

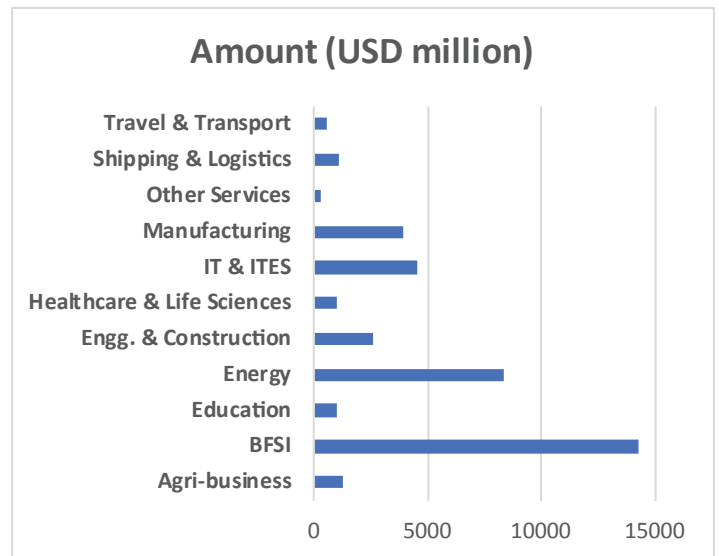
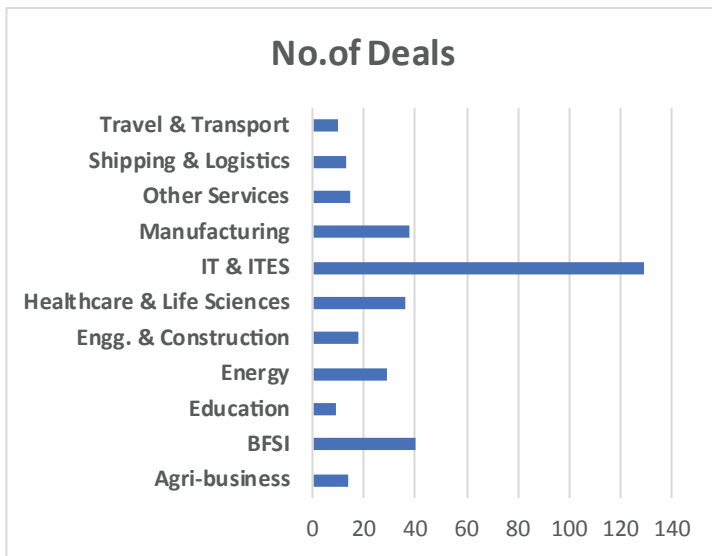


ELP Knowledge Series

# M&A QUARTERLY UPDATE

## SETTING THE CONTEXT

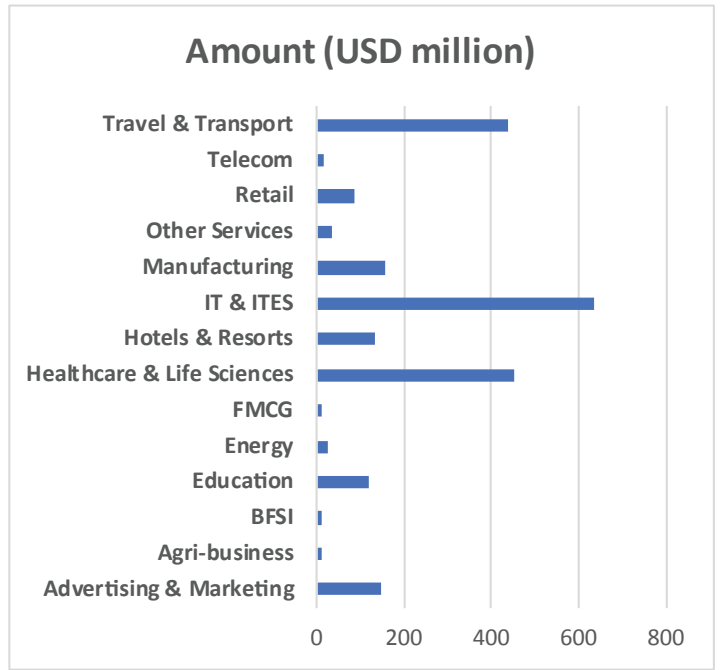
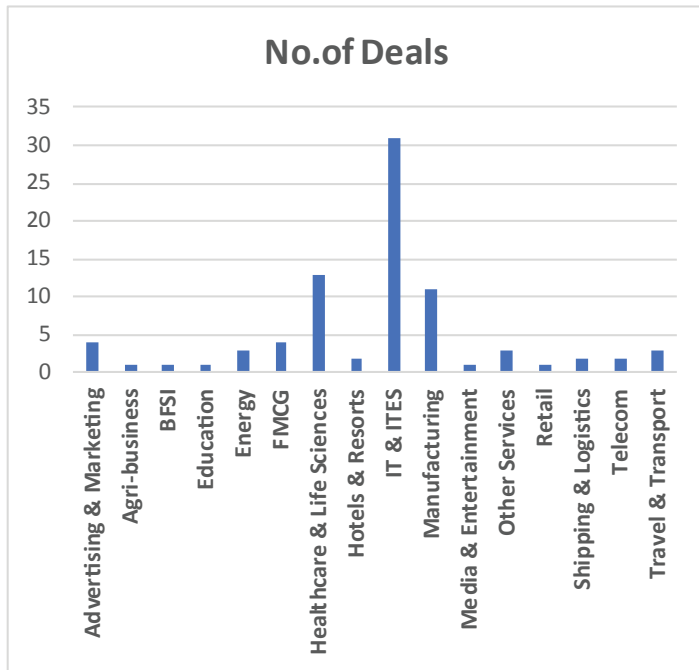
### Inbound and domestic M&A



Source - Venture Intelligence

- The period April 2019 – November 2019 saw 279 inbound and domestic M&A deals with announced value of USD 24.45 billion across 134 transactions, as compared to 343 inbound and domestic M&A deals with an announced value of USD 60.74 billion across 153 transactions for the same period in the previous year.
- This marks a 18.6% decline in terms of total deal volume, when compared to the same period last year.
- IT and ITeS, BFSI, and healthcare and life sciences dominated league tables in terms of deal volume whereas BFSI, energy, IT and ITeS, and engineering and construction dominated league tables in terms of deal value.

## Outbound M&A



Source - Venture Intelligence

- The period April 2019 – November 2019 saw 49 outbound M&A deals with an announced value of USD 1.3 billion across 23 transactions, as compared to 71 outbound M&A deals with an announced value of USD 7.49 billion across 40 transactions for the same period in the previous year.
- This marks a 30.9% decline in terms of deal volume, when compared to the same period last year.
- IT and ITeS, healthcare and life sciences and manufacturing dominated league tables in terms of deal volume.
- IT and ITeS, travel and hospitality, advertising and marketing dominated league tables in terms of deal value.

## Important Trends

The drop in outbound, domestic and inbound M&A is likely on account of global uncertainties and a slowdown in the Indian economy.

Domestic M&A comprised 62.2% by value and 68.8% by volume between April 2019 – November 2019, indicating significant domestic interest in M&A activity. While the domestic M&A deal count is consistent with past trends in the same period, there has been a significant increase in deal value attributable to domestic M&A.

Manufacturing, healthcare and lifesciences, and IT/ITeS remain “hot” sectors which continue to attract significant investor interest.

The liquidity squeeze plaguing NBFCs has perhaps contributed to deal activity in the BFSI sector.



### SEBI framework in relation to superior voting rights shares

- An unlisted company which has issued shares with superior voting rights (**SR Shares**) has now been permitted to list its ordinary shares through an initial public offer (**IPO**).
- Key eligibility requirements for companies having SR Shares for an IPO are as follows:

<b>Nature of Business</b>	The company should be engaged in making intensive use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology for providing products, services or business platforms with substantial value addition.
<b>Shareholding Criteria</b>	The SR Shares should have been issued only to the promoters/founders, who hold an executive position in the company.
<b>Net Worth Criteria</b>	The holder of the SR Shares is not part of a promoter group whose collective net worth is more than INR 500,00,00,000 (Five hundred crores).
<b>Voting Right Criteria</b>	The SR Shares have voting rights in the ratio of minimum 2:1 to maximum 10:1 compared to ordinary shares.

- Corporate governance requirements in relation to listed companies having outstanding SR Shares:

<b>Board of Directors</b>	At least half of the board of directors shall comprise of independent directors.
<b>Audit Committee</b>	Only comprise of independent directors.
<b>Other Committees</b>	At least two thirds of the following committees shall comprise of independent directors: <ul style="list-style-type: none"><li>▪ nomination and remuneration committee</li><li>▪ stakeholders relationship committee</li><li>▪ risk management committee</li></ul>

- **Coat-tail provisions:** The SR Shares shall be treated as ordinary equity shares in terms of voting rights (i.e. one SR share shall only have one vote) in the following circumstances post-IPO:
  - appointment or removal of independent directors and/or auditor
  - where a promoter is willingly transferring control to another entity
  - related party transactions in terms of these regulations involving an SR shareholder
  - voluntary winding up of the listed entity
  - changes to the Articles of Association or Memorandum of Association of the listed entity, except any change affecting the SR equity share
  - initiation of a voluntary resolution process under the Insolvency Code
  - utilization of funds for purposes other than business
  - substantial value transaction based on materiality threshold as specified under these regulations
  - passing of special resolution in respect of delisting or buy-back of shares
  - other circumstances or subject matter as may be specified by the Board, from time to time
- **Mandatory conversion into ordinary shares:** The SR Shares shall be converted into equity shares having same voting rights as that of ordinary shares on the 5th anniversary of listing of ordinary shares of the listed entity. However, the SR Shares may be valid for up to an additional 5 years, after a resolution to that effect has been passed, where the SR shareholders are not permitted to vote. Further, the holders of the SR Shares may convert their SR Shares into ordinary equity shares at any time prior to the period.
- **Automatic conversion into ordinary shares:** The SR Shares shall be compulsorily converted into equity shares having voting rights same as that of ordinary shares on the occurrence of any of the following events:
  - demise of the promoter(s) or founder holding such shares
  - an SR shareholder resigns from the executive position in the listed entity
  - merger or acquisition of the listed entity having SR shareholder/s, where the control would no longer remain with the SR shareholder/s
  - the SR equity shares are sold by an SR shareholder who continues to hold such shares after the lock-in period but prior to the lapse of validity of such SR equity shares

- **Lock-in:** SR Shares shall also be listed but shall be subject to lock-in post-IPO until their conversion to ordinary shares. In case of early conversion of the SR Shares to ordinary shares, such ordinary shares shall continue to be under lock-in for 3 years after listing of SR Shares considered for minimum promoter contribution and for 1 year for SR Shares in excess of minimum promoter contribution.

## Liberalization of FDI Norms



The Department of Promotion of Industry and Internal Trade issued Press Note 4 of 2019 (**PN4**) in terms of which it amended India's FDI Policy and liberalized foreign direct investment in Single Brand Retail Trading (**SBRT**), contract manufacturing, coal mining, and digital media sectors. PN4 states that the changes envisaged in PN4 will come into effect from the date of notification under FEMA. The changes under PN4 have been included in the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 by way of a recent amendment.



### Coal Mining

The Government has permitted 100% FDI under the automatic route for sale of coal, coal mining activities, including associated processing infrastructure, which would include coal washery, crushing, coal handling and separation (magnetic and non-magnetic).



### Contract Manufacturing

The amendment clarifies that foreign investment in the 'manufacturing' sector (including contract manufacturing) is under the automatic route. Manufacturing activities can now be either self-manufacturing by the investee entity or contract manufacturing in India through a legally tenable contract, whether on a principal to principal or principal to agent basis.

Further, PN4 clarifies that a manufacturer is freely permitted to sell its products manufactured in India to all customers through wholesale/retail, including through e-commerce under the automatic route.



### Digital Media

Foreign investment in publishing of newspaper and periodicals dealing with news and current affairs and in up-linking of 'News & Current Affairs' TV channels is restricted to 26% and 49% respectively. Given the concerns around fake news and the sudden spurt in social media feeds which air news and current affairs, it appears that the government wants to regulate foreign investment in such activities as well. Accordingly, the government has capped foreign investment in "uploading/ streaming of news and current affairs through digital media" to 26%.



### Single Brand Product Retail Trading (SBRT)

The conditions pertaining to 30% domestic sourcing by entities engaged in single brand retail ("SBRT Entities") with foreign investment in excess of 51% have been relaxed and the amended regime on domestic sourcing for such entities is as follows:

- All procurements made from India by SBRT Entities for that single brand will be counted towards local sourcing, irrespective of whether the goods procured are sold in India or exported.
- An SBRT Entity is also permitted to set off sourcing of goods from India for that single brand for global operations. Such sourcing can be done directly by the SBRT Entity, its group companies or indirectly through a third party under a legally tenable agreement.
- The Government has permitted companies to undertake SBRT through online platforms prior to opening brick and mortar stores, subject to the condition that the SBRT Entity opens brick and mortar stores within 2 years from the date of commencement of online retail.

## Amendments to the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011

- The Competition Commission of India (**CCI**) is the first competition authority in the world to have envisaged a 'deemed approval' in respect of transactions that qualify under a 'green channel', or simply, transactions that do not have an appreciable adverse effect on competition.

- A 'green channel' transaction is one, where, considering all plausible alternative market definitions, the parties to the transactions (including their group companies and subsidiaries):
  - Are not competitors i.e., do not produce/provide similar or identical or substitutable products/services;
  - Are not and cannot potentially be vertically related i.e., are not engaged in any activity relating to production, supply, distribution, storage, sale and service or trade in products or provision of services which are at different stage or level of production chain; and
  - Are not engaged in any activity relating to production, supply, distribution, storage, sale and service or trade in products or provision of services which are complementary to each other.
- Parties to a 'green channel' transaction can file notice with the CCI in Form I with a declaration that the proposed transaction falls under the 'green channel' and is not likely to cause an adverse effect on competition. Once such a notice is filed and an acknowledgement granted by the CCI, the transaction would be deemed to be approved under section 31 (1) of the Competition Act, 2002.
- While the 'green channel' construct is a welcome move, a few questions and issues remain unaddressed:
  - It is unclear as to when the CCI will assess if the 'green channel' route has been correctly taken. Should the CCI later hold the deemed approval to be void ab initio, unless otherwise clarified, the parties may be liable for non-compliance proceedings under the Competition Act, 2002.
  - Parties still have to file the detailed Form I and pay filing fee of INR 1.5 million.

There is still no fast track procedure for transactions arising out of the insolvency resolution process under the Insolvency and Bankruptcy Code, 2016. Notably, the Competition Law Review Committee had recommended that such transactions be included within their proposed automatic route.

## DEALTALK

### Material Adverse Effect

#### Introduction

Material Adverse Change or Material Adverse Effect (**MAE**) clauses are heavily negotiated in any M&A transaction as they are designed to enable the buyer to 'walk away' from the transaction prior to closing if certain unforeseen events occur in the period between signing and closing of the transaction, that deteriorates the position of the target.

MAE provisions are also used (though sparingly, in a well negotiated deal) to qualify warranties given by the sellers/target, thereby increasing the threshold for the breach of such warranties.

#### Setting the context

Recent economic and political developments have underscored the need to thoroughly think through MAE provisions. Should a buyer proposing to acquire a target in the UK with significant customer base in the EU be allowed to walk away, upon, say, a 'no-deal' Brexit? Should a terror attack that is likely to result in a slow-down in the economy/industry permit the acquirer to walk away from an acquisition?<sup>1</sup>

From the buyer's perspective, it is obvious that it would want to have the ability to walk away from the transaction or renegotiate deal terms if any adverse event takes place; from the seller's perspective, it would want deal certainty and would want to ensure that the MAE triggers only in limited cases and is not misused to walk away on account of 'buyer's remorse'.

#### Buyer and seller wish-lists and what's 'market'

##### Buyer's wish-list

Generally speaking, the buyer would want to ensure that an MAE triggers upon the occurrence of any event that has, or could reasonably be expected to have, a material adverse effect on the business, assets, liabilities, operations, condition, or prospects, of the target.

##### Seller's wish-list

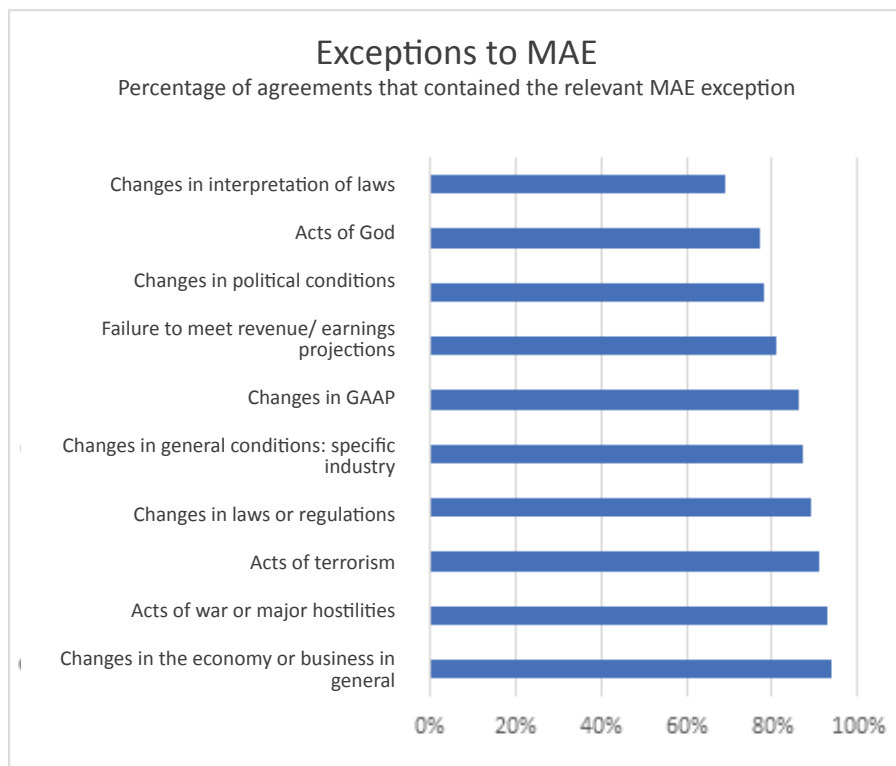
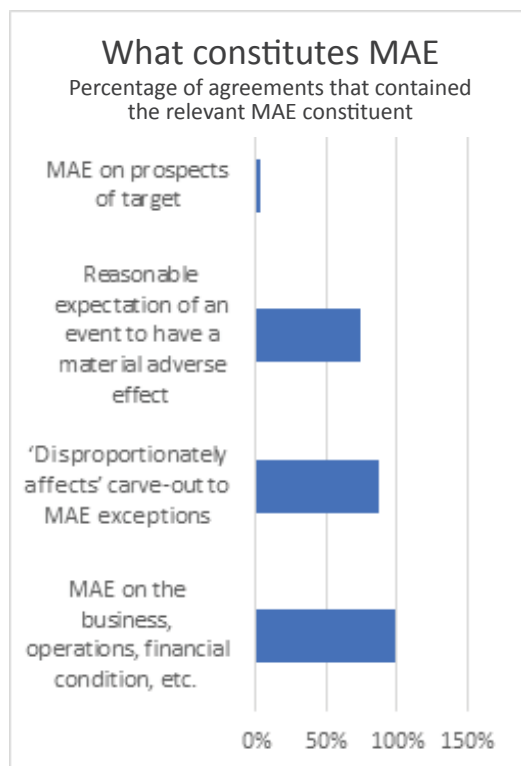
Conversely, the seller would want to limit material adverse effect to the business of the target 'as a whole' and not reference sub-sets such as assets, liabilities or 'condition' of the target. It is market to remove references to forward-looking constructs such as a material adverse effect on the 'prospects' of the target. Sellers should also carve out, amongst others, acts of war, major hostilities or terrorism, changes in laws, general economic conditions, changes in financial markets, political conditions, or changes that generally affect the relevant industry and market from the definition of MAE (**General Conditions Carve-out**).

While the General Conditions Carve-out are more or less universally accepted, buyers will do well to ensure that the General Conditions Carve-out should not apply where the target is 'disproportionately affected'; this ensures that the buyer still has the right to walk away where the effect of a General Conditions Carve-out on a target is disproportionately adverse, as compared to its peers.

<sup>1</sup>The Takeover Panel in the United Kingdom held that WPP Group Plc ("**WPP**") could not claim that an MAE had occurred in respect of its offer to acquire shares of Tempus Group Plc ("**Tempus**") from its shareholders on account of the terror attacks on September 11, 2001 in the United States. Tempus was able to produce evidence that the recession in advertising had been underway for some time and that the impact of the events of September 11 was likely to be relatively short lived. Further, on October 10, 2001 (a month after the attacks), WPP itself had stated in its announcement that it "remained convinced of the strategic merits of combining WPP and Tempus"; *Takeover Panel Statement 2001/15 (Offer by WPP Group plc for Tempus Group plc, 6 November 2001)*.

## What's 'market'?

A recent survey by Nixon Peabody, which reviewed 200 publicly available acquisition agreements (filed with the US Securities Exchange Commission) in the United States with transaction values ranging from USD 100 million to over USD 74 billion, revealed the following trends in the usage of various constructs in MAE definitions:<sup>2</sup>



## Precedents

There aren't a lot of instances where a buyer sought to invoke an MAE in an M&A transaction, which was ultimately decided by a court. However, an analysis of the decisions of courts in New York and Delaware in the United States have revealed the following trends:

- MAE was held to have occurred or likely have occurred in the following instances:
  - Where the seller's representations in respect of FDA regulatory compliances were inaccurate and would reasonably be expected to result in an MAE;<sup>3</sup>
  - A 50% decline in earnings over the first half of the fiscal year (July – December) (though the court did not definitively conclude that an MAE had occurred);<sup>4</sup>
  - A loss in the target's earnings of \$6,347,000, compared with positive earnings of \$2,105,000 in the prior year;<sup>5</sup>
- MAE was held to not have occurred in the following instances:
  - Where there was a 64% decline in earnings from operations as compared to same quarter in the previous year;<sup>6</sup>
  - Failure to achieve targets could not be the basis of an MAE since the company had specifically disclaimed any representations regarding projections.<sup>7</sup>

## Concluding remarks

Despite emerging trends on MAE clauses, there is no 'straight-jacket' formula on what would constitute an MAE and such determination will depend on the facts and circumstances in each case. Accordingly, it is advisable to appropriately address foreseeable events which may be relevant to consider in respect of the transaction, depending on the industry, location and nature of the target.

<sup>2</sup> MAC Survey NP 2019 Report available at <<https://www.nixonpeabody.com/ideas/articles/2019/11/19/2019-mac-survey>>; last accessed on 4 December 2019.

<sup>3</sup> Akorn, Inc. v. Fresenius Kabi AG, No. 535, 2018 (Del. Dec. 7, 2018).

<sup>4</sup> Raskin v. Birmingham Steel Corp., No. 11365, 1990 Del. Ch. LEXIS 194, at \*3 (Dec. 4, 1990).

<sup>5</sup> Katz v. NVF Co 119 Misc. 2d 48.

<sup>6</sup> IBP, Inc. v. Tyson Foods, Inc. 789 A.2d 14 (Del. Ch. 2001).

<sup>7</sup> Hexion Specialty Chemicals, Inc. v. Huntsman Corp., C.A. No. 3841 (VCL) (Del. Ch. Sept. 29 2008).



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