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MERGERS & ACQUISITIONS - SHORT CUT TO GROWTH

INTRODUCTION

Basic essence of capitalization is to make profits. In a free market economy profit is the reflection of the success of the company. Growth of profit is directly related to the growth of business. The two fundamental approaches followed by businesses to grow are organic and inorganic. In following the organic approach, a company gradually and over a period of time increases its infrastructure, customer base, human resource and thereby increasing its revenues and profits. But, the inorganic approach allows the company to skip a few steps on the growth ladder by resorting to mergers and acquisitions of other businesses.

What is Merger and Acquisition?

As the terms suggest, 'Merger' is unification of two players/businesses into one entity and 'Acquisition' is one player/business buying out another to combine the bought entity with itself.

Assessing worth of the Company before Merger and Acquisition

Before any merger and acquisition can take place, proper valuation of the company to be merged or acquired, has to be done. Some of the valuation techniques are:

- **Earning based valuation** - takes into account the future earnings of the business i.e. the projected revenues and cost of running the business in future.
- **Market based valuation** - is arrived at by multiplying the number of shares of the company with the existing market value. In case of unlisted companies the price of comparable listed company is taken into consideration to arrive at a market value.

- **Asset based valuation** - is done by taking book value (total assets minus the liability) or the net adjusted value (revalue the existing assets and subtract the value of the assets contained in the accounts). The value of intangible assets like brands, copyrights, patents and other intellectual property rights etc. are valued independently and the same is added to the net asset value to arrive at the business value.

Relevant procedure and Legal provisions

Mergers and acquisitions in India are governed by the provisions of **Chapter V** of the Companies Act, 1956 ('**The Act**'). The relevant sections governing this procedure are Section 389-396A. Following a decision/intent to merge with a suitable partner and/or amalgamate, the following corporate and commercial steps have to be followed.

- **Structuring the transaction:** Structure the scheme of amalgamation i.e. terms of transfer of assets and liabilities, description of the proposed share exchange ratio, conditions of payment of dividends, status of employees, provisions relating to taxes, approvals from relevant statutory agencies etc.
- **Board Approvals:** The scheme of amalgamation has to be approved by the board of directors of both the transferor and transferee company. Approval of the proposed scheme has to be sought from specialized financial institutions/ banks if the company has taken any loans / trustees for debenture holders.
- **Regulatory Approvals:** If the scheme of amalgamation seeks to issue shares or make payments in cash i.e. if the transferor

company gives an option for payment for the repurchase of shares to the non-resident Indians or foreign nationals then Reserve Bank of India's (RBI) prior approval also has to be sought¹. Intimation to Stock Exchange about proposed amalgamation has to be given in case the company is listed on the stock exchange. The information has to be issued as soon as the scheme is approved by the board and made available to the media.

- High Court Application: Application for approval of the scheme to the High Court having jurisdiction over the registered office of the companies (transferor and transferee) has to be made. The application for judge's summons² should be accompanied with the transferor company's memorandum and articles of associations, balance sheets and certified copy of the board resolution approving the scheme. Upon receiving the summons the High Court fixes a date, time and venue for members meeting. Court appoints an advocate as the chairman to preside over the meeting and give a subsequent report of the same to the court.
- Notice for Shareholders meeting: Pursuant to the directions given by the High Court both the transferor and transferee company have to seek approval of court registrar to issue notice³ for calling the meeting of members/creditors. The notice has to be signed by the presiding advocate chairman and has to be dispatched to the members/shareholders at least 21 days prior to the meeting.⁴ Court may direct the publication of the notice of the meeting of members in the newspaper as per the approved format⁵. The chairman has to file an affidavit in the court of intimating the confirmation about the service of the notice a week prior to the actual meeting.
- Shareholders Meeting and Resolution: Shareholders general meeting is to be held on the appointed date⁶ and the proposed

resolutions should be passed by the majority of the shareholders⁷. Once approved, the resolution of the general meeting has to be filed with Registrar of Companies⁸ (ROC) within 30 days.

- Presiding Chairman's Report: Report of the chairman⁹ presiding over the general meeting has to be submitted in the court within seven days of the meeting. The report should contain the details of the number of the shareholders present and voting in the meeting and the resolution(s) passed at the meeting.
- Joint Petition to Court: The companies will submit the joint petition to the court¹⁰ for sanction of the scheme within seven days of the filing of report by the chairman. After receiving an application under Section 391 the court will issue notice to the Regional Director, Company Law Board under section 394-A and will consider any representation or objections made by him. After hearing the petition, court will confirm the scheme and pass an order¹¹ to the effect. The Court order¹² has to be filed with ROC by both the companies (transferor and transferee) pursuant to section 394(3) of the Act within 30 days of the passing of the order by the high court. The amalgamation will come into effect from the date of filing of the order with the ROC. Pursuant to Section 394(2) of the Act, the court can order the transfer of the assets and liabilities of the transferor company to the transferee company.
- Allotment of Shares: Allotment of shares to shareholders of the transferee company has to be done as per the exchange ratio/share swap ratio approved in the scheme of merger. The ratio will be based on the market based valuation, explained above, of the transferee company. An evaluator will decide on the basis of the valuation as to what proportion of shares of the transferor company will be allotted in lieu of the shares of the transferee

¹ FEMA Notification: Transfer or issue of Securities by a person resident outside India, 2000.

² Under form No. 33 supported by an Affidavit in form No.34 (Rule 82 of the Companies (Court) rules, 1959).

³ Notice as Contained in Form No. 36 along with the statement of arrangement and explanation as per Section 393 of the Companies Act, 1956.

⁴ Rule 73 of the Companies (Court) rules, 1959.

⁵ Form No. 38 Companies (Court) Rules.

⁶ Rule 74 of the Companies (Court) rules, 1959.

⁷ Such majority must represent the 3/4th value of the shares held by the members voting.

⁸ Form No. 23 Companies (Central Government's) General Rules and Forms, 1956.

⁹ Form No. 39, Companies (Court) rules, 1959.

¹⁰ Form No. 40, Companies (Court) rules, 1959.

¹¹ Form No. 41 and 42, Companies (Court) rules, 1959.

¹² Form No. 21, Companies (Court) rules, 1959.

company. In case of an unlisted company; the shareholders of the transferee company can surrender their old share certificates in lieu of new ones of the transferor company. In case of the listed company, the stock exchange has to be intimated of the record date (or date of closure of books i.e. till which date the transfers will be duly recorded in the register of members) by giving a prior notice. If allotment of the shares is to be made to Non Resident Indians, prior approval of the RBI has to be sought¹³. After making the allotments, the return of allotment¹⁴ has to be filed with ROC within 30 days of the allotment¹⁵. Listing of the new shares at stock exchange has to be done where the stocks of the transferor company are listed. Copy of the court order has to be annexed with the memorandum of transferee company filed with ROC as per Section 391(4).

- Books and papers of amalgamated company have to be preserved pursuant to Section 396A of the Act and no document can be destroyed without the prior permission of the Central Government.
- Withdrawal of the scheme once approved by majority shareholders and creditors of the company under Section 391 is not permissible by passing any subsequent resolution to the effect. But, the court can cancel the scheme of amalgamation and order winding-up of the company if it feels that the resulting scheme of merger is not sufficient to revive the conditions of the company and in order to secure the interest of the creditors it may pass the winding up orders at the petition moved by the creditors. The company cannot go ahead with the scheme of merger in such cases. The effect of winding up order is that except for certain preferential payments, provided in the Act, the property of the company is applied in the satisfaction of its liabilities *pari passu*¹⁶. This was held by the

Supreme Court in *J. K. (Bombay) (P) Ltd. Vs. New Kaiser-I-Hind*¹⁷.

CONCLUSION

Mergers and Acquisitions definitely are a short cut to increasing the net worth of the business. But, working out values requires experience, good judgment and diligence as one is projecting the future growth of business which is unknown. Though the procedure to be followed is elaborate and requires a lot of formalities to be complied, it is still an effective and efficient way of business expansion.

(Adity Gupta)

¹³ FEMA Notification: Transfer or issue of Securities by a person resident outside India, 2000.

¹⁴ Form No. 2, Companies (Central Government's) General Rules and Forms, 1956.

¹⁵ Section 75 of the Act.

¹⁶ The creditor who have lined up for the assets of the company are entitled to receive out of the funds of such a company their dues without any precedence to each other.

¹⁷ AIR 1970 Supreme Court 1041.

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