ECONOMIC LAWS PRACTICE
ADVOCATES & SOLICITORS

ELP Knowledge Series

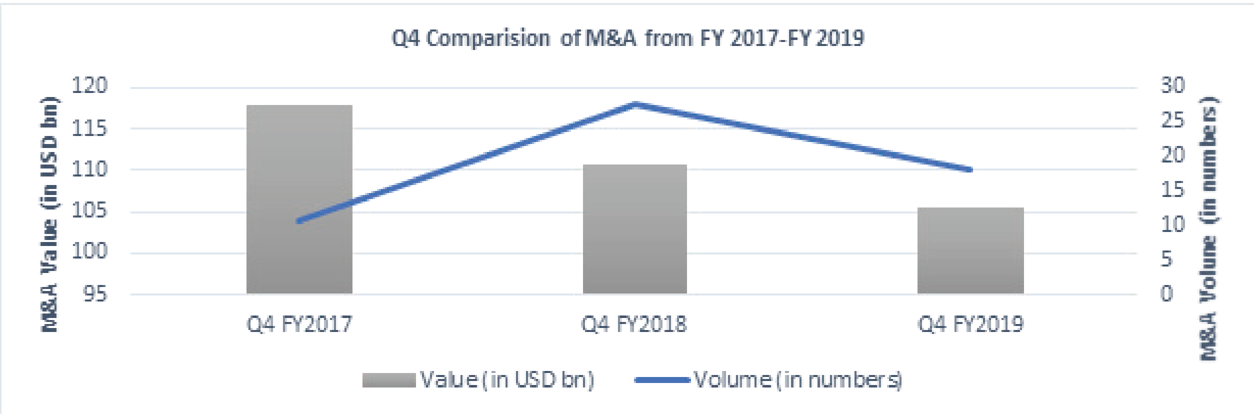
M&A QUARTERLY UPDATE

Volume 1 of 2019

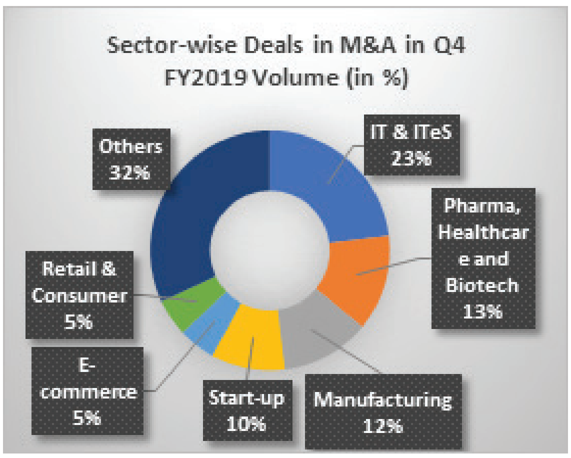
SETTING THE CONTEXT

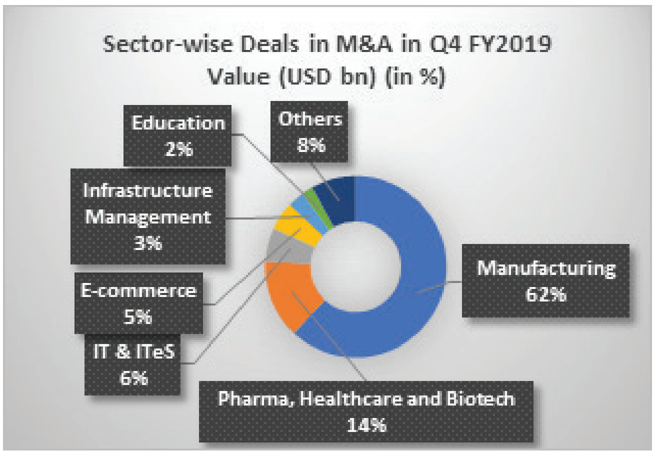
The last quarter of the financial year 2019 saw M&A deals worth USD 12.5 billion across 110 transactions. Although this was a decline of approximately 33% in deal value when compared to transactions in the same period in the previous year, FY 2019 has been a landmark year for M&A in India with deals touching the USD 83.9 billion mark across 462 transactions. This was a significant jump from the figures of USD 31.5 billion across 426 deals in FY 2018. Manufacturing and Pharma & Healthcare sectors dominated league tables in terms of deal value; while IT & ITeS dominated the league tables in terms of volume. Visible interest is also discernible in the E-commerce, Infrastructure Management and Retail sectors.

Q4 2018 vs Q4 2019 – Deal Volume and Value



Q4 2019 – Sector Break-up





Source - M&A Report by Grant Thornton

Diversification and consolidation

A very interesting trend that emerged in FY 2019 was the increase in the number of transactions that were aimed at diversification of business. Given the disruption caused by technology and artificial intelligence in multiple industries, this is perhaps aimed at mitigating risk for companies. In addition, a number of transactions were led by considerations of forward and backward integration.

M&A for resolution of stressed assets

Sustained investor interest was evident in stressed assets despite numerous resolution plans being mired in litigation. There are various teething issues in the insolvency resolution process and challenges are often made by other resolution applicants to frustrate the successful bidder even after it has been selected by the committee of creditors.

PEs acquiring control

FY 2019 saw a number of private equity funds acquire control in Indian companies. This meant that promoters looking at strategic players to divest a majority stake also had private equity investors expressing interest. For private equity funds, a majority position often helps in securing an exit, particularly in IPO and strategic exits. This also helps them in bringing in professionals to manage the company. However, acquiring control also has challenges including the possibility of classification of the private equity investor as a “promoter” in an IPO and lack of expertise in running a business in a particular sector. Further, investor nominated directors often have to contend with issues related to their fiduciary duties.

Increased focus on diligence

The Indian legal and regulatory landscape has undergone significant changes in the recent past that may potentially expose companies and their management to risk – for instance, significant changes have been made in India in relation to the insolvency and bankruptcy regime, data privacy, Specific Relief Act, 1963, etc. However, many companies have been unable to track the implications of these changes and appropriately address them in their compliance policies and regimes. Accordingly, investors are increasingly placing emphasis on undertaking a thorough legal due diligence, particularly in regulated sectors.

KEY LEGAL AND REGULATORY CHANGES IN Q4 2019

1

Amendments to FDI Policy in relation to investments in Ecommerce

- Restriction on equity participation in seller entities by E-commerce platform or its group companies
- Deemed control by marketplace if 25% or more purchase by any seller is from E-commerce platform or its group companies
- E-commerce platform cannot compel exclusive selling on its marketplace
- Common services (including logistics, warehousing, payments, etc) should be provided by E-commerce platform to sellers in a fair and non-discriminatory manner

2

Amendments to the Insider Trading Regulations

- Not all material events to be disclosed under Listing Agreement may be classified as 'unpublished price sensitive information' (UPSI) under the Insider Trading Regulations
- Obligation on Board of Directors to define their own policy relating to legitimate purposes for sharing UPSI
- Two separate codes of conduct for listed companies and market intermediaries and fiduciaries
- Obligations on the board of directors, CEO/MD, audit committee and compliance officers to ensure compliance through effective system of internal controls

3

Relief to start-ups from Angel Tax

- Expanded definition by DPIIT of start-ups by increasing timeframe and turnover thresholds
  - Timeframe increased from 7 years to 10 years
  - Turnover requirements increased from INR 25 Cr to INR 100 Cr
- This expanded definition of start-ups will now enable a larger number of companies to avail benefits under Section 80-IAC of the IT Act wherein 100% profits can be claimed as a deduction
- Section 56(2)(viib) of the IT Act – which dealt with so-called Angel Tax – notifies new categories of investment and enhances certain thresholds, to exempt start-ups from onerous angel tax requirements

CASE STUDY

The following section sets out a case study of a transaction in which ELP advised a private equity fund in relation to the acquisition of a majority stake in a company engaged in the cosmetics business.

Business structure

- Company A is a private limited company engaged in the business of manufacturing cosmetics and is one of India's leading mass-market cosmetics brands. The promoters of Company A also had a number of proprietorship concerns and partnership firms ("Associate Entities" and together with Company A, referred to as the "Target Group") that were operating manufacturing facilities and acted as trading entities that were relevant to the business.

Legal due diligence considerations

- Among the other considerations / issues that are standard in due diligence exercises, special emphasis was laid on the following:
  - Given that Target Group was engaged in a regulated sector, one of the focus areas of the diligence was mapping the product line of the Target Group with the drugs and cosmetics licenses obtained and identifying gaps, if any.
  - The transaction contemplated acquisition of the business / assets of the Associate Entities by Company A. Accordingly, material contracts of the Associate Entities were thoroughly reviewed for restrictions that may have implications for the transaction.
  - The Target Group had obtained trademark registrations and copyrights in India and overseas jurisdictions and accordingly, it was important to identify trademarks and copyrights that were required to be transferred to Company A by the Associate Entities.
  - Special emphasis was also laid by the diligence team in identifying risks in relation to product liability issues.

Transaction considerations

- One of the preliminary issues was to effectuate the transfer of the business / assets of the Associate Entities to Company A in a tax efficient manner – which was achieved by a combination of asset transfers and a slump sale.
- The share purchase agreement in relation to the investment in Company A by the investor contemplated a post-closing working capital adjustment and a significant amount was structured as a deferred consideration.
- Given that the parties were on a tight timeline to close the transaction, there was a complex interlinkage between the acquisition of shares of Company by the investor and the internal restructuring amongst the Target Group.

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