Seat No.: ________ Enrolment No.___________

GUJARAT TECHNOLOGICAL UNIVERSITY

MBA – SEMESTER 4 – • EXAMINATION – SUMMER 2016

Subject Code: 2840201 **Date: 05/05/2016**

Subject Name: Mergers and Acquisitions (M&A)

Time:10.30 AM TO 01.30 PM **Total Marks: 70**

Instructions:

1. **Attempt all questions.**
2. **Make suitable assumptions wherever necessary.**
3. **Figures to the right indicate full marks.**

Q – 1(A) Choose the correct option [06]

1. If an automobile manufacturer were to acquire one of the firms listed below, which acquisition would be called a horizontal merger?
   A. A steel Mill
   B. A rival manufacturer
   C. A tire producer
   D. A bank

2. The cost of a merger equals the
   A. Cash paid for the target firm.
   B. Increase in total earnings less price paid.
   C. Premium paid over the target's value as a separate entity.
   D. None of the above

3. If two merged firms are shown to have a higher combined market value than the sum of the individual market values, then:
   A. Economic /Synergy gains are said to have taken place
   B. The firms were previously under priced
   C. The merger provides diversification to investors.
   D. There is no cost involved in the merger.

4. What is the minimum size of mandatory open offer under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
   A. 24%
   B. 25%
   C. 26%
   D. 27%

5. A form of corporate restructuring involving transfer of all or substantially all the assets and assets, liabilities, loans and business of one of business divisions or undertaking to another company whose shares are allotted to the shareholders of the transferor company on a proportionate basis and transferor company continue to carry on at least one of the businesses.

A. Spin off
B. Split up
C. Split off
D. None of the above

6. A defense tactic in which the target company sells its highly profitable or attractive business division to make takeover bid less attractive to the raider.

A. Poison pills
B. Shark Repellents
C. Blank Cheque
D. Crown Jewels

Q – 1 (B) Explain following terms [4]

1. Demerger
2. Joint Venture
3. Buy Back
4. Delisting

Q – 1 (C) What is corporate restructuring? What are different motives of corporate restructuring [4]

Q – 2 (A) State the major methods of effecting payment of consideration to the shareholders of target company. Explain features of each method in detail. [7]

Q – 2 (B) Imperial Chemical Industries (ICI), a British company is looking at an opportunity to enter the Indian market. Instead of entering on its own, ICI wanted to make an entry by taking over a major player in the Indian market. The company (ICI) shortlisted Asian Paints as the right target to fulfill its aspirations. However Asian Paints is not willing to get acquired by Imperial Chemical Industries (ICI). With reference to this, explain the concept of hostile takeover and suggest various defense tactics that Asian Paints can use to avoid the hostile takeover by Imperial Chemical Industries (ICI). [7]

OR

Q – 2 (B) After TATA tea acquired Tetley in early 2000, in last fifteen years a number of Indian companies have made global acquisitions. One of the important features of these acquisitions is that in most of the cases the target companies have been far bigger in size than the Indian acquirers. To take an example Tetley's turnover at the time of acquisitions was more than three times the turnover of Tata tea. Similarly when Tata Steel acquired Corus Plc. Corus's turnover was four times more than Tata Steel's turnover. With reference to this, explain various sources of funds for cross boarder acquisitions. [7]

Q – 3 (A) Explain major provisions of Securities and Exchange Board of India (Buy back of securities) Regulations, 1998. [7]

Q – 3 (B) Videsh Ltd. Is keen on reporting EPS of Rs. 6 per share after acquiring Swadesh Ltd. The following financial data are given [7]

Particulars	Videsh Ltd.	Swadesh Ltd.
Earning Per Share	Rs. 5	Rs. 5
Market Price Per Share	Rs. 60	Rs. 50
Number of shares	10,00,000	8,00,000

There is an expected synergy gain of 5 per cent. What exchange ratio will result in a post merger EPS of Rs.6 for Videsh Ltd.?

OR

Q – 3 (A) Mergers and acquisitions can have an adverse impact on healthy state of competition prevailing in the markets. One of the objectives of the competition act 2002 is to promote and sustain healthy state of competition in markets. With respect to this explain in detail major provisions of Competition act 2002 governing combinations. [7]

Q – 3 (B) Black & Co. is planning to acquire White & Co. The relevant financial details of both the firms before acquisition are [7]

Particulars	Black & Co	White & Co
Market Price per Share	Rs. 70	Rs. 32
Number of shares	20 million	15 million

The merger is expected to bring the gain which has present value of Rs. 200 million. The exchange ratio agreed is 0.5. What is the true cost of merger for Black & Co?

Q – 4 (A) Explain the concept of strategic alliance. Why do companies enter into strategic alliances? What are the implications of strategic alliance? [7]

Q – 4 (B) Cross border acquisitions are becoming very popular due to their capacity to generate additional revenues for the acquirer. Globalization and liberalization have made the business environment more conducive for them. While cross border acquisitions are good, they do not always succeed due to number of challenges faced by the acquirer before and after the acquisition. With reference to this, explain various difficulties encountered in cross border acquisitions. [7]

OR

Q – 4 (A) Explain the concept of Delisting. State the features of compulsory and voluntary delisting. [7]

Q – 4 (B) The following financial information is available for company D, a pharmaceutical company [7]

PBDIT	Rs. 18 Crore
Book value of assets	Rs. 90 Crore
Sales	Rs. 125 Crore

Based on evaluation of several pharmaceutical companies, companies A, B and C have been found to be comparable to company D. Looking at the characteristics of A, B and C following multiples are reasonable for company D.

MV/ PBDIT	17

MV / Book value	3
MV / Sales	2.2

Find out value of D by using each of the above multiple

Q – 5 **Marriot's Bondholder's taken for a spin (or for a ride?)** [14]

In 1993 Marriott Corporation (MC) carried out a spinoff of its hotel management business to shareholders. In 1992, MC had revenues of $8.7bn and operating profits Di $496m. The group consisted of two broad categories of businesses — the lodging managemeat group including hotels that contributed 52% of group revenues and 68% of operating profits, and contract services catering and facilities management, airport and highway concessions that accounted for the rest. With two-thirds of its operating profit from lodgings related businesses, MC was generally viewed as a hotel company.

MC pursued ambitious growth and profitability objectives in the hotel business through a strategy of developing and then selling hotels while retaining the right to manage them. Management sperated from the ownership of these properties, required smaller capital to fund growth but also reduced the volatility of cash flows. This low volatility allowed MG management to maintain high levels of debt. MC's operating profit increased yearly from 1986 to 1989 in both lodging management and contract services group. However, in 1990-91 recession hit the, hotel occupancy rates and profits. The contract service businesses also suffered. MC had built up a large portfolio of hotel properties that were difficult to sell in the recession. It replaced high-risk senior debt with lower-risk subordinated debt against the background of falling credit rating of its debt.

Under the spinoff plan announced in October 1992, the lodging management, catering and other service businesses were to be spun off into Marriott International (MI). The parent, renamed Host Marriott (Host) retained ownership of the hotel and real estate interests. MI, under a long-term contract with Host, would manage the hotel properties. The Marriott family would continue to oversee all of the businesses and the senior management of MC would be split between MI and Host.

MC argued that the spinoff would benefit shareholders by

- allowing MI to exploit its growth opportunities in the management business;
- allowing the capital markets to value MI more accurately because of better financial information;
- giving shareholders better investment options between a high-growth management company and a capital-intensive company with strong cash flow and long-term capital appreciation.

The initial spinoff proposal allocated most of MC's long-term debt to Host. When compared with the level of assets and operating cash flow, this allocation made Host vastly more risky than MT as shown below. This sparked considerable resistance from creditors who felt their debt was being put at high risk since most of it was being assigned to cyclical property business and very little to the management business with more stable cash flow. The interest cover ratio shows higher risk clearly. Such an allocation reduces the default risk faced by the shareholders and increases it for creditors, thereby transferring some of the corporate value from creditors to shareholders.

Assets/Liabilities	MC	First Proposal		Final Proposal	
		MI	Host	MI	Host
Total assets	6333	2360	4620	3017	3888
Proprietary and equipment	3672	360	3310	772	2689
Current Liabilities	1189	1130	210	1280	394
Long term debt	2891	20	2870	899	2313
EBITDA/Interest expenses	2.6	20.3	1.3	6.5	1.8

Given the storm of protest from creditors and their Class action suits, MC revised the spin off proposal and reallocated more debt to the management business. This mitigated the additional risk faced by the creditors. MC was forced to accept several conditions, such as repurchase of debt, stricter covenants, higher coupon rate on new debt, etc. to the benefit of creditors. The revised spinoff plan was implemented.

Robert Parrino estimated the market-adjusted bondholder loss at $195m and industry adjusted shareholder gains at $81m, Thus the spinoff caused a $114m decline in the total value of these securities from spinoff announcement to distribution. The spinoff failed to create shareholder value in the period surrounding the spin off and destroyed the bondholder value. What could be the reasons for this? There are several direct and indirect costs to a spinoff— direct transaction costs, loss of ability to offset Host's losses with MI’s profits and thereby save on corporation tax, the increased coupon on new debt, value of warrants issued to creditors, duplication of accounting and financial systems, higher costs of new security issues, etc.

The Marriott family continued to maintain control over the entire firm. The spinoff limited the potential losses to Marriott family from any default on debt. The separation improved the management business's debt capacity and this would allow the family to pursue growth in this business aggressively without losing control.

1. Why did Marriott decide to go for a spinoff?
2. What is the initial structure of the spinoff? Why MC was required to change it?
3. Is there a conflict of interests in spinoffs among various stakeholders?
4. How were these resolved in the Marriott case?

OR

Q – 5 **Hindalco Novelis Deal** [14]

Introduction

In early 2007, Hindalco Industries Ltd (Hindalco), the flagship company of Aditya Birla Group, announced that it would acquire the Canadian company Novelis. The transaction would make Hindalco the world's largest aluminum rolling company and one of the biggest producers of primary aluminium in Asia as well as India's leading copper producer. Novelis was to be acquired in an all cash deal valued at approximately $6 billion, including debt. Under the terms of the agreement, Novelis shareholders would receive $44.93 in cash for each outstanding common share.

The Chairman of the Aditya Birla Group, Kumar Mangalam Birla was of the opinion that aluminium was a core business with enormous growth potentials in revenues and earnings. The acquisition of Novelis was a step in this direction as it was felt that the combination would establish an integrated producer with low-cost alumina and aluminium facilities combined with high-end rolling capabilities and a global footprint.

Industry Overview

The global aluminium industry is seeing increased scope in packaging applications. The other sectors using aluminium increasingly are power, infrastructure and automobiles. These sectors shall provide the much-needed fillip to the aluminium industry and demand is expected to grow rapidly and attain double-digit growth. Domestic and global demand will rise over a long-term period. A number of other factors influence the market of aluminium, such as lowering of import duties, domestic realization of aluminium majors, pressure on Hindalco and Nalco, reduction in buffer on international prices, greater linkage to international prices, and volatility in financials. To negate the effect of these factors, producers have started moving downstream to mitigate higher volatility. The key features of the industry are as follows:

- The industry is highly concentrated with only five primary plants in the country.
- All the producers use the Bayer- Hall–Heroult technology.
- The industry has a very high energy cost, 40% of manufacturing cost for metal and 30% for rolled products.
- Technology cost is very high and this is the main barrier in achieving high energy efficiency.
- The main aim of the industry is energy conservation and reduced consumption.
- The industry faces stiff competition from imports.

Aluminium is a power-intensive industry with one tonne of aluminium requiring over 15,000 KW of power. Power constitutes almost 40% of the total cost of production. Hindalco enjoys an advantage in this respect with the smelters backed by captive power plants, making it one of the lowest cost producers globally.

As regards Hindalco, the following issues were found to be prominent: large upstream and midstream production, cyclical business linked to commodity prices, low cost commodity operations, proximity and good access to Asian markets. With regard to Novelis, the factors that were crucial were market leading downstream portfolio, stable cash flows, substantive proprietary technology-led operations, and leading world market position.

Hindalco—The Aluminium Giant

Hindalco, the metals flagship company of the Aditya Birla Group, is the world's largest aluminium rolling company and one of the biggest producers of primary aluminium in Asia. Its copper smelter is the world's largest custom smelter at a single location. Established in 1958, Hindalco commissioned the aluminium facility at Renukoot in eastern Uttar Pradesh in 1962. The company grew from strength to strength through acquisitions and mergers with Indal and Birla Copper. With the acquisitions of the Nifty and Mt Gordon copper mines in Australia in 2003, its position was strengthened in value-added alumina, aluminium, and copper products.

Its aluminium units across the globe encompass the entire gamut of operations, from bauxite mining, alumina refining, and aluminium smelting to downstream rolling, extrusions, foils, along with captive power plants and coal mines. Similarly its copper unit, Birla Copper, produces copper cathodes, continuous cast copper rods, and other by-products such as gold, silver, and DAP fertilizers. The Birla Nifty copper mine consists of an underground mine, heap leach pads, and a solvent extraction and electrowinning (SXEW) processing plant, which produces copper cathode. The Mt Gordon copper operation consists of an underground mine and a copper concentrate plant. Until recently, the operation produced copper cathode through the ferric leach process. Nifty and Mt Gordon have entered into a long-term 'life of mine' offtake agreement with Hindalco to supply copper concentrate to the copper smelter located at Dahej, Gujarat.

A strong presence across the value chain and synergies between operations have provided Hindalco with a dominant share in the value-added products market. The ever-expanding market for value-added products and services has provided the opportunity for the launch of three new products—Everlast roofing sheets, Freshwrapp kitchen foil, and Freshpakk semi-rigid containers.

Novelis—The Canadian Giant

Novelis is a Canadian corporation formed in January 2005, as a spin-off from Alcan Inc. It is the world's leading producer of aluminium-rolled products based on shipment volume. The company produced an estimated 19% of the worlds flat-rolled aluminium products, and is the biggest producer in Europe and South America, and the second-largest in North America and Asia.

Novelis has also been a world leader in the recycling of used aluminium beverage cans, with nearly 39 billion cans recycled into new can sheet to be manufactured into beverage cans in 2008. The company operates in four continents and is the only company that has the expertise to produce premium aluminium-rolled products. The company has expertise in producing end-use applications and light gauge products that include beverage and food cans, food and packaging, transportation, electronics, construction, and industrial products. The company also operates bauxite mining, primary aluminium smelting, and power generation facilities.

Hindalco's Strategy

A business model describes how a company will operate in the market so that the pre-determined marketing goals are attained effectively. Hindalco had a very clear business model for its aluminium business. The model focused on a totally integrated business solution, keeping in mind the large size of the division. The company pursued an objective of optimally exploiting the aluminium value chain balancing between the more volatile high-margin upstream products and the steadier low-margin downstream portfolio. Its upstream strategy focused on continuing the existing low-cost operations and gradually progressing to new greenfield projects. This, it was presumed would further improve cost competitiveness through lower production costs; by controlling key resources, such as bauxite mines, refineries, power plants and coal; and reaping the benefits of economies of scale.

Added to this strategy is the fact that Indian bauxite is of the highest quality with high alumina content, less than 2% Boehmite content, very low reactive silica content, and negligible organic content. It also possesses a higher liquor purity and productivity that is more cost-efficient. Again large deposits of bauxite are found in a single plateau, which allows more efficient extraction. India also has abundant coal supplies, easy availability of labour, and is located in close proximity to the fast-growing markets. All these factors create the right setting for producing high quality aluminium.

The Acquisition Advantage

Hindalco's decision to acquire Novelis was influenced by the fact that Novelis had a well-diversified geographical market base, which would enhance the stature of Hindalco in the area of downstream production. The growth seen at Hindalco was the result of a well-crafted growth and integration strategy that hinged on three cornerstones like cost competitiveness, quality, and global reach. The company was also committed to the triple bottom line accountability of economic, environment, and social factors.

Novelis was the world leader in rolled aluminium products, which would help Hindalco to extend its reach in the industry. Novelis also had long-standing relationships with leading customers, which Hindalco expected to exploit. The list of customers included Agfa-Gevaert, Alcan, Anheuser-Busch, Ball, Coca-Cola, Crown Cork & Seal, Daching Holdings, Ford, General Motors, Lotte Aluminium, Kodak, Pactiv, Rexam, Ryerson Tull, Tetrapack, and ThyssenKrupp. The fact that Novelis used advanced scientific techniques and applied knowledge to deliver innovative, customer driven products also made it a good buy. The extensive research and development capabilities ensured that Novelis was able to provide innovative production and application technologies, including breakthroughs in the following areas:

- Alloy development/optimization for improved properties such as strength, formability, corrosion resistance
- Molten metal and advanced solidification technology
- Innovative manufacturing technologies
- Advanced surface treatment and coating technologies for semi-finished products
- Modelling of forming processes for automotive sheet components and product performance for auto structure crash behaviour and beverage can down-gauging
- Development of innovative products like heat exchanger materials, automotive sheet, beverage and semi-rigid containers, etc.

Novelis also used the concept of global technology organization wherein it committed itself to providing world-leading research and technology support. This allowed Novelis to share its knowledge and experience rapidly between teams and facilities around the globe so that innovations could be applied appropriately, and with the same speed, by customers who possess regional worldwide manufacturing capabilities. The company collaborated very closely with customers to identify their needs in the areas of manufacturing process support, the introduction of new manufacturing technologies, and the design and development of new and improved products. The collaboration involved physical simulation of a customer's processes and products through the development of pilot line capabilities, and simulation via state-of-the-art computer-aided design and engineering. Novelis had the technology, economic strength, commitment, and skills in financial, environmental and social dimensions to excel as a sustainable corporation. Hindalco's acquisition made sense because of all these factors.

What Did The Deal Mean In Numbers?

The acquisition was very crucial for Hindalco and in terms of numbers it meant the following:

- The acquisition was executed through an all-cash transaction wherein Novelis was valued at approximately $6 billion, including around $2.4 billion in debt.
- The merger would establish a globally integrated aluminium producer with low-cost alumina and aluminium production facilities combined with high-end aluminium rolled product capabilities.
- The merger would ensure that Hindalco would become the biggest rolled aluminium products maker and fifth largest integrated aluminium manufacturer globally.
- Novelis, being a global leader in aluminium rolled products and aluminium can recycling, with a global market share of about 19%, would make Hindalco a major player in the market. At the time of acquisition Hindalco held 60% share in the high-growth Indian market for rolled products which today appears to be very small.
- Hindalco has always been one of the lowest cost producers of primary aluminnium in the world, but the merger would enable it to leverage its and become a key player globally.
- Novelis, it was expected, would incur a loss of $263 million in 2006. However, it expects to make a profit of $68 million in 2007. The total free cash flow was expected to be $175 million in 2006.
- The debt component of Novelis stood at $2.4 billion and additional $2.8 billion would be added as this is the amount Hindalco would take to finance the deal. This was expected to put a tremendous pressure on profit due to high interest burden.
- Hindalco was then planning a major expansion at an investment of Rs. 250 billion. This would put a tremendous interest burden on the company.

Looking at the financial position of the two entities and their future growth plans, they would not have been able to finance the deal through a high debt mix. Let's take a look at the numbers to substantiate our argument. Novelis had a debt equity ratio of 7.23 : 1, making it practically impossible for it to borrow any further.

Hindalco proposed to buy the $3.6 billion worth of Novelis's equity as follows:

- $2.85 billion through borrowing
- $300 million as debt from group companies
- $450 million from its cash reserves

The second part of the deal was the debt of Novelis of $2.4 billion. Hindalco proposed to take refinancing facility to finance these borrowings. These were ultimately to be repaid with the cash flows of Novelis.

Based on above case study give your comments on followings

1. What is the strategic rationale for this acquisition?
2. What are financial challenges for this Acquisition?
3. How this deal is beneficial for Hindalco?
4. Explain funding structure of Hindalco Novelis deal.