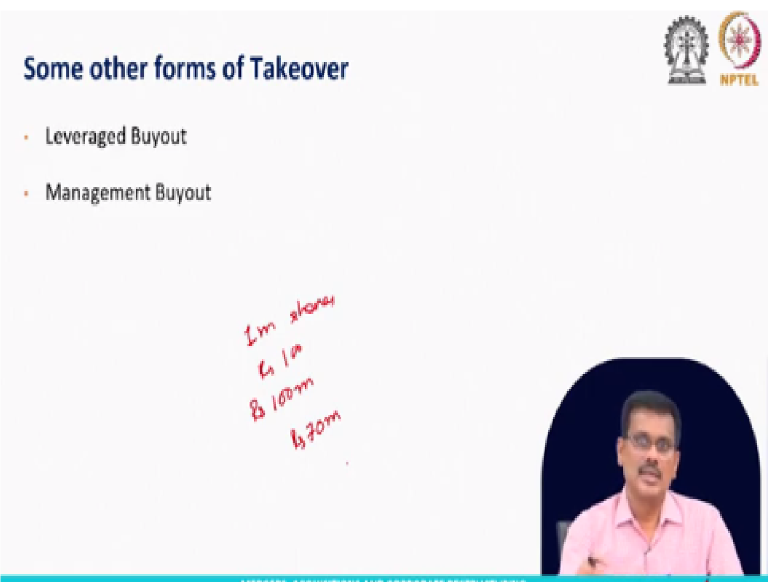

So, that different forms of takeover buyout, because leverage buyout and management layout. So, these are certain things where there is no attempt hostile attempt for the company to be taken over somebody. But some there is some interesting party to acquire this company not necessary

hostile and they like to buy this particular company and the target may be willing to be taken over by some other than the existing management may like to leave the company for that matter for whatever reason.

And in that case whatever money is required for the company to take over and let us say target companies shareholders like to get the cash in consideration they do not want to continue. So, lot of money may be required for that and that money that is required is actually typically financed by a date. So, a major percentage let us say companies in the target companies has let us say 1 million shares and maybe this is the value is taken as 100 rupees.

So, the company has to now arrange rupees 100 million to buy all the shares of the target company and the company is attractive, acquiring company may be also good or some the group may be good company also good, good investors also but they may not have money sufficient money with them. So, in that case what they do? They go for loan or borrowing and the borrower also may be finding it that acquisition is a good one.

And the substantial portion of the financing is taken care by loan. So, let us say they go for a loan of let us say 70 million that means 70 million is borrowed and 30 million is their own money existing available. So, substance 70, 80 something like that so they are actually leveraging their financing of the deal assets called leverage buyout. And the same leverage buyout or the same buyout is actually executed by the existing management.

Management people like to continue the operating management the CEO and team will like to continue and the sellers do not want to continue. So, this existing management will like to buy the shares from the shareholders and they will be the shareholders as well as managers of the company and again they may also go for loan for that matter to acquire this company. So, the buyout is executed by the existing management operating management it is called a management buyout. So, those things will discuss subsequently.

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Leveraged Buyout (LBO)

- Target firm's control is acquired by purchasing majority of their stocks using leveraged money or borrowed money
- 70-80% of the funding of the deal is through debts
- Generally after a LBO the ownership lies with few private players
- If the investors cannot pay back the debts or are in a hurry to book profits, they sell parts off the target firm to make profit and also to repay the debts
- Examples:
  - Tata – Tetley (2000)
  - Hindalco – Novelis (2007)
  - Tata – Corus (2006-07)

So, in leverage buyout so the target firms control is acquired by purchasing majority of the stocks or maybe full 100 percent stock using a loan leveraged money or borrowed money as you discussed in the previous slide. And typically, 70 to 80 percent of the financing is done through a debt that is why it is leverage buyout. And only LBO takes place the management or the ownership remains with few players actually.

It is not that there are wide group of shareholders who will be now the owners of the target company. And if the investors cannot pay back the dates or they are inherited to book the profits in that case they can also sell the part of their target stock to some other person make profit and repay the debt also that is also possible. That is a future course of action. So, some examples that you talk about in fact in Indian **(()) (05:19)** or takeover market for that matter in value Indian companies.

The Tata acquiring Tetley of UK is taken as one of the fast documented LBO in India for that matter which involves an international acquisition. Similarly, Hindalco Novelis dealt took place in 2007. So, that deal was financed Hindalco finance the deal was substantial date, Tata Corus is another example where Tata finance the deal with the substantial day in 2006-2007. These are certain big cases of LBOs celebrated well-known cases of leveraged buyouts. We will also discuss some more cases in the subsequent slide.

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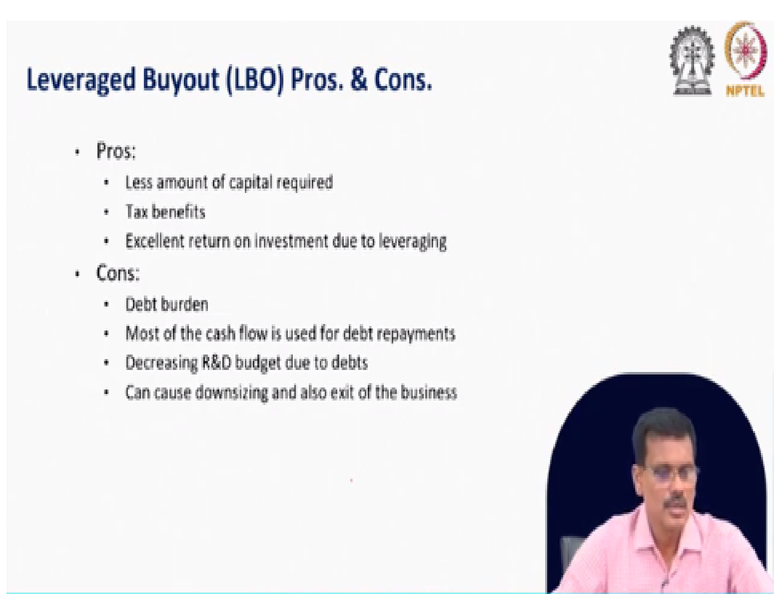

So, what are the pros here? Owners from companies like to make an attempt to acquire the company they will need less money. So, for example in the previous example we are talking about out a 100 million cash required 30 millions available. So, 70 million that means you need only 30 million and the strength of that you borrow 70 million and use 100 million for acquiring a company. So, that way owners require less money for that matter.

There could be some tax benefit because date brings interest equal expense that is also one benefit. So, in that way you the return on investment also going to possible higher because of leveraging for that matter. The consequences could be that yes is a huge dead burden for the company and you since you have taken so much money on a loan then future you have to make lot of investment then the cash flow will be used for principal repayment also.

There will be lot of pressure on the cash plus generated by the target company and that can lead to reduction in this some strategic investments R and D. It is because your chaos is going to that particular side that is the repayment of the loan and payment of the interest and it also can cause the downsizing. Because people suppose in future the loan is cannot repaid very well then you company may downsize in terms of laying of employees company by downsizing in terms of laying of the assets that means selling the assets or company making it small.

So, in that case this could be future consequence if you have taken a lot of money. In fact, this particular thing is applicable for any company which goes to a lot of borrowing not necessarily for mundane purpose. So, that is always the date is always riskier as long as you generate cash flow to repay the principle and pay the interest nothing like it. If there is a uncertainty in the business that can always be riskier whether it is used for acquisition company or use for organic expansion of the company for that matter.

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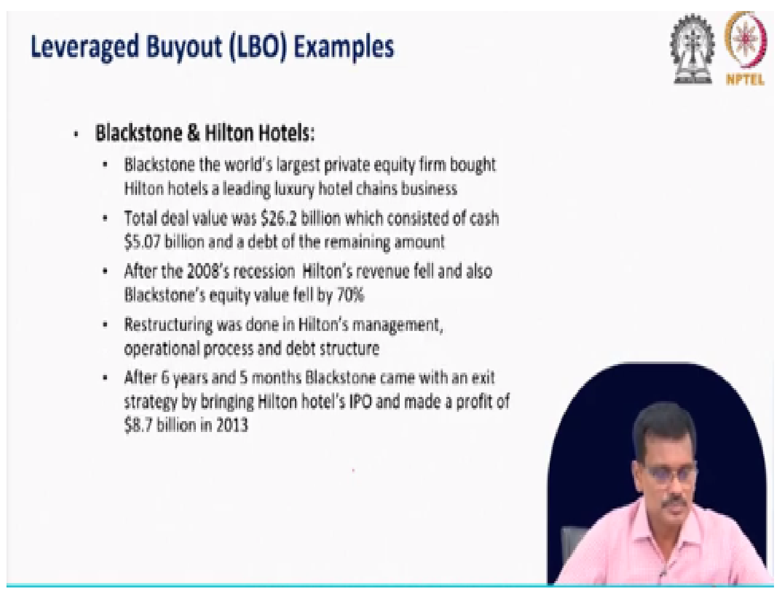

So, certain examples you have here like in Blackstone and Hilton Hotel is the case that was in 2008 after recession. Hilton's revenue actually fell and Blackstone financing company is a private equity player for that matter a big private equity firm they bought Hilton hotels and total deal were 26.2 billion which considered of cash 5.07 and they got date of rest of the amount and restructuring also top down.

And what happens in LBOs also when the private PLR players come, they are private equity players come and they take a loan and finance dealers and they will also try to restrict the management. They may replace the management they may take big decisions for that matter harsh decisions for that matter. So, that the company actually becomes profitable as quickly as possible.

And after six years and five months of this acquisition Blackstone came with an exit strategy by bringing hotels LBO and made a profit. So, then Blackstone actually existed. So, LBO financing they become owner then they existed with a 8.7 billion profit in 2013 for that matter.

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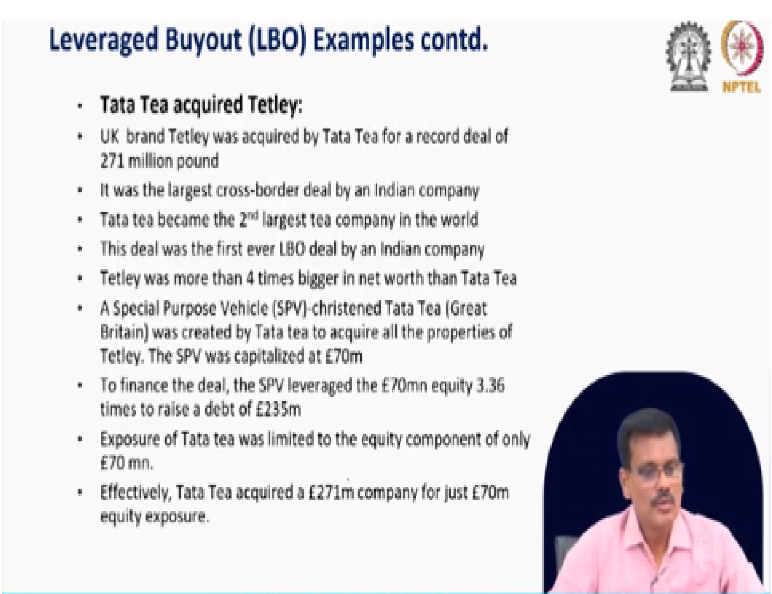

Then you have another that a Tata tea acquired Tetley, UK brand Tetley is a very famous international tea brand for that matter beverages brand for that matter and they got a deal of 271 million pound was the size of the deal for that matter. It was the largest cross border deal at that point of time in by an Indian company. If this what happened Tata tea became the second largest state company in the world with that particular acquisition.

It was first ever documented LBO deal by any Indian company and Tetley was actually four times bigger than Tata tea. So, you see with this small companies actually acquiring a big company that one international company with a lot of presence across the world for that matter. So, they created a special purpose vehicle called Tata tea Great Britain which actually acquired the company called Tetley and the SPV was created with 70 million pound of equity given by Tata group companies.

And with 70 million equity and they also went for three times of that at 235 million. So, 3.36 times a lot of money 70 million equity and 235 million day. So, with this much equity the

acquired a company which is four times bigger than the acquiring company for that matter. It was possible because of the loan given by the financiers for that matter.

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And then we have called management buyout. In that case the management executives of the company they pull resources and they try to acquire the company and for that purpose they may take a loan from some other some financials and they will try to manage the business and they take over this take from the existing shareholders. And since the maximum cases what happens management try to buy entire stake from the shareholders.

And they turn it private like we have listed company in the private property you know come they make it private. So, that you do not have interference from the other server. So, they are free to do whatever you feel like as management in the interest of the company for that matter. So, that they can get the best out of the company and they can grow and maybe subsequently they can comparing and still go for a public offer for that matter.

So, they have made the management team will actually team up with some venture capitalist or private equity players for that matter who may finance this particular deal. They may also take some equities take in this company but the management may remain with the existing management. So, private equity player may not try to interfere because they feel that the existing management is doing well and they are becoming the owners.

So, the company is going to be done doing good in future also. And it is very appealing for professional manager they become owners of the company because they also know being in the part of the government a lot of good opportunities there. So, they will get better rewards by having controlling interest for that matter. And majority of shares is owned by the internal employees organization and is taken from the existing servers also known as employee buyout. Management buyout is also known as employee buyout.

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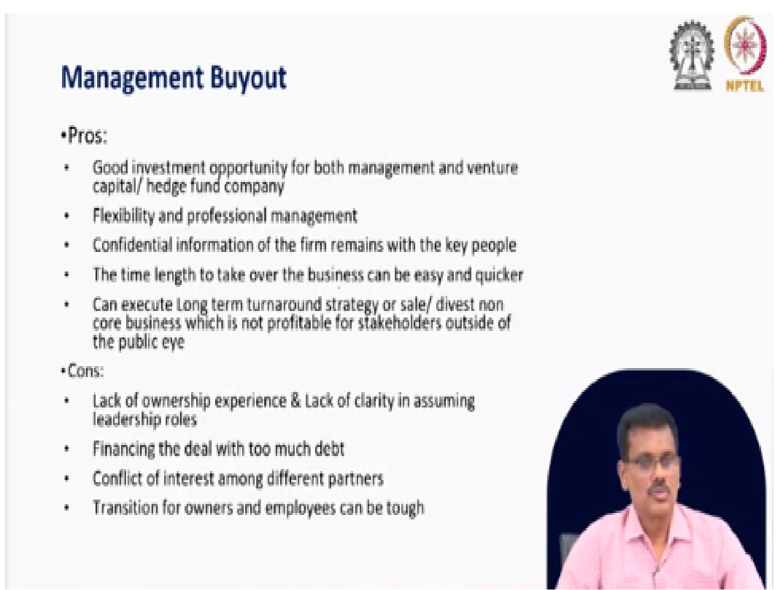

So, pros are the good opportunity for the both management and the venture capital or the private equity players or the hedge fund for that matter the financing companies. People have flexibility in managing the business they are professional players who will be actually owners as well as manager the company. And the good in confidential information remains the key people because if a listed company may be able to disclose those information's also which is not possibly good from the competition point of view will not like discuss now.

But you have disclosed listed companies, the strategic information or the price sensitive information is there. But in case a private limited company do not you are not under the obligation to disclose that and it can be also, take out the business is going to be little easy because the existing people are taking over the company and you can also execute long. Suppose it is a sick company also can be taken over the management and they can turn it around.

Because they know that is a good thing and about existing shareholders are not giving more money for the operations. So, they will say that we will take over the company will finance the deal with some other people and will manage the company assets. The turning it around is going to be easy for that matter. At the same time management may not have the ownership experience there is a consequences also.

And what table literacy role they can assume that uncertain can be there and you are financing that lot of dates that brings its own risk. And between different people there can be some conflicts who are actually become partners in the stakeholders, stakeholder company can be conflicts that can be there. And transition for owners and employees can be tough employees becomes actual owners and owners actually the exit leaves.

So, that can be also a little tough for the management to manage access. But at the same time several management buyers actually have taken place it is still happening also.

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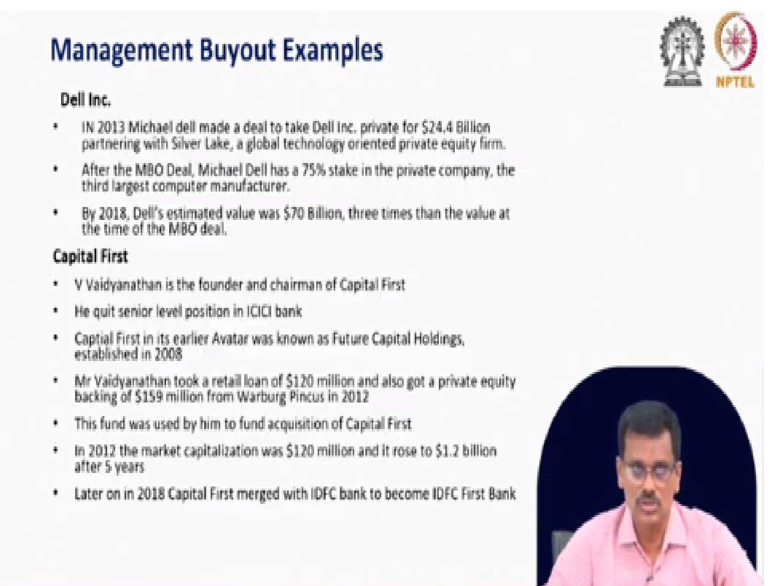

Some example like Dell incorporation 2013 Michael dell made of deal to dell in corporate private they converted publicly come to private in a company by for 24.4 billion. By partnering with a private equity player called global technology private team firm is called silver lake. Under the MBO deal Michael dell has 75 percent stake in the private company and they are the

third largest computer manufacturer and by 2018 the value was 70 billion dollar three times the value the time of the MBO dealers.

So, that way that Michael dell is actually managing he is the 75 percent owner no interference so they could get a lot of benefits without any interference from the regulators from the market from the other shareholders for that matter and possibly they can go for public offer in future also. Similarly, in India we had a capital first and Mr Vaidya Nathan is the founder of that particular company Chairman's actually.

Capital first was in earlier Avatar known as future capital holdings that is a future group Biyani Kishore for that matter it was a 2008. So, that was taken over by Mr Vaidya Nathan who became the CEO of the company, he took the loan from private equity with private equity backing. And from the Warburg Pincus is a private equity Firm I mean financing firm for that matter and they could it was used for funding the acquisition capital first.

And at that time the market capitalization 120 million and it goes to 1.2 billion after five years and later the capital first has now is more IDFC bank which is become now IDFC first bank for that matter which you discussed as a case of congeneric in our one of the earlier sessions when you are talking about types of marginal acquisition. This is an example of congeneric for that matter.

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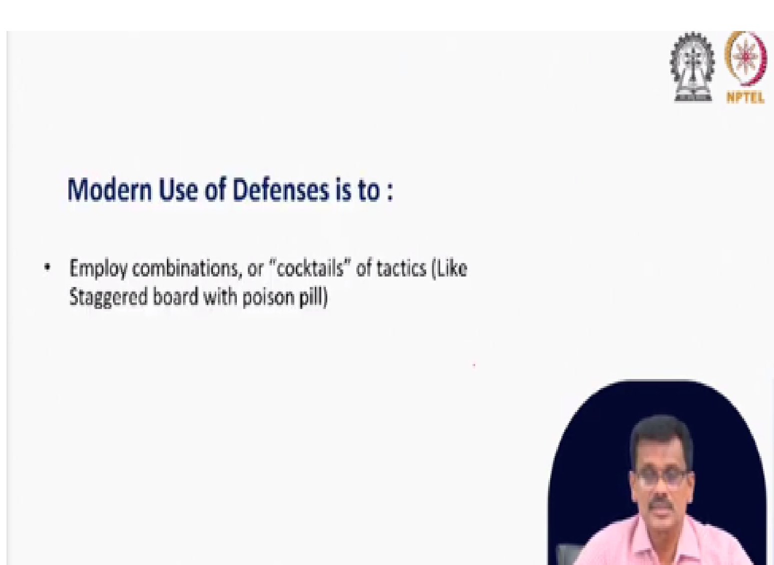

So, this is another example good number examples can there people can always one can always go through the newspapers, websites and find out lot of deals are actually happening. Having discussed that these are the deals that take place there are different techniques of acquiring in this previous session we talked about the different techniques of acquire, different techniques or difference mechanism there.

A particular company acquiring company target company it is not specific to LBS for that matter that is just discussed rather it is specific to the other session that discussed in the previous two sessions. Any company that acquiring a target they do not apply one technique of takeover attempt or one taken of defense they actually make a cocktail of the different things as such. So, for example as a takeover defense one company may have a staggered board as well as the poison pill.

So, and plus it can also have something called golden parachute. So, couple of things are there a mix of things are actually adapted by different companies.

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Now in the having discussed that we will be taking some two real life cases where this how this different companies adapted different means different types of takeover techniques and defense mechanism. We will discuss that one of the very little older case but is a very well-known case when takeover of Arcelor, it is steel industry by Mittal steel and a very one of the quite old cases take our Raasi cements by India cements some long time back in India as such.

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So, on June 2006 the summary of the deal was that Arcelor finally agreed to be acquired by its rival steel group company Mittal group for 33.7 billion dollar and the consideration has to be given both in cash and stock. That means Arcelor shareholders will also be getting cash as well

as shares in the combined entity. And this was a strategic move but actually these two companies Arcelor and the Mittal group are actually come competing for the same source competing for the same market lot of competition taking place.

So, with this is in one group now so that there is no conflict with two parties because they become part of same company assets and it is one of the very classic case in European Union where they took merger took place. And the main purpose was to that consolidating steel industry and there is overcapacity gets reduced. And they had estimated that because they will have now control over a better bargaining power with supplier as well as customers for that matter.

So, they thought that there is going to lead to around 1 billion dollar of pre-tax savings for the company for that matter annual savings is going to be their assets.

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So, and how it took place? 2001 Arcelor was created by merging different companies in France Luxemburg and Spain. And so out of that whatever plan there 90 steel plants of Arcelor was in Europe. Mittal is a group by Laxmi Mittal who it belongs to an industrial family in India and they went for multiple serial acquisitions and they become bigger company in the European Union for that matter.

And most of these companies were actually basically lower-level cost companies countries the strategy they used to do that and Laxmi Mittal has 88 percent stake in the Mittal steel corporation and before the acquisition and the company was headquartered in Netherlands basically for the purpose of saving the tax assess. And in 2006 January Mittal actually proposed to the management of Arcelor like a beer hog that we like to take over your company.

You like to buy the shares of your company will you like to merge, that was the first attempt which is taken as an example of beer hog further matter.

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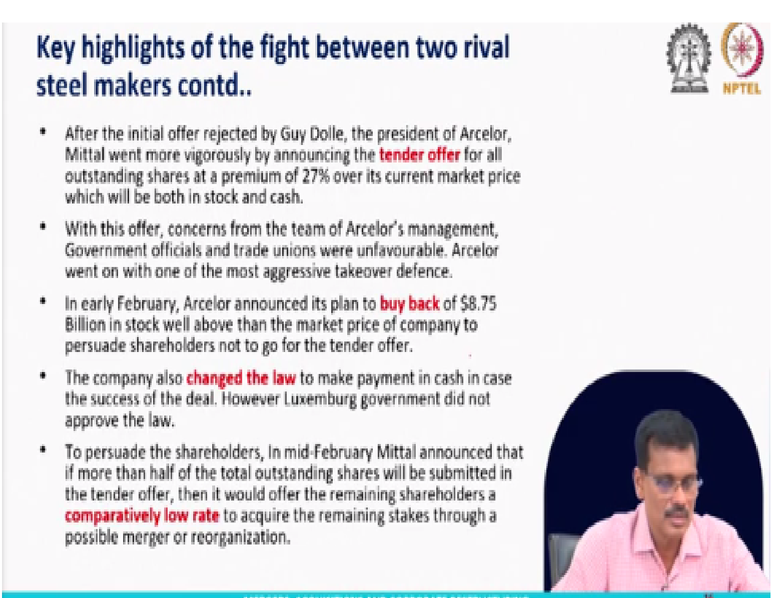

But the Guy Dolle who is the top management of the company of Arcelor they rejected and because of that what happens? They Mittal group now made a tender offer in the open market which can be taken as like earlier it was beer hog now, they said strong beer up with the maiden open **(()) (20:37)** open offer. So, because they did not the existing management did not appreciate it, they did not want to agree to that.

So, Mittal made an open offer to the market that we like to buy the shares of this particular company at a 27 percent premium over the existing market price. So, they give and in terms of both stock as well as cash, and then what happened? The management, government officials, their concerns, their union, trade union they possibly found suggest that is actually unfavourable is not a good terms and condition.

And but finally it took place we will see what happened as a reaction would happen as you talked about that takeover defense now. Arcelor made a announcement to buy back the share of 8.75 that means now Arcelor will buy back the shares and shareholders may go for buyback or go for a Mittal offer well above this market price. So, that the person is seller they do not go to Mittal, we will like to buy back the shares from USS.

The company also change the its own charter as a reaction and they say that only because Mittal had offered cash as well as stock in the offer. So, they said that no if the merger has to take place, then you have to actually give only in cash. So, that means Mittal has to organize more cash to acquire company so to creating little inconvenience for the acquiring company. And but Luxemburg government did not approve this change in the law of the company.

So, this is like this when acquiring company sorry the term target company goes to something does something to prevent. Acquiring company can also go to the court or the regulator and complain about it and say the what they have done is actually not right for that matter. There is also defense acquiring technical assets. Then what happens? Mittal announced that in more than half the total outstanding shares will be submitted tender offer.

They said that if half of the shares are tendered by the existing shareholders subsequently other shares will be tender later, they will be getting lower price. It is like our you discuss like two consideration there. If you give it now then you get more price but if you give it later you get less price it is called creating something called a prisoner's dilemma that we talk in the management. Now what to do as an exit shelter.

If I do not tender now, I will be tendering tomorrow the company may accept or not. If they accept, they will be accepting lower price if I tender now this year tender shares now, I will be getting more price. So, in that case what will happen? It will create a panic so that all the sellers like to give the shares as quickly as possible. So, that they get the best price to them also the higher price for that matter that is called that means prisoner dilemma.

So, with this help of the two tire offer we discussed that in the takeover tactic this is a two tire offer. The review of give this as now you get X rupees if you give the shares in future, you will be getting y rupees for that matter which is actually Y is less than X in that case.

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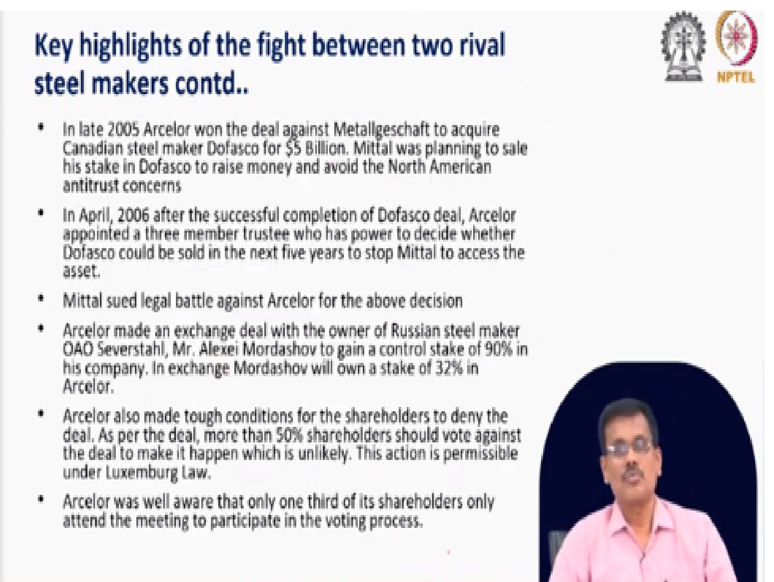

Then the what happened 2005? Arcelor had also made a deal to get the Dofasco case Dofasco mines for that matter 5 billion and it was rumoured that Mittal was actually after take over Mittal wanted to sell the Dofasco mines. So, that they get the cash so they can manage it and usually make it liquidity for the operations of the combined company for the winter. So, to create the future in some inconvenience what the Dofasco, Arcelor made a three member trustee.

And they can only approve whether Dofasco can be sold or not, that means even if they take over takes place merger takes place the without the approval trustee Mittal cannot sell. So, that means they are creating a future inconvenience for the acquiring company for that matter. But Mittal did suit this particular thing in the court of law and they got the battle this no, this particular provision that you have to do like this it is not actually legally tenable.

Then came the role of the white knight here where Arcelor say that will not go to Mittal group rather, we will go to some other company say went to Russian steel maker Severstahl. And the Mr Mordashov was given that he will be giving 90 percent stake in your company and in exchange Mordashov will go on a 32 percent stake in the Arcelor. In that case and so it is a

white knight now. So, we will not like to go to Mittal rather we will go to some other Russian player but not Mittal group that matter.

And then also they made some tough condition that yes only when the 50 percent the entire voting votes then only the particular deal will actually take place that is they also made some chartered amendment which is again caused in the court of law and but they know at this particular time only few people not so many people actually come for voting. Actually, what happens in this voting it the voting is taken as the voters present both in proxy as well as physically present.

But they made the no total voters are present or not that will be taken as the decision that 50 total votes have to be voted then only the till can take place.

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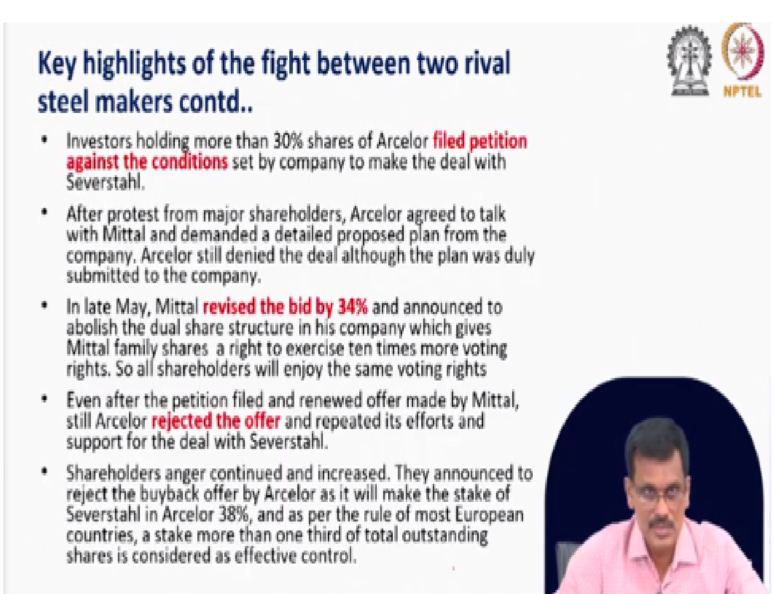

That is another thing the Arcelor is a defense mechanism but investors and file repetition that it is not a good provision that the company has made and they in fact say that you should actually go for they deal with the Mittal because they are giving a better price and then Arcelor because all this time as we were not talking to the Mittal group going to the table, they talk about that they are not going for it.

But then they sat with them and then Mittal revised the dividend by 34 percent and Mittal had a dual structure in its own company. So, that the family members had some shares where they had more voting rights for those shares compared to other ordinary shares. So, the Mittal agreed ok, will not have such structure in our shareholding will remove that that is a concession they gave and then Arcelor again rejected the offer then repeatedly then continue to repeat the efforts.

And then they Arcelor wanted to go for this white knight that is a vestal and finally again the shareholders captain increasing they put pull out of pressure and in the buyback offer also rejected by the shareholders and then finally the two deal actually take place.

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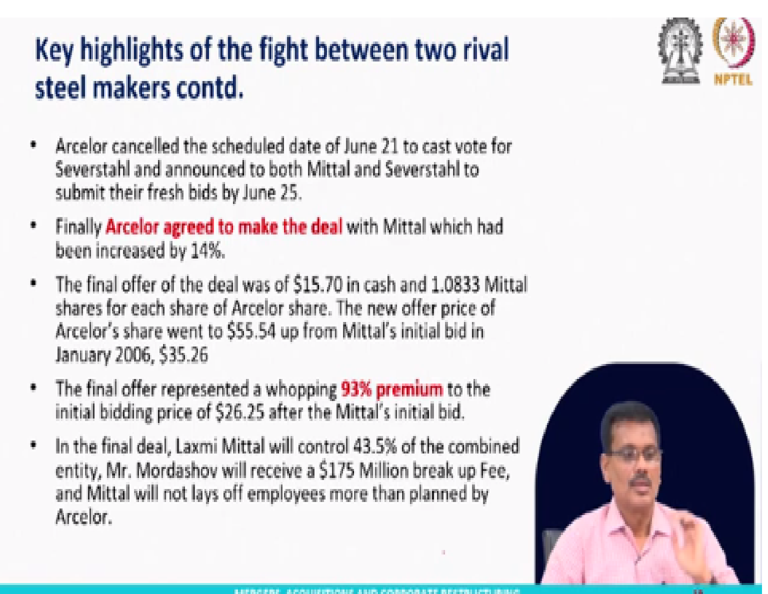

The Arcelor cancel the on June 25 that meeting they that scheduled date for the deal with Severstahl and then they asked them to buy the fresh beats. Finally, Arcelor agreed to make the deal with Mittal which had been increased 5 by the 14 percent and the final offer was 15.70 dollar in cash which was and then you have to they will also give 1.0833 shares in Mittal group for everyone share Arcelor and finally the premium that they got was 55.54 more than the earlier one 35.26.

So, eventually they got some 93% premium to the initial bidding price of 26.25-dollar initial bid and it is a huge premium and then the deal took place and the combined company the Laxmi Mittal will be holding 43.5% taking the combined company and the Mr Mordashov with the

white knight with the dealing so they had a breakup fee with the condition with the Arcelor. So, they got a 175 million breakup fee and Mittal also can say that Mittal groups that we are not going to lay up them.

There is a concern by the labour union possibly they say that we will not do thing lay up the employees. So, this deal actually once it took place. If you look at in that case so many tools and techniques under both the parties. But in the finally if the servers got a very huge premium compared to what was initial offer then possible one can say that Arcelor management strategy was actually beneficial.

If they fought it in the interest of the shareholders and they got a very good deal compared to the earliest offer further matter.

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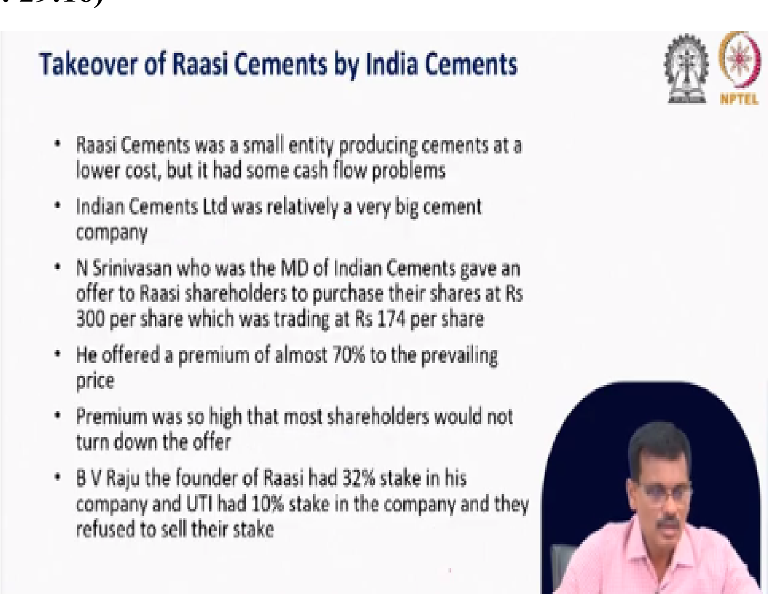

Similarly in India we had one hostile takeover attained by Raasi India cements. So, Raasi cement was actually supposed to be acquired by India cements. India cement limited was related big cement company in cement industry in southern India Raasi cement also southern typical air soil Andhra Pradesh. They have a lot of presence they offered like a godfather offer for 175 rupees price in the share, they offered actually 300 rupees per share.

And it is like something huge premium they actually offered assets. So, premium was so high that most sellers could not turn down the offer. But Mr BV Raju who was the 32 percent he was actually opposing and UTI also that time UTI unit trust India had 10 percent taken that and they said will not like to sell it.

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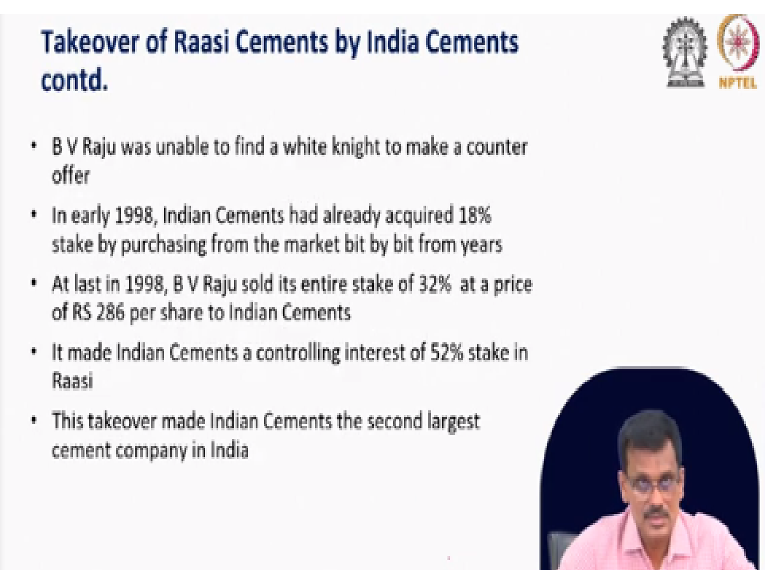

But the legal battle took place and but before as you could not get a white knight to defend and finally and what happened the Srinivasan that India cements were already had a toe hold stake of 18 percent in the company and it is bought from different shareholders in the existing shareholders, they have already got 18 percent stake. So, they can create even the takeover does not take place they can still create inconvenience in **(()) (30:37)** 18 percent is not a small stake in any company for that matter.

And finally, B V Raju sold this entire stake of 32 per stack to India cements at rupees 286 and it media then India cements had the controlling stake in the assessments of 52 percent stake in Raasi and in fact with this India cements became the second largest cement company in India for that matter.

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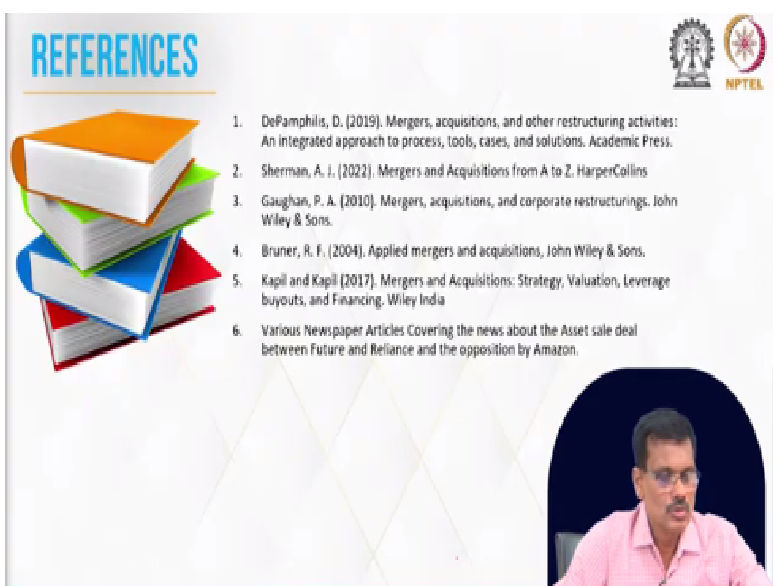

So, we discussed the two different cases of my **(()) (31:09)** and the earlier on Arcelor Mittal case we saw how different techniques can adapted. We also saw in Raasi cements and India as I mean how hostile takeover attempt was there but finally the Raju group of Raasi cements accepted the offer and they exited and India's cements become the assessment gots merged with India cements for that matter subsequently and became part of India cements for the matter.

So, there are two cases discussed. So, with this I end this session and thank you and happy learning.