Mergers & CR: Lecture Notes

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Module-III

Defence against Takeovers

- Identify the part of your company that is most attractive to the predator and dispose it off in such a way that it continues to allow your company to have access to it. Example: Transfer the sought after "Brand" to a fully owned associate company and work out on licensing agreement.
- Restructuring the company as defence against takeover:
- Split a Division : This is generally done when companies have diversified in unrelated business and finds it difficult to harmonize and feel vulnerable. For example : BILT split into BILT Paper, BILT Investment Services & BILT Chemicals.
- Form wholly owned subsidiary
- Form Independent Company
- Reverse Mergers
- Take advice of consultant / Parent Company / Stakeholders: For example : Johnson & Johnson restructured itself in a manner that one Division started reporting to Switzerland and other to Singapore.
- Mergers & Amalgamations done within group to form a big company to compete with large companies. Example: BPL Ltd. Is amalgamation of its four companies namely BPL Sanyo, BPL Refrigeration & BPL Sanyo Utilities. Also merger of Brook Bond, Ponds, Lakme into HLL.
- Business Process Re-engineering (BPR): Break away from outdated rules and fundamentals, remove many layers & unnecessary jobs. Re-write whole Business process on a clean slate. Jobs become redundant after some time, people don't.
- Smart sizing: e.g. : Glaxo undertook disinvestments ICI & Ciba Geigy.
- Benchmarking.
- Best defence against Take over is to do good Financial Housekeeping. Keep a tight rein on scrap value, large transfers, placing blocks of shares in friendly hands, making sure that assets value is properly reflected in share value.
- Delaying tactics legally, which is called as spoiling tactics.

- Greenmail to all shareholders.
- Asset striping. Target company may strip the assets and convert itself into a shell company.
- Poison Pill : Make a special issue share with voting rights exercisable after some time e.g.10 days or which after hostile takeover will yield, entitles share holders some lollypops, which will jack up cost of acquisition. E.g. "EL Paso Natural gas"
- The white Knight. (The third party friendly to incumbent management brought in to rescue from an undesired takeover)

Financial Defensive Measures

What makes a Company vulnerable?

- Low stock price in relation to the replacement cost of assets or their potential earning power.
- Highly liquid balance sheet with large amount of excess cash or significant unused debt capacity.
- Good cash flow relative to current stock prices.
- Subsidiaries or properties which can be sold without affecting cash flow.
- Relatively small stock with the incumbent management.

Steps to be taken :

- Debt should be increased.
- With borrowed funds, repurchase the equity from Market.
- Dividends on remaining shares should be increased.
- Loan repayment may be accelerated.
- Securities portfolio should be liquidated.
- Cash flow from operation to be invested in positive net Value projects. Acquire other firms with excess liquidity available.
- Divest Subsidiaries without impairing Cash Flows.
- Adjustment in Assets and ownership structure.
- Issue a new class of preferred shares to common shareholders with voting rights. Thereby diluting the holdings of the Bidder.

- Create a consolidated Vote bank by share issues or by repurchasing from Market.
- Leveraged recapitalisation known as Leveraged Cash Outs (LCO) where outside shareholders receive a large one-time cash dividend from newly borrowed funds and insiders receive new voting shares. There by raise the firm's leverage to an abnormally high level and discourages the takeover.
- Golden Parachutes: Separation clause of an employment contract for loss of job under a change of control clause. (being criticised as reward for failure).
- Anti-takeover Amendments are included in Firm's corporate charter. These are subjected to shareholder's approval and law as it helps entrenchment of incumbent management.
- Supermajority Amendments: Require two third to 90% share holder vote. Many times board has power to revoke this amendment.
- Fair Price Amendment: The bidder should offer the highest price during a specified period, which is generally about 10-15% above the Market price or EV.
- Classified Boards: Provides for staggered, or classified, boards to delay effective transfer of control in a takeover. New shareholders will have to wait till incumbent directors retire by turns.
- Authorisation of preferred stocks: The board of directors are authorised to create a new class of securities with special voting rights; issued to friendly parties as defence against takeover.