Mergers, Acquisitions and Corporate Restructuring
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Lecture – 05
Case Studies: Do M and A Pay?

Hello friends. In the previous session you talked about mergers, acquisition theories and in this particular session we will talk about different cases of mergers, acquisitions done by different companies in India.

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And this is the concept we are going to cover today. In fact, we will be covering two cases of two companies which have gone for multiple merger acquisition in growth strategy and one of them is Hindustan Unilever Limited a multinational company in India. Another is Crompton Greaves Limited which is an electrical equipment company. We will also talk about whether a merger acquisition pay or not and then we will talk about what makes a particular merger, acquisition successful for any particular company?

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So, going to the first case we have and also we will be discussing the growth through M and A and M and A success these are the keywords, economic profit, ROCE, asset turnover ratio the last three are actually to measure the impact of merger acquisition of the company’s performance.

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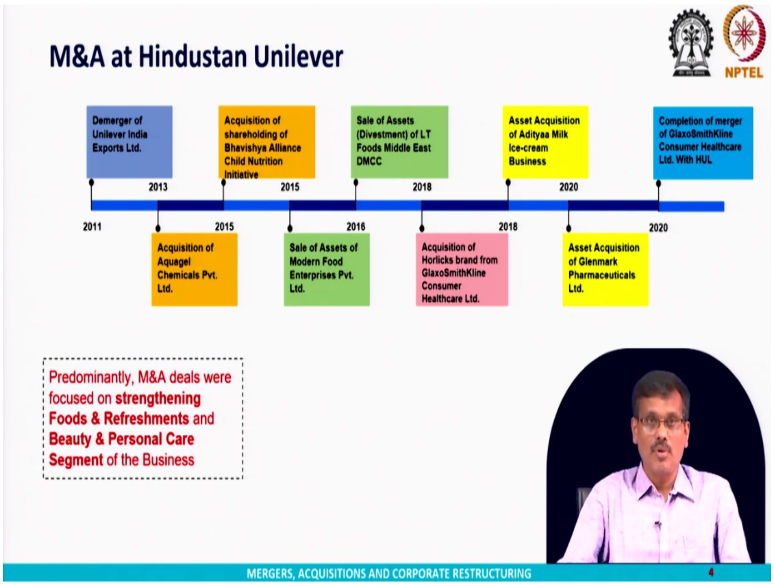

And we have first case called Hindustan Unilever. Hindustan Unilever is a group company Unilever a multinational company. In 2011, we have covered not this select merger acquisition restructuring have been covered in this particular slide. One can see here that Hindustan Unilever Limited going for demerger of Unilever India Exports Limited as a restructuring.

Then 2013 they acquired Aquagel Chemicals Private Limited which take care of their beauty and personal care segment then they also acquire shareholding of Bhavishya Alliance Child Nutrition Initiative for food and refreshment segment because if you look at HUL has now gone from detergents, personal care to other all aspects of (()) (02:29) consumer goods as such.

Then they had purchased and they had acquired the Modern Food Enterprise Limited which is bread and bakery company which was actually Government of India company they had acquired sometime back and later they as a strategic realignment they have sold that particular company to another company. They also sold assets of LT Foods Middle East DMCC. These are the divestment done by this company in the last year in 2016.

Then they acquired the famous Horlicks brand from GlaxoSmithKline Consumer Healthcare that is GSK and Horlicks is a very popular brand and it has got a very big brand recall, brand presence and GSK wanted to get rid of that, they want to divest and for HUL, for expansion the health and nutrition segment health drink. This was the right pick for them then they also acquire the ice cream business of Adityaa milk to augment their ice cream business.

Subsequently, they also acquired Glenmark Pharmaceuticals Limited certain products, subdivision which was complimentary for HUL and then they also completed the merger of GSK Consumer Healthcare with HUL. So, these are one can say how a company has gone from multiple merger acquisition, (()) (03:54) etcetera as a growth strategy as to align their growth with their growth.

And if you look at predominantly we will see that they are strengthening foods and refreshments category as well as the beauty and personal care segment of the business. So, this is an very good example similarly you have several other examples we can see, we can track the M and A activities by different company in its last several years in different sector and we can find such things also.

This is a current phenomena for any prominent big companies or any bluechip companies for that matter.

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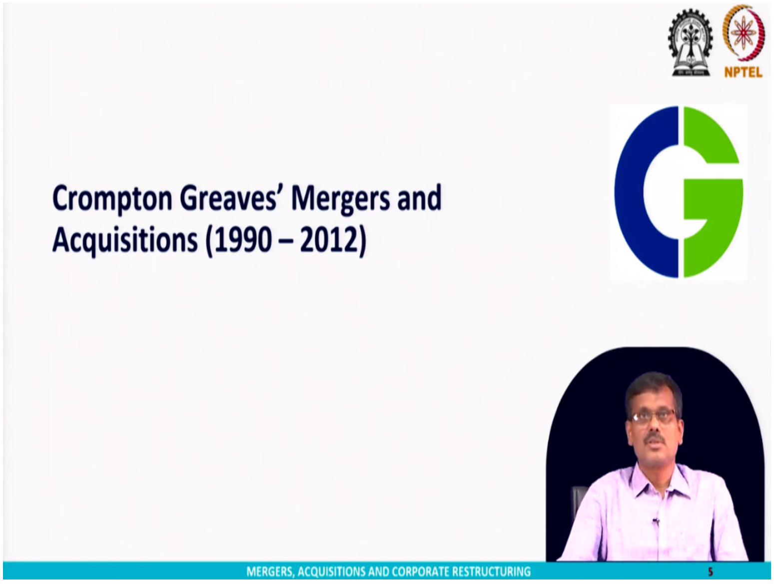

Then we have another case that is where little exhaustive study of that is your erstwhile Crompton Greaves Mergers and Acquisition during 1990 and 2012 although it is a little old case, but if you look at the type of M and A they have done so that make sense for the learning of this particular subject.

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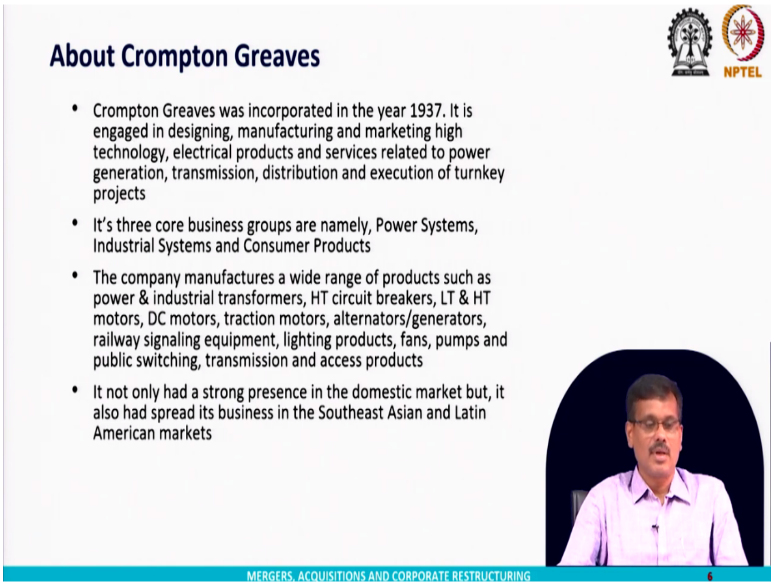

So, the Crompton Greaves was incorporated in 1937 it was engaged in designing, manufacturing a marketing high technology, electrical products and services related to power generation, distribution and transmission also they were involved in execution of turnkey projects. It had three core business like power system, industrial systems and consumer products that means they are in B2B segment as well as B2C segment for that matter.

They have got very wide range of products like in power industrial transformers, circuit breakers, LT and HT motors, DC motors, traction motors, alternators, generators, lighting products, fans for retail consumers for that matter, pumps and public switching all those transmission and access products. So, if you can look at they are into lot of variety of products in this electrical segment, generation, distribution and transmission.

And it had not only presence in the domestic market it also has good presence in the international market including South East Asia and Latin American markets. So, they have a good geographical presence, they have good scope of products across different products, different markets.

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And what was the motive that the Crompton Greaves went for that it was product portfolio to wide and acquire new technology and they had objective of cost cutting and they wanted to exit from unrelated businesses and they wanted to transform a product company to a complete solution provider. So, everything at one place the customer can get so that customer did not have to go to multiple entities for that matter.

They also wanted to improve the operational efficiency in terms to energy, cost reduction, expansion of the cells and also increase the capacity and they wanted to be in top 10 transformer manufacturers in India and they also wanted to go to globally present and so that they can go for enter new markets.

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And they also wanted to gain technological competence and acquire intellectual property because intellectual property give a long term advantage for any company and R and D also will give long so that company can come with new products, they can come with innovations and also from any company to prosper further it should also have good brand name at the same time they also wanted to have financial benefit.

They have increase in earnings per share and then profit after tax. They also wanted to have new customers in new markets and new distribution channels for that matter, they wanted to have economies of scale and scope which you have discussed in our previous classes which talks of mergers and acquisition motives. So, they are also similar cases in case of Crompton Greaves for that matter and not only that they want to have technology, products, market.

They also wanted to have good talents pool so that they can face competition and respond to any changing industry concentration. They also thought of using their free cash the cash which can available for expansion so that they can be better use. They thought that this free cash can be one option can be company can declare as dividend, they can also use such buyback of shares instead of that they thought they can acquire good targets.

And you make use of free cash flow so that the overall shareholders worth is actually maximized and as a another outcome of this also yes in certain cases they can also reducts the tax. Suppose, beside that companies target being strategically fit and the company may be loss making, but strategically fit in that case that unabsorbed losses can be absorbed by the combined company and the company can have certain tax benefits subject to the tax regulation of the country for that matter.

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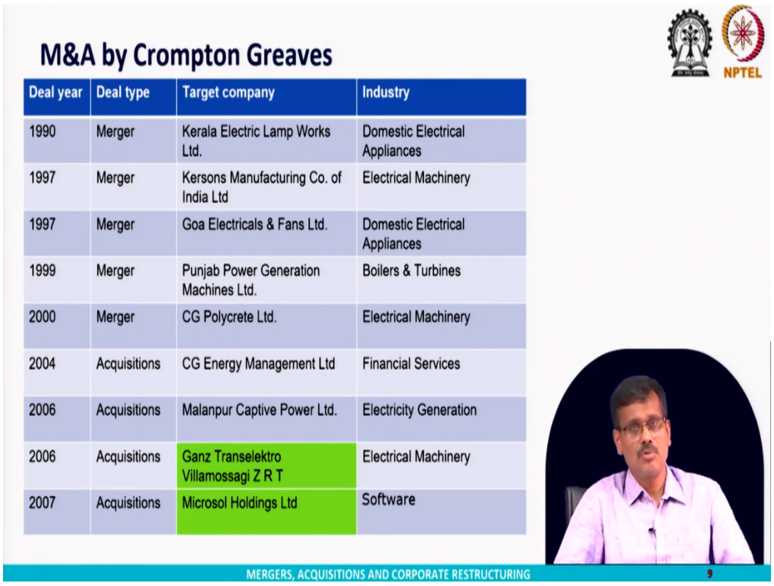

So, these are the other motives and if you look at we have covered from select deals from 1990 till 12 year. So, we have talked about the type of deal where you talk about merger or acquisition. So, if you look at 1990, 1997 two acquisition mergers are there where they have acquired four companies up to 99 that is Punjab Power Generation Machine Limited. They have acquired four domestic companies.

And if you see that industry in electrical appliance and other electrical machinery, so two sectors are covered then also boilers and turbines. So, we look at multiple product segments they have focused on and accordingly they have chosen certain companies whereas they merged their own company CG Polycrete Limited, electrical machinery the group company they merge so that they can streamline and bigger company for the matter.

They also acquired the CG Energy Management Limited which is a financial services company without having a separate company they wanted to merge as such then they acquired Malanpur Captive Power Limited which was for electricity generation then if you look at 2006 all the M and A are involving domestic companies, but 2006 again they went and acquired Ganz Transelektro which is an electrical machinery a foreign company. They also went ahead with the Microsol Holdings Limited which is a software company.

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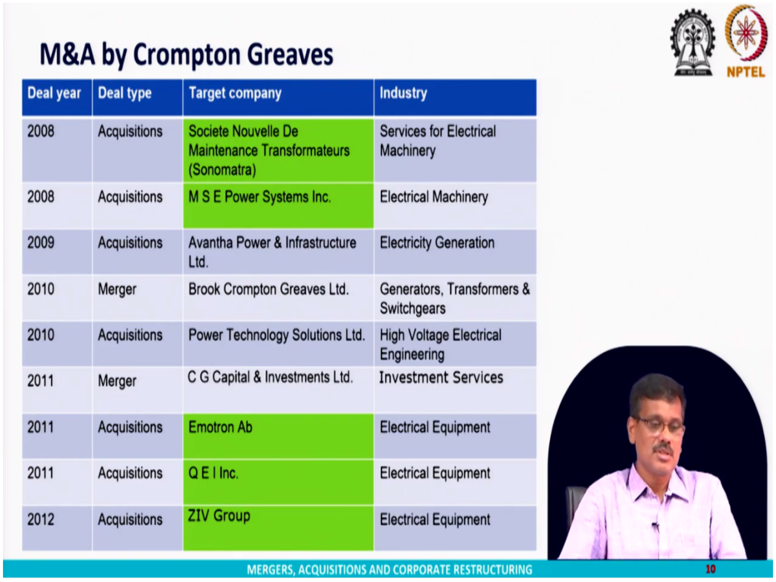

And similarly they went to another international acquisition Societe Nouvelle De Maintenance Transformateurs which is for services of electrical machinery then they went for MSE Power Systems Incorporations. So, these green are actually typically the foreign acquisitions and mergers and other ones are the domestic M and A as such. Avantha Power Infrastructure, Brook Crompton Greaves.

So these two Avantha Power and Brook Crompton Greaves actually they are group company. So, they streamlined a group and make a single bigger company they want to try. They also acquired a Power Technology Solutions Limited which is solution provider. So, for high voltage electrical engineering then also they are invested in services company where they merged with themselves.

Then they have three acquisitions in 2011 and 2012 in electrical equipment segment they all are like from Emotron to ZIV Group they were all in international acquisitions. So, you can see that in that particular two decade scenario 1990 2012 they went for multiple merger acquisition involving different products, services, allied services in electrical segment for that matter electrical market.

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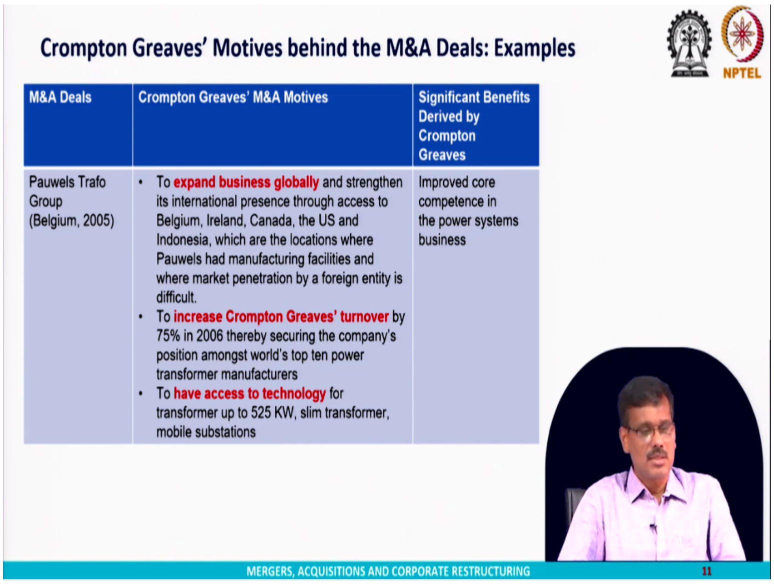

So, if you look at we have covered here specific certain deals that company has gone for like they went to Pauwels Trafo Group which is Belgium company and the major motive for this particular acquisition was to expand the business globally. So, they had definitely opportunity to expand domestically, but they thought that they should also go for international presence. So, this particular company gave them access to Belgium, Ireland, Canada and US and Indonesia and where this particular company was operating.

So, in this particular with one acquisition foreign acquisition they could have presence in five different countries or they augmented they have already existing presence in five different countries for that matter. It also increase the turnover by some 75% 2006 or increase in turnover is one of the access they also had an access to technology for transformer up to 525 kilowatt.

They also had technology for slim transform and mobile substations. So, in that way they have improved their core competence in power system business by acquiring this particular company.

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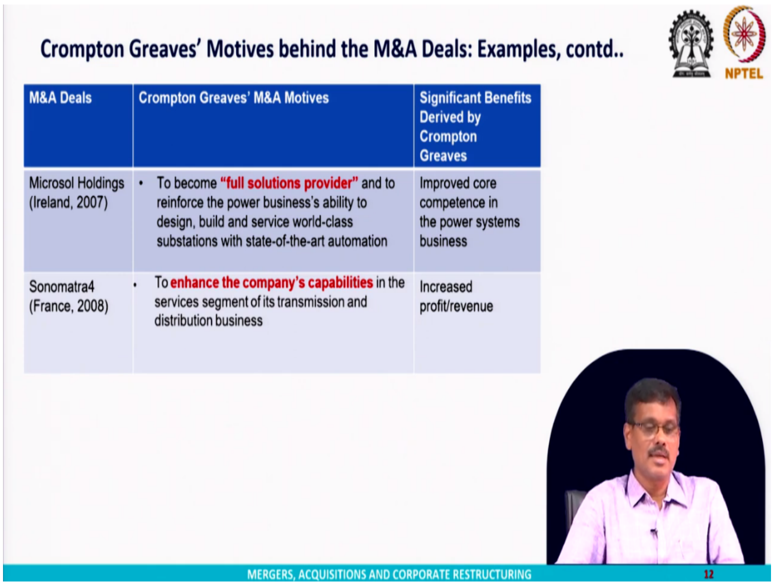

Then similarly they went for microsol holdings and with this they become a full solution provider in the power business so that they can design, build and service world class substations and state of the art automation. So, it increase they improve their core competence in giving a full solution for a customer. Similarly, they vote for sonamatra 4 for France company where with which they could enhance the company's capabilities in services of segment of its transmission and distribution business and this also increase the profit and revenue for that matter.

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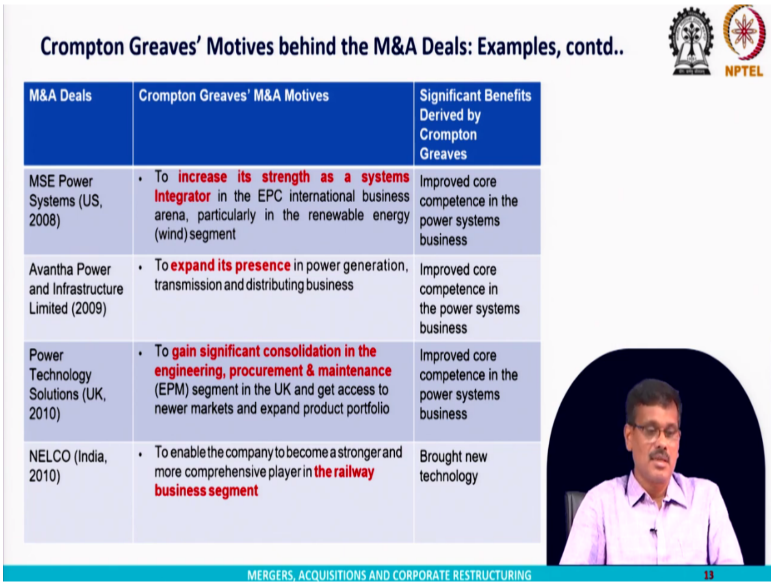

Similarly another couple of cases where they went for MSE Power where with the MSE Power acquisition merger they could increase in strength in systems as a system integrated in the EPC international business segment particularly the renewable energy MSE. Renewable energy at that point of time lot of discussion about expansion of renewable energy and so many power sector companies are actually going for renewable energy.

So, as a service provider or as an (()) (13:53) electrical segment you also should have the company should also have technology related to renewable energy then Avantha Power and in fact that is actually their own group company where they again concentration in the power generation segment they could expand their presence and then power technology solutions UK.

So, they had the objectives to gain significant consolidation in the engineering procurement and maintenance segment and the last one in this side we have NELCO India which is an Indian company. So, they wanted this particular acquisition made them their presence in the railway business segment which possibly they had little lower revenue from there and besides new technology also went to another market that is railway business segment.

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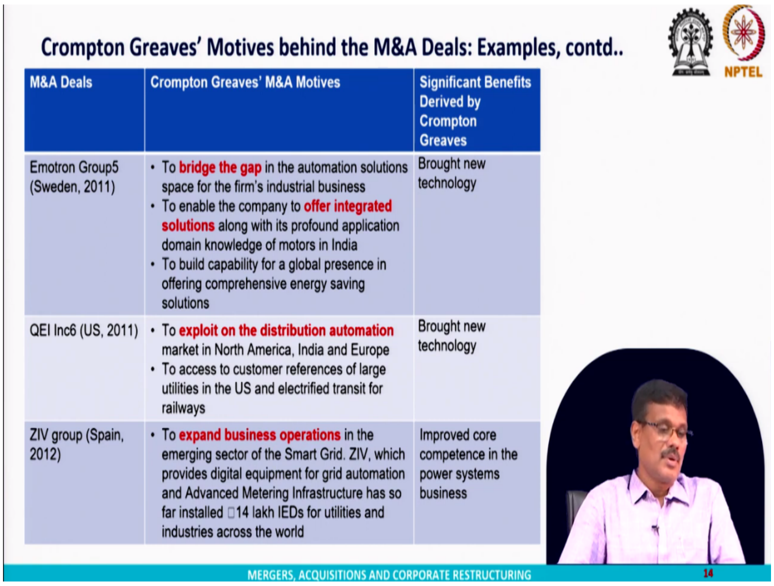

Then the Emotron groups where they had bridge the gap in automation solution that they have. It also enable the offer integrated solutions for their products, for the customers and by going by QEI incorporation 6 they could exploit the distribution automation market in North America it is an international acquisition and we would help them exploit the distribution automation in North America, India as well as Europe.

Also they could got good customer references from these particular companies so that they can also sell their existing products and utilities then ZIV Group is a Spain company where it could help them expand the business operations globally and also new segments and so it also increase their core competence in the power systems business. So, this talks about that how this company has gone for different M and A and different aspects of their growth has been taken care both in technology upgradation, distribution system, new products in different electrical segments for that matter.

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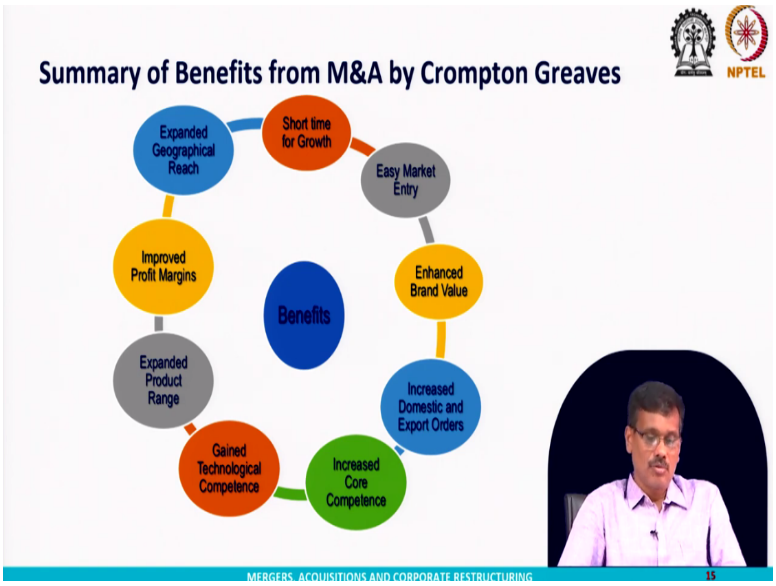

So, if you look at the summary of benefits that talked about in the previous slides yes they had expanded geographically by going for acquisition in multiple countries. They could grow in a short time they do not have to wait for long time they have to organically grow so by this they could do it. They could also enter new market geographically because when I acquire another company in some other countries.

So, with that they also acquire like we saw in one example they acquired one company and they entered five different geography for that matter and because they got the international brands in new companies so their brand value that also has got enhanced. They could get more orders also because they acquired companies which has got their existing orders because orders for a electrical equipment company the order size is one of the key indicator of workman that is a leading indicator that yes the company is going to do well in terms of sales in future.

So, that way they got orders of existing companies into their hold, they could also increase the core competence, they gain technological competence and they expanded the product range and they improve also profit margins. So, these are the overall summary or benefits for

Crompton Greaves by going for multiple merger acquisition the two decades from 1990 to 2011-12.

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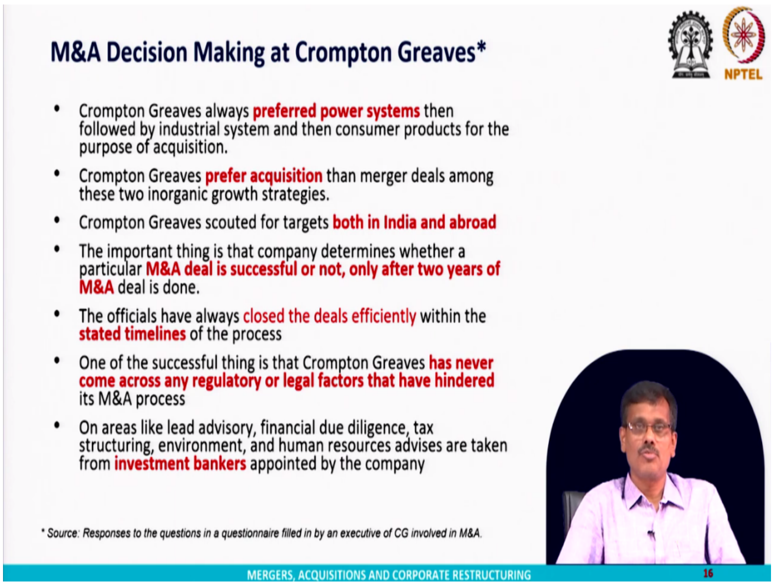

Then in fact this is as part of a study where there is study done with the help of questionnaire with the team from Crompton Greaves and we found that what type of decision making was there in case of Crompton Greaves. So, they actually preferred as a M and A strategy which I want to talk about in subsequent session, acquisition search which particular company you are going to acquire, where (()) (17:50) and how to filter them.

There are multiple products in particular segment. So, which particular segment and product we should go for. So, the company will have their own filtration strategy. So, this company has a filtration strategy is that they went for power systems and followed by industrial systems and then they went for consumer. So, in the hierarchy they gave first preference to the power systems for that matter.

And instead of merger they wanted to go for acquisition so that the existing shareholders have no role so they gave the cash and got the company acquired and instead of mergers for that matter. Mergers the shareholders will like to continue in the combined business, but they possibly did not want that so they want to have full control about the acquired company or the target for that matter.

And they went for both Indian average not that they went only for multinational acquisition they went for both the domestic as well as foreign market and so they also had a thing that yes they also had their own internal matrix of success of M and A and after two years only they say whether the particular M and A has been successful depending on what is the objective of that particular acquisition.

And they had a timeline for closing the deal, closing the M and A deal is one of the important aspect of merger acquisition process. So, they close the deal efficiently within the stated timelines for the process and in this particular process of M and A they have not come across any regulatory legal problems that has hindered the process as such so that is what they claim.

And then like advisory and financial due diligence etcetera they did not do on their own they rather dependent on the exports from the investment bankers appointed by the company. So, they were the experts which are actually giving them the advisory services for due-diligence, tax restructuring, environment etcetera. In fact, there are several investment bankers who were experts in this and the companies go for their advice when they go for M and A as a growth strategy.

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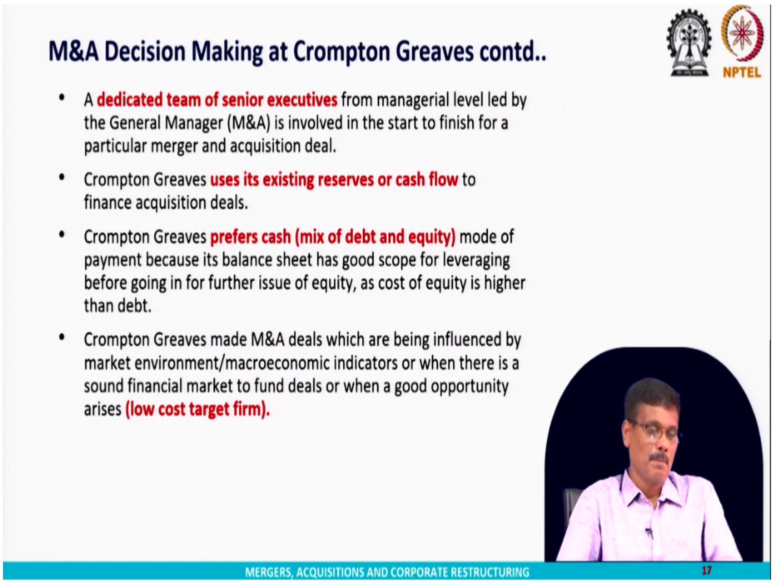

They also had a dedicated senior team possible one acquisition done they were looking for another acquisition and then the team was involved and so they become (()) (20:10) experience from the previous acquisition may be they might have learn something from the previous acquisition and merger and they could now implement than the new acquisition for that matter. So, scope for learning was there and they use their existing free cash flow to finance the acquisition.

Of course they also took certain debt for financing the acquisition and they preferred a cash deal that means earlier was talked about that yes they are going for acquisition means you will pay the cash to the shareholders of the target company and that case you need cash and they used a mix up date and also internal equity as well as external equity to some extent so that you make that particular payment.

And it is not that they went for debt because debt is not for bad, debt also leverages the company in terms of return on equity and also they went for debt because cost of equity is traditionally higher than cost of debt and they got the deals which are influenced by the market environment. So, they look at the microeconomic indicators and accordingly they choose the particular target for acquisition.

And they look for low cost target so that they can pay lesser for acquiring. Anybody who like to pay less for acquiring anything for that matter so this is a good financial prudent that you do not overpay and then regret later. So, those are the major thing they talked about.

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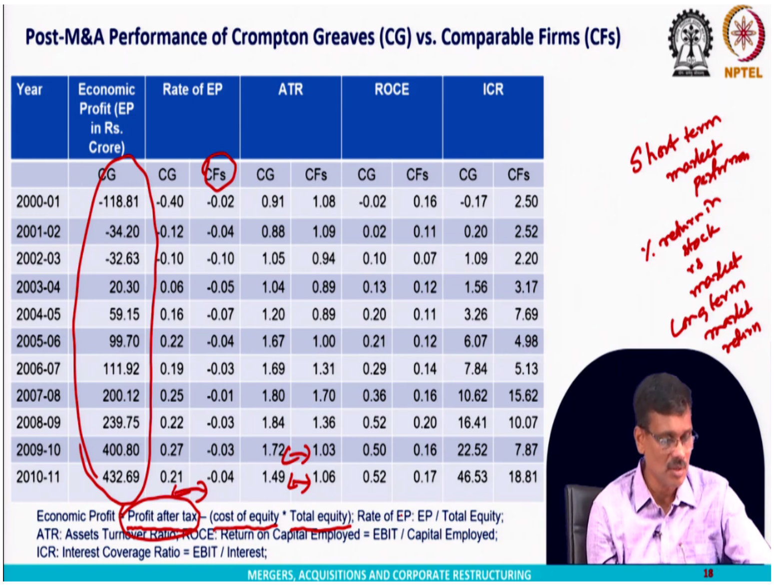

And subsequently we have to see that whether any company in which goes for mergers, acquisitions, is it going to be long term beneficial or not. So, there are couple of matrix that we use for measuring the post merger performance. One is that we can do in terms of short term market performance. So, here you will look at the change or percentage return in the stock of the company versus the market that is there.

And that is short term that immediate what is the reaction of the market to the announcement that is one way another is that long term. So, in long term also we can go for market return as a matrix and how much growth in this share price has taken place to the acquiring company vis-a-vis the market maybe let us say in India Sensex or Nifty for that matter, how the Nifty has grown and how this particular company has grown in terms of market price or the similar type of companies in some segments how they have done.

But another thing is that we can also look at the long term implication in terms of certain financial matrix, could be related to profitability, liquidity, solvency and all. So, in this case what we did, we did the study has done it took some couple of matrix several matrix, but couple of them have been shown here. One of them is called the economic profit; economic profit is nothing, but if you are earning a profit more than the expectation of the investors that is called economic profit.

So, from equity point of view your profit after tax minus cost of equity which is expectation of the shareholders, equity holders into total equity so that is the expectation and you are having a profit after tax over and above this that means you are making economic profit or you are making economic loss. So, that way if you look at the economic profit for this particular company.

So, you see that in this economic profit you see the economic profit of the company has actually gone up over 2000. We took the last decade in that acquisition scenario and we saw that you can see the overall the economic profit is actually increasing not only overall even economic profit as a percentage of total equity is also more or less increasing over (()) (24:00).

So, it was negative in 2001 with multiple acquisitions they have actually become positive for that matter and if you look at the comparable companies, comparable firms that you are talking about in the same segment if you compare them in fact this company was doing bad earlier, but now if you look at like 0.2 and 21% was the economic profit of total equity which was actually minus negative in case of comparable companies. So, if you look at the spread the difference in that is much bigger.

That means we can say in economic profit term the company was creating more profit, more economic profit from vis-a-vis the industry that means we can say the possible the M and A was beneficial for companies compared to the company which has not gone for merger and acquisition. So, this comparable firm that you talked about were actually those companies which you have not gone for merger acquisition, but they are in the same segment.

Similarly, if you look at asset turnover ratio you see that there is an increase in asset turnover ratio as well as if you look at the difference between let us say comparable companies and Crompton Greaves asset turnover ratio talks about efficiency though Crompton Greaves has being a more has utilized assets more efficiently compared to the comparable companies and one can possibly attribute it to the M and A.

So, with more M and A they have gone for more asset utilization or efficiency in asset utilization. Return on capital employed also we can see that yes there is a difference now in those companies so these companies has more return on capital employed and interest coverage ratio also it is high for this particular companies. So, that way you can conclude that yes this company has done well in this particular time period in terms of financial matrix.

Different financial matrix have been considered and we saw that they have done better compared to other companies who have not gone for mergers and acquisitions. The control group is companies which have not gone for merger, acquisitions that means this is actually a case study we cannot generalize, but we can make an example that yes possibly mergers and acquisition in long term benefit the companies.

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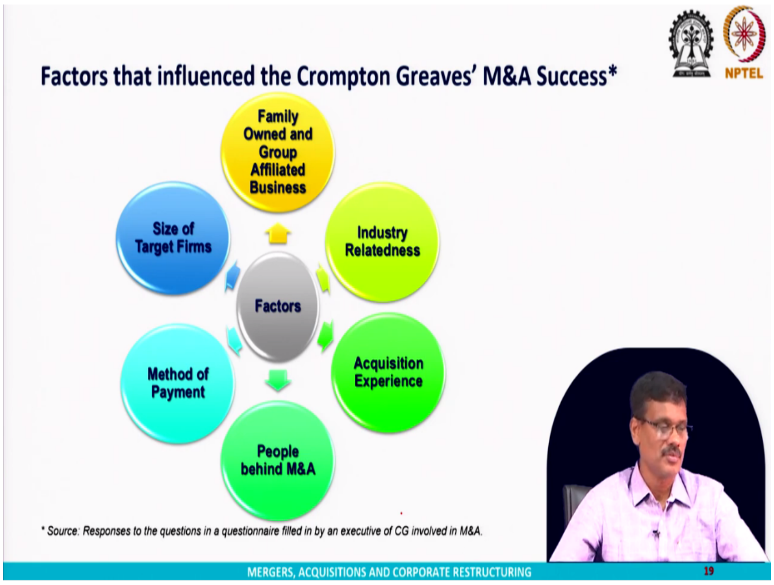

Then we also ask them their team that what has made this particular M and A success possible? So, they said that time family owned group affiliated businesses so it was easy for them to merge the group affiliated businesses that is there and (()) (26:21) streamlined organization structure so that you could reduce the bureaucracy in the company and they always went for related industry.

They did not go for like conglomerate, they were (()) (26:31) industry where they could have economy of scale and scope and essentially they went for more and more acquisitions. So, they got a good learning from acquisition experience and they had a good team the people or group for any organization merger acquisition to do they should have a dedicated people and they had a dedicated team senior management team which were actually managing the merger, acquisition.

And if they mostly went for as long as non group acquisitions are concerned they went for acquisition and they made the payment in terms of cash, they did not go for payment in terms of share. We will talk about the merger payment method detail in deal structure and as of now let us say that merger payment can be in terms of shares and can be in terms of cash, in terms of cash and debt also can be a mix of that.

So, they went for more on cash payment and for group companies they obviously went for merger and the shareholder acquired company were given shares in the acquiring company and mostly the target firm they had was smaller than the acquiring company that means they did not go for a company which was bigger than the Crompton Greaves for that matter that is another thing.

So, they attribute these are the possible five or six factors which led to M and A success as the company claim and also we saw previously how they have done better as such.

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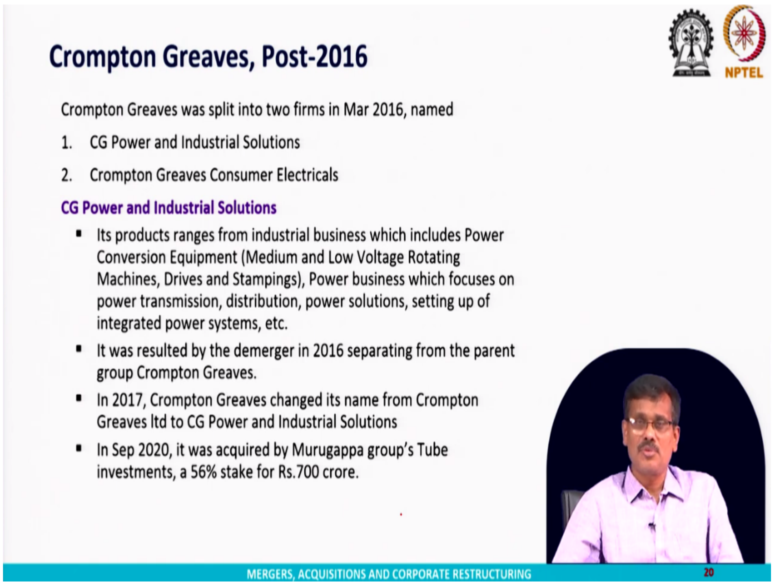

But there is a catch here the company up to 2011-12 went for merger acquisition now what happened in between there could be a certain allegation like that they had manipulations in their financial statement. So, now we are talking about a case which was supposed to be celebrated as successful case of M and A, multiple M and A, multiple segments then they have gone for bigger problem.

Although we found they were successful using different matrix, but later something happened and the company were actually not in good position. So, that led to company being split into two parts that means now we are talking about the same company which talked about multiple mergers and acquisitions. They now went for split that is called the restructuring. They split the company into two parts CG Power and Industrial Solutions.

And then they went for Crompton Greaves Consumer Electricals and Crompton Greaves Power and Industrial Solutions is into different ranges that industrial ranges it change to power conversion equipment, power business which focus on transmission, distribution power solution and setting up the integrated full solution power system which they got that capacity to do by going for multiple acquisitions in the last two decades.

Then they demerged it make a separate company from the parent group and this particular company was then converted into the business were CG Power and Industrial Solutions and September 2020 it was acquired by the Murugappa Groups the tubes investment acquired this particular company by 56% stake in this particular company by paying 700 crore that means it is now gone for the Avantha Group. It is with the new group for that matter.

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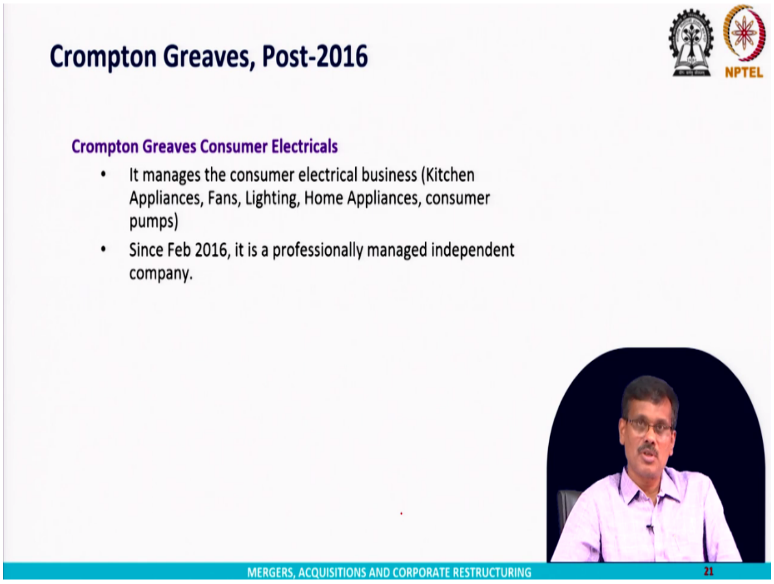

And the second company they retained, but they also now has become, they also become the professionally managed independent company and this is called Crompton Greaves Consumer Electricals that means they have now split into two segment industrial segment, B2B segment vis-a-vis the B2C segment for consumer electrical and this is also now managed by a professional independent company where new private equity players have come and taken the stake in this particular company.

So, the objective of this particular case is talking about yes we celebrate success in terms of merger acquisition and it may benefit at a particular point of time in the economic condition, the strategy the people at the (()) (30:28), but if something can go wrong then the company can be into doldrums as it happens in Crompton it is a very prominent company now with another group of owners.

So, anything can actually happen with business as long as you manage well you are sensible to what is happen in the market and you are agile then the merger, acquisition restructure can be successful otherwise you can also burn your finger.

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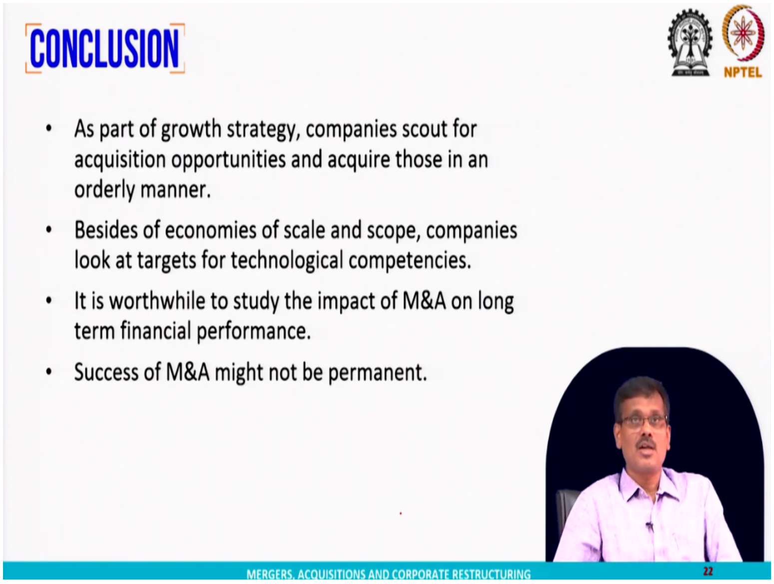

So, in a conclusion you can talk about yes as a part of growth strategy companies scout for acquisition opportunities and acquire those in orderly manner as we saw in both the cases like in HUL as well as in case of Crompton Greaves. Besides economies of scale and scope the company also look for targets for technological competencies also competence across the supply chain vertically.

And it is also worthwhile for people to say that does it benefit you made an acquisition, made an (()) (31:25) announcement and then people are happy about it, but what happens subsequently did the company do well, did the company achieve those objectives of M and A which they had mentioned at the time of announcement or not and the success of M and A might not be permanent.

So, one should not be overwhelmed by going for multiple acquisitions and possibly then you have problem in integrating, managing the business it is a big business for that matter. So, with this we conclude and the subsequent session we will talk about the more and how orderly you can go for acquisition and you can also talk about what type of due diligence one company should do and companies go for mergers and acquisitions.

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So, these are the references including this case study from where you have taken and annual reports of two companies for this particular session. Thank you and see you in the next session.