NPTEL ONLINE CERTIFICATION COURSES

MERGERS, ACQUISITIONS AND CORPORATE RESTRUCTURING

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LECTURE: 31
TITLE: Legal Aspects of M&A-1

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Concepts Covered

- Legal Aspects of Mergers and Acquisitions in India
- Definition of Merger / Amalgamation as per companies Act, 2013
- Scheme of Merger or Amalgamation
- Amalgamation Process
- Major changes in the Companies Act, 2013 with respect to merger or amalgamation

Keywords

- Amalgamating company
- Amalgamated company
- Transferor company
- Transferee company
- Merger by absorption
- Merger by formation of a new company
- Merger Scheme

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Legal Aspects of Mergers and Acquisitions in India

- The mergers or amalgamations are governed by provisions of different Acts
  - The Companies Act, 2013 (Sections 230 to 240)
    - The Companies Act, 1956 (Sections 390 to 394)
  - The Competition Act, 2002
  - The Income Tax Act, 1961
  - Indian Stamp Act, 1899
  - Accounting Standards [Ind AS]
  - Sectoral Regulations, if applicable

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Legal Aspects of Mergers and Acquisitions in India, contd..

- The takeover or acquisition involving listed companies are also regulated by
  - Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015 [Last amended on July 25, 2022]
  - Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 [Last amended on December 06, 2021], commonly known as SEBI Takeover Code

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Legal Aspects of Mergers and Acquisitions in India, contd..

- Depending on the domain or industry where the companies operate, sector specific regulators also play role in regulating M&A, e.g.,
  - Reserve Bank of India (RBI) in case of Banks and NBFCs
  - Insurance Regulatory and Development Authority of India (IRDAI) in case of insurance companies
  - Telecom Regulatory Authority of India (TRAI) in case of telecom sector
- In addition to the above, cross-border M&A are regulated/ governed by
  - Regulations related to foreign direct investment
  - Foreign Exchange Management Act, 1999

The Companies Act, 2013

- Sections 230 to 240 of the Companies Act, 2013
- Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, effective from 15th December, 2016.

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Companies Act, 2013: Definition of Merger / Amalgamation

- Merger or Amalgamation is not specifically defined by the Companies Act, 2013.
- **'Amalgamation'** is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another and as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or the amalgamated company.
- Amalgamated company is surviving whereas amalgamating company does not survive.

Companies Act, 2013: Definition of Merger / Amalgamation, contd..

- Examples:
  - Company A and Company B are merged to form a new company, Company C. The shareholders of Company A and Company B shall receive shares in Company C in lieu of shares held in the respective company. Companies A and B are amalgamating companies whereas Company C is amalgamated company.
  - Company B is merged with Company A. Company A exists, Company B ceases to exist. Shareholders of Company B shall receive shares in Company A in lieu of shares held in Company B. Company B is amalgamating company, whereas Company A is amalgamated company.

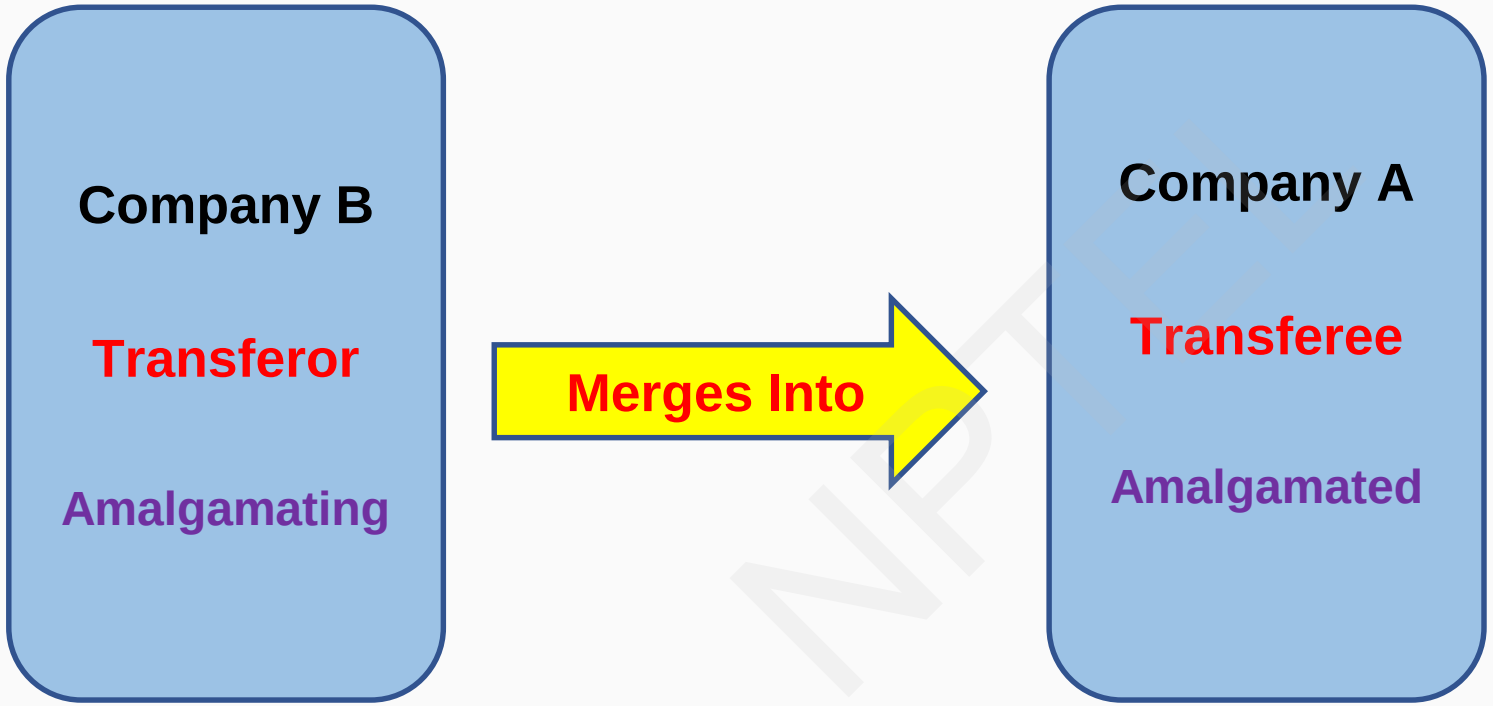
The Companies Act, 2013: Definition of Merger / Amalgamation, contd..

- Explanation as per Section 232 of the Companies Act, 2013:
  - In a scheme involving a merger, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, **it is a merger by absorption**.
  - In a scheme, where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, **it is a merger by formation of a new company**;
  - In general M&A parlance, the first one can be considered as **takeover** and the second one can be considered as **merger or amalgamation**.

The Companies Act, 2013: Definition of Transferor and Transferee Company

- **Transferor Company** means the company which is amalgamated into another company.
- **Transferee company** means the company into which a transferor company is amalgamated.
- In a merger or amalgamation, transferor company ceases to exist whereas transferee company survives.
- In M&A parlance, the target company is transferor company and acquiring company is transferee company provided the business of the target are transferred to the acquiring company.

Amalgamating vs Amalgamated or Transferor vs Transferee



A Summary of Steps Followed in Amalgamation Process*

- Going through the Memorandum of Association (MoA) of the transferee company (acquirer) with specific reference to capital and objective clauses
- Convening board meeting and preparation of valuation reports and scheme document
- Application to the National Company Law Tribunal
- Notice given to stock exchanges and regulating agencies
- NCLT approves time, date and venue of the meeting of shareholders and creditors for merger
- General meeting convened for passing of scheme of merger
- Reporting of results of the meeting to the tribunal
- Filing of representations by regulators to the tribunal
- Approval of merger by the tribunal
- Filing of certified copy of approval with the Registrar of Companies

**** Adapted from Kapil and Kapil (2017), pp. 165-167***

Scheme of Merger or Amalgamation

A scheme of merger or amalgamation is prepared by the companies involved in merger after they officially agree to merger. The scheme of merger may consist of the following (not exhaustive):

- Description of Parties: Transferor and Transferee
- Description of the Scheme
- Rationale for the Scheme
- Definitions
- Share Capital
- Transfer of:
  - Assets
  - Liabilities
  - Contracts, Deeds, Licenses, etc.
  - Legal, taxation and other proceedings
  - Employees
  - Statutory obligations like, provident fund, gratuity
- Treatment of taxes and unutilized tax benefits

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Scheme of Merger or Amalgamation, contd..

- Consideration
- Issuance of transferee company shares for amalgamation
- Reorganization of share capital of the transferor company
- Consolidation of authorized capital of the transferor company with the authorized capital of the transferee company
- Amendment of the MoA of the Transferee Company
  - Objectives of the Company
  - Share Capital
- Conditions related to dividend distribution by Transferee and Transferor Companies prior to the effective date of merger
- Accounting treatment (Ind AS 103)
- Dissolution of the transferor company
- Other Terms and Conditions
- Costs related to the Scheme

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Major Changes in the Companies Act, 2013 with respect to merger or amalgamation

- Notice of meeting to different agencies and regulatory authorities
- Disclosure of certificate of valuation of target
- Certificate of auditors regarding compliance of relevant Accounting Standard with respect to amalgamation
- Objections to the merger scheme: Only person holding not less than 10 percent of equity or not less than 5 percent of debt as per latest audited financial statements can object to the merger scheme. As per Companies Act, 1956, any shareholder or creditor could object to the scheme of merger.
- Merger between foreign company and Indian companies allowed subject to prior approval of the Reserve Bank of India

Major Changes in the Companies Act, 2013 with respect to merger or amalgamation, contd..

- Merger of a listed company into an unlisted company will not in itself result in listing of an unlisted company (As per Companies Act, 1956, that as soon as the unlisted company is merged with a listed company, the unlisted company gets listed automatically without there being any process of IPO.)
  - If the shareholders of the listed company want to exit, it will be the duty of the unlisted company to facilitate exit with a pre-determined rate as per the SEBI guidelines.
  - This is to prohibit reverse takeover where a private limited company becomes a listed public limited company with going for IPO.
  - Till the SEBI guidelines regarding allotment of share to public are complied with, the unlisted company shall remain unlisted.
- Short Form or Fast Track Merger: Prior approval of NCLT or other regulatory agencies are not required if merger takes place between two small companies or between a parent and a wholly owned subsidiary.
  - However, notices have to be sent to the Registrar of Companies and the official liquidator. The scheme needs to be approved by at least '90% of the shareholders' and 'creditors representing nine-tenth of the value of creditors'.

CONCLUSION

- Merger or amalgamation involves considerable number of steps w.r.t. regulatory aspects.
- The newly announced rules as per Companies Act 2013, have brought a paradigm shift in the way of Mergers and Acquisitions done in India
- The new rules aim to simplify the procedure and increase transparency.
- Additionally, the NCLT's authority over these issues ensures uniformity and speed up the overall process.

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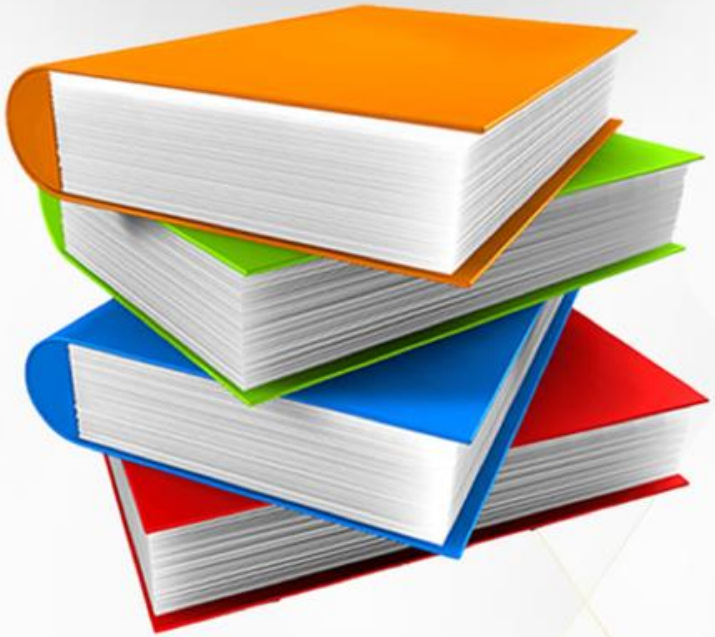

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LECTURE: 32
TITLE: Legal Aspects of M&A-2

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Concepts Covered

- Genesis of Competition Law
- The Competition Act, 2002 and its select provisions related to M&A
- Relevant Markets from the Competition Act point of view

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Keywords

- Anti-trust
- Competition
- Concentration
- Threshold Limits
- Relevant Markets
- Relevant Geographic Market
- Relevant Product Market

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The Genesis of Competition or Anti-Trust Laws

Sherman Anti-Trust Act (1890)*

- The Sherman Anti-trust Act of 1890 was the first measure passed by the U.S. Congress to prohibit trusts.
- A trust is an arrangement by which stockholders in several companies transfer their shares to a single set of trustees. In exchange, the stockholders receive a certificate entitling them to a specified share of the consolidated earnings of the jointly managed companies (in the context of USA). The trustees managed the affairs of the business, thus operating like a monopoly.
- This Act was dismantled by the US Supreme Court in 1895.

*https://www.archives.gov/milestone-documents/sherman-anti-trust-act, accessed on 22 December 2022

Herfindahl–Hirschman Index: A Measure of Concentration

- Herfindahl–Hirschman Index (HHI), is a commonly accepted measure of market concentration. The HHI is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers.
- $HHI = \sum_{i=1}^{n} s_i^2 = s_1^2 + s_2^2 + s_3^2 + s_4^2 + \ldots + s_n^2$
  - Where, S_i = i^{th} firm's market share
- HHI approaches zero when a market is occupied by a large number of firms of relatively equal size and reaches its maximum of 10,000 points when a market is controlled by a single firm.
- HHI can be high if a substantial portion of the market is controlled by limited number of firms even if the number of firms in the industry is very large.

Example of Herfindahl–Hirschman Index (HHI)

Firm Id	Market share (%)	Firm Id	Market share (%)	Firm Id	Market share (%)	Firm Id	Market share (%)
1	12	1	40	1	16	1	50
2	14	2	30	2	16	2	40
3	16	3	8	3	17	3	2
4	15	4	7	4	18	4	3
5	16	5	6	5	17	5	2
6	14	6	5	6	16	6	3
7	13	7	4				
HHI	**1102**	**HHI**	**2690**	**HHI**	**1670**	**HHI**	**4126**

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Competition Law in India

- Any agreement between businesses regarding the acquisition or control of knowledge and information, the production, distribution, or purchase of goods and services, which results in a monopoly, has a negative influence on competition.
- Both mergers and acquisitions have the potential to end competition and establish monopolies that are detrimental to the interests of the general public, consumers, and other market competitors.
- Every nation strives to eliminate unfair trade practices, promote healthy competition, and prevent the formation of monopolies for the better functioning of the economy.
- In a competitive market, firms system must adhere to two major constraints: demand substitution and supply substitution. A market is competitive if customers can choose between a range of products with similar characteristics or features and if the supplier does not face obstacles to supplying products or services on that market.

Competition Law in India, contd..

- The Competition Act, 2002 replaced the erstwhile Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 in response to the evolving nature of the global competitive environment and rising mergers and acquisitions trends in India. The Competition Act, 2002 came into effect in 2009.
- The focus of the MRTP Act was to curb monopolies while the focus of the Competition Act is to promote competition.
- In accordance with the Competition Act, Competition Commission of India regulates anti-competitive agreements, abuse of dominant position in the market, and consolidation resulting into monopoly while the Competition Appellate Tribunal regulates it.

Competition Law in India, contd..

- The statutory provisions related to M&A in India from the point of view of competition are covered by:
  - The Competition Act, 2002
  - The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011
  - The Competition Commission of India (General) Regulations, 2009
  - Notifications issued by the Competition Commission of India from time to time.

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Scope of the Competition Act , 2002

- Prohibition of Certain agreements (Section 3)
  - Any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect (AAEC) on competition within India: Any agreement entered into in contravention to this provision shall be void
- Abuse of Dominant Position (Section 4): Dominant position arises when an enterprise indulges in-
  - Directly or indirectly imposing discriminatory condition in purchase or sale (including predatory price) of goods and services
  - Limiting the production of goods or provision of services.
  - Restricting technical or scientific development.
  - Indulging in practice resulting in denial of market access.
  - Making condition of contracts subject to acceptance by other parties of supplementary obligations, which has no connection with the subject of such contract.
  - Utilization of dominant position in one relevant market to enter or protect another relevant market.

Scope of the Competition Act , 2002, contd..

- Regulation of Combination (Section 5), which comprises of:
  - Acquisition of control, shares, voting rights or assets have been acquired or are being acquired
  - Acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service
  - Any acquisition, merger or amalgamation among the enterprises

Financial Threshold Limits for Combinations*

Thresholds for Filing Notice				
		Assets		**Turnover**
Enterprise Level	**India**	> 2,000 INR Crore	OR	> 6,000 INR Crore
	Worldwide with India leg	> USD 1 billion with at least > 1,000 INR crore in India		> USD 3 billion with at least > 3,000 INR crore in India
OR				
Group Level	**India**	> 8,000 INR Crore	OR	> 24,000 INR Crore
	Worldwide with India leg	> USD 4 billion with at least > 1,000 INR crore in India		> USD 12 billion with at least > 3,000 INR crore in India

Regulation 9 of the Combination Regulations states that it is the responsibility of the acquirer to notify an acquisition or a hostile takeover. In case of a merger or an amalgamation, a joint notice is to be filed by the merging or amalgamating parties. In case of formation of a joint venture, the responsibility to file a notice would lie with all the parties forming the joint venture.

*Source: https://www.cci.gov.in/faqs, accessed on 22 December 2022

Combinations ordinarily not notifiable (Schedule I of Competition Regulations)#

- Certain transactions, listed in Schedule I of the Combination Regulations, are unlikely to have any AAEC and therefore, are not ordinarily notifiable. These transactions do not enjoy absolute exemption and have to be assessed on a case-to case basis. Some of the transactions are#:
  - An acquisition of less than 25% of shares or voting rights of an enterprise solely as an investment or in the ordinary course of business, not amounting to control
  - An acquisition of stock-in trade, raw materials, stores and spares, and other similar current assets in ordinary course of business.

#Source: https://www.cci.gov.in/combination/combination/filing-of-combination-notice/introduction, accessed on 22 December 2022; This link provides for the full list of exemptions.

Combinations ordinarily not notifiable (Schedule I of Competition Regulations)#, contd..

- An acquisition of shares or voting rights or assets by a person/ enterprise of another person/ enterprise within the same group (intra-group acquisition), except where the acquired enterprise is jointly controlled by enterprises that are not part of the same group.
- A merger or an amalgamation of two enterprises where (i) one enterprise has more than 50% shares or voting rights in the other, and/or (ii) 50% or more shares or voting rights in both enterprises are held by enterprise(s) belonging to the same group, provided there is no change from joint control to sole control.

- Similarly certain sector specific exemptions are also allowed (regional rural banks, public sector banks, etc.).

#Source: https://www.cci.gov.in/combination/combination/filing-of-combination-notice/introduction, accessed on 22 December 2022; This link provides for the full list of exemptions.

De Minimis Exemption

- The Government of India has granted exemption to acquisition of small targets which is known as *de minimis* exemption. Combinations where the assets or the turnover is below the specified thresholds (Assets <Rs.350 crore and Turnover < Rs.1,000 crore).
- This exemption was announced as per notification No.S.O.988(E) dated March 27, 2017 for a period of five years.
- This makes the M&A process easier for small targets including those in business groups.

Combinations ordinarily not notifiable (Schedule I of Competition Regulations)#, contd..

- Irrespective of the exemptions listed earlier, if a combination causes or is likely to cause an appreciable adverse effect on competition within the **relevant market** in India, it can be modified/prohibited by the Competition Commission.

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#Source: https://www.cci.gov.in/combination/combination/filing-of-combination-notice/introduction, accessed on 22 December 2022; This link provides for the full list of exemptions.

Relevant Market (Section 2 of the Competition Act)

- “relevant market” means the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets;
- “relevant geographic market” means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas;
- “relevant product market” means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use;
- The factors considered by the Commission for “relevant geographic market” and “relevant product market” are given in Appendix-1

Changing Nature of Relevant Market

- In view of the changing market dynamics, the Competition Commission interprets relevant market on a case to case basis.
- In the 2020 CCI dismissal order in Lifestyle Equities v. Amazon, the Commission specifically remarked[##]:
  - "Delineation of relevant market and competitive assessment are based on market realities as they exist at the time of assessment, keeping in view the facts and allegations. In rapidly changing markets in particular such as the one in the present case, market assessment cannot have a static approach."

#Source: https://www.barandbench.com/columns/delineation-of-relevant-market-by-the-cci-change-in-practice, accessed on 22 December 2022.

CONCLUSION

- The Competition Commission of India (CCI) as envisaged in the Competition Act, 2002 deals with approval of M&A subject to certain exemptions.
- Depending on threshold limits, the acquiring company (or merging companies) has to notify to the CCI about mergers and acquisitions effected by them.
- Prior to approving, modifying or rejecting an M&A, the CCI inquires about the appreciable adverse effect on competition (AAEC) of the particular M&A in the relevant markets, viz. relevant geographic market and relevant product market.

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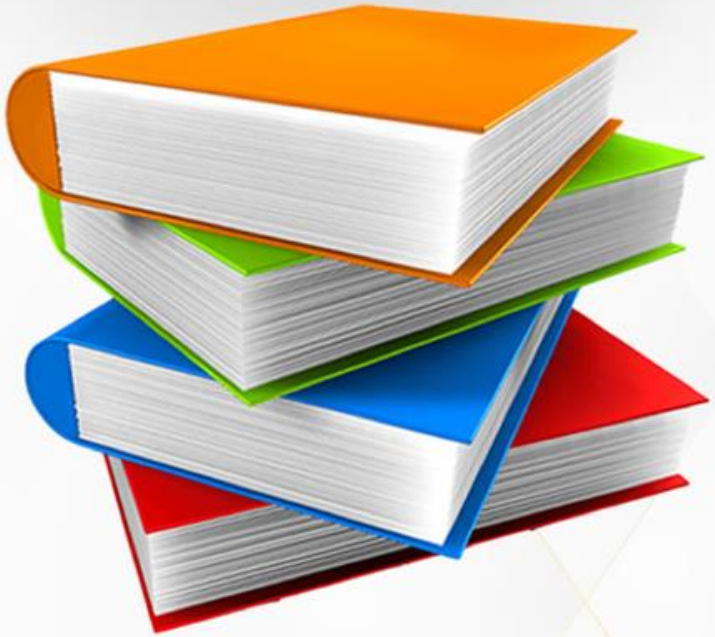

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Appendix-1:

Factors considered by CCI while determining the "relevant geographic market" and "relevant product market":

Relevant geographic market	Relevant product market
a) regulatory trade barriers; b) local specification requirements; c) national procurement policies; d) adequate distribution facilities; e) transport costs; f) language; g) consumer preferences; h) need for secure or regular supplies or rapid after-sales services.	a) physical characteristics or end-use of goods; b) price of goods or service; c) consumer preferences; d) exclusion of in-house production; e) existence of specialised producers; f) classification of industrial products.

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LECTURE: 33
TITLE: Legal Aspects of M&A-3

Concepts covered

- Competition Act, 2002
- Inquiry into combination by Competition Commission
- Substantial Acquisition of Shares and Takeovers Regulations, 2011 or SEBI Takeover Code, 2011

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Keywords

- Competition Act, 2002
- Takeover code, 2011
- Disclosure of shareholding as per Takeover Code
- Threshold limits for open offer as per Takeover Code
- Mandatory Offer
- Voluntary Offer

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Inquiry into Combination by the Competition Commission

- The Competition Commission may, upon its own knowledge or information relating to acquisition referred to in clause (a) of section 5* or acquiring of control referred to in clause (b) of section 5* or merger or amalgamation referred to in clause (c) of that section, inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India.
- The Commission shall not initiate any inquiry under this subsection after the expiry of one year from the date on which such combination has taken effect.

*** Of the Competition Act, 2002**

Inquiry into combination by the Competition Commission, contd..

- For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission shall have due regard to all or any of the following factors, namely:—:
  a) actual and potential level of competition through imports in the market;
  b) extent of barriers to entry into the market;
  c) level of combination in the market;
  d) degree of countervailing power in the market;

  The entire list is available in the Appendix-1

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Prescribed Timetable as per the Competition Act

- M&A transactions subject to review by the Competition Commission of India can not be consummated until a clearance is obtained or a review period of 210 calendar days from the notification passes, whichever is earlier. Thus, the merger control regime in India is suspensory in nature.
- CCI can conduct the investigation into M&A in two phases:
  - Phase I: The CCI is required to form its prima facie opinion on whether the combination is likely to cause or has caused an AAEC within the relevant market in India within 30 working days of receipt of the notice. This time period is exclusive of the time given to third parties or other regulators (maximum 15 working days) for the assessment of the impact.
  - Phase II: If the CCI forms an opinion that the M&A is likely to have AAEC, it can extend the review period up to 210 calendar days statutory period. This period is exclusive of extension allowed as per Section 29 (6) and 29 (8) of the Act. [***Please refer The Competition Act, 2002 for more details***]

Examples of CCI Orders

- Tata Sons, Air India and Air Asia
- Merger of Multiplex Chains PVR and INOX

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Takeover Code – Some Principles

- Takeover codes are prescribed in all major countries so as ensure a systematic framework for acquisition of stocks in listed entities.
- Takeover codes ensure that the public shareholders are treated fairly in relation to a substantial acquisition in or takeover of a listed company.
- The public shareholders should have fair exit option in the event of takeover.

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SEBI - Takeover Code, 2011

- Takeover of companies whose securities are listed on one or more stock exchanges in India is regulated by the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 [SAST], as amended from time to time.
- Besides SAST, an acquirer also has to understand the compliance requirements of under the SEBI LODR (Listing Obligations and Disclosure Requirement) Regulations, 2015 as amended from time to time.
  - SEBI LODR mandates a listed company to comply with the minimum public shareholding requirements specified in Rules 19(2) and 19A of the Securities Contracts (Regulation) Rules, 1957

Select Definitions as per SEBI - Takeover Code, 2011

- "Acquirer" means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company [Regulation 2(1)(a)];
- "Acquisition" means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company. It means that agreement to acquire the share or voting or control in a listed company without actual acquisition of share will also be treated as acquisition for the purpose of SEBI Takeover Regulations, 2011. [Regulation 2(1)(b)];

Select Definitions as per SEBI - Takeover Code, 2011, contd..

- "Control" includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner; *Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position;* [Regulation 2(1)(e)]
- "Persons Acting in Concert (PAC)" means persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company. [Regulation 2(1)(q))]

Disclosure of Substantial Holding in Target Company*

- Event Based Disclosure (Regulation 29)
  a) Any person, who along with PACs crosses the threshold limit of 5% of shares or voting rights, has to disclose his aggregate shareholding and voting rights to the Target Company at its registered office and to every Stock Exchange where the shares of the Target Company are listed within 2 working days of acquisition as per the format specified by SEBI.
  b) Any person who holds 5% or more of shares or Voting rights of the target company and who acquires or sells shares representing 2% or more of the voting rights, shall disclose details of such acquisitions/ sales to the Target company at its registered office and to every Stock Exchanges where the shares of the Target Company are listed within 2 working days of such transaction, as per the format specified by SEBI.

*SEBI Takeover Code, 2011

Disclosure of Substantial Holding in Target Company*, contd..

- Continual disclosures (Regulation 30): Continual disclosures of aggregate shareholding shall be made within 7 days of financial year ending on March 31 to the target company at its registered office and every stock exchange where the shares of the Target Company are listed by:
  a) Shareholders (along with PACs, if any) holding shares or voting rights entitling them to exercise 25% or more of the voting rights in the target company.
  b) Promoter (along with PACs, if any) of the target company irrespective of their percentage of holding.

*SEBI Takeover Code, 2011

Open Offer under SAST Regulations, 2011*

- An open offer is an offer made by the acquirer to the shareholders of the target company inviting them to tender their shares in the target company at a particular price.
- The primary purpose of an open offer is to provide an exit option to the shareholders of the target company on account of the change in control or substantial acquisition of shares, occurring in the target company.
- If an acquirer has agreed to acquire or acquired control over a target company or shares or voting rights in a target company which would be in excess of the threshold limits, then the acquirer is required to make an open offer to shareholders of the target company.

*** SEBI Takeover Code, 2011**

Threshold Limit for Making an Open Offer*

- **3 (1) Acquisition of 25% or more shares or voting rights:** An acquirer, who (along with PACs, if any) holds less than 25% shares or voting rights in a target company and agrees to acquire shares or acquires shares which along with his/ PAC's existing shareholding would entitle him to exercise 25% or more shares or voting rights in a target company, will need to make an open offer before acquiring such additional shares.
- **3 (2) Acquisition of more than 5% shares or voting rights in a financial year:** An acquirer who (along with PACs, if any) holds 25% or more but less than the maximum permissible non-public shareholding in a target company, can acquire additional shares in the target company as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31, only after making an open offer.
- 3 (3) An open offer, other than a voluntary open offer under Regulation 6, must be made for a minimum of 26% of the target company's share capital.

***Regulation 3, SEBI Takeover Code, 2011**

Threshold Limit for Making an Open Offer, contd..*

- **3 (3)** When any person or entity acquires shares, if the individual shareholding of such an acquirer post such acquisition exceeds the threshold limit of 25% as laid down in Regulation 3(1) of the Takeover Regulations or the creeping acquisition limit of 5% in a financial year as laid down in Regulation 3(2) of the Takeover Regulations, that person or individual or entity would be under an obligation to make a public announcement of an open offer. This is irrespective of the aggregate shareholding of such an individual or an entity with persons acting in concert with him.
- An open offer, other than a voluntary open offer under Regulation 6, must be made for a minimum of 26% of the target company's share capital.

*Regulation 3, SEBI Takeover Code, 2011

Example, 33.1

- Suppose Alpha intends to purchase 4,000 shares from Beta, the promoter by way of a share purchase agreement. Alpha's shareholding will increase to 5,000 shares representing 25% of the voting rights in the company. In such case, Alpha is under an obligation to make a public announcement with open offer.

Name of the Shareholder	Number of shares held	Percentage of voting rights
Beta (Promoter)	10,000	50%
Alpha (part of the public)	1,000	5%
Other Public Shareholders	9,000	45%
Total	**20,000**	**100%**

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Example, 33.2

- The Company make a preferential allotment of 1,600 shares to Beta as a result of which Beta's number of shares in the company will increase to 6,000.
- Change in % stake of Promoters: (8,000 / 20,000 i.e. 40%) to (9,600 / 21,600 i.e. 44,44%): 4.4% change which is less than 5%
- Change in % stake of Beta: (4,400/20,000, i.e. 22%) to (6,000/21,600, i.e.27.48%: crossing the individual limit to beyond 25% thus triggering public announcement with open offer by Beta.

Name of the Shareholder	Number of shares held	Percentage of voting rights
Promoters:		
Beta	4,400	22%
Theta	3,000	15%
Gamm	600	3%
Public	12,000	60%
Total	**20,000**	**100%**

Voluntary Open Offer*

- A voluntary open offer under Regulation 6, is an offer made by a person who himself or through Persons acting in concert, if any, holds 25% or more shares or voting rights in the target company but less than the maximum permissible non-public shareholding limit. In such case, the minimum open offer has to be 10% of the share capital of the target.
- Any person holding less than 25% of shares/ voting rights in a target company can make an open offer provided the open offer is for a minimum of 26% of the share capital of the company.
- Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SAST Regulations, 2011 for frequently or infrequently traded shares.

*SEBI Takeover Code, 2011

CONCLUSION

- The Competition Commission of India (CCI) can inquire into M&A events suo moto or when notified.
- As per SEBI Takeover Code, 2011, the acquiring company or persons in concerts or persons need to announce the shareholding in a target based on the threshold limits.
- There are provisions related to mandatory and voluntary open offers as per SEBI Takeover Code 2011 so as to offer a fair exit option to the public shareholders.

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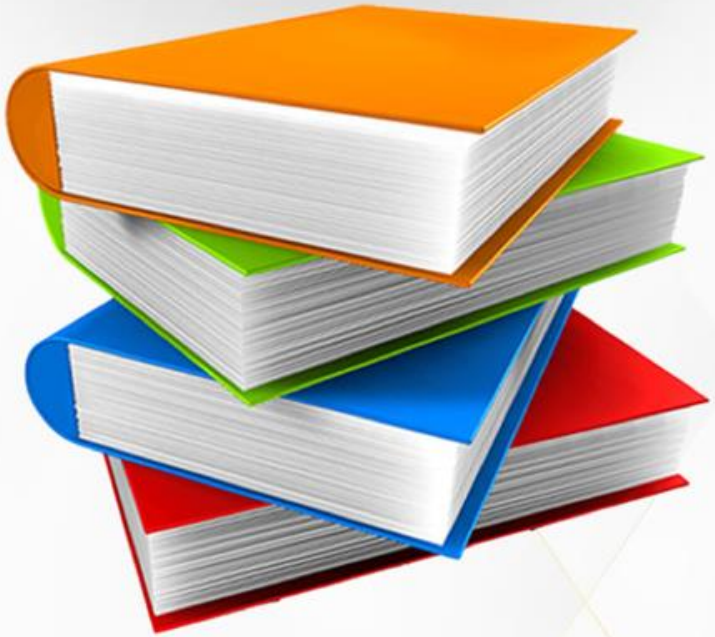

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Appendix-1:

List of Factors looked into by the Competition Commission while determining whether the combination causes or is likely to cause an 'appreciable adverse effect on competition' (AAEC) in the relevant market:

a) actual and potential level of competition through imports in the market;
b) extent of barriers to entry into the market;
c) level of combination in the market;
d) degree of countervailing power in the market;
e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
f) extent of effective competition likely to sustain in a market;
g) extent to which substitutes are available or arc likely to be available in the market;
h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
j) nature and extent of vertical integration in the market;
k) possibility of a failing business;
l) nature and extent of innovation;
m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;
n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

Tata Sons, Air India and Air Asia

- The names of the parties to the combination are:
  - **Air India Ltd. (AIL); and**
  - **Air Asia (India) Private Limited (Air Asia India / Target).**
- The proposed merger involves Air India Ltd. (AIL), an indirect wholly-owned subsidiary of Tata Sons Private Limited (TSPL), acquiring the entire equity share capital of AirAsia (India) Private Limited (Air Asia India / Target) (TSPL). TSPL now owns 83.67% of Air Asia India's equity share capital.
- The Proposed Combination is notifiable under Section 5(a)(i)(A) and 5(b)(i)(A) of the Competition Act, 2002.

Tata Sons, Air India and Air Asia contd..

- **AIL** : It is a completely owned indirect subsidiary of TSPL. A recent transaction involving the acquisition of AIL by TSPL (via its fully owned subsidiary, Talace Private Limited) was authorized by the Hon'ble Commission in an order dated December 20, 2021. AIL's main line of business is the provision of (a) domestic scheduled air passenger transport service, (b) international scheduled air passenger transport service, (c) air cargo transport services in India, and (d) charter flight services in India. Air India Express Limited (AIXL), AIL's wholly-owned subsidiary, also participates in this line of business.
- **Air Asia India**: As previously mentioned, Air Asia India is a joint venture between TSPL and AAIL, with TSPL currently owning 83.67% of the shares and AAIL owning 16.33%. The "AirAsia" brand is used by Air Asia India. They provide all the services like AIL except the passenger transport in international route
- **CCI opinion**: Regardless of how the relevant markets are characterized, the proposed combination will not make any changes to the competitive environment or have a significant negative impact on competition in India.

Merger of Multiplex Chains PVR and INOX

- The proposed merger to be known as PVR-INOX, which would be becoming the largest film exhibition company in India, operating 1546 screens across 341 properties in 109 cities.
- Existing screens will keep their current names, INOX and PVR, respectively. PVR-INOX will only be the name of new theatres that are opened after the merger.
- Analysts estimate the combined entity will control 50% of multiplex screens and 16% of the market overall, including single screens.
- INOX and PVR announced their merger on March 27. But as the deal fell below the regulator's threshold level, the entities were not obligated to request CCI permission.
- The merger has got the approval of the respective shareholders of the two firms, creditors, stock exchanges NSE and BSE, NCLT as well.

Merger of Multiplex Chains PVR and INOX, contd..

- **Complaint**: A non-profit organization named CUTS had demanded a thorough investigation of the two organizations after claiming that the proposed merger agreement would have anti-competitive implications on the film exhibition business.
- The Competition Commission of India (CCI) dismissed it stating apprehension of likelihood of anti-competitive behavior by an organization cannot be the basis of an investigation.
- **CCI Order**: The regulator stated that it was of the opinion that suspicions of an AAEC (Appreciable Adverse Impact on Competition) by a potential company that has not yet taken shape cannot be the subject of an investigation under Section 3 or 4 of the Competition Act.
- Upon approving the order, the regulator made it clear that any subsequent allegations of abusive behavior might be investigated in accordance with the Act's requirements.

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MERGERS, ACQUISITIONS AND CORPORATE RESTRUCTURING

Prof. CHANDRA SEKHAR MISHRA

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Indian Institute of Technology Kharagpur

LECTURE: 34

TITLE: Accounting Aspects of M&A – I

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Concepts covered

- Accounting for Business Combination
- Pooling of interest method and purchase method
- Identification of the Acquirer
- Determination of Acquisition date

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Keywords

- Business Combination
- Pooling of Interest method
- Purchase method
- Step Acquisition

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Accounting for Amalgamation [AS 14 (India)]

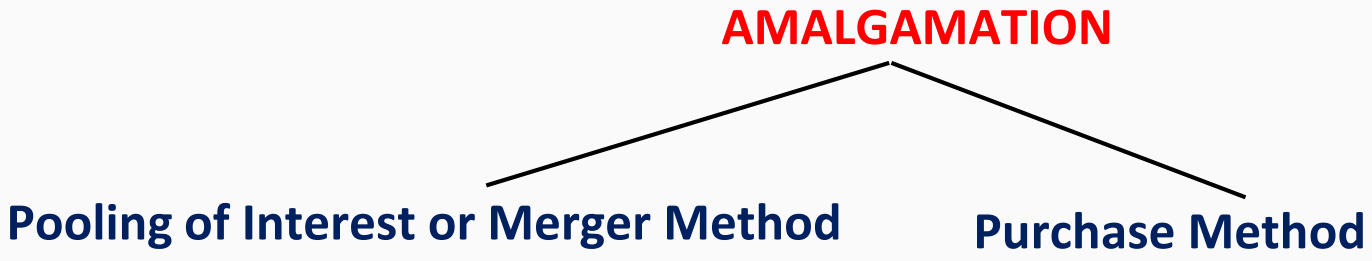
Amalgamation refers to the process of merger of two or more companies into a single entity or where one company takes over the other by outright purchase. Therefore, the term “amalgamation” contemplates two kinds of activities:

- two or more companies join to form a new company or
- absorption and blending of one by the other

Example 1: Company A and Company B amalgamate to form Company C (Amalgamation).

Example 2: Company P is taken over by Company Q (Purchased).

As per Accounting Standard-14 (India), Amalgamation can take place in two ways, i.e. in the nature of merger and in the nature of the purchase.



Pooling of Interest Method

As per AS 14, following conditions need to be satisfied to be considered amalgamation in the nature of the merger:

- All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- Shareholders holding not less than 90% of the face value of the equity shares of the transferor company become equity shareholders of the transferee company.
- The consideration for the amalgamation is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
- The business of the transferor company is intended to be carried on by the transferee company after amalgamation.

No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee companies except to ensure uniformity of accounting policies.

Purchase Method

- When any one or more conditions specified for amalgamation in the nature of the merger are not satisfied then that type of amalgamation is to be said as amalgamation in the nature of the purchase.
- Under this type of amalgamation, generally, one company acquires another company and equity shareholders of the combining entities do not continue to have proportionate shares in the equity of the combining entity or the business of the acquired company is not intended to be combined after the amalgamation.

Major Differences between Pooling and Purchase Method

Pooling of Interest Method	Purchase Method
There is transfer of all assets and liabilities.	There need not be transfer for all assets and liabilities.
Equity shareholders holding 90% of the equity shares in transferor company become shareholders of transferee company.	Equity shareholders need not become shareholders of transferee company.
Purchase consideration is discharged wholly by issue of equity shares of transferee company.	Purchase consideration need not be discharged wholly by issue of equity shares.
Assets and liabilities are recorded as per their existing value except where adjustment require to maintain uniformity.	The assets and liabilities taken over are recorded at fair value or at their existing carrying amounts.
No goodwill is created.	Goodwill is created.

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Major Changes in Accounting for Business Combination as per International Financial Reporting Standards (IFRS)

- Elimination of pooling of interest method of accounting in M&A*
- Elimination of amortization of intangible assets
- Replacement of amortization with impairment of intangible assets
- Adoption of IFRS as Ind AS in India and related changes for Business Combinations
  - Ind AS 103: Business combination and Corporate Restructuring
  - Ind AS 110: Consolidated Financial Statements in case of Holding and Subsidiary relationships/ Group Companies
  - Ind AS 27: Separate Financial Statement (Subsidiaries, Joint Ventures and Associates)

*Pooling of interest method is used in case of common control business transactions.

Select Definitions related to Accounting for Business Combination (Ind AS 103)

Please Refer Annexure 34.1

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Steps in Accounting for Business Combination (as per Ind AS 103)

- **Step-1** Identifying the Acquirer
- **Step-2** Determining Acquisition date
- **Step-3** Recognizing and measuring identifiable assets and liabilities and NCI (Non- controlling interest)
- **Step-4** Recognizing and measuring Goodwill and Gain from a bargain purchase

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Step-1: Identifying the Acquirer

- The acquiring enterprise is the enterprise that obtains **control** and the determination of control as per Ind AS 110.
- The acquirer or investor is said to have control if it fulfills the following condition
  - Power over the investee;
  - Exposure, rights, or to variable returns from its involvement with the investee;
  - The ability to use its power over the investee to affect the amount of the investor's return.

Indicators of Control		
More than 50% voting rights	Power to appoint and remove Board of Directors	Investor have currently exercisable potential voting rights

Example 34.1: Identifying the Acquirer

L Ltd. acquired 4,000 equity shares out of 10,000 shares in M Ltd. on 23rd March 2021. As part of the agreement, L also had an option to acquire (Potential shares – capable of being converted into equity shares) an additional 2,500 shares. The option is exercisable at any time in the next 12 months. The exercise price includes a small premium to the market price at the transaction date i.e. *excess over the market rate*.

Answer:

- To determine whether L has obtained control over M, L should consider not only the 4,000 shares it owns, but also its option to acquire another 2,500 shares. The following points should be kept in the mind:
  - The options are currently exercisable and there are no other required conditions before such options can be exercised;
  - If exercised, the options would increase L's ownership to a controlling interest of 52% [(4,000 + 2,500) / 12,500] before considering other shareholders' potential voting rights.
  - Although other shareholders also have potential voting rights, if all options are exercised L will own majority shares.
- Hence, L will be the acquirer.

Points to remember while identifying the Acquirer

If a business combination has occurred, but applying the guidance in Ind AS 110 does not clearly indicate which of the combining entities is the acquirer, the following factors shall be considered:

- In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.
- In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues equity interests. However, in some business combinations, specially in the case of Reverse Acquisition, the issuing entity is the acquiree.
- In case of business combinations involving more than two entities, the combining entity that initiated the combination as well as the relative size of the combining entities can be considered for determining the acquirer.
- The acquirer is usually the combining entity whose relative size (for example in terms of assets, revenues, or profit) is significantly greater than that of the other combining entity or entities.
- A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs, B13 to B17 of Ind AS 103. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Example 34.2

The shareholders of entity A Ltd. and B Ltd. Agree to merge, to get the benefit of lower delivery and distribution costs. The business combination is carried out by setting up a new entity N, which issued 100 shares to A's shareholders and 50 shares to entity B's shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination.

- **Is N company the acquirer? If not, which entity is the acquirer, and how is the combination accounted for?**

Answer:

- **No N is not the acquirer.**
- Though the transaction has bought together entities A and B and it has been affected by company N by acquiring them.
- But in this case, N company is the new entity that has been formed only to issue equity instruments to effect a business combination.
- In this case, Entity A should be treated as an acquirer for accounting purposes. Because it is the largest entity, and **it has higher control** in the combined entity e.g. 67% of the shares (100/ 150)

Accounting implication: When N will prepare the financial statement, Entity A's assets and liabilities shall be shown at their **book values** while Entity B's assets and liabilities shall be shown at their **fair values**.

Example 34.3 (a)

Company X and Company Y operate in the textile industry and both entities are operating entities. Company X has a much larger scale of operations than company Y. Company Y merges with Company X such that the shareholders of Company Y would receive 1 equity share of Company X for each share held in Company Y. Such issue of shares would comprise 25% of the issued share capital of the combined entity. After the discharge of purchase consideration, the pre-merger shareholders of company X hold 75% of the capital in company X. Find out the acquirer.

Answer: In this transaction, as per Ind AS 103, Company X is the acquirer. Because by merging the entire shareholding of Company Y, Company X has acquired control over company Y, as shareholders of company Y hold only 25% of the paid-up capital of the merged entity, they do not obtain control over company X.

Example 34.3 (b)

In the previous example now consider that Company X has a smaller scale of operation than Company Y. Company Y merges with Company X such that the shareholders of Company Y would receive 10 equity shares of Company X for each share held in Company Y. Such issue of shares would comprise 70% of the issued share capital of the combined entity. After the discharge of purchase consideration, the management of company Y would manage the operations of the combined entity. Find the acquirer in this case.

Answer:

- In this case, company Y will be the acquirer as per Ind AS 103. Because, after the merger, the shareholders of company Y will have a controlling interest and management of the combined entity.
- Though company Y is considered an acquirer for accounting purposes only but for Legal and Reporting purposes company X would be considered an acquirer.

Step:- 2 Identifying Date of Acquisition

- The date on which acquiring enterprise obtains the control of the acquiree is simply known as the date of acquisition (DOA).
- It is the date on which the usually company transfers the consideration and acquires the assets and liabilities; it is also known as the closing date.
- However, the control can be obtained before or after the closing date. And the date on which it obtains control is referred to as DOA.

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Example 34.4

P acquires Q's 75% equity shares for cash consideration. The relevant dates are as follows. **Determine the date of acquisition**

Details	Date
Date of shareholder agreement	1st June, 2020
Date of obtaining control over the board	1st July, 2020
Date of payment consideration	15th July, 2020
Date of transfer of shares	1st August, 2020

Answer:

In this case, the control over financial and operating policies is acquired through obtaining the Board representation on 1st of July, 2020. So this date should be treated as the date of acquisition.

Example 34.5

On 1st April 2022 X Ltd. agrees to acquire the shares of Y Ltd. in all equity deals. As per the agreement, X Ltd. will get control on 1st April, however, consideration will be paid only when shareholders approve this and the shareholder meeting is scheduled on 30th April 2022. If shareholders disapprove this then consideration will b paid in cash.

Answer:

In this case, the date of acquisition should be 1st April 2022.

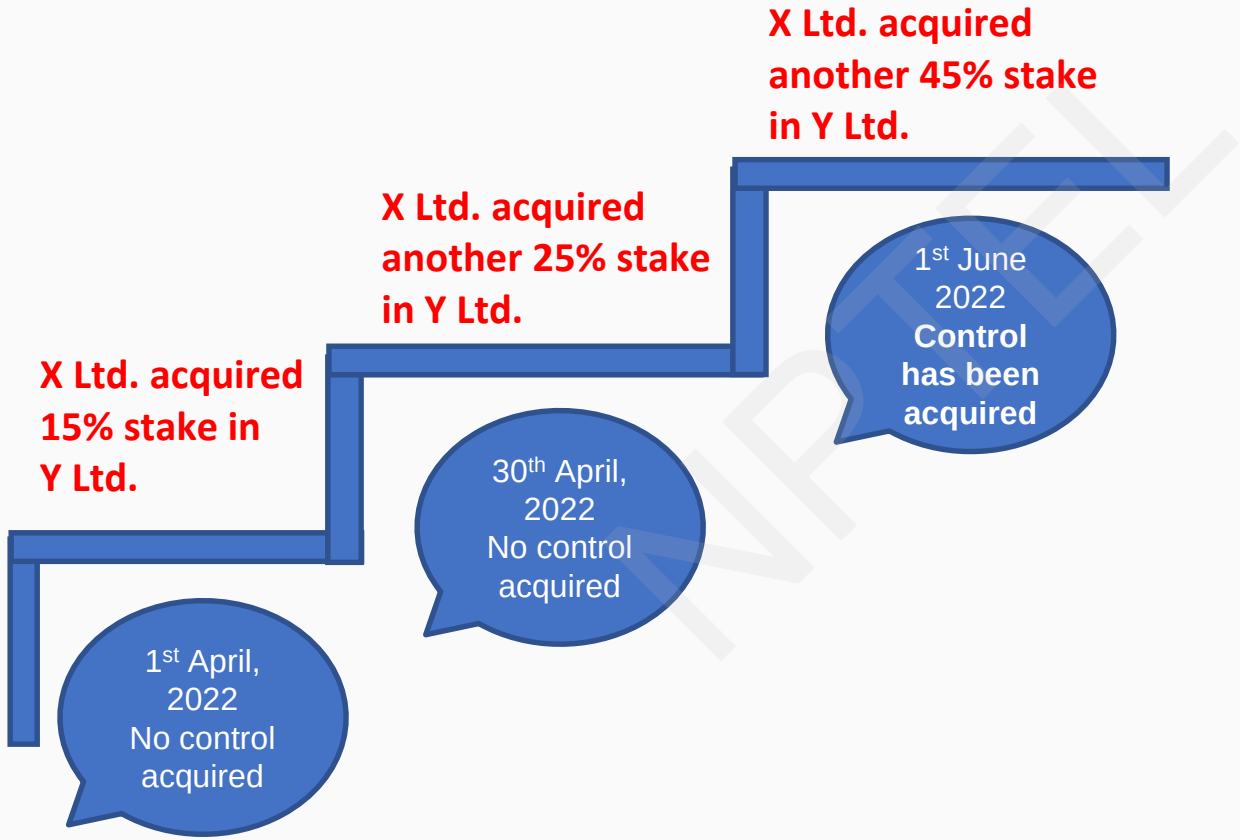
On April 1, 2022, X Ltd. Will get control over Y Ltd., though the payment of purchase consideration will be finalized on 30th April, it is sure that even if shareholders deny to give the shares to Y Ltd., X Ltd. will give cash in such case and would execute the deal.

Step Acquisition

- In the case of step acquisition, an entity acquires another entity in a series of purchases. In such cases, the Date of Acquisition will be the date on which the acquirer obtains the control over acquiree.

- If a business combination is achieved in stages, then the acquirer shall re-measure its previously held equity interest in the acquiree **on Fair value** at its acquisition date. Further, any gain or loss, if any, should be adjusted in profit or loss or other comprehensive income, as appropriate.

Example of Date of Acquisition in case of Step Acquisition



CONCLUSION

- Ind AS 103 deals with accounting for business combinations. Earlier AS 14 dealt with accounting for amalgamations.
- Identification acquirer, determination of date of acquisition are integral part of accounting for combinations.
- Although as per AS 14, companies could choose from among Pooling of interest and purchase method of accounting subject to the guidelines, Ind AS 103 suggests only purchase method of accounting.

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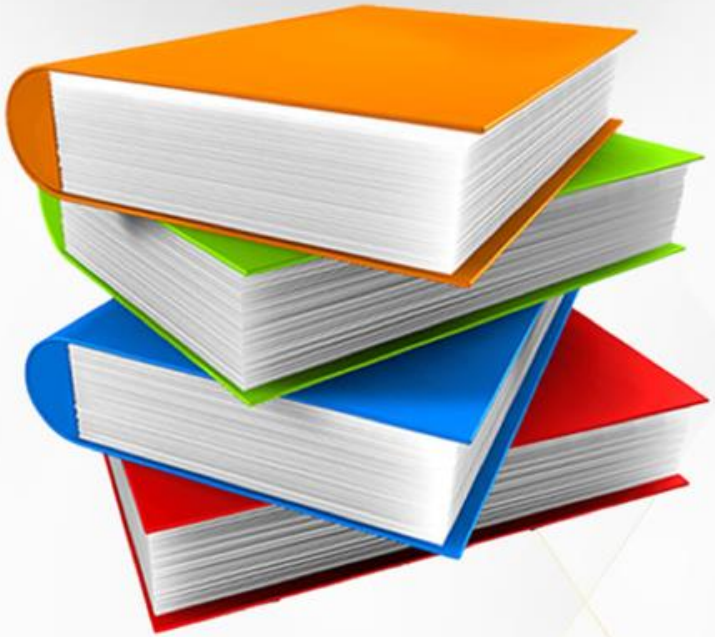

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Annexure 34.1: Select Definitions related to Accounting for Business Combination (Ind AS 103)

1. **Acquirer**: the entity that obtains control of the acquiree, it is also known as Transferee, Vendee, and Amalgamated company
2. **Acquiree**: the business the acquirer obtains control, it is also known as Transferor, Vendor, and Amalgamating company
3. **Acquisition date**:- the date on which the acquirer obtains control
4. **Business**: an integrated set of activities that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants.
5. **Business combination**: a transaction or other event in which an acquirer obtains control of one or more businesses.

Select Definitions related to Accounting for Business Combination (Ind AS 103), contd..

6. **Control**: the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities
7. **Fair value**: the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
8. **Goodwill**: an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized
9. **Non-controlling interest**: the equity in a subsidiary not attributable, directly or indirectly to a parent.

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MERGERS, ACQUISITIONS AND CORPORATE RESTRUCTURING

Prof. CHANDRA SEKHAR MISHRA

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LECTURE: 35
TITLE: Accounting Aspects of M&A – II

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Concepts covered

- Measuring identifiable assets and liabilities and Non-controlling interest
- Recognizing and measuring Goodwill and Gain from a bargain purchase
- Methods of Calculating Purchase Consideration
- Financial Statements of Business Combination

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Keywords

- Non-controlling interest (NCI)
- Goodwill
- Gain from Bargain Purchase
- Purchase Consideration

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Step 3: Recognizing and Measuring Identifiable Assets and Liabilities and Non-Controlling Interest (NCI)

What does identifiable exactly mean?

An asset or liability is said to be identifiable if:

- It is separable; i.e. capable of being separated from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract;
- It arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Recognition:- The following condition is applied while recognizing an asset or liability

- First and foremost all assets and liabilities which is to be recognized must satisfy the assets and liability definition as per the accounting standard framework.
- The acquirer should record only those assets and liabilities which have been assumed as a part of a business combination deal.
- It may record certain assets and liabilities which the acquiree had not recorded earlier.

How to Measure Identifiable Assets and Liabilities and Non-controlling Interest (NCI)?

The acquirer shall measure the identifiable assets acquired and liability assumed at their **fair value on the date of acquisition**.

NCI can be measured by the following methods;

- **Fair value method; or**
- **Proportionate share method**

Example 35.1:

Alpha Ltd. acquires Gamma Ltd. by purchasing 70% equity for ₹200 million in cash. The fair value of the NCI in the business is valued at ₹110 million. The net aggregate value of the identifiable assets and liabilities, was ₹70 million, as per Ind AS 103. Measure NCI based on two method

As per fair value method:	**As per Proportionate share method:**
NCI = ₹110 million	NCI = 30% of ₹70 million = ₹21 million

Exception to the Recognition and Measurement Principle

Ind AS 103 forces the acquirer to measure all the assets and liabilities in their fair value, however, there are some exceptions from the fair value measurement rule:

- Contingent Liabilities (**Ind AS 37**);
- Income taxes (**Ind AS 12**);
- Employee benefits (**Ind AS 19**);
- Indemnification assets;
- Reacquired rights;
- Share-based payment transactions (**Ind AS 102**);
- Assets held for sale (**Ind AS 105**);

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Step 4: Recognition and Measurement of Goodwill/ Gain from Bargain Purchase

The acquirer shall recognize goodwill as of the acquisition date, measured as the excess of (a) over (b). If (b) is greater that (a), it will be considered as gain from a bargain purchase*.

a) The aggregate of

I. The fair value of consideration on the date of acquisition;
II. The amount of any NCI in the acquiree; and
III. If it is a step-by-step business combination, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree.

b) The net of acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103.

*The gain from a bargain purchase shall be recognized as gain in other comprehensive income on acquisition date and accumulate the same in equity as capital reserve.

Example 35.2:

Motilal Ltd. acquires Oswal Ltd. by purchasing 70% equity for ₹200 million in cash. The fair value of the NCI in the business is valued at ₹120 million. The net aggregate value of the identifiable assets and liabilities, was ₹80 million, as per Ind AS 103. applying both the measure of NCI, and calculate Goodwill.

Calculation of Goodwill by following fair value measure of NCI:

In this case, the fair value of NCI is ₹120 million.

	Values in ₹ million	
	Dr.	**Cr.**
Identifiable net assets	80	
Goodwill	240	
To Cash		200
To NCI		120

Value of Goodwill:

(Fair value of consideration paid + NCI) – Fair value of Net assets

= (200+120) – 80 = ₹240 million

Calculation of Goodwill by following proportionate share measure of NCI:

	Values in ₹million	
	Dr.	**Cr.**
Identifiable net assets	80	
Goodwill	144	
To Cash		200
To NCI		24

NCI: Fair value of net assets * proportionate share of NCI = 80 * 30 = ₹24 million

Value of Goodwill:
(Fair value of consideration paid + NCI) – Fair value of Net assets
= (200+24) – 80 = ₹144 million

Purchase Consideration

It can be defined as the “aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company”

What can be included in the purchase consideration?

Potential forms of consideration include

- Cash
- Other assets
- Business or subsidiary of the acquirer
- Contingent consideration
- Ordinary or preference equity instrument
- Options, warrants, and member interests of mutual entities

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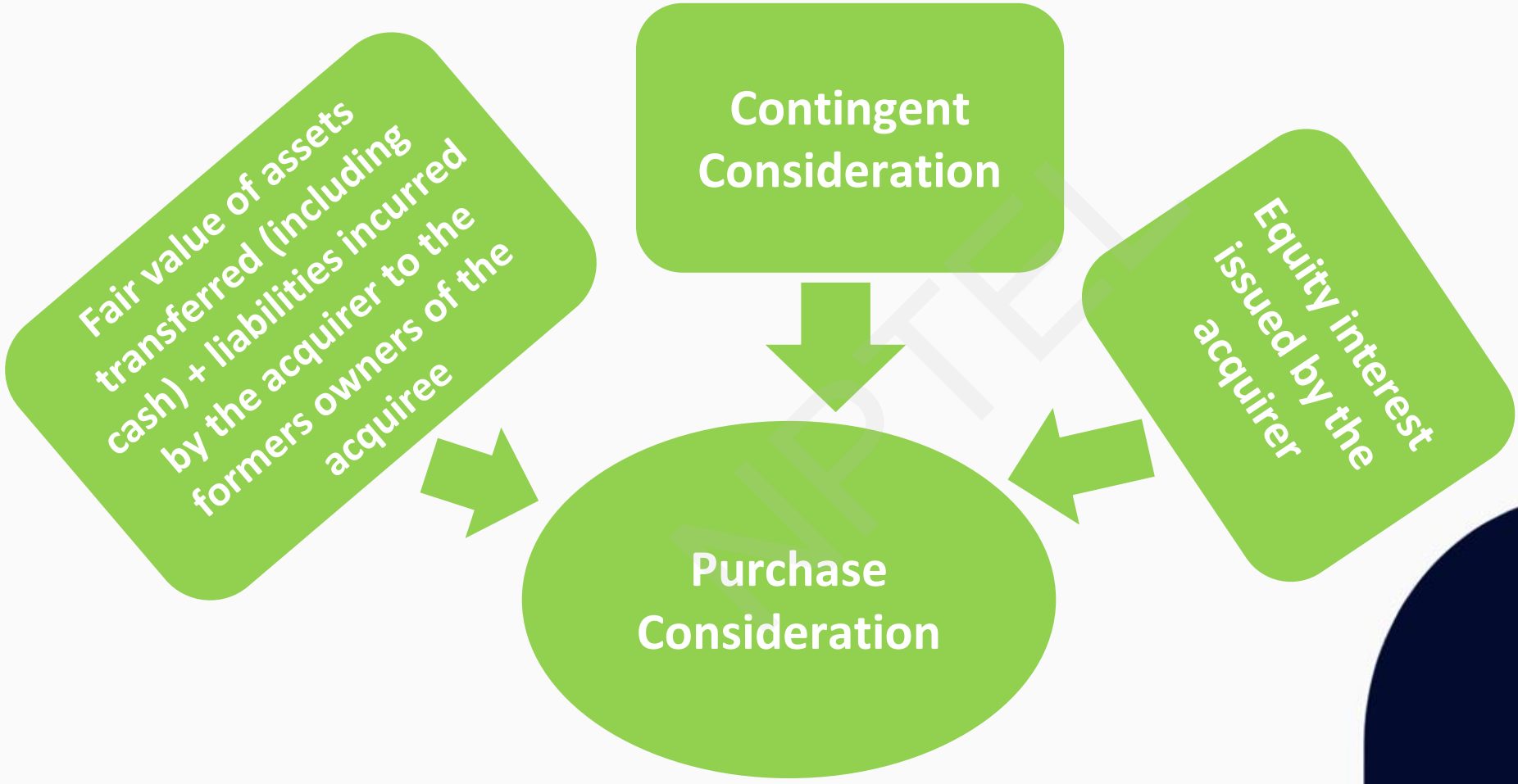
Fair value of assets transferred (including cash) + liabilities incurred by the acquirer to the formers owners of the acquiree
Contingent Consideration
Equity interest issued by the acquirer
Purchase Consideration

Example 35.3

ABC Limited decides to absorb XYZ Limited. gives the following information on the date of absorption:

Net assets	**₹4,50,000**
Profit and loss Account	**₹90,000**
Share capital: 5000 equity shares of @₹100 each	**₹5,00,000**
Preference shares	**₹1,00,000**

ABC agrees to take over the net assets of XYZ.

The terms of the purchase consideration payable are as follows:

- An equity share in XYZ, for purposes of absorption, is valued **@₹85** per share. ABC shall issue equity shares **@₹125** each for the equity shareholders of XYZ.
- ABC agrees to pay **₹80,000** in cash for payment to preference shareholders.

Calculate the Purchase consideration to be paid by ABC

Answer for Example 35.3

Value of 5,000 shares of XYZ: @ ₹85 = ₹4,25000
The purchase consideration will be = ₹4,25,000 (Equity shares) + ₹80,000 (Liability towards preference shareholders)
= ₹5,05,000 (₹80,000 out of this will be settled in cash and ₹4,25,000 in the form of equity shares of ABC, issued at @ ₹125 per share)

The number of shares that will be issued = ₹425000/ ₹125 = 3400 equity shares

Example 35.4

A Ltd. acquires 100% of the equity of B Ltd. on 31 December 2022. There are two elements to the purchase consideration: an immediate payment of ₹500 million, and further payments of ₹150 million if the return on capital employed (ROCE) exceeds 10% in the subsequent financial year ending 31 March. All indicators have suggested that this target will be met. A Ltd. uses a discount rate of 10% in any present value calculations.

Calculate the Purchase consideration to be paid by A Ltd.

Answer:

The fair value of the contingent consideration (payment to be made if B Ltd. achieves targeted ROCE)

= ₹150m/ 1.10 = ₹136.37 million

Total consideration = ₹500m + ₹136.67m = **₹636.37 million**

Example 35.5: Preparation of post-merger Balance Sheet

Balance sheet as on 31st March, 2020 (amount in ₹)

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share Capital			**Fixed assets**		
Fully Paid up Eq. shares @100 each	60,00,000	20,00,000	Buildings	20,00,000	
Reserve & Surplus			Goodwill	--	4,00,000
General Reserve	8,00,000	1,00,000	Machinery	26,00,000	16,80,000
Capital Reserve	--	2,00,000	Furniture	40,000	20,000
Profit & Loss A/c	4,80,000	1,40,000	**Current Assets**		
Secured Loans			Stock	16,00,000	7,20,000
12% Debentures	--	12,00,000	Debtors	9,20,000	7,20,000
Current liabilities			Cash & Bank	10,80,000	1,80,000
Creditors	9,60,000	3,80,000	Expenditure for new Project	--	3,00,000
	82,40,000	**40,20,000**		**82,40,000**	**40,20,000**

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Example 35.5, contd..

B Ltd. was absorbed by A Ltd. on April 2020 on the following terms

- Fixed assets other than goodwill are to be valued at ₹20,00,000 including ₹ 24,000 for furniture.
- Stock is to be reduced by ₹80,000 and debtors by 5%.
- A Ltd. will assume liabilities and discharge the 12% debenture by the issue of 11% debentures of the same value and an additional premium of 6% paid in cash.
- The new project is to be valued at ₹3,80,000
- Both the companies declared and pay dividends at 6% prior to the absorption
- The shareholders of B Ltd. are to receive a cash payment of ₹30 per share plus 4 equity shares in A Ltd. for every 5 shares held in B Ltd. Assume nominal values of share as the fair value on the acquisition date.
- Expenses of liquidation of B Ltd. Are to be reimbursed by A Ltd. to the extent of ₹20,000. The actual liquidation expenses amounted to ₹24,000

Prepare the Balance Sheet of A Ltd. after absorption assuming that A Ltd.'s authorized capital has been increased to ₹80,00,000

Calculation of Purchase consideration:

Particulars	Workings	Amount (₹)
To equity shareholders		
Cash	20,000 shares X @ ₹30 per share	6,00,000
Equity shares in A Limited	(20,000 X 4/5) @ ₹100	16,00,000
Total		**22,00,000**

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Calculation of Goodwill/ Gain from Bargain Purchase:

Particulars	Workings (₹)	(₹)	(₹)
Purchase consideration			22,00,000
Less: Net assets taken over			
Fixed assets		20,00,000	
Stock	(7,20,000 - 80,000)	6,40,000	
Debtors	(7,20,000 X 95%)	6,84,000	
Cash & Bank	1,80,000 - 1,20,000 (dividend) – 4,000 (liquidation expenses)	56,000	
New Project		3,80,000	
(-) Debentures	12,00,000 X 106%	(12,72,000)	
(-) creditors		(3,80,000)	
Total			(21,08,000)
Add: Liquidation expenses paid			20,000
Goodwill/ (Gain from Bargain Purchase, i.e. Capital Reserve)			**1,12,000**

Particulars	Workings (Amount in ₹)	Amount in ₹
Assets		
Non-current assets		
Property, Plant, and Equipment	20,00,000 + 26,00,000 + 40,000 +20,00,000	66,40,000
Goodwill		1,12,000
Total Non-current assets		**67,52,000**
Current assets		
Inventories	16,00,000 + 6,40,000	22,40,000
Financial assets		
Trade Receivables	9,20,000 + 6,84,000	16,04,000
Cash and Cash equivalents		84,000
Investment in new projects		3,80,000
Total current assets		**43,08,000**
Total assets		**1,10,60,000**

Calculation of Ending Cash Balance of A Limited:

Particulars	Workings	In ₹	In ₹
Cash & Bank balance at the beginning			10,80,000
Less:			
Dividend to equity shareholders	(₹60,00,000 x 6%)	3,60,000	
Cash paid to equity shareholders of B Ltd.	(₹20,00,000/100) @ ₹ 30	6,00,000	
Cash paid to Debenture holders	₹12,00,000 X 6%	72,000	
Reimbursement of liquidation expenses		20,000	
Total			10,52,000
Cash & Bank - Ending			**28,000**

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Particulars	Workings (Amount in ₹)	Amount in ₹
Equity and Liabilities		
Equity		
Equity share capital	60,00,000 + 16,00,000	76,00,000
Other Equity		-
Reserve & Surplus		
General Reserve		8,00,000
Profit & Loss A/c	4,80,000 - (60,00,000 X 6%)	1,20,000
Total Equity		**85,20,000**
Liabilities		
Non-Current liabilities		
Financial Liabilities		
Borrowings (11% Debentures)		12,00,000
Total Non-current Liabilities		**12,00,000**
Current Liabilities		
Financial Liabilities		
Trade Payables	9,60,000 + 3,80,000	13,40,000
Total current liabilities		**13,40,000**
Total Liabilities		**25,40,000**
Total Equity and Liabilities		**1,10,60,000**

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CONCLUSION

- The acquirer shall recognize the assets and liabilities of the acquiree at fair value.
- If the total of purchase consideration and NCI exceeds the net assets taken over by the acquirer, the difference amount shall be treated as goodwill.
- If the net assets taken over by the acquirer exceeds the total of purchase consideration and NCI, the difference shall be treated as gain from a bargain purchase.
- Computation of purchase consideration and non-controlling interest are integral part of M&A accounting.

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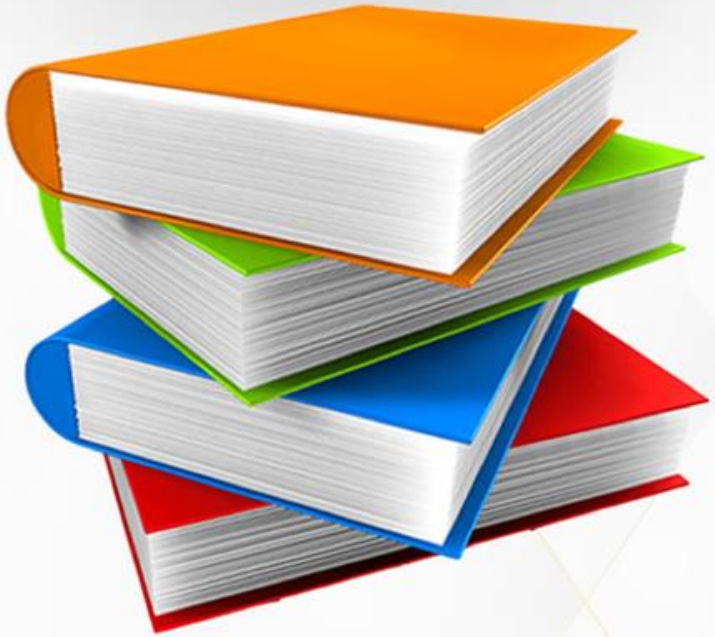

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Thank you