CONTROL DEALS INVOLVING TENDER OFFERS: FLASHBACK 2019

A DETAILED REPORT

cyril amarchand mangaldas

advocates & solicitors

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A. Introduction

Control deals are gaining popularity because of the ability of the incoming controlling shareholder to control the 'when' and 'how' of the business that is housed in the target company. Additionally, the stigma associated with the promoter's relinquishing control of their companies is on the wane in India. Despite the market conditions, 2019 saw a fair amount of control transactions in the country. For such category of deals, calendar year 2019 was comparable to calendar year 2018 in number and value terms.

In this report, we are sharing with you our detailed analysis of control transactions in which exit was offered to public shareholders through the tender offer route in 2019[1], under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (**Takeover Regulations**).

In most major transactions, the incoming controlling shareholder completely replaced the outgoing controlling shareholder. In a few, the incoming shareholder allowed the existing controlling shareholder to continue as joint promoter of the target company.

In 2019, we saw a rise in the number of transactions where the financial investors / private equity players acquired controlling stake in publicly-traded companies. Most of these financial investors were overseas investors, demonstrating their long-term vision and belief in the Indian economy.

As a firm, we were happy to see both domestic and foreign acquirers showing interest across various sectors in India in 2019, and we see 2020 having robust M&A activity in the country. Significant amount of deal activity in 2020 will be driven by stressed assets and amendments to key laws, including the (Indian) Insolvency and Bankruptcy Code, 2016 (**IBC**), which will make acquisition of stressed assets more attractive. In particular, we expect the second half of 2020 to be busier from a deal volume perspective.

We hope you enjoy this report and share your views with us.

[1] *Based on public announcements for open offers available on SEBI website as on January 3, 2020.*

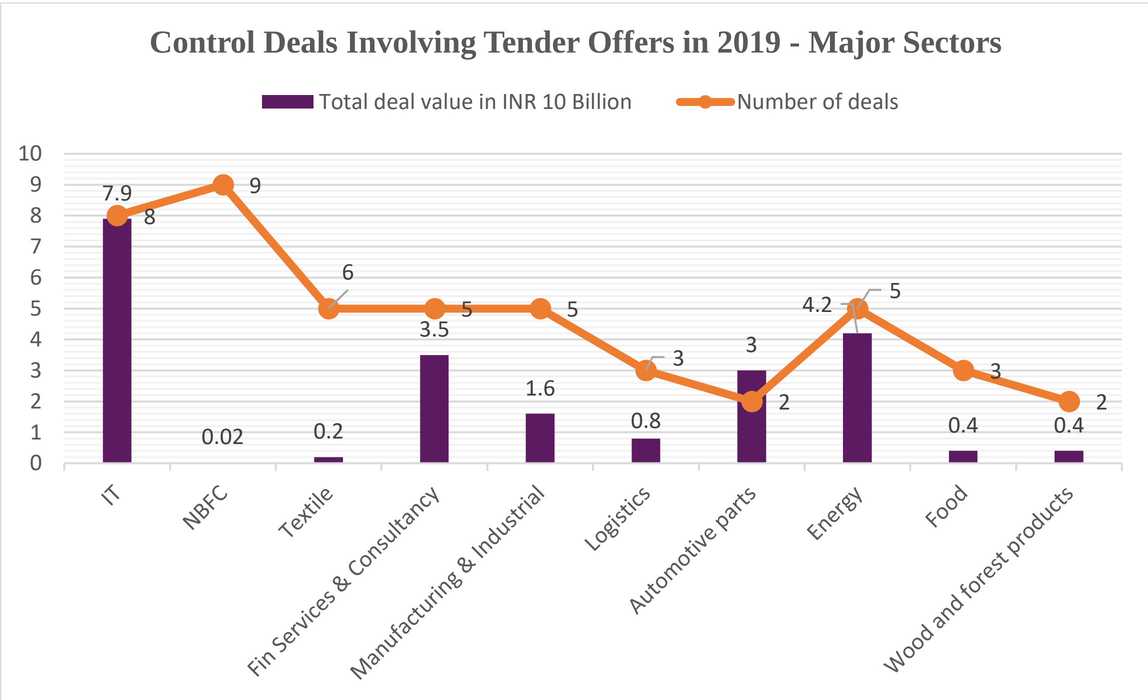
B. Sector-wise Activity in 2019

Between January and December 2019, the country witnessed a total of 61 control deals, involving tender offers, the aggregate value of which stood at INR 226 Billion, making it a comparable year to 2018, both in terms of value and numbers for such category of deals.

In value terms, the technology sector saw the highest aggregate value of tender offers at INR 79 billion. In number terms, the non-banking financial companies (NBFC) sector continued to see the highest number of tender offers (nine in all). Other sectors that saw high activity were energy, services (including financial), automotive parts, logistics and manufacturing of industrial products.

In 2019, the five biggest tender offers by value comprised 79.62% of the aggregate value of all tender offers in 2019[2].

The following graph shows in number and value terms tender offers in major sectors in 2019:



As is clear from the graph above, the NBFC sector saw highest number of control transactions in the listed space, but in value terms it was miniscule when compared to the technology sector.

Generally, the technology sector (including e-commerce) witnessed a very high M&A deal activity, with late stage start-ups soaring in valuations. The funding received by the technology sector as a whole is not a surprise as technology governs the way we live in today's world and is changing human behaviour and mannerisms of functioning. Technology has

[2] *For further details please refer to Section E below*.

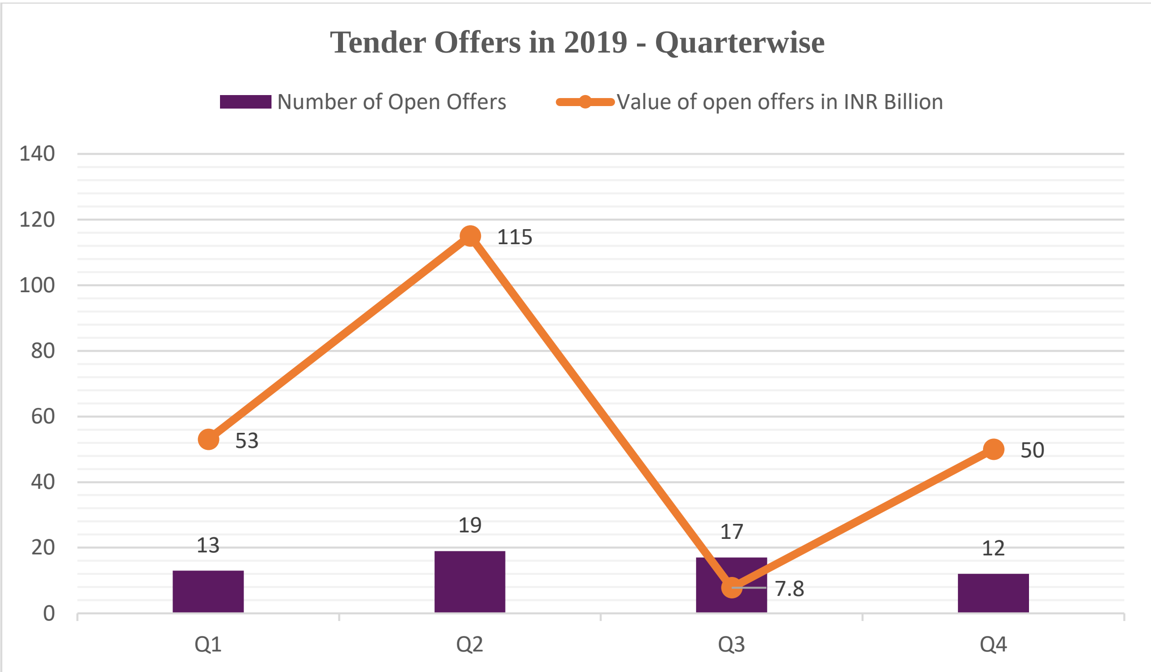
revolutionized every part of our lives including the way we buy groceries, make digital payments, avail and provide medical treatments, travel and book hotels.

We think that through 2020 the focus on the technology sector will continue, followed by the financial sector (banks and NBFCs).

C. Quarter-wise analysis of tender offers of 2019

The second quarter (Q2) of 2019 was the busiest quarter for such control deals with 19 tender offers being announced. The fourth quarter (Q4) of 2019 was the quietest with 12 tender offers being announced. The second quarter (Q2) of 2019 had the highest aggregate value of tender offers at INR 115 billion, while the third quarter (Q3) of 2019 witnessed the lowest aggregate value of tender offers at INR 7.8 billion.

Below is a chart analysing the number and aggregate value of tender offers announced in 2019:



Below is a list of target companies for the acquisition of which tender offers were announced in 2019 as per each calendar quarter:

Quarter	Target Companies	
Q1 (Jan 1 – Mar 31)	Grandeur Products Ltd.	VCK Capital Market Services Ltd.
	Indorama Synthetics (India) Ltd.	Ruchika Industries India Ltd.
	Ceinsys Tech Ltd.	Sangam Renewables Ltd.
	Danube Industries Ltd.	Upasana Finance Ltd.
	Orient Tradelink Ltd.	Mindtree Ltd.
	Integra Telecommunication & Software Ltd.	Vitesse Agro Ltd.
	Justride Enterprises Ltd.	

Quarter	Target Companies	
Q2 (Apr 1 – Jun 30)	WABCO India Ltd.	Ingersoll Rand (India) Ltd.
	Sarda Proteins Ltd.	Superior Finlease Ltd.
	NIIT Technologies Ltd.	Som Datt Finance Corporation Ltd.
	Allsec Technologies Ltd.	Reliance Nippon Life Asset Management Ltd.
	Essel Propack Ltd.	International Paper APPM Ltd.
	KPIT Technologies Ltd.	Kaycee Industries Ltd.
	TTL Enterprises Ltd.	Gujchem Distillers India Ltd.
	Leena Consultancy Ltd.	SRK Industries Ltd.
	Sobhagya Mercantile Ltd.	Manvijay Development Company Ltd.
	Overseas Synthetics Ltd.	
Q3 (Jul 1 – Sep 30)	Supra Pacific Management Consultancy Ltd.	Rapicut Carbides Ltd.
	Kavita Fabrics Ltd.	Lasa Supergenerics Ltd.
	Yogya Enterprises Ltd.	Continental Chemicals Ltd.
	Amarnath Securities Ltd.	Orchid Securities Ltd.
	Pulsar International Ltd.	DFM Foods Ltd.
	Garv Industries Ltd.	Frontier Informatics Ltd.
	Sunedison Infrastructure Ltd.	Mrugesh Trading Ltd.
	Kashiram Jain & Co. Ltd.	Uniply Industries Ltd.
	Corporate Merchant Bankers Ltd.	
Q4 (Oct 1 – Dec 31)	Amba Enterprises Ltd.	Mahaan Impex Ltd.
	Adani Gas Ltd.	Gati Ltd.
	Hi-Klass Trading and Investment Ltd.	SDC Techmedia Ltd.
	Accelya Solutions India Ltd.	M. B. Parikh Finstocks Ltd.
	Step Two Corporation Ltd.	Indo Tech Transformers Limited
	Alan Scott Industries Limited	Snowman Logistics Limited

D. Key features of such deals and comparison with 2018

A majority of the tender offers (being 50) were made by acquirers due to secondary market purchases. Other transactions (7 in all) involved primary issuances by the target listed companies. One transaction involved a combination of primary issuance and secondary market purchase. Three transactions were indirect acquisitions of the target listed companies.

Following table gives comparison in numbers of key features between the years 2019 and 2018:

	2019	2018
Number of tender offers	61	70
Completed tender offers (tender offers that were launched and completed in the same calendar year)	39	49
Number of direct tender offers	58	63
Number of indirect tender offers3	3	4
Number of tender offers made due to breach of 5% creeping acquisition limit	7	6
Total value of tender offers	INR 226 Billion	INR 268 Billion
Number of tender offers for NBFCs	9	12
Number of tender offer where underlying transaction was closed before closure of the tender offer	8	9

[3] *Tenders offers that are made as a result of acquisition of entities which ultimately hold a controlling stake in listed companies.*

E. Biggest tender offers of 2019

In 2019, the five biggest tender offers by value were (in descending order of value):

1. Larsen & Toubro Limited's tender offer for Mindtree Limited (Technology sector);

2. Total Holdings SAS's tender offer for Adani Gas Limited (Energy sector);

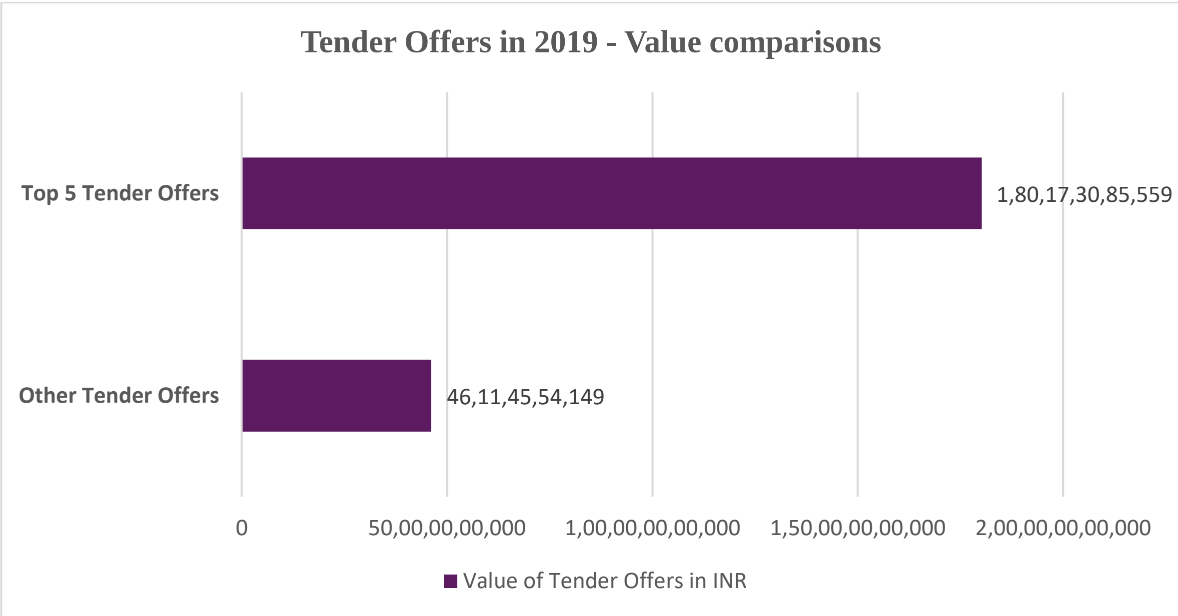
3. Nippon Life Insurance Company's tender offer for Reliance Nippon Asset Management Limited (Asset Management sector);

4. ZF Friedrichshafen AG's tender offer for WABCO India Limited (automotive parts manufacturing sector); and

5. Baring Private Equity's tender offer for NIIT Technologies Limited (Technology sector).

These offers comprised 79.62% of the aggregate value of all tender offers in 2019. At the other end of the spectrum, the tender offer for TTL Enterprises Limited was the smallest by value.

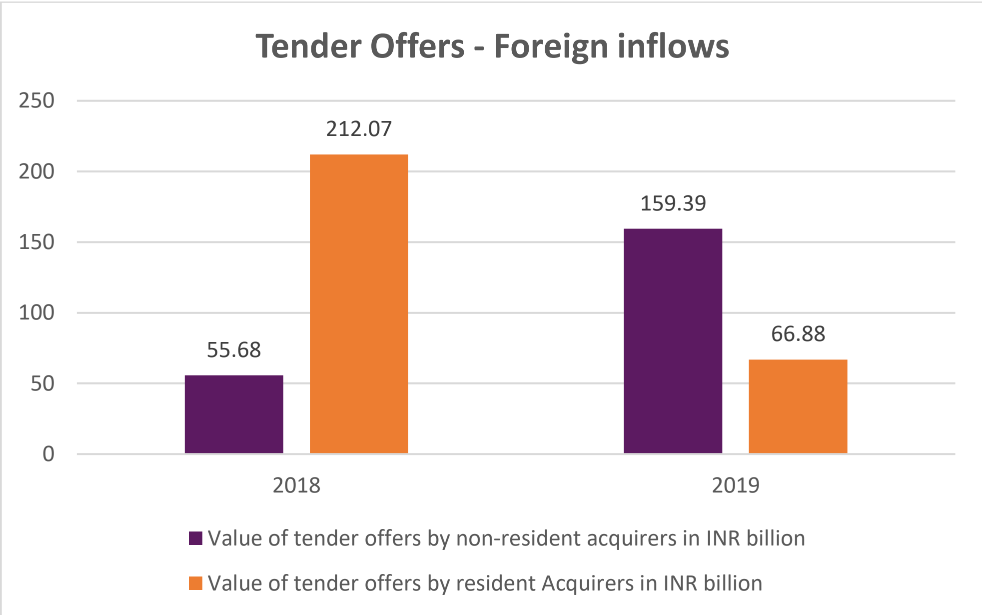
Below is a graph comparing the aggregate value of these top tender offers with the aggregate value of the other tender offers made during 2019:



F. Tender offers by non-resident acquirers

Non-resident acquirers made 10 tender offers in 2019 to acquire control of publicly-traded companies, with an aggregate value of INR 159 billion, which was 70.44% of the aggregate value of all tender offers in 2019. In comparison, in 2018, non-resident acquirers made 9 tender offers to acquire control of publicly-traded companies with an aggregate value of INR 56 billion, which was 20.79% of the aggregate value of all tender offers in 2018.

Below are graphs comparing the aggregate number and the value of the tender offers made by non-resident acquirers to the tender offers made by resident acquirers during 2019 and 2018:



The value of the tender offers made for acquisition of control by the non-resident acquirers in 2019 has tripled as compared to 2018. This is an evidence of the fact that the non-resident investors feel comfortable in making large bets on the Indian market and they are seeing substantial investment opportunities at attractive valuations amongst publicly-traded Indian companies.

G. Tender offers by financial investors

Traditionally, private equity (PE) investors in India were not keen on taking control of publicly-traded companies, deals due to various reasons, including regulatory oversight. However, in the last few years, there has been a significant uptick in PE investments going for control deals. This behavioural change is because PE investors now have a deeper understanding of the Indian regulatory environment and markets.

Tender offers made by PE investors to acquire control in 2019 are listed below:

Sr. No.	Financial Investor	Target Company	Sector	Value of Tender Offer (in INR Billion)
1.	Baring Asia	NIIT Technologies Ltd.	Technology	22.62
2.	Blackstone	Essel Propack Ltd.	Packaging	11.42
3.	Makarb Capital Group	Uniply Industries Ltd.	Wood products	4.05
4.	Vista Equity Partners	Accelya Solutions India Ltd.	Logistics	3.57
5.	Advent	DFM Foods Ltd.	Food	3.26
			Total	**44.92**

We believe that PE investors will continue to go for control deals in 2020 as well. Moreover, PE investors may also look at control deals for listed companies under financial stress in the near future, due to various favourable amendments to Indian legal and regulatory regime.

H. Analysis of SEBI's key observations on draft letters of offers

1. SEBI's interpretative concerns with Regulation 22 of the Takeover Regulations

One of the key concerns in the context of an underlying secondary transaction that triggers an open offer is whether such a transaction can be closed on the stock exchange? This is due to reservations expressed by SEBI in relation to the interpretation of certain provisions of the Takeover Regulations.

This has led to unintended consequences. It has cast a doubt on the legality of on-market closure of underlying share purchase transactions, to the extent that even on-market closure post the completion of the open-offer process is suspect. However, one must remember that on-market closure of underlying transactions is not contrary to the Takeover Regulations and its provisions are not subject to multiple interpretations.[4]

As per the Takeover Regulations, an acquirer can close the underlying triggering transaction 21 working days after the issuance of the detailed public statement, by fulfilling certain procedural requirements, rather than waiting till the closure of the open-offer process. Also, one has the option to close a negotiated transaction either on-market or off-market. For a seller, the on-market route is more tax efficient and, hence, a preferred option for closing the underlying deal.

Regulation 22(1) of the Takeover Regulations prohibits an acquirer from closing the underlying transaction that has triggered an open offer until the expiry of the offer period. This is applicable irrespective of whether the transaction is proposed to be closed on- or off-market. The exceptions to this prohibition are provided in Regulations 22(2) and 22(2A) and are summarised below:

a. Negotiated Deals: Irrespective of the mode used to close the underlying deal, Regulation 22(2) permits the acquirer to close the deal after the expiry of 21 working days from the date of the detailed public statement, if the acquirer has made a cash deposit of the entire consideration payable to the public shareholders in the open offer in a regulatory escrow account.

b. Primary Infusion and Non-negotiated deals: Regulation 22(2A), which was introduced in the Takeover Regulations in March 2013, permits the acquirer to acquire shares through preferential issue or through stock exchange settlement (other than through block deals / bulk deals) if the acquired equity shares are kept in a regulatory escrow and the acquirer doesn't exercise voting rights on such equity shares[5].

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[4] *Our firm has advised on transactions where the underlying deals have been closed on-market either prior to the completion of the open offer or after the completion of the open offer.*

[5] *Shares can move to acquirer's account if acquirer deposits entire open offer consideration in a regulatory escrow within a prescribed period of time.*

Therefore, Regulation 22(2A), only applies to (i) preferential allotment of shares; and (ii) "market purchases" executed through anonymous screen-based trading systems. Negotiated transactions implemented through a share-purchase agreement, with identities of the buyer and seller known to each other, are, therefore, excluded from the purview of this provision, and would be covered solely by the permission to close the underlying deals under Regulation 22(2).

SEBI's views on draft letters of offer (that envisage on-market closure of underlying deals) seem to suggest that all on-market closures of underlying deals are prohibited by Regulation 22(2A) and these observations ignore Regulation 22(2) as if Regulation 22(2A) overrides 22(2) or that 22(2) is redundant. However, these two provisions are unambiguous and completely independent of each other, and dealing with two separate categories of exceptions that were introduced at two different points in time under the Takeover Regulations. Regulation 22(2A) in its clear and unambiguous terms overrides Regulation 22(1) and not 22(2). Therefore, Regulation 22(2A) cannot be read in such a manner to create the possibility of two interpretations and deviate from the rule of literal interpretation of unambiguous provisions, attempting to block such on-market closures.

Conclusion and a Word of Caution

Both on- and off-market closure of underlying deals, whether prior to the closure of an open offer or after, is kosher. Separately, from a price-movement risk perspective, on-market closure prior to the closing of an open-offer (rather than later) might work out better. To date, SEBI has not litigated on the issue discussed in here, but has dealt with it as comments on the draft letters of offer. For those intermediaries and parties to the transaction who have a low regulatory litigation appetite, it is advisable to seek appropriate legal risks assessment prior to the execution of definitive documents envisaging on-market deal closures of such deals.

2. Time taken by SEBI to provide comments

The time taken to complete an open offer is mainly a function of the time taken to receive SEBI's observations on the draft letter of offer and other regulatory approvals, as the rest of the process typically moves on an auto-pilot mode.

In 2019, the average time taken by SEBI to issue its final observations on the draft letter of offer was 46 days. To issue its final observations, SEBI took anywhere between 15 days (in the case of Rapicut Carbides Limited and Yogya Enterprises Limited) and 98 days (in the case of Som Datt Finance Corporation Limited), which when compared to 2018 is significantly less.

3. Trend in penalty for disclosure violations

While SEBI reviews a draft letter of offer, it also goes into past compliance with disclosures required to be made under Takeover Regulations. Like in the past, in 2019 too, SEBI typically imposed penalties in the range of INR 1,00,000 to INR 3,00,000 per violation of disclosure norms under the Takeover Regulations. If the violations are repetitive, then the penalties tend to be higher.

4. Withdrawal of tender offers

Whilst Regulation 23 of the Takeover Regulations allows withdrawal of tender offers on certain specified grounds, SEBI has never allowed withdrawal of a tender offer for reasons other than non-receipt of regulatory approvals required for the transaction. This year, SEBI allowed withdrawal of tender offer for Upasana Finance, a NBFC, as the Reserve Bank of India did not approve the change in control.

I. The Year Ahead

We see positive and robust recovery of the Indian economy in 2020. Additionally, resolution of stressed assets will continue, whether pre-IBC or through IBC, leading to control deals. We may also see FDI revival, perhaps even in the government divestments space.

Sectors that are likely to see a lot of M&A activity in 2020 (irrespective of whether it is a control deal) are energy, financial services, manufacturing, commercial real estate, technology (including e-commerce) and healthcare (including pharma).

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Contributors List

- **Cyril Shroff,** Managing Partner
- **Gautam Gandotra,** Partner
- **Gagan Sharma,** Principal Associate
- **Arnav Shah,** Senior Associate

Disclaimer

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