Our Views

Real beauty of MnA deals is yet to come in India

On April 25th, when the board of Twitter decided to accept the offer of Mr. Elon Musk of the total value of app $44bn, the one thing nobody doubted was the funding of the deal. Neither the buyer nor the seller was under any illusion about the financing of it. As per the filing with SEC on May 9th the broad financing structure included an equity of ~$27bn and debt of ~$19bn with a total financing ~$46bn. It's another story that when I am writing this column, the deal has taken an unexpected turn after the big statement of the review of the deal on Friday the 13th. So, it's never done until it's done.

Reflecting this situation in the Indian context, could we have done a similar MnA/ Acquisition transaction in India? There are a couple of unique points in this deal which must be evaluated to answer this question. First, ability to do a 100% buyout of a listed company. Under the US regulation one can make an offer for a 100% buyout whereas under the Indian takeover code, acquisition is restricted to a particular limit beyond which a reverse book building approach is required for the offer. Further, while one can delist the company upon a successful reverse book building offer, a 100% buyout is still not possible as there is no provision for a minority squeeze out. In a nutshell, one will have to have the company listed with certain percentage of minority shareholding. This does not allow the buyer to utilise 100% cash flow of the company for a leverage buyout. While there have been discussions in the past to create an ability to buyout 100%, there may be merit in revisiting this requirement. A 100% buyout allows all shareholders to exit at a price which is usually higher than the market price. The argument that a reverse book building ensures better price realisation for the public shareholders is not necessarily based on a sound logic in this context.

Secondly, in the above transaction, almost half of the purchase price is funded through debt financing. Funding through the debt allows the potential buyer to pay higher purchase price as the cost of the debt is theoretically lower than the cost of equity. Getting a better price through a debt financing structure or a leverage buy out is indeed a positive from the investor's perspective. However, the key issue is about the lender of debt. Should a lender be financing an acquisition? This is purely a risk, credit, and commercial decision. A lender should have the ability to analyse its risk appetite and evaluate its options accordingly. I would argue that by not allowing the opportunity to fund an acquisition, one is denying a lender an ability to do business. This could be an important business proposition within the risk framework of a lender.

However, in India, Banks's ability to lend for acquisition is very restricted. In 1992, we witnessed the first capital market scam, the 'Harshad Mehta Scam' where leverage finance was used as a tool to fuel the equity investment and the stock market. This had subsequently resulted into a market crash. More recently in 2007-08, in the US, we saw a similar credit build up in the mortgage financing which resulted into the market crash. These were all signs of excesses. It's true that "Yada yada hi dharmasya glanirbhavati bharata Abhythanamadharmasya tadatmanam srijamyaham" Similarly, whenever excesses are witnessed, government intervenes and stops such practices. Therefore, since 1992, Indian banks are not permitted to finance equity beyond a certain limit.

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I would argue that a lot of water has flown under the bridge since the 1990s. Several activities which were not allowed in 1992 are flourishing today. Therefore, we should be open to re-examine both leverage buyout via bank financing as well as a 100% buyout situation. We should keep in mind that we would not allow a level playing field to an Indian player if they are deprived of the leverage whereas a foreign buyer can find leverage outside India via a holding company structure. I totally understand that this will be a significant step and a reversal of status quo situation of the last over 3 decades. But, this government and regulators have shown the ability and willingness to pick up issues afresh and revaluate them in the current context.

I hope that we would have a global style MnAs/ Acquisitions soon.

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