

Reverse Mergers Take Off

If carried out with proper diligence, a reverse merger is an alluring mode of corporate restructuring, as witnessed in the recent Ambuja-Holcim deal.

Corporate structuring has been an integral part of any company striving for success. Globalisation and the demand for newer pocket-friendly and tax-friendly routes for restructuring have led to the adoption of many new business practices by Indian companies. There are various modes of corporate structuring such as business transfers, asset transfers, share purchase, slump sale, mergers, demergers, etc. Globally, mergers may be categorised as horizontal mergers and vertical mergers. Reverse mergers form part of the same genesis of mergers.

The definition of 'reverse merger' has not been provided in any statute. However, there are several kinds of reverse mergers. Amongst others, a reverse merger may be in the form when a holding company/unlisted company merges with its investee company/subsidiary company/listed company. Other kinds of reverse mergers are when a profit-making company merges with a non-profit making/weak/sick company.

Recent Trends

There are numerous mergers and reverse mergers taking place in India and abroad. However, a reverse merger only comes into the limelight when the interest of the general public or a listed entity is involved. We set out below certain recent reverse mergers that have taken place in India.

Recently, the Ambuja-Holcim saga has grabbed the interest of all the stakeholders in the cement industry due to the unique and complex structure adopted by the promoter companies leading to the reverse merger.

Ambuja Cements Limited, a listed entity on BSE and NSE ("**Ambuja**"), Holcim India Private Limited, an Indian investing company and wholly owned subsidiary of HIL ("**Holcim**") and Holderind Investment Limited, a Mauritius-based investment arm of Holcim Limited ("**HIL**") entered into an agreement dated July 31, 2013 ("**Agreement**") wherein Ambuja purchased 24 per cent shareholding of Holcim for a consideration of approximately Rs 3,500 crore, on the terms and conditions contained under such Agreement. A Scheme of Amalgamation ("**Scheme**") was also formulated for amalgamation of Holcim (Amalgamating Company) into Ambuja (Amalgamated Company). As a result thereof, (i) the direct shareholding of Holcim in Ambuja (9.76 per cent) stood cancelled and the said shareholding also reduced as per the relevant provisions of the Companies Act, 1956 and (ii) 50.05 per cent shareholding of ACC Limited ("**ACC**") held by Holcim became the shareholding of Ambuja and ACC became a subsidiary of Ambuja.

There was a huge uproar in the cement industry and the public shareholders of Ambuja since the structuring involved cash-out of approximately Rs 3,500 crore from the pockets of Ambuja to its promoter company. It was alleged that Holcim was merely a tool in the hands of HIL to keep the shareholding of Ambuja, and under the garb of restructuring Indian operations, the promoter company HIL absorbed most of the cash reserves of Ambuja. It was also alleged that Holcim was in dire need of money during 2013 and the aforesaid cash reserves could not

provide any benefit to the public shareholders to which they were legally entitled to, in the form of dividend, buyback etc. The role of independent directors on the board of Ambuja was also questioned in this regard. Despite all such allegations, Ambuja received consent from majority of its public shareholders approving the (i) Agreement; and (ii) Scheme and thereby settling the chaos created by some of the stakeholders.

Since the transfer of shares under the Agreement was subject to receipt of approval from the Foreign Investment Promotion Board, India ("**FIPB**"), as stated by Holcim before the Delhi High Court, an application was made by Holcim to the FIPB in this regard. FIPB, in its meeting dated May 20, 2016, recommended the said proposal to the Cabinet Committee of Economic Affairs ("**CCEA**"). CCEA also approved the aforesaid proposal for acquisition of 24 per cent shareholding of Holcim by Ambuja on July 20, 2016, as disclosed by Ambuja to the BSE on July 21, 2016. Pursuant to the approval accorded by CCEA, Ambuja and Holcim have implemented the transaction involving acquisition of 24 per cent shares of Holcim and further allotted the required number of shares to HIL, in terms of the provisions of the Scheme.

Apart from the above, another instance is that of Hardcastle Restaurants Private Limited ("**HRPL**"), a master franchisee which operates the McDonald's branded restaurants in western and southern India and which also became the direct subsidiary of Westlife Development Limited ("**WDL**"), a BSE-listed company, by way of a Composite Scheme of Arrangement

In order to understand the reverse mergers, we set out below a SWOT analysis:

STRENGTHS	OPPORTUNITIES
<ul style="list-style-type: none"> • Cost effective • Time saving • Less compliances and complexities • Not vulnerable from the equity market response till the time of listing • Tax benefits in terms of set-off against losses of weak/sick entity, if applicable • Synergies of combined resources 	<ul style="list-style-type: none"> • Providing convenient exit alternatives to investors • Further issue of shares/rights issue to general public • Access for an unlisted company to capital markets • Acquisition of goodwill/trademark in terms of intangible assets of the transferor company • Acquisition of licenses of the transferor company enabling the transferee company to undertake new business
WEAKNESS	THREATS
<ul style="list-style-type: none"> • Adoption of debts and liabilities of each company • Dilution of promoters' shareholding • Reluctant attitude of shareholders for approval of reverse merger • Conflicting accounting treatment, if any • Compromised market support due to less information of transferor company in the public domain 	<ul style="list-style-type: none"> • Dilution of promoters' shareholding carry the risk of hostile takeover • Hidden liabilities and litigations, detrimental to the interest of the transferor company • Risk of jeopardising the reputation of the transferor company • Compromised market response at the time of initial trading • Misrepresentation resulting in fraud

and Amalgamation under a reverse merger in the year 2013.

This reverse amalgamation provided a way for the Indian investors to grab a share in the ever-growing market of McDonald's through WDL. This arrangement was also a win-win for both HRPL and WDL, as it enabled McDonald's to create a new market and strengthen its operations in the country and caused an instant upsurge in the market capitalisation of WDL.

The year 2013 also witnessed the reverse merger of Indiabulls Financial Services Limited, a listed holding company, into its wholly owned unlisted subsidiary Indiabulls Housing Finance Limited ("IHFL"), a mortgage finance company. The synergies of this reverse merger resulted in strengthening the housing finance and mortgage loan business of IHFL, which is presently listed with BSE and NSE.

A recent trend is also emerging wherein Indian companies are taking a backdoor entry in other cross-border jurisdictions, wherein specific shareholding of such companies is acquired by foreign listed entities, thereby enabling such companies to

access foreign capital markets, as observed in the recent case of Videocon D2H, etc.

Based upon the commercial understanding between the parties, a transaction involving a reverse merger may be structured in different forms including by way of an agreement or scheme of amalgamation/arrangement. However, for the protection of interest of shareholders, the shareholders are often provided with opportunities (such as at the time of passing any resolution in an extraordinary general meeting, by way of postal ballot and e-voting, if listed etc.), to oppose such reverse mergers, if they think that the same is not beneficial to them. Therefore, every reverse merger taking place in Indian jurisdiction has to go through the line of sanction from its shareholders in some manner.

Pros and Cons of Reverse Mergers

Often, the challenges involved in the case of reverse mergers are case-specific, based upon the nature of the entities concerned and the commercial understanding between the parties. For instance, in the case of Ambuja, BSE and NSE specifically

directed Ambuja to obtain the approval for the Agreement from its public shareholders by way of postal ballot and e-voting.

Conclusion

Since a reverse merger is an alluring mode of corporate restructuring, companies do opt for it in their interest and the interest of their shareholders due to the benefits stated above. Amongst other advantages, reverse mergers have paved a way for unlisted entities (by a merger with a listed entity) to obtain access to capital markets, thereby avoiding cumbersome requirements of a public issue. Subject to certain conditions, taxation benefits may also be availed by a transferee entity, in terms of Section 72A of the Income-Tax Act, 1961.

As a precautionary measure, companies are always advised that before entering into such reverse mergers, a thorough research is conducted of the transferee entity, to avoid any kind of contingent liability, which may arise in the future. **ICR**

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