



N P T E L O N L I N E C E R T I F I C A T I O N C O U R S E S

MERGERS, ACQUISITIONS AND CORPORATE RESTRUCTURING

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LECTURE: 36

TITLE: Alternative Exit and
Restructuring Strategies-1

- Corporate restructuring
- Business alliances
- Reasons for corporate restructuring
- Features of successful business alliances

Keywords



- Corporate restructuring
- Business alliances
- Financial restructuring
- Portfolio restructuring

Corporate Restructuring

- Any corporate action that raises productivity, revenues, lowers costs of capital, or increases shareholder wealth.
- Restructuring operations cover a wide range of actions made by businesses, such as buying a new company, cutting debt from the capital structure, selling a traditional company, integrating its business units, or breaking up existing business units into smaller groups.
- Each restructuring activity has a different conclusion; nonetheless, the business's wealth can be maximized through wise implementation of carefully planned and well executed restructuring initiatives.

Need for corporate Restructuring

- To make correct the previous wrong strategic decisions
- Efficient allocation of existing resources
- Improvement in efficiency and cost reduction
- Upgradation of technology and research and development
- Scope for improving managerial skills
- To grab opportunities and combat threats
- Development of core competencies

Benefits of corporate Restructuring

- Increasing focus
- Mitigating financial distress
- Achieving greater transparency
- Providing a source of financing
- Wealth transfers
- Transferring assets to those who can use them more efficiently

Types of Corporate Restructuring

- Organizational Restructuring
 - Organizational structure reform
 - Redesigning Divisional boundaries
 - Markets, employees
 - Product portfolio reduction
- Financial Restructuring
 - Leveraged Buy Out (LBO)
 - Management Buy Out (MBO)
- Portfolio Restructuring
 - Divestment or Divestiture
 - Business Alliance (Joint venture, Strategic Alliance)
 - Merger and Acquisitions
- Overall Corporate Restructuring
 - Breaking company into multiple companies
 - Carving out a company from out of a bigger company

Organizational Restructuring

- Organizational restructuring occurs when a company makes significant adjustments to its organizational structure, including changes to its span of control, hierarchy, and business divisions.
- It includes redesigning a company's general organizational structure, changing its divisional boundaries, markets, workers, product portfolio reduction, etc.
- An important aspect of organizational restructuring is value creation through achieving the company's vision.
- Over the last decade, globally, firms have undergone reform and **redesign** over the management hierarchy, divisions, **downsizing, span of control, performance-linked compensation models**, and **corporate governance efforts**.

Organizational Restructuring example..

- Elon Musk the new CEO of Twitter started laying off its employees after the takeover of the business.
- Before the takeover there were over 7,500 employees in the firm and the number of employees had reduced to less than 2,000 after the takeover took place.
- As per Elon Musk's statement he thinks that the expenses of the company is now in control.
- He trimmed down the employees and introduced a "hardcore" work culture to recover his spending on buying this social media platform and to become profitable

Financial Restructuring

- The capital structure of a company is generally a combination of debt and equity. Financial restructuring caters to changes in the capital structure of the firm resulting in value enhancement for the firm.
- Firm activities including debt recapitalization, leveraged buyouts, equity swaps, and debt conversion from high to low cost debt, among others, have an impact on the capital structure of the company and, hence, the total cost of capital. It also affects the cash flow and firm's performance.
- It strengthens capital structure by adding debt to lower the overall cost of capital, debt rescheduling, equity for debt swaps, restructuring for financial distress, and improving firm's credit rating.

Financial Restructuring contd..

- Financial restructuring is typically undertaken by a company in response to an internal organic strategic plan, such as an expansion or new project, to poor financial health, such as financial hardship, or in response to an inorganic strategic plan, such as M&A, Alliance.

Portfolio Restructuring



- Portfolio restructuring relates to changes in the assets possessed by the company and the business line mix the firm engages in. It includes activities like alliances and joint venture, M&As, Demergers, Spin-off, Split-off etc.
- Putting it simply, portfolio restructuring includes asset divestiture and assets expansion strategies.
- Main motive for portfolio restructuring is that the firm needs to explore the room for value maximization in align with the vision and mission of the firm.

Portfolio Restructuring, contd..



- Diverse portfolio restructuring strategies are used by firms in the same industry since they have different visions and missions.
- It may lead to a firm more concentrated or more diversified in its business activities.

Business Alliance

- Business alliances involve sharing the risk, reward and control among the partners
- Cooperative relationship amongst the participants
- The degree to which each partner is dependent upon the abilities and resources of the other determines the success of the majority of coalitions

Motivations for business alliance

- Sharing of risk
- Sharing proprietary knowledge
- Sharing management skills and resources
- Sharing significant capital expenditure
- Securing sources of supply
- Access to new markets
- Cost reduction
- Entry into global markets

Features of Successful business alliance

- Synergy
- Roles and responsibilities
- Clarity of goals
- Good communication and cooperation
- Creating win-win situations
- Choosing the time frame
- Top management support

Types of business Alliances

- Joint Ventures
- Strategic Alliances
- Licensing
- Franchising

Examples of Business Alliances

- The case of Maruti Suzuki Limited
 - Earlier known as Maruti Udyog Limited – a joint venture (JV) of Government of India and Suzuki Motor Corporation as a minor partner (26% stake) established in 1981
 - Suzuki raised its stake in the JV - to 40 per cent in 1987 and then, to 50 per cent by 1992 – making it an equal partner with the Government of India.
 - The Government of India exited from the ownership gradually starting with divesting of 27.5% equity (for around Rs 1,000 crore) along with the IPO made by the company in 2003. Subsequently the Government has exited from the ownership of the company.
- Transformation from public sector company to a private sector company.



Examples of Business Alliances, contd..

- This joint venture helped Indian economy access modern technology in the automobile sector.
- It helped development of ancillary industries in the automobile sector
- The consumers in India got an affordable car to buy thus penetrating the passenger car market.
- Now Maruti Suzuki is an exporter of passenger cars from India.



Examples of Business Alliances, contd..

- **Alliances in Online Retail Market**
 - Walmart – Flipkart
 - Tata Starbucks- a joint venture between Tata Consumer Products and Starbucks (US)
 - Tata Hitachi Construction Machinery Company Pvt Ltd: A joint venture company between Tata Motors (India) and Hitachi Construction Machinery of (Japan): a leading player in manufacturing of construction equipments in India
 - Tata AIA Life Insurance: a joint venture between Tata Sons Pvt. Ltd. and AIA Group Ltd. (AIA). Earlier it was established as Tata AIG Life Insurance in 2001.
 - AIX Connect, formerly known as AirAsia India set up as a joint venture between Tata Sons and Air Asia (Malaysia)
 - Vistara – (Name of the company: Tata SIA Airlines Limited) – a joint venture between Tata Sons (51% stake) and Singapore Airlines (49%)



Examples of Business Alliances, contd..

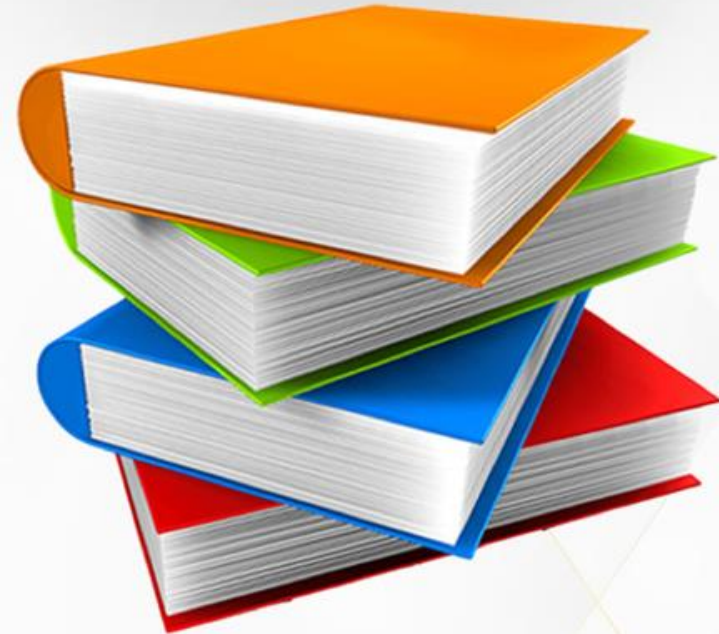
- **Alliances in Online Retail Market and New Technology Sector**
 - Walmart – Flipkart
 - Spotify – Google
 - Spotify – Samsung Mobile
 - Uber and Spotify
 - Starbucks and Barnes & Noble Book Stores



CONCLUSION

- Corporate restructuring arises due to problems faced by the company or because of new opportunities.
- Corporate restructuring can take the form of asset of liability side restructuring
- Corporate restructuring can also involve restructuring of portfolio of activities
- Joint ventures and business alliances have got their inherent advantages due to pooling of resources.

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LECTURE: 37

**TITLE: Alternative Exit and
Restructuring Strategies-2**

- Growth through non M&A Activities
- Business Alliances
- Franchising and Licensing as source of growth



Keywords



- Joint venture
- Strategic Alliance
- Licensing
- Franchising
- Divestiture

Types of Business Alliances (*continued from Session # 36*)

- Joint Ventures
- Strategic Alliances
- Licensing
- Franchising

Joint Ventures

Key characteristics:

- Partners contribute money, property, effort, knowledge, skill, or other assets to a common undertaking.
- May be organized as a corporation, partnership, or other legal/business organization chosen by the parties.
- Ownership, risks, responsibilities, and rewards shared by parties.
- Expectation of profit, or presence of “adventure”
- Each party retains their corporate identity and autonomy.

Joint Venture contd..

Rationale for Joint Ventures:

- Strategic planning
- Knowledge Acquisition
- Risk reduction
- Tax aspects
- International aspects

Joint Venture contd..

Making joint venture – a success:

- Each participant has to contribute something valuable to the activity.
- Participants should engage in careful preplanning.
- The agreement or contract should provide flexibility as needed in the future.
- Key executives must be involved in implementing important decisions.
- A separate unit in the organizational structure should be authorized in negotiating and making decisions.

Strategic Alliances

Key characteristics:

- Partners collaborate on specific factors like technology transfer, R&D sharing and cross marketing, manufacturing capability
- Do not involve the formation of separate legal entities
- Precursor to Joint venture, Partnership, or Acquisition
- Cooperation or collaboration which aims for a synergy with shared expenses and risk
- It is possible to have a non-equity alliance.

Strategic Alliance contd..

Benefits of Strategic Alliance:

- Access to knowledge, new technology, intellectual property rights
- Letting each partner focus on their own competitive advantage
- Opportunity to manage and achieve desired results from a corporate ecosystem
- Reduce uncertainty and risk while entering into a new market
- Access to resources and target markets

Strategic Alliance contd..

Risks

- Partner's performance and its quality
- Loss of competencies
- Information leakage
- Inefficient management
- Partner lock-in
- Product or service failure of partners and spillover effect on alliances

Examples of Strategic Alliances

- **Panasonic & Tesla Motors:** Panasonic, in collaboration with Tesla motors (2009) for using their batteries in the car
- **Walmart & Flipkart:** Walmart had invested in Indian e-commerce giant Flipkart to compete with Amazon
- **Google and NASA:** Google and NASA, together developed google earth
- **Starbucks and Kroger:** They are striving to develop intelligent retail operations to meet their unique customer base expectations

Examples of Strategic Alliances, contd..

- Reliance Industries Limited (RIL) and BP (British Petroleum)
 - Developing oil and gas fields
 - Retail business of petroleum fuel (JioBP)
 - Technology access
 - Market expansion
- Reliance Jio Platforms – Qualcomm (US based)
 - 5G infrastructure and services (July, 2020)
- Reliance India purchased Ambri pilot system
 - A part of its broader Energy Storage System from Ambri (startup in US focusing on clean energy) in which Reliance is already a strategic investor. (October 2022)



Licensing

Key characteristics:

- Copyrights, patents, and trademarks licensed in return for a fee or royalty
- Generally no sharing of risk and reward
- usually specifies what is being sold, how and where it may be used, and for how long
- Typically, payments are made in the form of an upfront fee and royalties based on a percentage of future license sales

Examples of Licensing:

- **Microsoft Office:** It can also apply to the use of software e.g. a company using Microsoft Office on its computers
- **Mickey Mouse:** A company using the design of a popular character, e.g. Mickey Mouse, on their products.
- Clothing manufacturer like "LIFE IS GOOD" licensing its designs and brand in a certain country to a local company.

Franchising

Key characteristics:

- Network of alliances where participants are connected through license agreements (example: fast food chains, hardware stores)
- Exclusive rights to sell or distribute goods or services in specific geographic areas or markets
- It can be necessary for licensees to buy products and services from other companies in the alliance.

Examples of Franchising

- McDonalds
- Subway
- KFC
- Domino's:
 - Jubilant FoodWorks Limited is the Master Franchisee of Domino's Pizza in India, Bangladesh, Sri Lanka and
- Dunkin Donuts
 - Jubilant FoodWorks
- Varun Beverages Ltd – Franchisee of Pepsico (US)

Divestiture

- A divestiture is the sale of a portion of a company's assets to a third party, usually generating cash for the parent company.
- A firm may decide to sell an undervalued or underperforming enterprise that is non-strategic or unrelated to its core business in order to fund investments in potentially higher-return options, including debt repayment.
- The benefit of reducing unfavourable synergies, improving focus, and effective management of core assets is provided to the divestors through disposal or sell-off. Additionally, it contributes money in cases where alternative financing options are prohibitively expensive or unavailable.

Divestiture contd..

- It helps the divestor in gaining competitive edge and better meet market demands.
- To put it simply, the perspective is the asset's strategic alignment with the company's mission and core values.

Characteristics of Divestiture

- Generally, operating performance is inferior to that of the parent company
- Spin-offs sell for a lower price than carve-outs, measured by the ratio of market value to book value of assets
- Slightly underperform their peers in the preceding year
- Typically unrelated to other companies owned by the parent.

Potential reasons for Divestiture

- Post strategic fit of division
- Reverse synergy
- Poor performance
- Capital market factors – better signal to capital market
- Liquidity of the market for corporate assets
- Cash flow needs
- Abandoning the core business

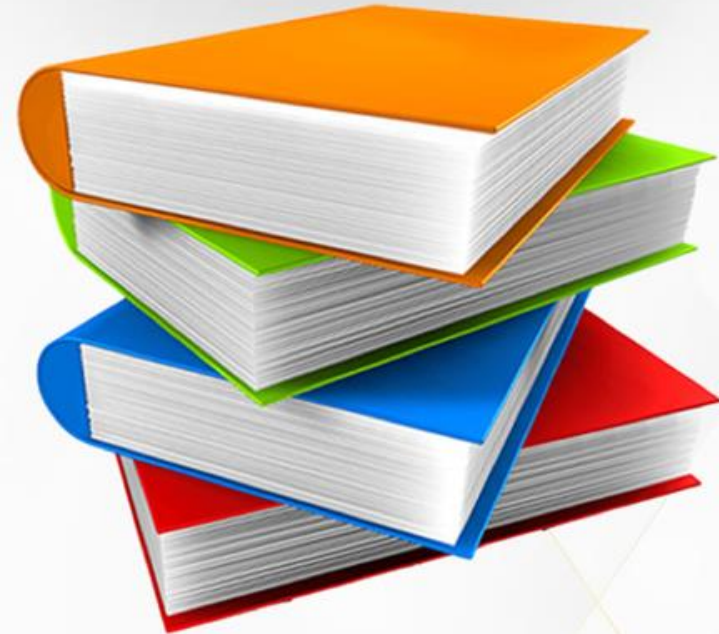
Examples of Divestitures

- Metro AG is a German multinational company known for Metro Cash & Carry sold its India operation which operates under the 'Metro India' brand, sold the India operations Reliance Retail Ventures Limited (RRVL), a subsidiary of Reliance Industries Ltd, for a cash consideration of Rs 2,850 crore (December, 2022)
- Sale of power business of Reliance Infra to Adani Transmission (2017)
- Sale of electrical business by L&T to a consortium of France-based Schneider Electric SE and Singapore state investor Temasek Holdings Pte for Rs 14,000 crore (2018)
- Jaiprakash Cement (Jaypee group) sold a part of its cement business to Ultratech Cement (2016)

CONCLUSION

- Corporate restructuring arises due to problems faced by the company or because of new opportunities.
- Business alliances, franchise and licensing help companies in growth – across products and territories
- Licensing and Franchising can be used to enter markets across the globe, followed by direct investment.
- Divestiture can solve the problem of liquidity and solvency.

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LECTURE: 38

**TITLE: Alternative Exit and
Restructuring Strategies-3**

oncepts covered



- Corporate restructuring
- Value enhancement through corporate restructuring
- Alternate corporate restructuring mechanisms
- Exit Strategies

Keywords



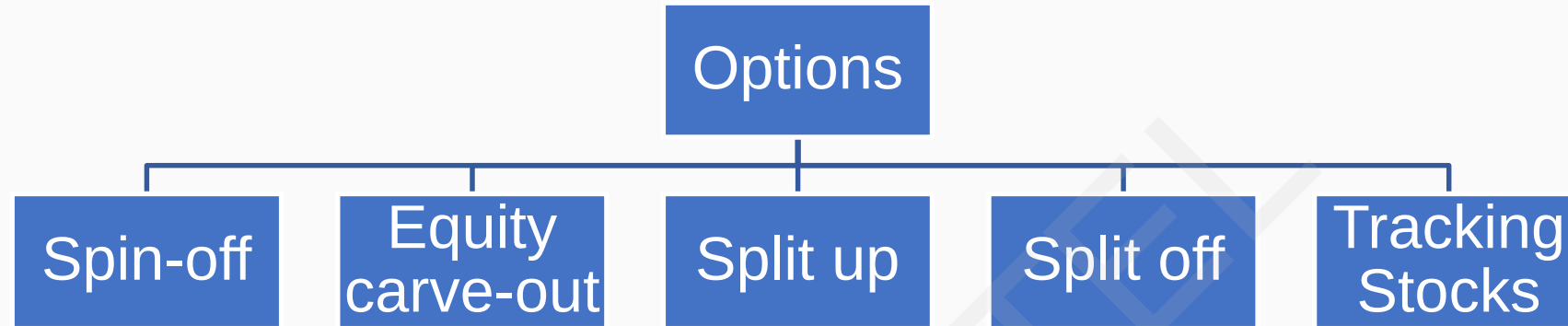
- Spin Off
- Split Off
- Equity Carve Out
- Split Up
- Tracking Stocks

Carving out Multiple Companies out of a single Company



- Motivations
 - Strategic issues
 - Managerial issues
 - Regulatory requirements
 - Risk reduction
 - Conglomerate discount
 - Differences in profitability among multiple arms of single company

Carving out Multiple Companies out of a single Company – Different options



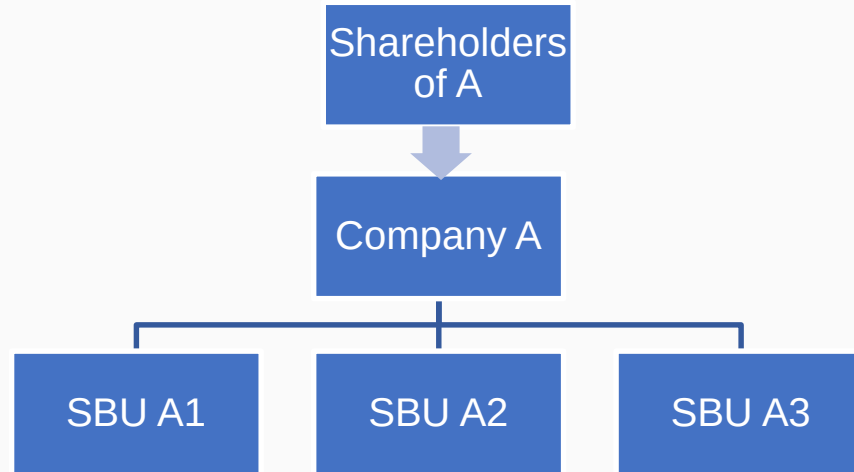
Spin-off

- In a spin-off, the parent firm distributes shares of the business it is getting rid of to shareholders, proportionally to their ownership stake in the parent company.
- A spin-off is an alternative to a complete divestiture in which the corporation sells the unit for cash or other consideration.
- The spun-off entity then becomes an independent business separate from the parent corporation. The shareholders of the parent company are also the shareholders of the subsidiary, but the two companies typically operate independently.

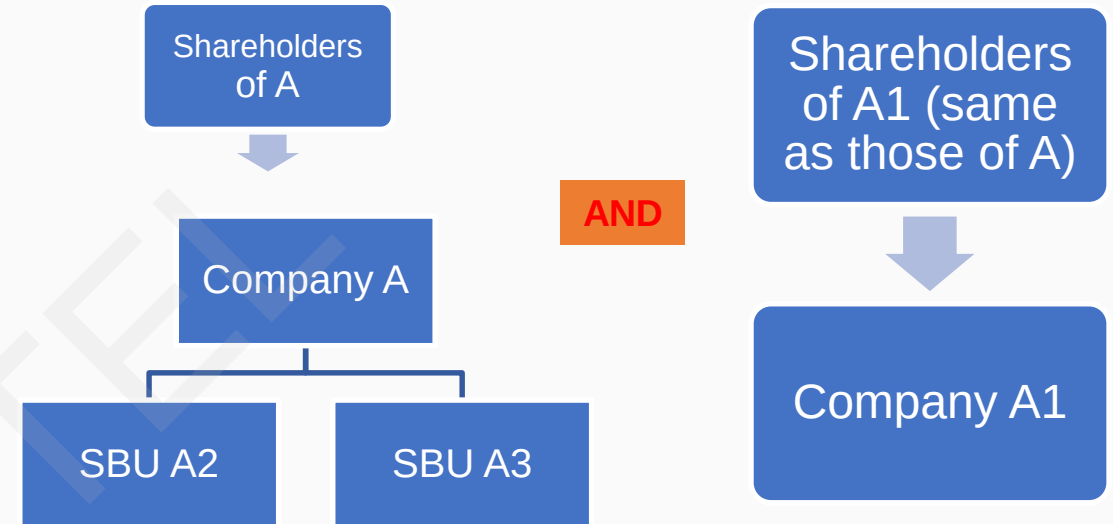
Spin-off, explained.



Pre Spin-off



Post Spin-off



Spin-off contd..

- The company's debt is divided between the remaining parent company and the spun-off organization. Typically, this is done based on the respective post-transaction sizes of each business.
- The spin off does not result in a cash infusion to the parent business, unlike the divestiture or equity carve out. After the spin-off, the firm's owners own both shares of the parent company and shares of the unit participating in the spin-off.
- Spin-offs may be more difficult to execute than divestitures, but they are by no means straightforward. The parent company must ensure that the to-be-spun-off unit is fully operational and legally separated from other parent operations, and that there are no ongoing liabilities linked with the spun-off units.

Characteristics of Spin off

- Generally faster growing and more profitable than divested business
- Typically operate in industries linked to those in which the parent company engages
- operational performance is inferior to that of the parent
- somewhat underperform peers in the preceding calendar year

Examples of Spin off

Tata Chemicals:

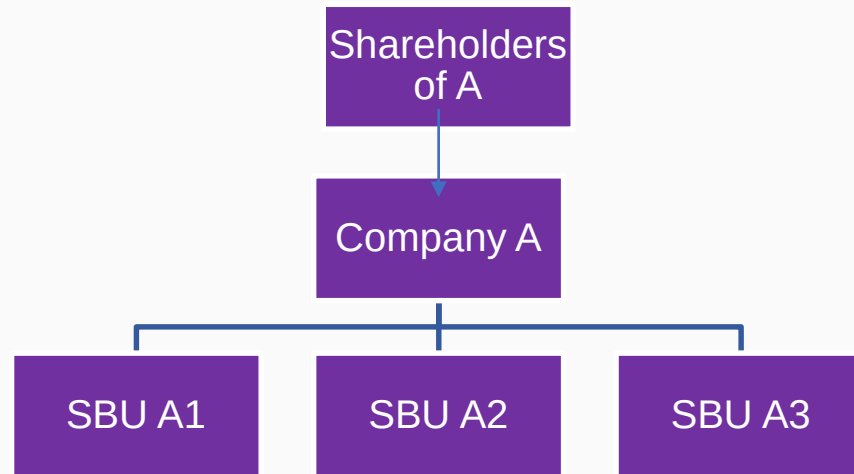
- In 2020, Tata Chemicals' consumer products segment was demerged into Tata Global, which was renamed as Tata Consumer Products.
- Tata Chemicals shareholders received 1.14 shares of Tata Global for each share held in the company.

Equity Carve Out

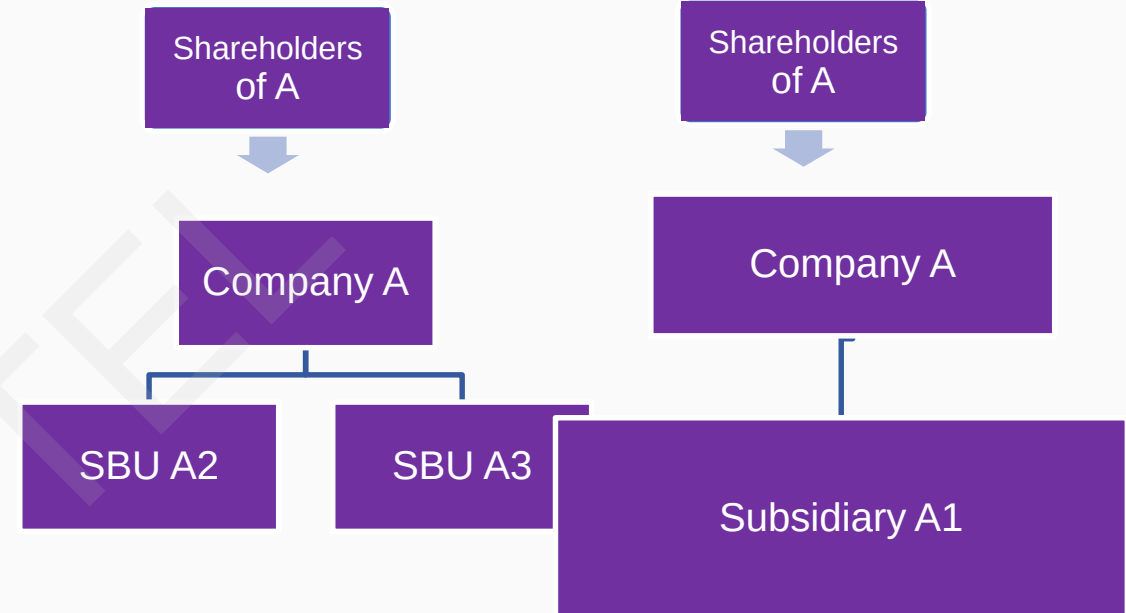
- A equity carve out is the public offering of a partial stake in a wholly-owned subsidiary. It can be said to be a partial spin off.
- Although the seller might, in theory, sell up to 100 percent of the offering, they are unlikely to do so. Typically, just a partial interest is sold
- Usually, the seller keeps ownership of the unit, although a carve out may be the first step in selling the entire corporation
- If the parent has major contractual commitments with the subsidiary, such as supply agreements, carve-outs may be utilized
- Initial public offering and subsidiary equity carve outs are the two primary types of equity carve outs.

Equity carve-out, explained

Pre Equity Carve-out



Post Equity Carve-out



Equity Carve Out, contd..

Subsidiary equity carve out

- It is a transaction in which the parent establishes a wholly-owned, independent subsidiary with its own stock and management team, and issues a portion of the subsidiary's stock to the public.
- Even while the parent retains control , due to the public sale of shares, the subsidiary's shareholder base may differ from that of the parent
- Typically, the public is only offered a minority stake in the parent company's subsidiary.

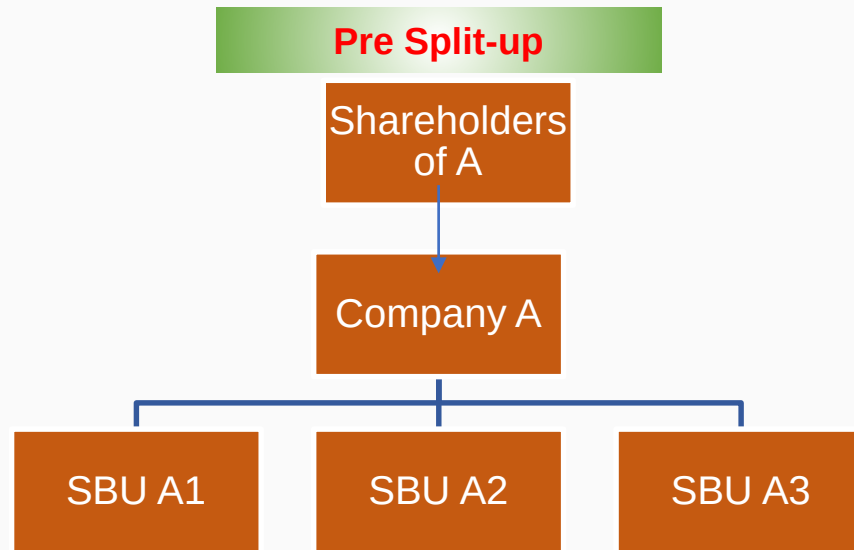
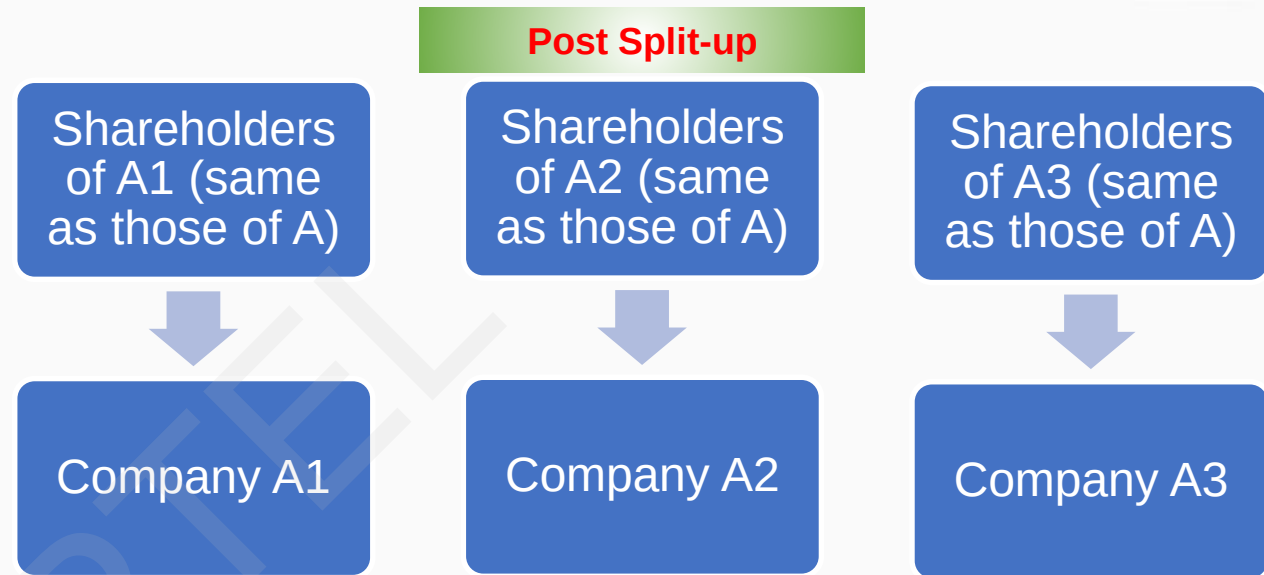
Characteristics of Equity Carve Out

- Carve outs are typically more profitable and grow faster than spin-offs and divestments.
- Often operating performance exceeds parents.
- Companies typically operate in industries with a high ratio of market value to book value.
- Generally outperform competitors in the preceding year.

Split Up

- It describes a restructuring strategy in which a single corporation divides into two or more independently controlled firms. After the split, the original company's shares are cancelled, and it no longer exists.
- Split up may occur due to government intervention in companies' activities to reduce the monopoly practices.
- Companies also undergo split up to enjoy the strategic advantage it offers. Separate management of each section of business lines often results in better performance and efficiency of the divided entities, exceed those of the original entity from which they were separated.

Split-up, explained



Example of Split Up

Hewlett-Packard:

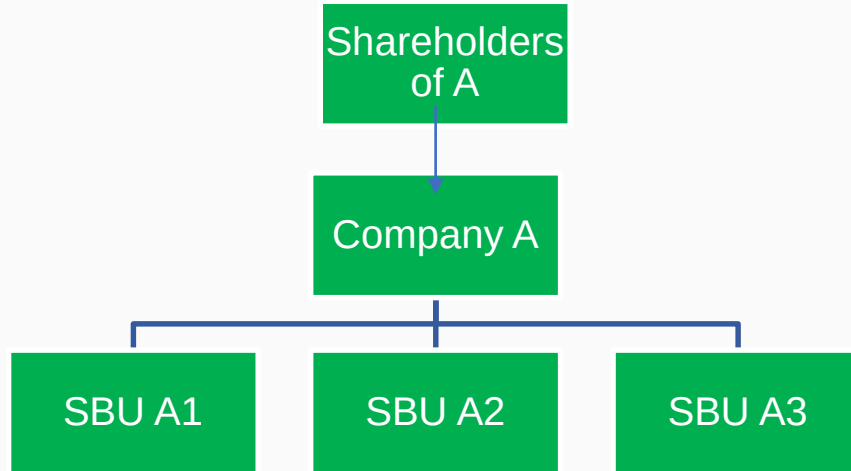
- In October 2015, the Hewlett-Packard Company completed a split-up which resulted in the official formation of two new entities: HP Inc. and Hewlett-Packard Enterprises.
- The split-up was executed to strategically silo these two groups, because each of them had focus on different business models.
- Hewlett-Packard Enterprises markets hardware and software services to large businesses seeking big data storage and cloud computing technology.
- HP Inc. focuses on manufacturing personal computers, printers, and other devices geared toward small and medium-sized business owners.
- This split-up ultimately allowed each business entity to more efficiently run its own organizational structure, management team, capital allocation strategy, salesforce, and research and development initiatives.

Split off

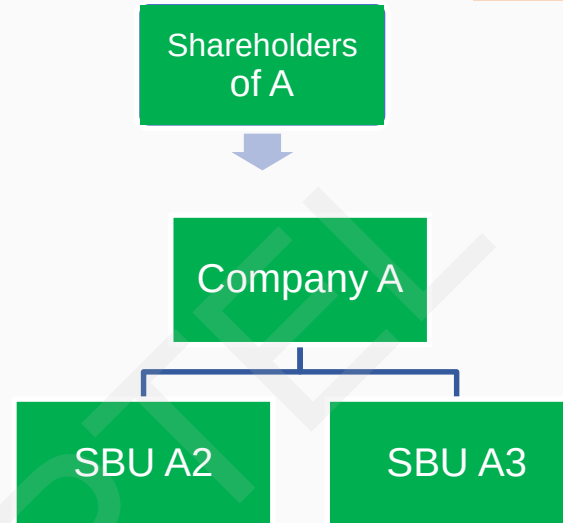
- In a split-off, the subsidiary becomes an independent company, while the parent company generates no additional cash.
- It involves an offer to exchange parent's stock for subsidiary's equity at a defined exchange ratio by the parent firm. It frequently occurs when a portion of a parent company's shareholders prefer to own the subsidiary's shares rather than the parent's.
- The exchange also raises the earnings per share of the parent company by reducing the number of outstanding shares, as long as the impact of the reduction in outstanding shares exceeds the loss in earnings of the subsidiary.
- Typically, they are not proportional shares.
- The split-off provides the parent shareholder with the option of holding parent shares, split-off company stock, or a mix of both.

Split-off, explained

Pre Split-off



Post Split-off



OR

Shareholders of
A1 (Some out
of those in A)

Company A1

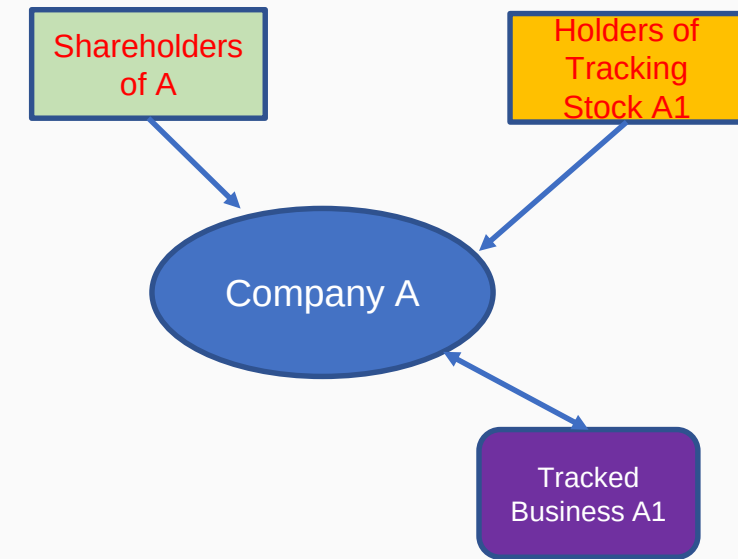
Example of Split off

Viacom Inc. & Blockbuster Inc.

- In 2004, New York City-based media giant Viacom Inc. and its video rental subsidiary, Blockbuster Inc., jointly announced the terms of their separation.
- The transaction involved Viacom's distribution of its interest in Blockbuster through a "split-off" exchange offer to Viacom stockholders.
- Blockbuster paid \$5 per share, or a total of approximately \$905 million based on the number of shares currently outstanding, to all stockholders, including Viacom.

Tracking stocks

- Tracking stock is a type of common stock that connects the shareholder's return to the operating performance of the subsidiary
- In contrast to the ownership interest in the subsidiary, such stock reflects an ownership interest in the parent
- One or more divisions of a corporation may be permitted to trade independently as tracking stocks, if it acquires other businesses but the combined entity's market price sells at a discount
- The first tracking stocks were created when General Motors (GM) bought Electronic Data Systems (EDS) in 1984.
- Tracking stocks enables investors to value different operations based on their own performance within a single corporation



Tracking stocks contd..

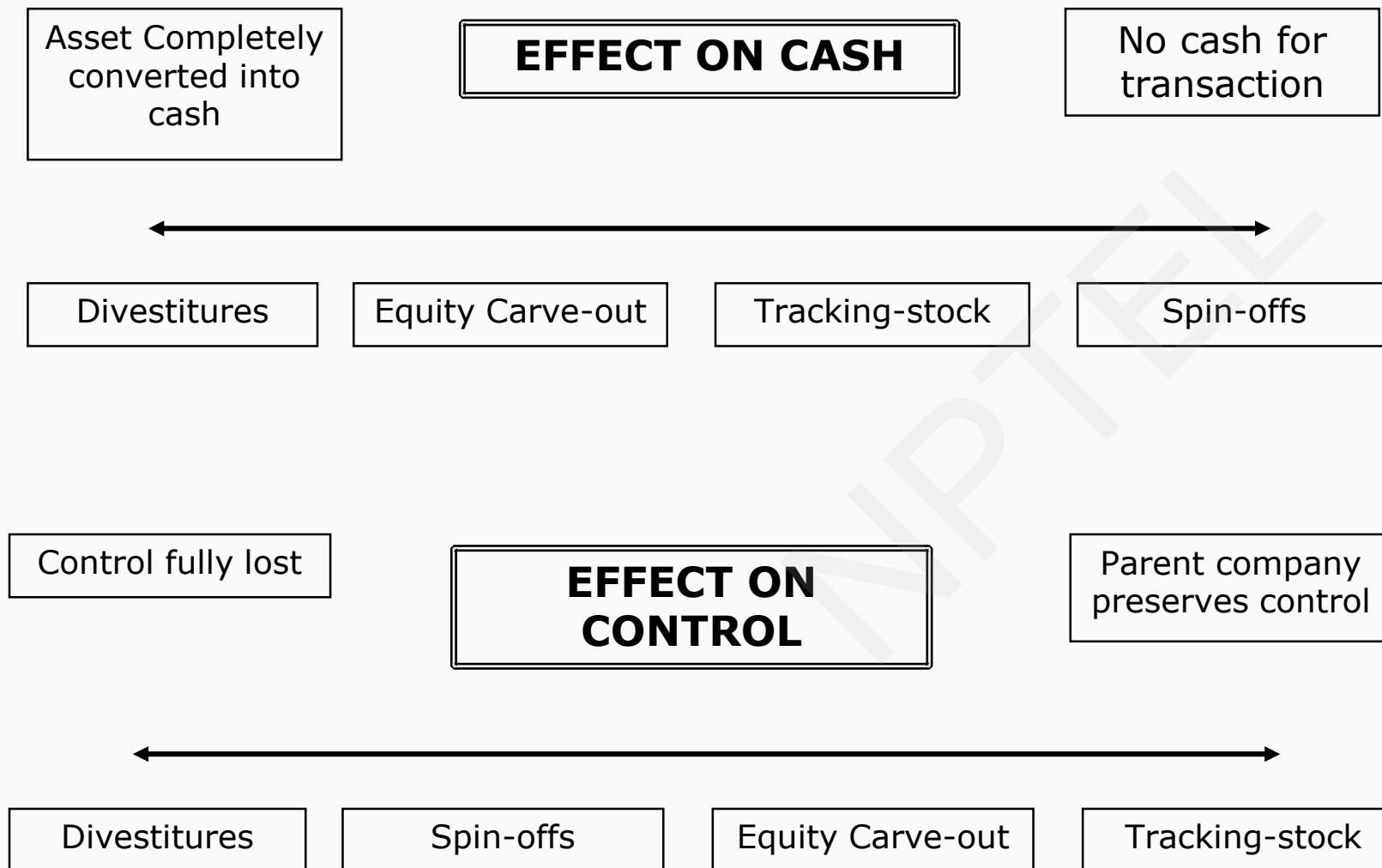
- Companies started issuing tracking stocks as an alternative to sell-offs in the 1990s. Additionally, it may go by the names letter stock or alphabet stock.
- A sell-off creates a new legal entity, which is one of the main distinctions between tracking stocks and sell-offs.
- With a tracking stock, the shareholder has a legitimate stake in a division's profits, but the division still belongs to the overall company. Typically, investors of targeted shares continue to have voting rights for the entire firm.

Examples of Tracking Stock

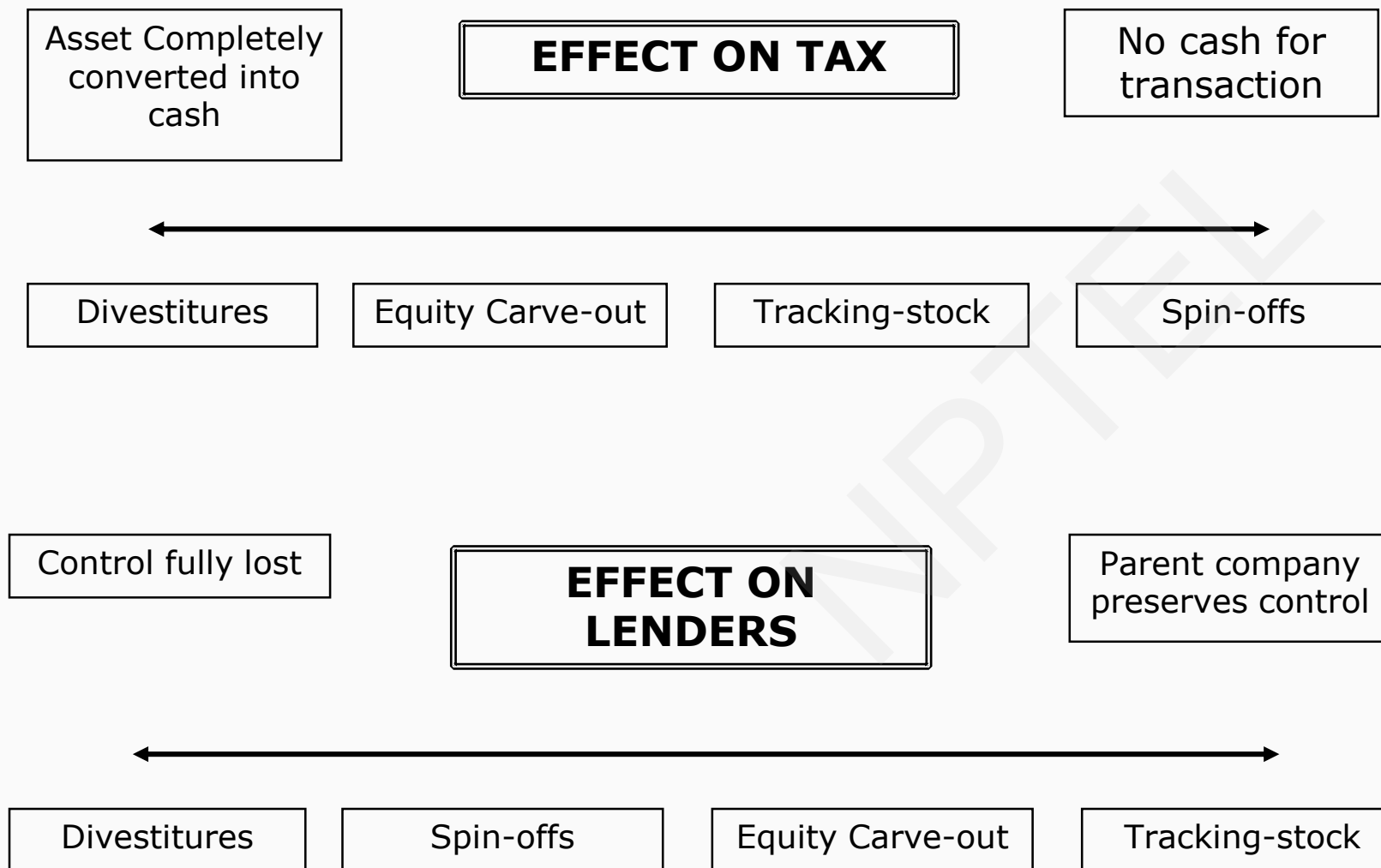
Walt Disney Company (1999)

- During the dot-com bubble, Walt Disney Company identified their internet operations as high-growth divisions that would benefit from a tracking stock.
- It issued a tracking stock for its internet holdings division, Go.com in 1999.

Differences in the actions



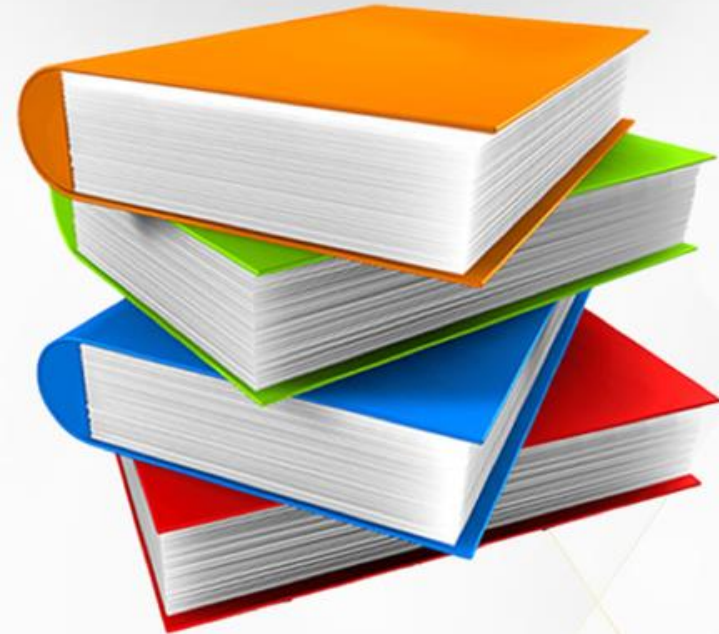
Differences in the actions



CONCLUSION

- Corporate restructuring arises due to problems faced by the company or because of new opportunities.
- Companies can carve out businesses out of those to form new companies
- This action can lead to reduction in risk for the investors
- Conglomerate discount can be avoided by splitting a company into multiple companies.
- There can be clear signal to the market through these actions.

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LECTURE: 39

TITLE : Leveraged Buyouts

- **Leveraged Buyouts (LBOs)**
- **Making a successful LBO**
- **Management Buyouts (MBO)**
- **Financing of LBOs**



Keywords



- Financial Leverage
- LBOs
- MBOs
- Senior Debt
- Subordinated Debt
- Mezzanine Finance

Example 39.1: Financial Leverage



	Situation I			Situation II	
	LL	HL		LL	HL
Sales	₹ 60,000	₹ 60,000		₹ 66,000	₹ 66,000
Variable expenses (60%)	₹ 36,000	₹ 36,000		₹ 39,600	₹ 39,600
Fixed expenses	₹ 15,000	₹ 15,000		₹ 15,000	₹ 15,000
Operating profit or Earnings before interest and tax (EBIT)	₹ 9,000	₹ 9,000		₹ 11,400	₹ 11,400
Interest	₹ 2,000	₹ 4,000		₹ 2,000	₹ 4,000
EBT	₹ 7,000	₹ 5,000		₹ 9,400	₹ 7,400
Tax @ 25%	₹ 1,750	₹ 1,250		₹ 2,350	₹ 1,850
Profit after tax	₹ 5,250	₹ 3,750		₹ 7,050	₹ 5,550
Return on Equity	13.13%	18.75%		17.63%	27.75%
Change in Sales				10.00%	10.00%
Change in operating profit (EBIT)				26.67%	26.67%
Change in profit after tax				34.29%	48.00%
Degree of Financial Leverage					
EBIT / EBT	1.29	1.80			
(% change in Profit after tax to % change in EBIT)				1.29	1.80

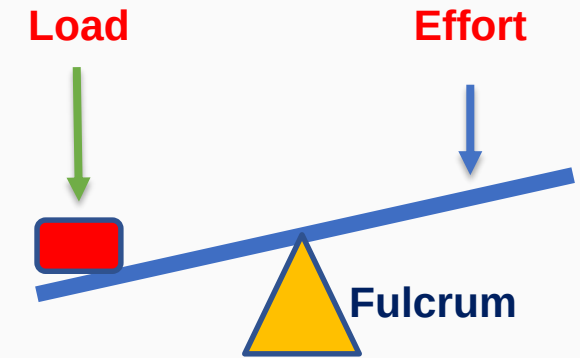
	Company LL	Company HL
Equity	₹ 40,000	₹ 20,000
10% Debt	₹ 20,000	₹ 40,000
Variable expenses to sales	60%	60%
Fixed expenses (excluding interest)	₹ 15,000	₹ 15,000

$$DFL = \frac{\% \text{ Change in EPS}}{\% \text{ Change in EBIT}}$$

$$DFL = \frac{EBIT}{EBIT - \text{Interest} - \left[\frac{\text{Pref. Div.}}{(1 - T)} \right]}$$

Understanding Leveraged Buyouts (LBOs)

- A leveraged buyout is when a buyer buys a firm financed primarily by debt to the extent of 50% or more.
- Equity financing portion is substantially lower in case of LBO deals.
- The need for LBO arises when the target's shareholders have to be paid in cash and the acquiring company does not have enough liquid assets like cash execute the deal.
- LBO structure is made in such a manner that the target company is liable for the new debt. Target's assets are used as collateral. In an LBO, the cash flow of the target's business is the primary source of servicing the debt.
- LBOs can be made for acquisition of shareholding in target or assets in target.

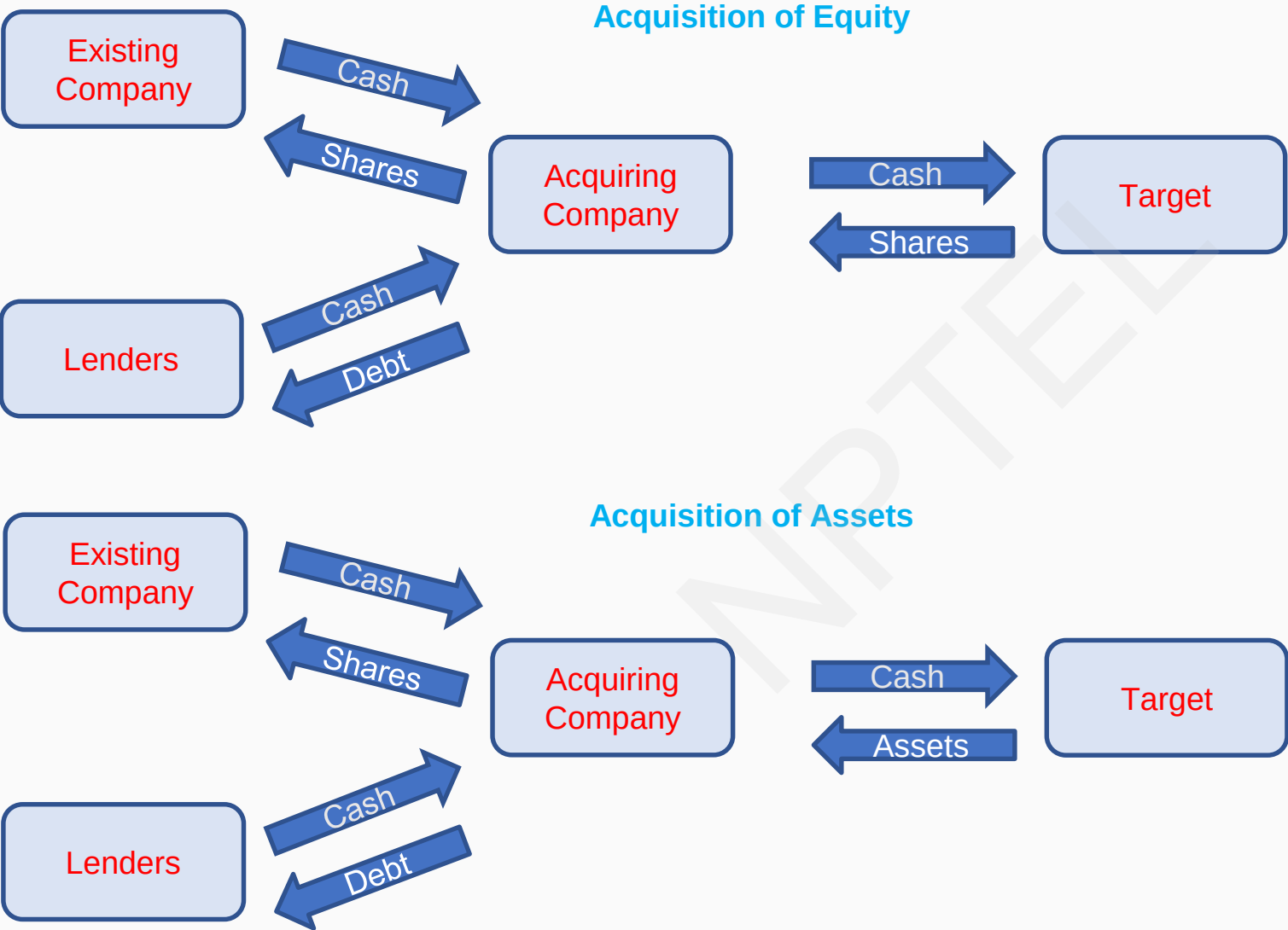


Use of Levers/ Fulcrums

Understanding Leveraged Buyouts (LBOs), contd..

- The debts used for the LBOs can be of different types based on
 - Tenure (short, medium, long term)
 - Secured/ unsecured
 - Convertibility option
- Debts for LBOs generally carry higher coupon rates in view of the risks involved.
- LBOs can be executed by
 - Strategic Buyers (companies in related sector)
 - Financial Buyers (like private equity players)
- Financial Buyers usually have an exit plan, i.e. an investment horizon.
- Generally a separate company is created by the acquiring group for the purpose of LBO transaction. As a result, the parent company is insulated from the dos and don'ts of the target company. But with a caveat!
- If an LBO is executed by the existing management of the target, it is known as **Management Buyout (MBO)**.

LBO Structures

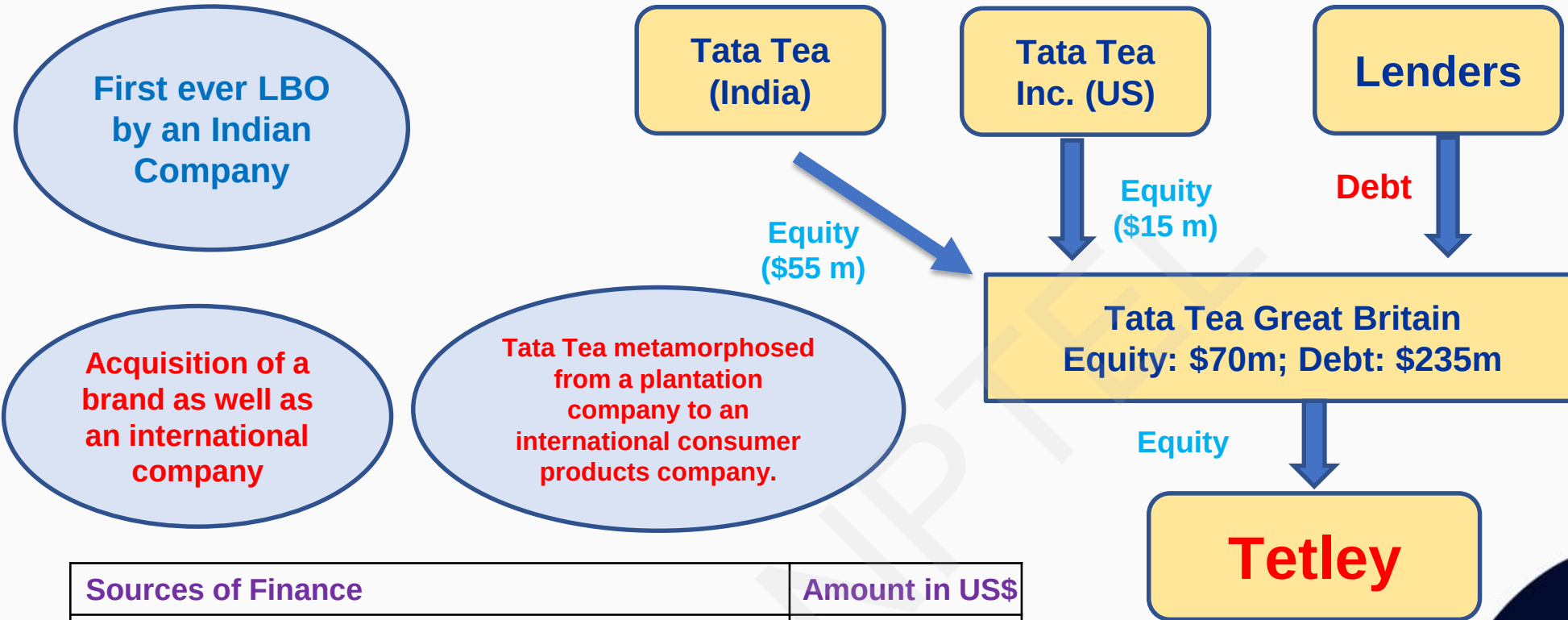


10 Most Famous Leveraged Buyouts (LBOs) in History*

- RJR Nabisco (1989): \$31 billion
- McLean Industries (1955): \$49 million
- Manchester United Football Club (2005): \$790 million
- Safeway (1988): \$4.2 billion
- Energy Future Holdings(2007): \$45 billion
- Hilton Hotels (2007): \$26 billion
- PetSmart (2007): \$8.7 billion
- Alltel (2007): \$25 billion
- Kinder Morgan (2006): \$22 billion
- HCA Healthcare (2006): \$33 billion

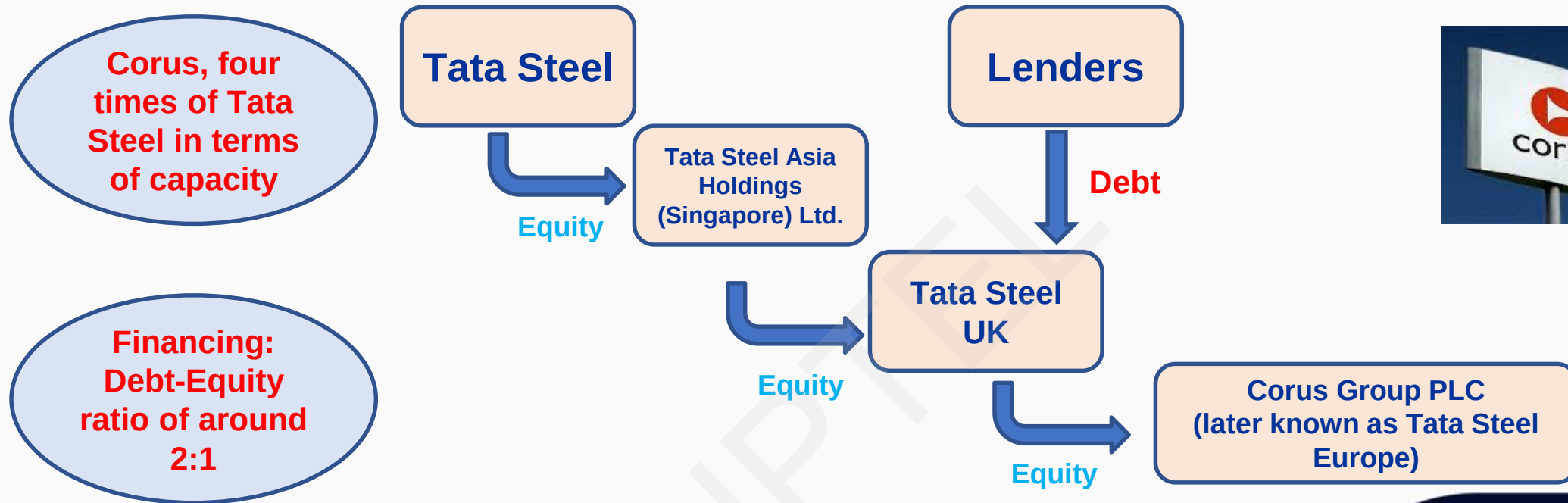
Source: <https://dealroom.net/blog/the-most-famous-leveraged-buyouts-in-history>, accessed on 20 December 2022

Examples of Strategic LBOs by Indian Companies: Tata Tea – Tetley (2000)



Sources of Finance	Amount in US\$
Equity Capital from Tata Tea Ltd and Tata Tea Inc	70 m
Prudential Mezzanine Capital	10 m
Schroders	10 m
Intermediate Capital Group	30 m
Rabo Bank	185 m
Total	305 m

Examples of LBOs by Indian Companies: Tata Steel – Corus (2007)



Sources of Finance*	Amount in US\$
Equity Capital from Tata Steel Ltd	4.10 billion
Long-term debt from consortium of banks	6.14 billion
Quasi - Equity funding at Tata Steel Asia Singapore	1.25 billion
Long term Capital funding at Tata Steel Asia Singapore	1.41 billion
Total	12.90 billion
*Source: https://www.tatasteel.com/media/newsroom/press-releases/india/2007/funding-of-corus-transaction/ , accessed on 20 January 2023	

Making a Successful LBO and Create Value

- Target Selection
 - Attractive industry or its segment
 - stable and mature industries
 - Stable stage with growth opportunities
 - Competent and motivated management
 - Good operating margin
 - Potential for improvement in margin
 - Else, poorly performing with potential to improve
 - Underperforming divisions of larger companies
 - Strong Balance Sheet
 - High collaterals (like tangible assets)
 - Absence of control covenants from existing lenders

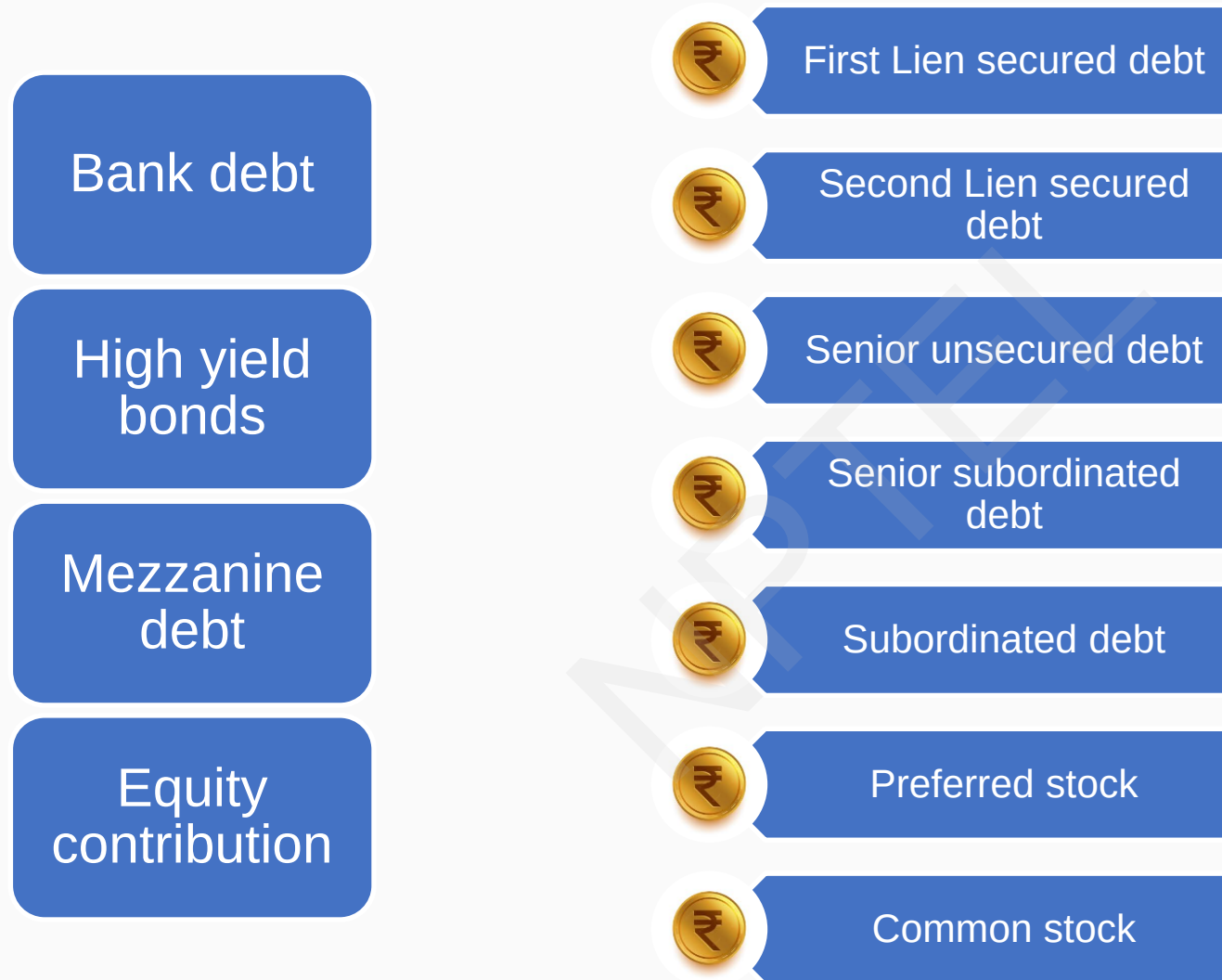
Making a Successful LBO and Create Value, contd..

- Avoid overpayment – thus over borrowing
 - Debt is a double-edged sword: too much of debt can hurt the company
- Continuous improvement in performance
 - It may call for harsh decisions (compared to strategic buyers, financial buyers are less hesitant while taking harsh decisions)
- Making it private
 - Avoid public company agency problem (between public shareholders and management).
 - Introduce professional management methods.
 - Discipline in management of the entity so as to ensure timely servicing of debt (interest payment and principal repayment)

Making a Successful LBO and Create Value, contd..

- Tax shield
- Gradual reduction in debt
- Timely exit (by financial buyers) or invite potential investors for participating in equity

General ranking of financing sources in an LBO capital structure



Source: Rosenbaum, J., & Pearl, J. (2021)

Alternate Methods of Exit by Financial Buyers from LBOs

- Second round LBO, i.e. exit in favor of another financial buyer
- Sale to a strategic buyer
- Initial Public Offer – making the company public from private

Challenges for LBOs in India

- Reserve Bank of India prohibits domestic banks from providing loans for acquiring shares of Indian companies.
- External Commercial Borrowings (ECB) regulations prohibits Indian entities from taking loans from non-residents for acquiring capital instruments (like equity shares)
- Thus for facilitating an LBO in India, the acquiring company can depend on foreign lenders & private equity players and venture capitalists – both Indian and foreign.

CONCLUSION

- Companies can benefit out of financial leverage.
- In case of LBOs, the financing is majorly done with debt.
- There are several layers of debt in terms of secured/unsecured and seniority available for financing an LBO.
- Financial Buyers have an exit intention in case of an LBO.
- Multiple exit options are available in case of LBOs.

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Thank you





N P T E L O N L I N E C E R T I F I C A T I O N C O U R S E S

MERGERS, ACQUISITIONS AND CORPORATE RESTRUCTURING

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LECTURE: 40

TITLE: Alternative Exit and
Restructuring Strategies –
Insolvency and Bankruptcy

- Insolvency and Bankruptcy Code
- Causes and Symptoms of Insolvency and Bankruptcy
- Corporate Insolvency Resolution Process (CIRP)



Keywords



- Insolvency
- Bankruptcy
- Financial Failure
- Business Failure
- Altman's Z-Score
- Financial Creditor
- Operational Creditor
- Waterfall Mechanism

Concepts of Insolvency and Bankruptcy

- The words “**Insolvency**” and “**Bankruptcy**” are generally used interchangeably, but they have different meanings.
- The word “bankruptcy” is the condition of insolvency. It is a legal status of a person or a business who cannot repay debts to creditors.
- The term “insolvency” denotes the state of one whose assets are insufficient to pay their debts; or their general inability to pay their debts.
- The bankruptcy process begins with filing of a petition in a court or before an appropriate authority designated for this purpose. The assets of the debtor are then assessed and applied to the legal payment of the creditors.

Concepts of Insolvency and Bankruptcy, contd..

- Insolvency
 - Individuals: Bankruptcy
 - Organizations and Corporates: Corporate insolvency
- If insolvency is untreated it will lead to
 - Bankruptcy in case of non-corporates
 - Liquidation in case of corporates, i.e. winding up of a corporation or incorporated entity. Liquidation proceedings can be initiated by
 - Regulatory Bodies
 - The Directors of a Company
 - The Shareholders of a Company
 - An unpaid creditor a Company

Signs of Bankruptcy or Financial Distress

Financial distress or bankruptcy does not appear overnight. It is possible to get a signal or sign of bankruptcy / financial distress in a business firm. Some of the signs are:

- Continuous decrease in sales of products/ services
- Escalating costs of operation without commensurate increase in revenue
- Falling margins
- Insufficient cash flow for payment of regular operating expenses
 - Delay in payment for utilities, salaries, wages, etc.
 - Delay in payment of statutory dues like PFs, tax payments, etc.
- Warnings and legal letters from non-owner stakeholders

Signs of Bankruptcy or Financial Distress, contd..

- Increasing trade payables without commensurate increase in business activities
 - Not making timely payment to the vendors
 - Seeking extended terms from vendors
- Increasing trade receivables without commensurate increase in business activities
 - Increase in average collection period
- Denial of credit and other credit related facilities by banker
 - Invoking of guarantees by the banker/ lender
 - Higher interest payments
 - Decrease in credit score, downgrading of credit rating
- Imposition of restrictions by vendors
- Higher attrition rate of key management persons; high employee turnover in comparison to industry;

Signs of Bankruptcy or Financial Distress, contd..

- Other than Other than cases of outright fraud, the debtor may be insolvent because of*
 - **Financial failure** - a persistent mismatch between payments by the enterprise and receivables into the enterprise, even though the business model is generating revenues, or
 - **Business failure** - which is a breakdown in the business model of the enterprise, and it is unable to generate sufficient revenues to meet payments. Often, an enterprise may be a successful business model while still failing to repay its creditors.
- A sound bankruptcy process is one that helps creditors and debtors realise and agree on whether the entity is facing financial failure and business failure. This is important to allow both parties to realise the maximum value of the business in the insolvency.”

*Source: The report of the Bankruptcy Law Reforms Committee of November, 2015
(https://ibbi.gov.in/BLRCReportVol1_04112015.pdf accessed on 20 December 2022)

Predicting Bankruptcy – Altman's Z-Score

Altman's Z-Score suggests the likelihood of bankruptcy of a publicly traded manufacturing company.

$$Z\text{-Score} = 1.2 \cdot T_1 + 1.4 \cdot T_2 + 3.3 \cdot T_3 + 0.6 \cdot T_4 + 1.0 \cdot T_5.$$

T_1 = **Working Capital / Total Assets**: This measures liquid assets as firm in trouble will usually experience shrinking liquidity.

T_2 = **Retained Earnings / Total Assets**: This indicates the cumulative profitability of the firm, as shrinking profitability is a warning sign.

T_3 = **Earnings Before Interest and Taxes / Total Assets**: This ratio shows how productive a company in generating earnings, relative to its size.

T_4 = **Market Value of Equity / Book Value of Total Liabilities**: This offers a quick test of how far the company's assets can decline before the firm becomes technically insolvent (i.e. its liabilities exceed its assets).

T_5 = **Sales / Total Assets**: Asset turnover is a measure of how effectively the firm uses its assets to generate sales.

$Z > 2.99$: Safe zone
$1.8 < Z < 2.99$: Grey zone
$Z < 1.8$: Distress zone

A Glance at Insolvency and Bankruptcy Code, 2016



- The Insolvency and Bankruptcy Code, 2016 (IBC) is an Indian law that establishes a unified framework that governs insolvency and bankruptcy proceedings for companies, partnership firms, and individuals.
- On 22 August 2014, the Ministry of Finance created the Bankruptcy Legislative Reforms Committee (BLRC) under the chairmanship of T. K. Viswanathan to draft new bankruptcy law. Subsequently, it passed through a joint parliamentary committee, Loksabha, Rajyasabha, and finally came into force on 28 May 2016 after receiving the assent of the president.
- Before the IBC, there were several other laws that made up the insolvency and restructuring legal framework, such as the Companies Act, 2013, SARFAESI Act, 2002, RDDBFI Act, 1993, Sick Industrial Companies (special provision) Act, 1985, naming a few. The presence of multiple laws, forums, and complexities resulted in delays in the prompt settlement of the distressed entities.

A Glance at Insolvency and Bankruptcy Code, 2016, contd..



- The National Company Law Tribunal (NCLT) issued the first insolvency resolution order under to this legislation on August 14, 2017 in the instance of Synergies-Dooray Automotive Ltd.
- Since the Act came into effect, as many as 5,258 insolvency cases have been filed by lenders of which 3,403 of these had been resolved as of March, 2022.
- Of the 3,406 instances that were successfully settled, roughly 47% of the businesses were liquidated, and 17% were withdrawn after 90% of lenders agreed, following an offer made by the promoter. Roughly 22% of the cases are currently active, while in 14% of the instances, the settlement plan has been approved.

Desired Objectives of Corporate Insolvency Regime



- Protect the interests of stakeholders like, lenders, employees, shareholders, vendors, etc.
 - Reorganizing the viable businesses and liquidate unviable businesses
 - Early completion of insolvency process
- Efficient allocation of economic resources so as to promote economic growth

Desired Objectives of Corporate Insolvency Regime, contd..



- Protecting the rights of creditors
 - In the long run, the cost of credit is expected to decline.
 - Control of a company is not divine right. When a firm defaults on its debt, control of the company should shift to the creditors. In the absence of swift and decisive mechanisms for achieving this, management teams and shareholders retain control after default. Bankruptcy law must address this*.
- Improve business environment and encourage entrepreneurship
 - Smooth exit option for the entrepreneurs who fail due to genuine business reasons

*Source: The report of the Bankruptcy Law Reforms Committee of November, 2015
(https://ibbi.gov.in/BLRCReportVol1_04112015.pdf accessed on 20 December 2022)

Alternative exit strategies for failing firms

The following two independent stages are outlined in Part II of the 2016 Insolvency and Bankruptcy Code:

- A. Corporate Insolvency Resolution Process** (Sections 4 and 6 to 32)
- B. Liquidation** (Sections 33 to 54 and Section 59)
 - In corporate bankruptcy resolution procedure, the financial creditors examine the viability of debtor's business and the choices for its revival and rehabilitation
 - If the corporate insolvency resolution process fails or the financial creditors decide that the business of the debtor cannot be carried on in a viable way and it should be wound up, the debtor's firm enters the liquidation procedure.

Corporate Insolvency Resolution Process (CIRP)

- CIRP refers to corporate insolvency procedures in which a corporate debtor who defaults would then allow a financial creditor, an operational creditor, or the corporate debtor itself to begin a corporate bankruptcy resolution process with respect to such corporate debtor.

Who can initiate CIRP?

- Section 7 – Initiation of corporate insolvency resolution process by **Financial creditor**
 - According to Section 5(7) of the Code, a "financial creditor" is any person who is owed money, including someone to whom the debt has been legally assigned or transferred.
 - Financial Creditors are the organizations from whom the corporate debtor borrowed money as a loan or with interest under any credit facilities. Ex: Banks, financial institutions, NBFCs, etc. are some examples.

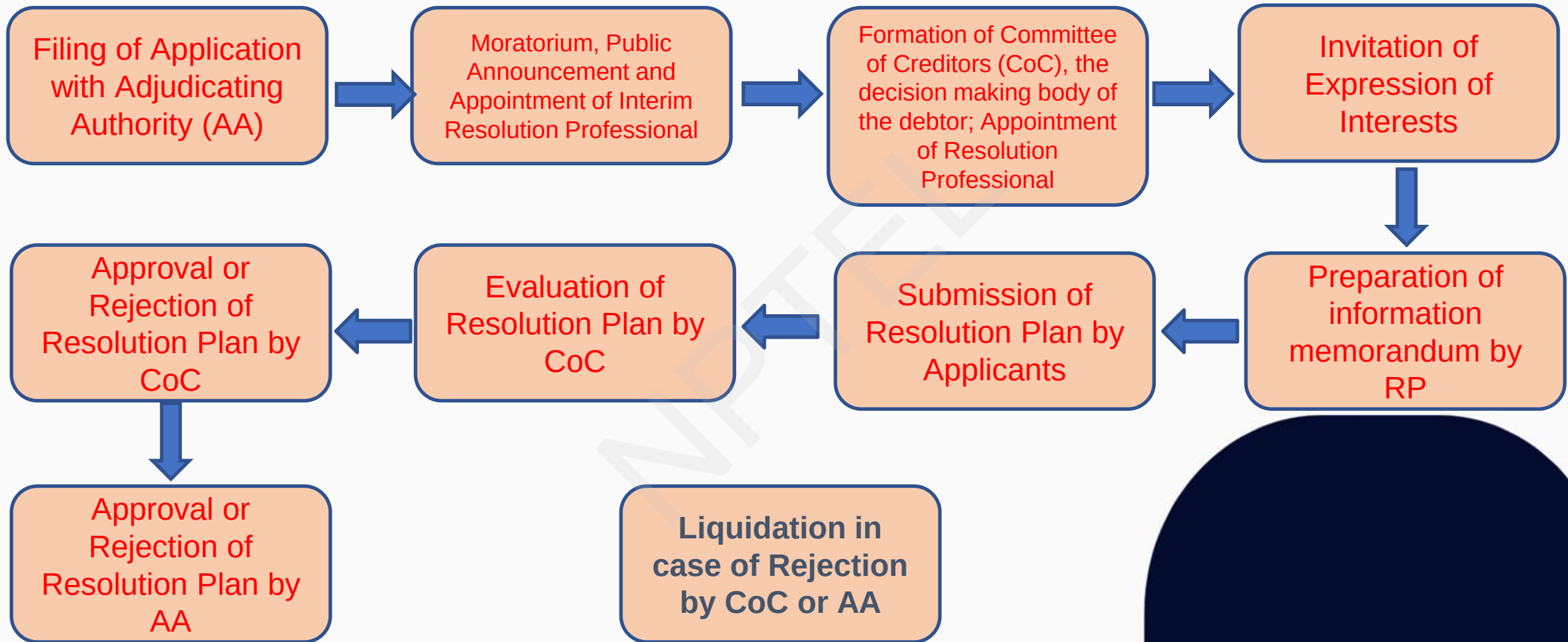
Who can initiate CIRP (contd..)?

- Section 8 and 9 – Initiation of corporate insolvency resolution process by **Operational creditor**.
 - As per Section 5(20), a person who owes an operational debt, including anyone to whom it has been legally assigned or transferred, is referred to as an "operational creditor" .
 - These creditors include those who work for the business or who owe money for goods and services they rendered to the corporate debtor. For instance, workers, employees, suppliers etc.

Who can initiate CIRP (contd..)?

- Section 10 – Initiation of corporate insolvency resolution process by **Corporate applicant**.
- As per Section 5(5) of the code, the following persons can be “corporate applicant” i.e.,
 - corporate debtor or
 - a member or partner of the corporate debtor who is authorized to make an application.
 - an individual who is in charge of managing the operations and resources of the corporate debtor.
 - a person who has control, and supervision over the financial affairs of the corporate debtor.

CIRP Process Flow – Broad View



The process is time bound and it is expected to be completed within 180 days (+ extension up to 90 days if allowed), unless fast-tracked.

Liquidation process under IBC,2016

- It should as per Insolvency and Bankruptcy Board of India (Liquidation process) Regulations, 2016 in congruence with IBC, 2016
- Form E of schedule II, provided by the corporate debtor must be submitted in person, by mail, or electronically to the liquidator as a proof of claim.

Steps of Liquidation under IBC,2016

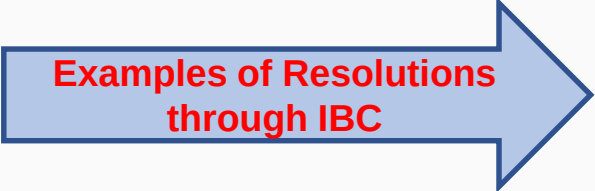
- Appointment of Liquidator
- Announcement of liquidation and calling for submission of claims and appointment of valuers
- Verification and acceptance of claims
- Preparation of asset memorandum and other reports
- Formation of Liquidation estate (with inclusions and exclusions)
- Sale of assets
- Distribution of assets as per waterfall mechanism
- Dissolution of corporate debtor (to be done within 1 year)

Waterfall Mechanism under IBC

- Insolvency Resolution Cost & Liquidation Cost
- Debts to Secured Creditor (who have relinquished their security interest) & Workmens' dues (for 24 months before commencement)
- Wages & Unpaid Dues to employees (other than workmen) (for 12 months before commencement)
- Financial Debts to Unsecured Creditors
- Workmen's Dues for earlier period
- Crown Debts
- Remaining Debts
- Preference Shareholders
- Equity Shareholders or partners

Dirty Dozen

- On June 13, 2017 Internal Advisory Committee of RBI identified 12 highly stressed debtors for insolvency resolution under the IBC popularly referred as “Dirty Dozen”.
- As per reports, Bhushan Steel, Bhushan Power, Electrosteel Steels, JP Infra, Era Infra, Amtek Auto, ABG Shipyard, Jyoti Structures, Monnet Ispat, Lanco Infratech, Alok Industries, and Essar Steel are the 12 dirty accounts.
- The report said, identified 12 insolvent accounts that were in charge of 25% of current gross non-performing assets of the banking system.
- Their total outstanding claims totaled 3.45 trillion rupees, compared to a liquidation value of Rs.73,220 crore.
- It is notable that of these 12, 8 have currently been resolved, two are still undergoing insolvency proceedings, and liquidation has been ordered in the case of the other two as of June, 2022.
- The eight cases that were saved through resolution plans had recoveries that varied from 115% to 387% of the liquidation value.



Examples of Resolutions
through IBC

CONCLUSION

- The Corporate Insolvency Resolution Process (CIRP) has been streamlined by the Insolvency and Bankruptcy Code, 2016.
- There is a reasonable certainty with respect to resolution of insolvency and bankruptcy.

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Thank you



IBC Examples

Bhushan Steel Limited:

- It was incorporated in 1983
- In 1987, Brij Bhushan Singal and his sons Sanjay Singal, Neeraj Singal and associate companies took over the management of the company by acquiring the entire stake
- In 2001, they started expansion projects in Maharashtra
- They formed a strategic agreement with Sumitomo Metal Industries in Japan in 2003 for the purpose of exchanging process knowhow for the production of automobile steel sheets.
- Bhushan Steel (Australia) Pty Ltd and Bhushan Steel Global FZE were two fully owned subsidiaries
- In 2003, they decided to build an integrated steel plant in Odisha
- It was a time of great optimism for the steel sector. Steel prices were rising continuously. So they took financing from banks for their expansion

IBC Examples, contd..



Bhushan Steel Limited, contd..

- However, the steel industry is cyclical, and as Chinese demand decreased following the 2008 Summer Olympics, prices fell as quickly as they have done in the past.
- Steel prices dropped to \$300/tonne in December 2012 from a peak of \$1265/tonne in 2008, and by 2012
- The business was clearly in trouble by March 2014. While the corporation was spending more than Rs 1,600 crore annually on interest payments alone, profit had fallen to a meagre Rs 62 crore.
- In March 2014, SBI and a consortium of lenders sanctioned fresh loans, giving a chance to survive
- However, because of persistently low steel prices and rising Bhushan's interest costs, the company's total debt increased by 30% in just two short years, from Rs. 35,710 crore in 2014 to Rs. 46,062 crore in March 2016.

IBC examples, contd..

Bhushan Steel Limited, contd..

- In accordance with the Insolvency and Bankruptcy Code's rules, the CIRP process was initiated on July 26, 2017.
- On 15th May 2018, NCLT approved Tata steel Ltd's (TSL) resolution plan
- Through its wholly-owned subsidiary Bamnibal Steel Ltd. (BNL), which Tata Steel has acquired, the company bought Bhushan Steel (BSL), where it now holds a controlling 72.65% share.
- In order to facilitate the acquisition of Tata Steel BSL Limited (TBSL) through the corporate insolvency resolution process mandated under the Insolvency and Bankruptcy Code, 2016, Bamnibal Steel Limited (BNL), a public limited company formed as an SPV (Special Purpose Vehicle), is a wholly owned subsidiary of TSL and was founded on January 19, 2018.

IBC examples, contd..:



Essar Steel

- Essar Steel India Limited (ESIL), an integrated steel producer with an installed steel-making capacity of 9.6 million tonnes per annum (MTPA), was promoted by the Ruia/Essar group.
- ESIL, was one of India's top four steel producers and the biggest integrated steel producer in Western India.
- Its product line comprises hot rolled steel, cold rolled steel, galvanised and colour coated coils, plates, pipes, etc.
- Out of the “Dirty Dozen” It was the single-largest settlement under the IBC in terms of the amount and percentage of amounts recovered by creditors, the largest M&A transaction of the year, and the greatest FDI for the year because it drew FDI from ArcelorMittal, the biggest steel manufacturer in the world.
- It had financial debts of Rs. 49,000 crore. The money was owed to a consortium of banks led by SBI that comprised PSU and private sector banks.

IBC Examples, contd..

Essar Steel, contd..

- In July 2017, the lenders referred ESL to NCLT Ahmedabad for bankruptcy resolution. Five metal goliaths, including ArcelorMittal and Numetal, submitted their EOL after the NCLT admitted the insolvency proceedings in August 2017.
- The case which has great importance in the recent bankruptcy resolution history went through NCLT, NCLAT and the final verdict was given by the supreme court.
- The order finally paved the way for the resolution of Essar Steel, one of the oldest cases in the IBC process.
- Arcelor Mittal became the winner with a bid of a total of 42,000 crores; 92% of the total claims and it took 865 days to complete the resolution process.
- ArcelorMittal and Nippon Steel's joint venture, AM/NS India, successfully completed the \$5.7 billion (Rs. 420Billion) acquisition of Essar Steel India Limited, now renamed as ArcelorMittal Nippon Steel India Ltd.

IBC Examples, contd..

Dewan Housing Finance Ltd. (DHFL)

- DHFL was established and incorporated by Rajesh Kumar Wadhawan on 11 April 1984. It was established to provide lower- and middle-income populations in semi-urban and rural areas of India with access to affordable home financing.
- DHFL has filed for bankruptcy, With over 90,000 crore in debt to several lenders, including banks, mutual funds, and private investors who maintained fixed deposits with the firm.
- The third-largest pure-play mortgage lender at the time, DHFL, has been recommended by RBI for resolution under the IBC in November 2019. It was the first financing business that the RBI has sent to NCLT utilising its unique authority granted under Section 227 of the IBC.
- As part of resolution process under the Insolvency and Bankruptcy Code (IBC), lenders led by Union Bank of India favoured the bid by Piramal Capital and Housing Finance to take over the beleaguered housing finance firm.

IBC Examples, contd..

Dewan Housing Finance Ltd. (DHFL), contd..

- Piramal Capital had received approvals from the Competition Commission of India (CCI) and the Reserve Bank of India (RBI) AND National Company Law Tribunal (NCLT). The creditors of DHFL have approved its resolution plan with 94% of the vote.
- In January 2021, the Piramal Group won the bid to acquire stressed DHFL after seeing stiff competition from its competitor, Oaktree Capital.
- Piramal Group's Rs.37,250 crore offer includes Rs.12,700 crore in cash up front, Rs.3,000 crore in interest income recorded on DHFL's books, and Rs.19,550 crore in non-convertible debentures that must be repaid over a ten-year period.

