



OPPORTUNITIES FOR CHARTERED ACCOUNTANTS IN M&A

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M&A - DEFINED

Mergers and acquisitions (M&A) is a general term used to describe the consolidation of companies or assets through various types of financial transactions, including mergers, acquisitions, consolidations, tender offers, purchase of assets and management acquisitions.

The terms "mergers" and "acquisitions" are often used interchangeably, although in actuality, they hold slightly different meanings.

- Merger – a merger describes two firms, who join forces to move forward as a single new entity, rather than remain separately owned and operated
- Acquisition – When one company takes over another entity, and establishes itself as the new owner, the purchase is called an acquisition

OTHER TYPES OF M&A

- Tender Offer – one company offers to purchase the outstanding stock of the other firm, at a specific price. The acquiring company communicates the offer directly to the other company's shareholders, bypassing the management and board of directors
- Acquisition of Assets – one company acquires the assets of another company. The company whose assets are being acquired must obtain approval from its shareholders
- Management Buyout – company's executives purchase a controlling stake in another company, making it private. These former executives often partner with a financier or former corporate officers, in an effort to help fund a transaction. Such M&A transactions are typically financed disproportionately with debt, and the majority of shareholders must approve it.

MOTIVATIONS BEHIND M&A (1/2)

Value Creation: M&A results in synergies that increase the value of a newly created business entity

Synergies: value of a merged company exceeds the sum of the values of two individual companies

Revenue synergies

- Market expansion
- Rapid Growth
- Diversification
- Cross Selling
- R&D activities

Cost synergies

- Economies of scale
- Access to new technologies
- Elimination of certain costs

MOTIVATIONS BEHIND M&A (2/2)

Increased Market Power:

Horizontal merger – Buyer will absorb a major competitor thus increase its market power

Vertical merger – Forward/backward integration:
Reduces dependence on outside customers/suppliers
Control of critical supply inputs gives power to influence industry output and market prices

Rapid Growth:

Mature industries where organic growth opportunities are limited, M&A offers a much faster way to increase revenues

Diversification:

Entering into new markets or offering new products or services

Access To Unique Capabilities:

Company can either try to develop capabilities that it lacks in viz. R&D, intellectual property internally or acquire it.

M&A is a cost effective & less risky way to acquire proven capabilities or resources.

Unblocking Hidden Value:

A struggling company may be bought by an acquirer to unlock its hidden value by improving management, adding resources, improving organisation structure

Achieving International Business Goals:

Taking advantage of market inefficiencies (low labour cost), provide support to existing multi-national clients, overcome barriers to free trade

LAWS REGULATING M&A (1/2)

The Companies Act, 2013

- Regulates capital instruments issued by the company
- Procedures and ways of raising capital
- Board and shareholders consent requirements

The Competition Act, 2002

- Promotes free and fair competition
- Prohibit the or practices that have adverse effect on competition
- Prohibit the abuse of dominance in a market

Foreign Exchange Management Act, 1999

- Regulating issuance of shares by Indian entity to person residing outside India

LAWS REGULATING M&A (2/2)

SEBI SAST Regulations 2011 & Prohibition of Insider Trading Regulations 2015

- Mandatory open offer requirements in the case of substantial acquisitions
- Provides for disclosures of M&A transactions involving publicly listed companies

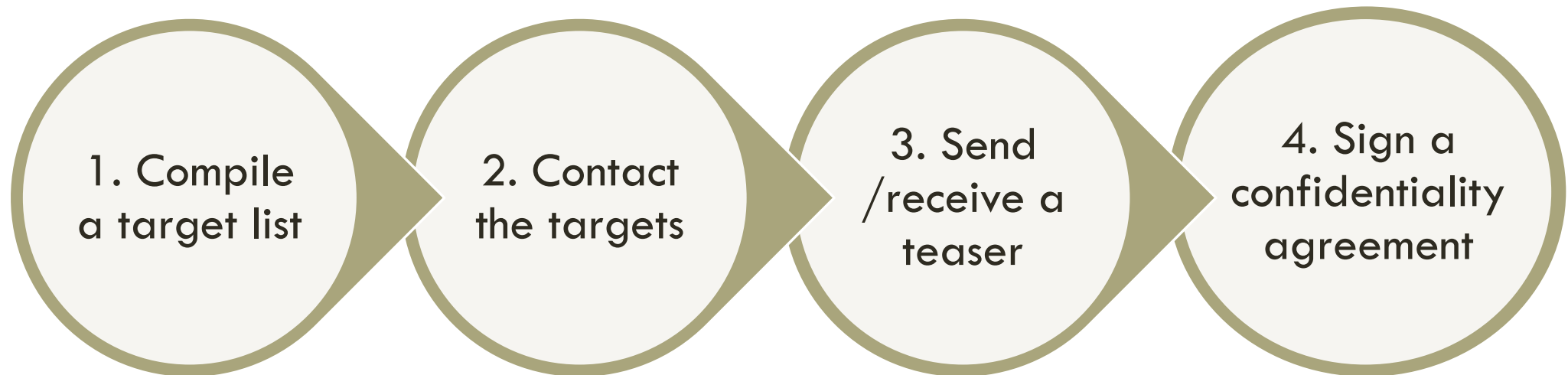
Mandatory permission by the courts

- Each of the companies proposing to merge with the other(s) must make an application to the Company Court

Intellectual Property Law

- All the intellectual property assets are transferred to the transferee company under the scheme of arrangement

M&A PROCESS (1/3)



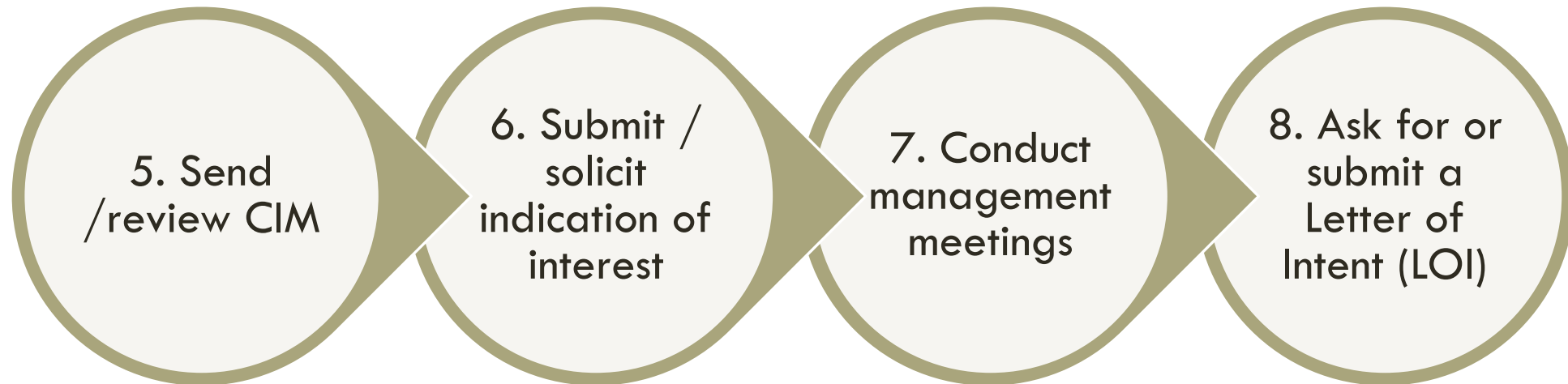
- List of suitable sellers and buyers

- Phone calls and discussions to gauge target's interest

- Usually anonymous
- Document Seller sends to Buyer
- Contains enough information to make Buyer want to learn more

- Both the parties agree to keep the deal discussions and material confidential

M&A PROCESS CONT..(2/3)



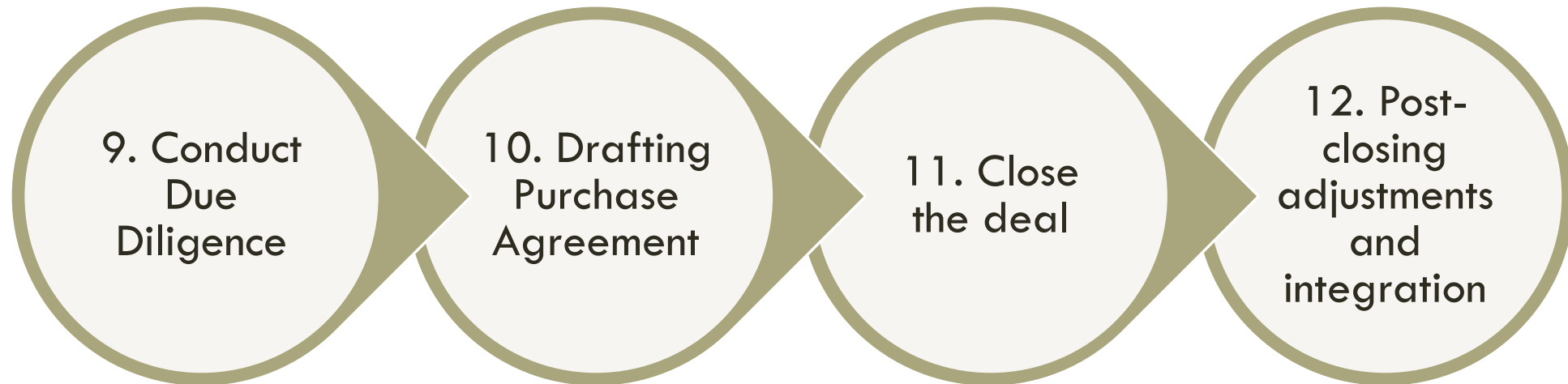
- Seller's bible, provides all the information buyer needs to determine whether to make an offer

- Buyer expresses interest in a written draft

- Both party gauge how compatible they are

- Based on the information in IM and management meetings, Buyer makes a detailed offer

M&A PROCESS CONT..(3/3)



- Buyer examines Seller's books and records to confirm everything Seller has claimed

- Buyer and Seller memorialize the deal in this legally binding contract

- Both sides sign lots of papers
- Agrees to follow Purchase Agreement

- Integration of two businesses takes place

ROLE OF CA IN M&A TRANSACTIONS – SELL SIDE



Preparing the Client

- Explaining the client about available opportunities
- Sharing Pros and Cons of M&A Transactions
- Giving them perspective of value creations



Information Memorandum

- Understanding the Client Business
- Collecting Information from the Client
- Preparing the Information Memorandum



Valuation

- Doing a Valuation exercise for the Client to give indicative valuation
- Setting the right expectation

ROLE OF CA IN M&A TRANSACTIONS – SELL SIDE



Vendor Due Diligence

- Review of corporate records
- Determining the suitable adjustments to Financial Statements
- Conducting legal and commercial due diligence



Information Preparation

- Preparation of documents for potential buyer due diligence
- Guiding the Client to ensure proper compliance to minimize issues during the transaction



Connecting with potential buyers

- Using network to locate potential buyers
- Reaching out through multiple channels of communication
- Using Social Networks

ROLE OF CA IN M&A TRANSACTIONS – SELL SIDE



Negotiation

- Initial discussion with potential buyers/their advisors
- Setting valuation expectation
- Assisting on various negotiations



Documentation

- Drafting Share Purchase Agreement
- Communicating the implications of each clause in the agreement



Regulatory Compliance

- Substantial areas of legal compliance which needs to be professionally managed
- Restrictions on merger control in any applicable law

ROLE OF CA IN M&A TRANSACTIONS – BUY SIDE



Preparing the Client

- Explaining the client about growth opportunities through Mergers and Acquisition
- Identifying areas of interest for the client



Connecting with potential sellers

- Using network to locate potential sellers
- Reaching out through multiple channels of communication
- Using Social Networks



Initial Discussion

- Initial discussion with potential sellers/their advisors
- Client Buy-in to evaluate the opportunity
- Setting valuation expectation – conducting own valuation

ROLE OF CA IN M&A TRANSACTIONS – BUY SIDE



Negotiations

- Assisting on various terms of transaction
- Arriving at consensus valuation
- Issuing term sheet/LOI



Due Diligence

- Review of Financial Statements for establishing accuracy of Financial Statements including any adjustment requirement
- Conducting legal and tax due diligence



Documentation

- Drafting Share Purchase Agreement
- Communicating the implications of each clause in the agreement
- Negotiation with Seller and finalization

ROLE OF CA IN M&A TRANSACTIONS – BUY SIDE



Regulatory Compliance

- Substantial areas of legal compliance which needs to be professionally managed
- Restrictions on merger control in any applicable law



Post Merger Integration

- Advisory to Client with respect of Post Merger Integration in the area of financial statements, internal control, etc
- Integrating Audit Procedures

M&A SKILLS

1. Valuation is Negotiable
2. Mergers and acquisitions can take a long time to market, negotiate, and close
3. Sellers need to anticipate the significant due diligence investigation the buyer will undertake
4. Multiple bidders will help the seller get the best deal
5. You need a great M&A team – Investment Banker, Lawyer, etc
 - M&A transactions involve complex, multifaceted agreements and deal structures as well as challenging legal issues.
 - They are typically fast-moving and can be contentious.
 - An M&A lawyer must be intimately familiar with both the business realities of M&A deals and the overall structure and inner workings of the acquisition agreement.
6. **Don't Get Trapped at the Letter of Intent Stage**
7. Understand the Negotiation Dynamics – Bargaining Power, Multiple Bidders, Non-Financial Terms
8. The definitive acquisition agreement is extremely important

ROLE OF INVESTMENT BANKER

1. Assisting the seller in designing and executing an optimal sale/buy process
2. Helping to prepare a confidential information memorandum for potential buyers
3. Advising on valuations
4. Identifying and contacting prospective buyers
5. Coordinating meetings with prospective buyers
6. Helping prepare management presentation materials for meetings with potential buyers and prepping the management team beforehand
7. Preparing and coordinating the signing of confidentiality agreements
8. Assisting in the negotiations on price and other key deal terms
9. Helping the management team in presentations to the company's Board of Directors
10. Coordinating the seller's responses to buyer due diligence requests
11. Concluding definitive agreements
12. Consummation of Transaction

TOP ISSUES IN M&A

1. DEAL STRUCTURING

- Cash – Shares – Combination
- Immediate– Deferred Consideration
- Performance Linked Payment
- Tax Implication

2. CULTURAL AWARENESS

3. EXECUTION RISK

4. ABILITY TO PAY

5. ABILITY OF SELLER TO STAND BEHIND CLAIMS

6. DUE DILIGENCE

- Commercial Contracts
- IP/Patents
- Regulatory Issues
- Compliance
- Product Liability

7. VALUATION ADJUSTMENTS

- Current Assets
- Milestone Payment
- Earn Outs

8. PROTECTION PACKAGE

- Warrantees
- Indemnities
- Material Adverse Changes

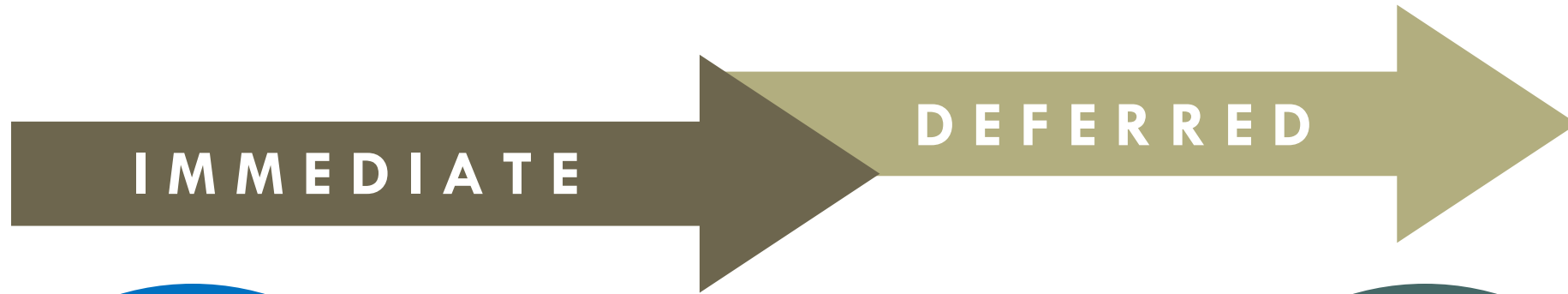
9. Ancillary Documentation

- Non-Compete
- IP Transfer
- Escrow Arrangement

10. Integration

- Seller Responsibility
- Tenure

STRUCTURE OF M&A CONSIDERATION



01

CASH DEAL

Acquirer simply pays an agreed amount of cash for target company's shares

CASH + STOCK DEAL

Hybrid of Cash and Stock

02

03

STOCK DEAL

Target shareholders receive shares of acquirer's common stock in exchange for their shares

KEY LOI TERMS

1. **The price**, and whether it will be paid in cash up front, or all or partly in stock (including the type of stock), and whether any of the purchase price will be deferred
2. Any **adjustments to the price** and how these adjustments will be calculated (such as for working capital adjustments at the closing).
3. The scope and length of any **exclusivity/no-shop provision** (it is always in the best interests of the seller to keep this as short as possible, such as 15 to 30 days).
4. The **non-binding** nature of the terms (except with respect to confidentiality and exclusivity)
5. **Indemnification** terms
6. **Reserved Matters** (in case of deferred payment)
7. **Stock Restriction**
8. Terms of **Management Team**, if any
9. Responsibilities and **Cost of transaction** including approval
10. Allocation of **Risk**

VALUATION

VALUATION MODELS

1. Price Earning Ratio
2. Enterprise Value to Sales Ratio
3. Enterprise Value to EBIDTA Ratio
4. Replacement Cost
5. Discounted Cash Flow

VALUATION BENCHMARKS

1. Trading Comparables
2. Transaction Comparables
3. Control Premium
4. Engineers Valuation
5. Weighted Average Cost of Capital

VALUATION IS NEGOTIABLE

REASON FOR M&A FAILURES

1. *Limited or no involvement from the owners*
 - Owners should be involved right from the start and rather drive and structure the deal on their own
2. *Theoretical valuation versus practical proposition of future benefits*
3. *Lack of clarity and execution of the integration process*
 - A careful appraisal can help to identified key employees, crucial projects and products, sensitive processes and matters, impacting bottlenecks, etc
4. *Cultural integration issues*
 - a proper strategy should be devised either to go for hard-decision forceful integration setting aside cultural differences or allowing the regional/local businesses run their respective units
5. *Required capacity potential versus current bandwidth*
 - Expansion require an assessment of the current firm's capacity to integrate and build upon the larger business
6. *Actual cost of a difficult integration and high cost of recovery*
7. *Negotiations errors*
8. *changes to the business environment*
9. *Backup plan*

AREAS OF DUE DILIGENCE

IT Due Diligence

- Scalability of systems, robustness of the processes, the level of documentation of processes

6

Legal Due Diligence

- Ensures no legal issues in buying a business
- Review of legal documents such as MOA, employee contracts etc.

1

Commercial Due Diligence

- Rights the company have in various intellectual property

5

Tax Due Diligence

- Ensures that there are no past tax liabilities in the seller firm
- Acquirer should not be held liable for any future tax liability

2

IP Due Diligence

- Rights the company have in various intellectual property

4

Operational Due Diligence

- Buyer reviews the operational aspects of a target company
- Confirms that business plan is achievable

3

DUE DILIGENCE

BUSINESS

(coverage varies based on industry)

1. Strategic Fit
2. Trends in Financial Performance/Margins
3. Future Projection
4. Quality of Earnings – Sustainability
5. Material Contracts Risk
6. Customer Concentration Risk
7. Supplier Dependence Risk
8. Channel of Sales – Marketing arrangement
9. Risk of Customer flight after acquisition
10. Warranty Risks – past period
11. Non-Compete Impact
12. Collective Bargaining Agreements
- 13. *Environmental Issues***
14. Manufacturing Process and Outsourcing
15. Competitive Landscape
16. Technological Landscape

DUE DILIGENCE

FINANCIAL

(coverage varies based on industry)

1. Review of Past Financial Statements
2. Unusual Revenue Recognition
3. Debtors and Inventory Ageing
4. Indebtedness of Company
5. Contingent Liabilities – Guarantees, etc
6. Expense Recognition
7. Normalized EBIDTA
8. Related Party Transaction
9. Future Projection
 - Reasonableness
 - Normalization of Working Capital
 - Capital Expenditure estimation
 - Estimate of Future Infusion required

TAX (filings and compliance)

(coverage varies based on industry)

1. Income Tax
 1. Filings
 2. Tax payment
 3. Notices, Pending assessment
 4. Carry forward of losses, etc
 5. Tax concessions
 6. Past Settlement
2. GST/Service Tax/VAT/Excise/Customs
3. Allocation of Purchase Price

DUE DILIGENCE

LEGAL

(coverage varies based on industry)

1. Lien on assets – Fixed, Current, IP, etc.
2. IP ownership and any interest therein
3. IP litigation
4. Indemnities provided by the Company
5. Legal contracts review
6. Approvals required for the agreement
7. Pending litigations – risk and impact
8. Insurance Claims
9. Government Proceedings
10. Independent Review with legal advisors of target
11. Competition Regulation
12. Adequacy of Insurance Cover

LEGAL

(coverage varies based on industry)

13. Charter Documents
14. Review of Subsidiary/Related Party
15. Stock Options
16. Shareholders Agreement
17. Pre-emptive Rights
18. Title of Shares
19. Existing encumbrances of assets and shares
20. Corporate Governance
- 21. Environmental Issues**
22. Other Licenses and Compliance thereof

DUE DILIGENCE

PROPERTY

(coverage varies based on industry)

1. Title of Property
 1. Freehold
 2. Leasehold
 3. Operating leases
 4. Mortgages
 5. Any interest created
 6. Insurance of Assets
 7. Sale and leaseback transaction

DUE DILIGENCE

TECHNICAL

(coverage varies based on industry)

1. Condition of Assets
2. Cost of Upgradation
3. Patent Assessment
4. Trademark & Copyright Registration
5. Infringement of Copyright
 - by company
 - By third party
6. ***Environmental Issues including continued compliances***

HUMAN RESOURCES

(coverage varies based on industry)

1. Employee Contracts
2. Collective Bargaining Agreements
3. Organization Structure
4. Labor Disputes
5. Key Employee Biographies
6. Employee Profile
7. Cultural Differences
8. Compensation Structure
9. Retirement Benefit and its financial impact
10. Contractual Manpower and its compliances

DEFINITIVE AGREEMENTS

CONTENTS

(Indicative Only)

1. Transaction structure (for example, share purchase, asset purchase, or merger)
2. Purchase price and related financial terms
3. Possible adjustments to the price (price adjustments based on working capital calculations, employee issues, etc.)
4. The milestones or other triggers for earnouts or contingent purchase price payments
5. Extent of rights and restrictions on stock of Sellers and Buyers (registration rights, co-sale rights, rights of first refusal, Board representation, etc.)
6. Treatment of employee stock options
7. Terms of any management team/employee hiring by the buyer
8. Condition Precedents
9. Condition Subsequent
10. Covenants between signing and closing
11. Responsibility and cost for obtaining any consents and governmental approvals including Competition Law
12. Representation and Warrantees
13. Allocation of risk of unknown liabilities
14. Indemnity escrow/holdback, period of holdback (typically 5-20% of the purchase price with an escrow period of 12 to 24 months)
 6. Scope and Exclusive from Indemities (including baskets, caps, and carveouts from the indemnity)

FUTURE PAYMENTS

- Most M&A transactions will have a part of the transaction price being deferred
 - Precision in drafting these provisions are essential
 - Suitable dispute resolution processes
 - Negotiating Board Seat can be useful
- To reduce dispute following needs to be clearly defined
 - Events on which they are dependent
 - Basis of calculation
 - Right to inspect and audit
 - Timeline for payment
 - Escrow of securities
 - Default remedies should be stringent
- Buyer should be restricted from making decision which has potential to impact future payments
 - Changing nature of business
 - Making major expenditure
 - Additional costs which are not likely to result in outcomes within payment time frame

TERMS FOR HIRING MANAGEMENT TEAM

Key Terms

- Tenure
- Responsibilities - including its tapering off over the tenure
- Early termination remedies
- No early termination if future payments are unpaid
- Non-Compete applicability

Caveats

- Existing Management Team might impact smooth transition
- Integration with Buyer's Management Process challenges
- Strong HR Issues

RESERVED MATTERS

To protect the interest of minority shareholders or other stakeholders, Reserved or veto or affirmative vote matters or consent rights are a bunch of contractually agreed matters provided that need consent of all the partners before being approved and implemented. ***Reserved matters must be incorporated in AoA through amendment for better enforceability.***

SAMPLES

1. listing of company
2. change in the main business and/or the objects of the company
3. change to the number of directors and the manner of their appointment
4. change to the powers of the Board
5. entering into an amalgamation, merger or consolidation with another company
6. formation, sale or winding up of the company
7. entering into a partnership or any arrangement for the sharing of profits
8. change in the share capital structure
9. related party transactions
10. transactions above a certain limit
11. capital expenditure beyond a limit
12. matter requiring special resolutions
13. declaration of dividend
14. appointment of key personnel
15. sale of assets
16. investment by the company

NON-COMPETE/NON-SOLICITATION

NON COMPETE

If the sellers of a business possess valuable customer relationships, know-how, or skills, a purchaser should consider insisting on a Non-Compete from the owners and key personnel.

Scope of Non-Compete

- Products
- Territory
- Channel of Sales
- Tenure
- Liabilities
- Assignment of Non-Compete Agreement
- Jurisdiction

ENFORCEMENT OF NON-COMPETE IS SUBJECT TO COMPETITION LAWS

NON SOLICITATION

Non-solicit agreements stipulate that one organization cannot lure the employees, suppliers of another organization for a certain period of time, which prevents loss of information and/or expertise for both

Scope of Non-Solicitation

- Suppliers, Employees
- Tenure
- Liabilities

ENFORCEMENT OF NON-SOLICITATION IS SUBJECT TO COMPETITION LAWS

CONDITION PRECEDENT

1. Continuing validity of Representation and Warranties
2. No Material Adverse Change
3. Compliance identified by Due Diligence
4. Permissions required for entering into transaction
 - Lenders, Shareholders, Government, etc.
5. Third Party Consents
 - Customer, Supplier, Lessor, etc.
6. Any technical upgradation identified by Due Diligence
7. Execution of concurrent agreements – non-compete, employment contracts, etc.
8. Obtaining of Financing by buyer
9. Delivery of Audited Accounts
10. Remedial Action identified by Due Diligence

CONDITION SUBSEQUENT

1. Delivery of Closing Financial Statements
2. Non –Critical Consents
3. Non-Critical Due Diligence Remedial Points

BUYER MAY WITHHOLD SOME CONSIDERATION AND LINK TO SATISFACTION OF CONDITION SUBSEQUENT

REPRESENTATION & WARRANTIES

A representation is an assertion of past or existing fact given by one party to induce another party to enter into an agreement.

A warranty is a promise that the assertion of existing fact or future facts are or will be true, along with an implied promise of indemnity if the assertion is false.

Due Diligence is not a protection from Representation and Warranties

Exceptions are provided through Disclosure Schedule

Representation and Warranties are often heavily negotiated areas of the agreement

REPRESENTATION & WARRANTIES

AREAS

1. Authority to enter transactions
2. Title to shares
3. Title to Assets
4. Liens and Encumbrances
5. Intellectual Property Rights - Ownership
6. Financial Statements
7. Related party transactions
8. Contingent & Unrecorded Liabilities
9. Taxes
10. Legal Compliances & Litigation
11. Permit and Licenses
12. Third Party Consents
- 13. Issues arising out of Due Diligence**
14. Full disclosures

LIMITATION (as negotiated)

- 1. Disclosure Schedule exception**
2. Period of coverage
3. Claim Period
4. Amount
5. Materiality

Disclosure Schedule exception

- 1. Items already reflected in the Financial Statements*
- 2. Items in the ordinary course of business*
- 3. Issues arising out of action taken based on buyer's request*
- 4. De minimis*

INDEMNITIES

Indemnification protects a party from losses associated with broken promises or statements of fact in the transaction agreement. The breaching party must pay up and make the other party “whole” again.

COVERAGE

1. **Cure Period** – Opportunity to the breaching party to remedy the breach
2. **Indemnifying party** – Buyer/Seller, their Promoters or any other party benefiting from the agreement
3. Joint and Several Liability
4. **Indemnified events** – Breach of Representation, Warranties, Covenants or litigation
5. **Indemnity period** – Time period during which a party can be held liable for losses. (12-24 months)
6. **Indemnity amount** – The amount covered for indemnification
 1. De Minimis
 2. Basket
 3. Cap
 4. Carve Outs – Title to Shares, Fundamental Representations
7. **Defend Claims** – Seller might insist on the right to defend any claim against the company for which Representation and Warranties are provided
8. **Set off** – Set off of any loss recovered from third party – tax benefit, insurance, etc.

DISPUTE RESOLUTION

Cost must be estimated so that dispute resolution is cost effective

1. Provide for dispute to be resolved at the senior management level of all the parties through negotiation
2. Mediation
3. Arbitration
 - Indian Arbitration Act
 - International Arbitration Chambers – Singapore, London
 - Seat of Arbitration
 - Number of Arbitrators – Appointment
4. Governing Laws – India, Foreign, Neutral



QUESTIONS??

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