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KNOWLEDGE PAPER INVESTMENT DEAL SUMMIT 2021



**I-DEALS
NETWORK**
CONNECTING BUSINESS LIVES

FOREWORD

Valuation is a vital part of well-functioning financial markets which promotes M&A opportunities for both investors and for the companies in which they invest.

The acquisition process has many valuation components. The acquisition price itself typically involves an estimate of the entity's value. Valuation is sometimes used to determine the tax consequences of certain transactions. Accounting standards for business combinations require the valuation of acquired assets and liabilities using a fair value standard of measurement to report the financial consequences of the acquisition to their investors on their financial statements. Also, proper valuations allow for efficient capital markets to raise funds for investment, helping companies grow, perhaps even funding future acquisitions.

Since high-quality valuations are vital for an efficient global economy, as a valuation profession we must ask ourselves, are we as a profession operating in a manner that enhances the public trust with our work?

When one thinks of a professional such as an accountant or a lawyer, there are typically common education requirements, a common set of professional standards, and mechanisms to enhance and maintain the quality of work and the integrity of those that practice within that profession. Can the same be said of the valuation profession? Perhaps, but if we are to be realistic about our profession, we may be lacking by comparison.

Regulators in many jurisdictions have expressed concerns about our profession as it relates to our vital role in global commerce. Do we operate within a profession that requires "specialized knowledge and often long and intensive academic preparation?" Again perhaps, but not consistently.

Globally, the valuation profession is committing to developing and implementing best practices for fair value measurements. The Fair Value Quality Initiative in the U.S. is an example of this enhanced commitment. In connection with the Certified in Entity and Intangible Valuation credential (CEIV) created through a collaboration of the Fair Value Quality Initiative, the Mandatory Performance Framework guides to improve documentation and facilitate auditing fair value measurements. Going forward, I expect further declines in audit deficiencies related to fair value measurements because of these developments as a profession.

One overarching way to enhance the public trust is for a profession to operate under one common set of valuation standards. Since valuation is a key input to global commerce and the profession is both operating and growing internationally, the need for uniform worldwide standards is increasing. Fortunately, there is a global standards setter for the valuation profession.

The International Valuation Standards Council (IVSC) is the global standard setter for the valuation profession. The IVSC enhances the public trust in the profession by developing and promoting high quality international valuation standards. The IVSC has as nearly a hundred-member Valuation Professional Organizations (VPO) across the globe. Additionally, the IVSC has support from several non-VPO organizations, including numerous international accounting and valuation firms.

The IVSC has issued highly quality a multi-disciplinary set of valuation standards which are known as International Valuation Standards or IVS. IVS is recognized globally by VPOs and other non-VPO organizations, including many government entities. IVS is comprised of two types of standards; General Standards which include all disciplines and Asset Standards which are characterized by various asset classes.

The IVSC follows an established due process for developing standards which is both inclusive and transparent. The process includes consulting with various global stakeholder groups with the overall objective of increasing the confidence and trust of users of valuations.

Education is another priority of a profession. The use of commonly accepted approaches and methodologies within the profession also promotes public trust in our work. Our profession must provide education for our members as to the profession's best practices. Education within a professional can take several formats- from classroom training to discussion papers prepared by VPOs, to knowledge papers such as this one. I applaud Chander Sawhney and the members of his firm, Transique Corporate Advisors along with RNC Valuecon for writing Knowledge Paper on Investment Deal Summit, 2021 encompassing thought leadership on Valuation, Transactions and Regulatory aspects which will be of tremendous benefit to professionals including Valuation and M&A professionals as the profession undergoes changes in India.

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PREFACE

Transactions are quintessential for an Organisation to grow, optimize & protect/enhance its Value. M&A, Re-organisation, Fund Raising, Re-structuring need thorough analysis and deliberate & thoughtful decisions to make it work for the Organisation.

Transactions generally take a long period from inception to consummation, requiring hand-holding and accurate financial, legal and commercial advise. From ascertaining the Fair Business/Asset value to identifying and negotiating with the proposed investor/ Target Company to drafting a proper investment/acquisition contract are all critical to making the transaction successful & beneficial to both buyers and sellers. In the case of start-ups, raising funds is even more challenging vis-à-vis finding the right investor fit at an appropriate time and terms while also protecting the interests of the Founders.

Investment Deal Summit, 2021 is organised on 30th July, 2021 to give a holistic understanding of various options of M&A, Valuations, Transaction Structuring, Re-organization & Fundraising including Legal and Regulatory challenges involved therein and mitigating associated risk including the understanding of the Process.



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VALUATION

KEY IN INVESTMENT DEALS



OVERVIEW

Most companies create economic value for their stakeholders by investing their capital efficiently in a manner that generates a return in excess of the cost of capital deployed. For companies to generate high ROCE and also maintain consistent growth, there must be certain inherent competitive advantages which in turn depends upon industry structure and market trends. Competitive advantage enables some companies to earn higher returns on capital employed than others.

However, the competitive advantages of today may not remain unique for a selected group of companies or industries for a very long period with a continuously evolving regulatory, technological and demographic environment. Accordingly, to maintain their competitive edge, companies should be receptive to new opportunities striving to increase their business efficiencies, creating long-term value. Beyond a point to remain competitive, companies need to look at inorganic growth that can take them to the next level. M&A is an important tool in this respect.

Valuation of a business, asset or liability is critical for strategic Corporate Transactions including M&A, Restructuring, Fund Raising, internal management decisions and also for applicable Regulatory, Tax or Financial reporting requirements. While certain markets provide a price for shares of companies or their assets at which buy and sale transactions can take place, the Intrinsic (Fair) value of shares of these companies or their assets can be materially different. Business valuation is thus undertaken to ascertain the Fair Value (fundamental intrinsic value using Income and Asset approach) and Market value (Relative value) to understand and

then attempt at reducing the gap between intrinsic and market value for value creation of companies before taking appropriate corporate actions.

The provisions of Registered Valuers and Companies (Registered Valuers and Valuation) Rules, 2017 as mandatorily applicable on the Companies Act and IBC valuations (also recently adopted by SEBI) also have the requirement of following the valuation standards while performing and reporting, prescribe the contents of the valuation report including permissible caveats and limitations, and requires the maintenance of record of each assignment for a specified period of time.

Even though it is accepted that divergent views are possible in the field of valuation, the purpose is defeated if the value is not authentic and genuine. Decisions arising from the use of inappropriate values, in addition to causing unfair gain or loss to the parties, has the potential to distort the market and misallocate National resources which may affect the economic growth of a country as well. The seriousness of the Valuation profession in India at this point of time can well be understood as the government is in the process of bringing in a new law to set up a National Institute of valuers (NIV) to regulate and develop a special cadre of valuers and an institutional framework for them. The central government is also working on the preparation of Indian valuation standards which will lead to the standardisation of Valuation practices in India. In the words of the Regulators, we the Professionals discharge secondary state functions as the extended arms of the regulator and work towards furthering the objective of the state. The Draft Valuers Bill, 2020 is already in the public domain.

VALUATION APPROACHES

THERE ARE THREE APPROACHES TO VALUATION

- **Asset approach:** Asset-based valuation approach values a company based on its underlying assets. The net asset value reflected in books do not generally include intangible assets of the business and may also be impacted by discretionary accounting policies. Asset value is thus not perceived as a true indicator of the fair assessment of value. However, it is often used to ascertain the minimum value of a business and is also considered appropriate for matured companies, those with asset-heavy businesses and also Investment holding companies.
- **Income approach:** Income-based valuation approach values a business based on its inherent business potential / fundamental value and underlying operational cash flows and profitability. It is generally considered as the best valuation methodology for going concern businesses. Under Income approach, discounted cash flow (DCF) method is the most frequently applied valuation method as it is futuristic and also considers the time value of money. DCF expresses the present value of the business as a function of its future cash earnings capacity. In this method, the appraiser estimates the cash flows of any business after all operating expenses, taxes and necessary investments in working capital and capital expenditure are being met.

Similar to the uncertainty involved in forecasting cash flows for enterprise/equity valuation, uncertainty exists in estimating an appropriate rate at which these cash flows should be discounted as there is no fixed rate of return like the coupon rate in case of bonds. Thus, for determination of cost of equity, both systematic (market linked) and non-systematic (company-specific) risks are considered over and above the risk-free return to arrive at the risk adjusted discount rates.

However, DCF method brings its own challenges and is quite sensitive to its underlying factors. Sensitivity and Scenario analysis is thus advised while applying DCF valuation by making cash flow forecast and adjusting the cost of capital and growth rate assumptions under different scenarios including conservative, aggressive and optimistic scenarios. DCF method results in controlling stake valuation.

- **Market Approach:** Market based valuation approach values a business based on the relative valuation by benchmarking the company vis-a-vis its peers in the same industry and after doing appropriate adjustments for size and marketability. Peer comparison can be with trading valuation multiples of Listed Companies or transaction valuation multiples of Private Companies.

- ♦ **Comparable (guideline) companies market multiples (CCM) method**

Trading/Market valuation multiples of comparable listed peer companies are computed and applied to the subject company after doing appropriate adjustments for size and marketability to arrive at a trading multiple based valuation. This method results in minority stake valuation.

- ♦ **Comparable transaction multiples (CTM) method**

This technique is used for valuing a subject company for M&A, based on the valuation multiples of similar M&A transactions that have taken place in recent past in the industry between independent parties at arm's length price. It is observed that most of the private investment transactions take place in closely held companies as investors prefer to keep stringent terms including restrictions on sale of shares, liquidation preferences etc., which may not be possible in case of a listed company. For listed companies, the open offer price can be considered for benchmarking as it takes into account the control characteristics resulting in controlling stake valuation.

SPECIAL SCENARIO VALUATIONS

A) VALUATION OF START-UP COMPANIES

Valuation of start-up companies is challenging as they have no past history, negligible revenues with high operational losses, negative cash flows, limited promoter's capital and high dependence on external sources of funds often leading to speculative/aggressive financial projections for early-stage start-ups. Start-up valuation is more about understanding promoters and management background, experience and vision, future potential of the business, people, technology, competitive landscape, traction and the probability of success and failure attached. It can be said that while valuating a start-up, the experience of a valuer plays a major role in value conclusion.

The Valuation of Investor funded start-ups requires experience in the valuation of complex securities as they have series of capital with different levels of preferred rights in the distribution of the company's value over other investors in the event of a sale or liquidation of the company besides participation in profits of the company. Such rights include liquidation preferences, tag along, drag along rights and other terms which have an impact on the Valuation for common shareholders of Companies.

The stronger the preferences assigned to investors, the lower would be the value of the equity shareholders.

Option pricing (Back Solve) model is applied in practice to derive the value of common stock based on the Price of Recent Investment of Preferred Stock.

VALUATION METHODOLOGY FOR EARLY STAGE START-UPS

Venture Capitalist/Exit Multiple Method

- Venture capitalist method is majorly used by venture capitalist looking for making investments in start-up companies.
- As start-ups are high-risk companies, investors expect higher returns.
- The exit method takes into account the current investment, the expected return, and the valuation at the time of exit to determine the current value of the company.

First Chicago Method

- The First Chicago method entails projections under three different scenario – success, failure and survival cases – and profitability estimates are assigned to each.
- This method results in a separate valuation and pricing for each outcome.
- These are then averaged and the weighted average valuation is determined (weights being the profitability assigned to each case).

Scorecard Method

- The scorecard valuation method is a more elaborate approach to the subject company valuation. It starts the same way as the First Chicago Method, i.e. by determination of a base valuation for the subject company and then adjusting the same value for the qualitative scores of management, traction, competitors, etc. The weighted average value is recommended as the value through scorecard methodology.

SPECIAL SCENARIO VALUATIONS

B) VALUATION OF DISTRESS COMPANIES

Distressed businesses often face Operational issues (Production issues, Supply chain mismanagement, Working capital blockage, Loss of key customers etc.), Financial constraints (High debt, Limited sources of funds, Overdue liabilities etc.), Loss of key people etc.

IBBI Regulations require Fair Value and Liquidation Value of the Assets of the Corporate Debtors. The stakeholders may unjustly liquidate a company if they use an inflated reference value for comparison with the value offered under resolution plans. Such decisions arising from use of inappropriate values, in addition to causing unfair gain or loss to parties, has the potential to distort market and misallocate resources which may impinge upon economic growth in a market economy.

VALUATION CHALLENGES

- High level of uncertainty (Risk) in sustaining business operations
- Non-availability of reliable data
- Requires greater due diligence of available data and underlying assumptions
- Quantification of Contingent Liabilities
- Premise of Valuation – Going Concern / Liquidation

CHOICE OF VALUATION METHODOLOGIES

- Distressed companies typically earn less than their cost of capital; thus, sale of their assets might earn more than the value of business.
- Cost of capital increases for distressed companies as the companies are seldom able to take tax benefits due to accumulated and recurring losses.
- The applicability of terminal value in a distress scenario is a question in itself as with negligible growth rate and high cost of capital, the terminal value comes insignificant.
- Non-availability of comparable companies.
- Enterprise Value is determined for distressed Companies rather than Equity Value as Value of Debt could be at significant discount to its book value.

The above factors lead to the asset approach being the preferred choice for the valuation of distressed companies. The value of inventory, debtors and unbilled revenue needs detailed verification as there are high chances of obsolete inventory and bad debts which can reduce the value significantly



SPECIAL SCENARIO VALUATIONS

C) VALUATIONS FOR PRIVATE EQUITY

Valuation for private equity purposes has inherent control characteristics as investors enter into private agreements with the companies and also get special information and rights including liquidation rights, Board seats, Veto powers etc.

Private equity Investors are required to carry out periodic valuations of Investments as part of their reporting process. International Private Equity and Venture Capital (IPEV) Valuation guidelines represent current best practice, on the valuation of private equity Investments in Debt and Equity instruments and their reporting at 'Fair Value' assisting the Investors to make better informed decisions.

IPEV Valuation Guidelines are applicable to Alternative Investment Funds (seed and start-up venture capital, buyouts, growth/development capital, credit etc.; hereafter collectively referred to as Private Capital Funds) and financial instruments commonly held by such Funds. They also provide a basis for valuing Investments by other entities, including Fund-of-Funds, in such Private Equity Funds.

These valuation guidelines are in sync with the Fair Value principles in IFRS and US GAAP as followed in financial reporting. It is further clarified that other jurisdictions that use a similar definition of Fair Value, such as "willing buyer and willing seller" may also find these Valuation Guidelines applicable.



M&A VALUATION - REGULATORY ASPECTS

To remain competitive in the market, the companies need to look at inorganic growth that can take them to the next level. Mergers and Acquisitions (M&A) play a crucial role in this aspect.

In the matter of Hindustan Lever Employees' Union v Hindustan Lever Limited and Others AIR 1995 SC 470, The Supreme Court of India held that, Jurisdiction of the Court in sanctioning a claim of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetical test. A company court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on fairness. It is not required to interfere only because the figure arrived at by the valuer was not as better as it would have been if another method was adopted. What is imperative is that such determination should not have been contrary to law and that it was not unfair for the shareholders of the company which was being merged. In case of amalgamation, a combination of all or some of the methods of valuation may be adopted for the purpose of fixation of the exchange ratio of the shares of the two companies. The Court's obligation is to be satisfied that valuation was in accordance with law and it was carried out by an independent body.

In case of a merger or amalgamation, the target or transferor companies are merged with the acquirer or transferee company. This requires the approval of National Company Law Tribunal (NCLT) in accordance with the applicable provisions of the Companies Act, 2013 and Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

A) MERGER / AMALGAMATION VALUATIONS

In case of valuation for merger or amalgamation, the emphasis is on arriving at the "relative" values of the shares of the transferor and transferee companies to facilitate determination of the "Equity Share Swap ratio". Hence, the purpose is not to arrive at absolute values of the shares of the companies. Real challenge in merger valuation is to have fairness to all shareholders, particularly where the shareholding pattern and shareholders vary between the transferor and transferee companies.

DEMERGERS

Demergers are another way to create value for shareholders of the companies. When multiple unrelated businesses are carried on in one company, the company carrying multiple unrelated businesses may not get the sum-of-the-parts (SOTP) valuation of individual businesses, which is how demergers helps in creating value as demergers result in independent business operations, management focus and more transparent financial reporting. However, holding company may or may not like to segregate its rights in the subsidiary company and all facts need to be individually evaluated. Some subsidiary companies may be highly leveraged and they may require assistance of the holding company and a full hive off may be difficult. In case of demerger, share entitlement ratio can be derived in lieu of share swap ratio.

SEBI REGULATIONS ON MERGER OR AMALGAMATION VALUATIONS

As per applicable SEBI Circulars, fair value of listed companies needs to be undertaken as per preferential allotment guidelines prescribed under the SEBI (ICDR) Regulations which state that the equity shares shall be allotted at a price not less than the higher of the following:

"Volume Weighted Average weekly high and low closing price over a trailing six month period, or a trailing two week period, from the "relevant date of transaction." The relevant date for this purpose is defined as the date of Board Meeting in which the scheme of merger is approved.

COMPUTATION OF FAIR SHARE EXCHANGE RATIO

VALUATION APPROACH	XYZ LTD	WEIGHT	PQR LTD	WEIGHT
	VALUE PER SHARE		VALUE PER SHARE	
Asset Approach	X	A	Y	d
Income Approach	X	B	Y	e
Market Approach	X	C	Y	f
Relative Value Per Share	X		Y	
Exchange Ratio (Rounded Off)			xx	

Note: Where any valuation approach has not been considered or applied by valuer, its reasons for not adopting particular approach also need be provided for in the valuation report.

Swap Ratio: x (xxx) equity share of XYZ Ltd of Rs 10 each fully paid up for every y (yyy) equity shares of PQR Ltd of Rs 10 each fully paid up.

FAIRNESS OPINION ON MERGER OR AMALGAMATION VALUATIONS

In accordance with SEBI Circular no CFD/DIL3/CIR/2017/21 dated 10 March 2017 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, the listed as well as the unlisted company getting merged shall each be required to obtain a 'fairness opinion' on the valuation of assets/equity shares done by the valuers from an independent merchant banker.

Essentially in case of fairness opinions, the merchant banker has to ensure that the public shareholders of listed companies are not affected due to this valuation. As market price for listed companies which are frequently traded is considered fair price, real challenge lies in value assessment for transferor companies which are unlisted companies. It needs to be verified that valuer has applied valuation methods on relative basis and the valuation is not biased in favour of shareholders of transferor companies.

B) ACQUISITIONS VALUATIONS

Acquisitions are good for the economy as it results in efficient allocation of resources. In case of an acquisition, the shares or business or assets of the target company are acquired by the acquirer.

The acquisition of shares of a listed company requires compliance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and that of unlisted company with Income Tax Law and RBI Regulations.

SEBI Regulations on Acquisition of Shares

SEBI Takeover code gets triggered when the shares of listed company get transferred beyond a threshold limit. It can also lead to change in control, thus requiring exit opportunity to the public shareholders by acquisition of their shares. For the purpose of determination of price of shares held by public shareholders, share valuation is required.

Under the SEBI Takeover Code, the shares are segregated based on their Trading volume into Frequently and Infrequently Traded shares.

Valuation of Frequently Traded Shares: The volume-weighted average market price of such shares for a period of 60 trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period.

Valuation for Infrequently Traded Shares: The price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies.

Income Tax Law on Acquisition of Shares

Valuation Methodologies prescribed-

Quoted Shares: Market price on recognised stock exchange on the valuation date or on a date immediately preceding the valuation date where on the valuation date there is no trading in such shares and securities on any recognised stock exchange.

Unquoted Equity Shares:

For Transfer of Shares of a closely held company, the rules have prescribed Adjusted Book Value method. The fair value of Land & Building, Jewellery, Shares & Securities and Artistic property needs to be undertaken for this purpose. In this methodology, the value of investments in shares is to be undertaken based on Net Assets Value in all underlying companies, down the line which makes it a detailed process, specifically for Investment/Finance companies.

For Issue of Shares of a closely held company, the valuation of business is to be done as per Discounted Free Cash Flow (DCF) or Net Asset Value (NAV) method or value as may be substantiated by the company to the satisfaction of the AO based on the value of its assets including intangible assets. The valuation is to be done exclusively by SEBI-registered category I merchant banker in case of application of DCF method.

Unquoted Shares (other than equity shares): Price it would fetch if sold in the open market as per any valuation methodology can be applied which can be substantiated.

COMPANY LAW ON ACQUISITION OF SHARES

In case of Fresh Issue of Shares, Valuation shall be done by Registered Valuer in accordance with the Companies (Registered Valuers and Valuation) Rules, 2017.

However, for preferential allotment of shares of listed companies, Preferential issue guidelines of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 need to be followed.



C) PURCHASE PRICE ALLOCATION ACCOUNTING FOR FINANCIAL REPORTING

Purchase price allocation ("PPA") is an exercise where the acquirer allocates the purchase price paid to the acquired assets and liabilities of the target company. PPA is carried out by the Acquirer for accounting and financial reporting under Ind AS 103 which requires all business combinations (except group consolidation) to report the Fair Value of assets (tangible and intangible assets) and liabilities acquired in their financial statements. PPA is also required for allocation of consideration paid in a 'Slump sale'/ 'Slump exchange' transaction. PPA process allocates the purchase consideration paid for acquisition of an entity / business to the Fair Value of tangible and intangible assets acquired and liabilities assumed. Intangibles need to be separable and identified based on their unique characteristics. PPA is a complex process and involve identification, measurement and valuation of intangible assets requiring an in-depth knowledge of the acquired business and its key value drivers as well as knowledge and experience in the application of various valuation approach and methodologies.

There are five major types of intangible assets and valuation methodologies vary for each of these methods. The remaining amount which cannot be apportioned to the respective Tangible and Intangible Assets forms part of Goodwill.

S. NO.	NATURE OF INTANGIBLE ASSET	MAJOR CONSTITUENTS
1	Marketing-related	Brand, Trademarks, Trade names, Internet domain names, Non-Compete Agreements
2	Customer-related	Customer lists, Backlog, Customer contracts
3	Artistic-related	Plays, books, films and music, etc
4	Contract-related	Licensing and royalty agreements, Service or supply contracts, Lease agreements, Permits, Broadcast rights, Servicing contracts, Employment contracts & Non-Compete agreements and Natural Resource rights
5	Technology-based	Patented technology, Computer Softwares, unpatented technology, Databases

The most commonly applied valuation methods for Intangibles are Royalty Relief method (for Brands and Trademarks), Multi-period excess earning method (for Customer relationships), Assembled Workforce (Cost method) and With or Without DCF methods for Intangibles in general.



CONCLUSION

Valuation is thus an integral part of any transaction. The depth of analysis is most important in any Valuation engagement and the ability of the Valuer to follow the complete valuation process right from understanding the purpose of valuation, seeking relevant information requisition (and follow on questions) from the company, performing financial analysis and normalization adjustments, understanding industry characteristics and trends, forecasting and reviewing company performance, considering and applying appropriate valuation methodologies to performing scenario analysis, value adjustments, documentation and reporting. Needless to say that the experience of the valuer plays a crucial role in reviewing the company's financial model, selection and application of appropriate valuation methodologies and value conclusion after suitable discounts and premiums. Independent valuations are thus essential for the efficient working of the markets, businesses, government and all its stakeholders.

It is stated that even though the Indian Valuation Standards are under formulation the global valuation standards (including IVSC valuation standards) already exist. The global valuation standards guide us that the Law of the Land overrides the Valuation Standards so, in case of conflict, the Regulatory provisions override the valuation standards and also the commercial understanding of the parties.

A low-angle, black and white photograph of several tall skyscrapers reaching towards the sky. The perspective creates a sense of height and scale, with the buildings' facades and structural details clearly visible. The sky is a uniform light gray, providing a stark contrast to the dark, detailed buildings.

M&A/PE TRANSACTION TRENDS

M&A / PE TRENDS

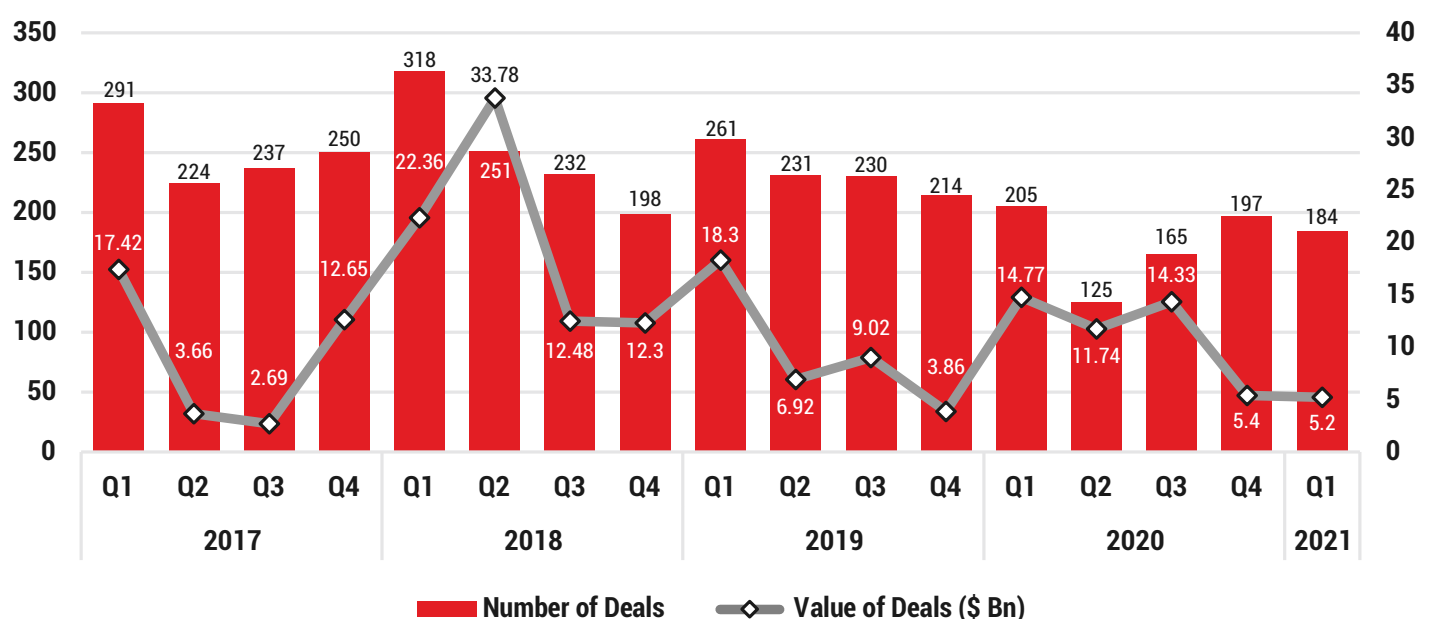
The M&A activity has picked up after the sharp decline last year, which mainly was due to COVID onset. The deal activity has started to improve in the last few quarters of 2020 but again after the initial pick up, Q1 2021 saw activity decline both in terms of the number of deals and value of the deals. The number of deals YoY declined by 10.24% but in value terms, they declined 65%, this was mainly due to Jio platform investments in Q1 2020 leading to a higher value in Q1 2020, the Q1 2021 was more of mid-segment deal activity in the \$25-\$50MN space.

The activity in Q2 2021 has again picked up pace in terms of the size of deals with Piramal Group and Adani Group leading the deals space with the acquisition of DHFL and SoftBank Energy respectively.

KEY LEARNINGS (2020 & Q1 2021)

- Amongst deals with disclosed deal value, several deals with a deal value ranging between \$25 mn and \$50 mn witnessed the highest improvement in activity during Q1 21 with a rise both in terms of numbers of deals and value by 83% and 85% YoY.
- The mean value of the deal in 2020 was significantly higher as compared to 2019, but the same declined during Q4 20 and Q1 21. The Jio platform was the main reason for the higher mean value during the First Three Quarters of 2020, where the investors poured in almost \$10.2Bn.
- In terms of volume during Q1 21, Energy, Information Technology and Utilities have emerged as the top gainers where Information Technology and Utilities witnessed a rise in deal activity by 40% and 31%, especially the Energy sector which experienced a boom of 2x in deal activity on Y-o-Y basis.
- The domestic deal activity continues to be strong on the back of domestic businesses buying the assets of other groups facing the cash crunch due to COVID. Amongst the largest M&A deals witnessed in 2020 Reliance Retail buying the Future Group for \$3.3Bn.

DEAL ACTIVITY



Source: VC EDGE

RECENT DEALS IN Q1 2021

SECTOR	DATE	BUYER	SELLER	AMOUNT
				(USD M)
Financials	Mar-21	SBI Cards and Payment Services Ltd.	Carlyle Asia Partners	542
Industrials	Mar-21	Gangavaram Port Ltd.	Warburg Pincus India Pvt. Ltd.	265.5
Consumer Discretionary	Feb-21	Crompton Greaves Consumer Electricals Ltd.	Advent International Corp	204.5
Materials	Jan-21	Indigo Paints	Sequoia Capital India	87.1
Financials	Jan-21	Home First Finance Company India Ltd.	Bessemer Venture Partners, True North Fund	77.92
Financials	Mar-21	India Shelter Finance Corporation Ltd.	Sequoia Capital India	60
Financials	Jan-21	IDFC Ltd.	Khazanah Nasional Berhad	48.5
Consumer Discretionary	Mar-21	Manash Lifestyle Pvt. Ltd.	IvyCap Ventures	44.7
Consumer Discretionary	Feb-21	Stove Kraft Ltd.	Sequoia Capital India	39.5
Consumer Staples	Feb-21	Bajaj Consumer Care Ltd.	Temasek Holdings	34.2

Source: VC EDGE

OUTLOOK

We expect the M&A activity to continue to rise in the country supported by the domestic deals, as the larger companies are looking to buy/ invest in startups related to their product line, we expect to see more activity in the FMCG space as some of the new companies have managed to achieve more than USD 5-7MN in revenues very quickly (less than 3 years), these would be an acquisition/investments targets for the bigger brands. We also expect to see a rise in M&A activity in the sectors hit badly by the COVID, mostly related to travel, offline retail etc.

THE UPSURGE IN STARTUP FUNDING IN THE RECENT PAST

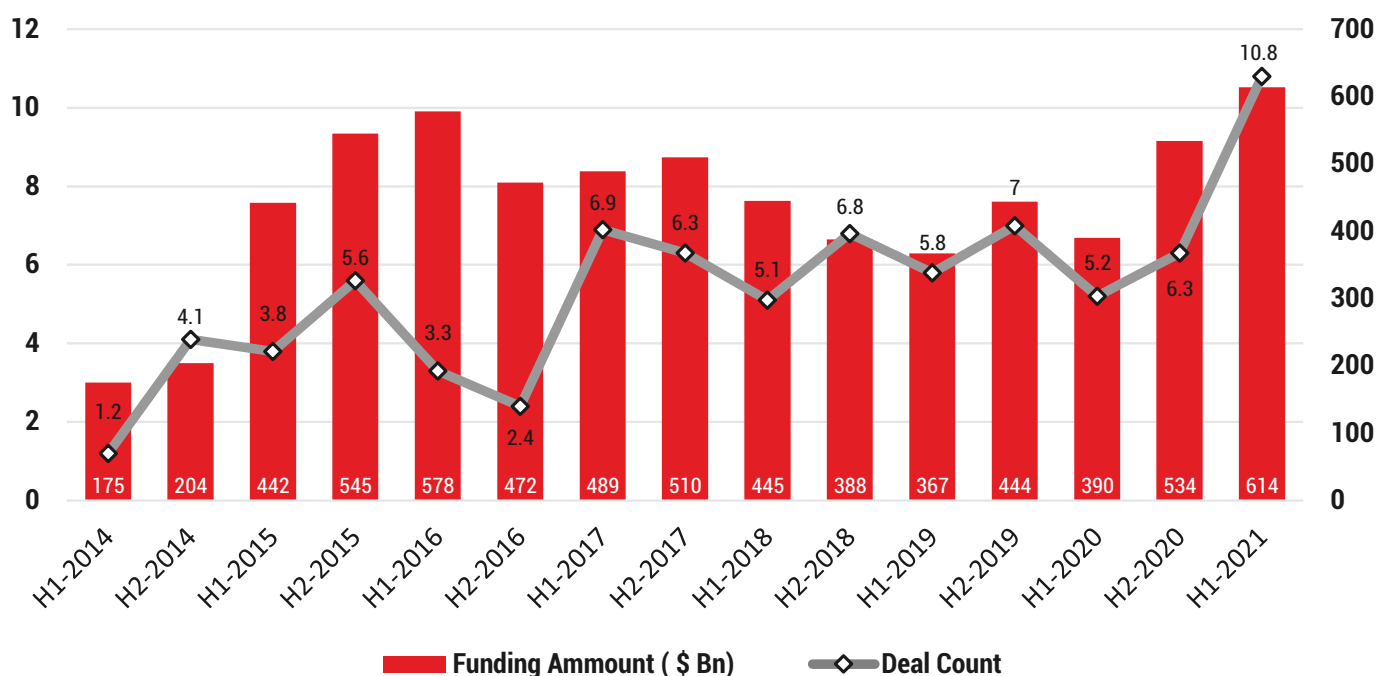
The COVID Push

The Indian Startup ecosystem has seen funding acceleration in the recent past, which is largely driven by the cheap money coming from the quantitative easing led by the US and European governments and the COVID push in digital adaption.

After the onset of COVID, the H1 2020 had been very tough for the Startups in terms of funding with little clarity on the expected impact of COVID on the businesses, but the situation has benefitted the tech-based companies which saw a huge acceleration in growth in terms of the number of users and revenues.

This has led to investors pumping in billions of dollars in the startups focused on tech. In the first six months of H1, 2021 Indian Startups have cumulatively raised \$10.8bn which is more than the money raised in the whole of 2020.

The Indian Startup ecosystem has also seen the return of the largest tech investors including Tiger Global and SoftBank, which have led the mega funding rounds in the growth stage startups.



Note: Data till June 26, 2021

Source: Inc42 Plus

PE KEY DEALS: Q1, 2021

SECTOR	DATE	BUYER	SELLER	AMOUNT
				(USD M)
Information Technology	Mar-21	Think and Learn Pvt. Ltd	Arison Holdings Ltd., B Capital Group Partners L.P., Baron Global Advantage Fund, MC Global Edtech Investment Holdings LP, TCDS India LP, XN Exponent Holding Ltd.	457.5
Information Technology	Mar-21	Sporta Technologies Pvt. Ltd	Steadview Capital, Tiger Global Management, TPG, Chrys Capital, Footpath Ventures, TCMI, Inc., D1 Capital Partners L.P., Falcon Edge Capital	400
Financials	Feb-21	Altico Capital India Ltd.	Ares Management	380
Consumer Discretionary	Mar-21	BrainBees Solutions Pvt. Ltd.	TPG Growth V LP, Premji Invest, Chrys Capital Investment Advisors India Pvt. Ltd.	313
Information Technology	Jan-21	Trustroot Internet Pvt. Ltd	Altimeter Capital Management, GGV Capital, DST Global, Lightspeed India Partners, Tencent Holdings Ltd., Octahedron Capital Management	280
Information Technology	Feb-21	ZCL Chemicals Ltd	Advent International Corp.	273.69
Information Technology	Feb-21	Zomato Pvt. Ltd	Tiger Global Management, Kora Investments I, Bow Wave Capital Management, Dragoneer Investment Group, FMR LLC	250
Financials	Mar-21	Five Star Business Finance Ltd.	KKR Global Impact Fund, Sequoia Capital India, Norwest Venture Partners, TVS Capital	234
Healthcare	Feb-21	Indegene Pvt. Ltd.	Carlyle, Brighton Park Capital	200
Information Technology	Feb-21	Finnovation Tech Solutions Pvt. Ltd	Mirae Asset, PremjiInvest, Arkam Ventures, Alpine Capital, NewQuest Capital Partners, Mope Investment Advisors .	145

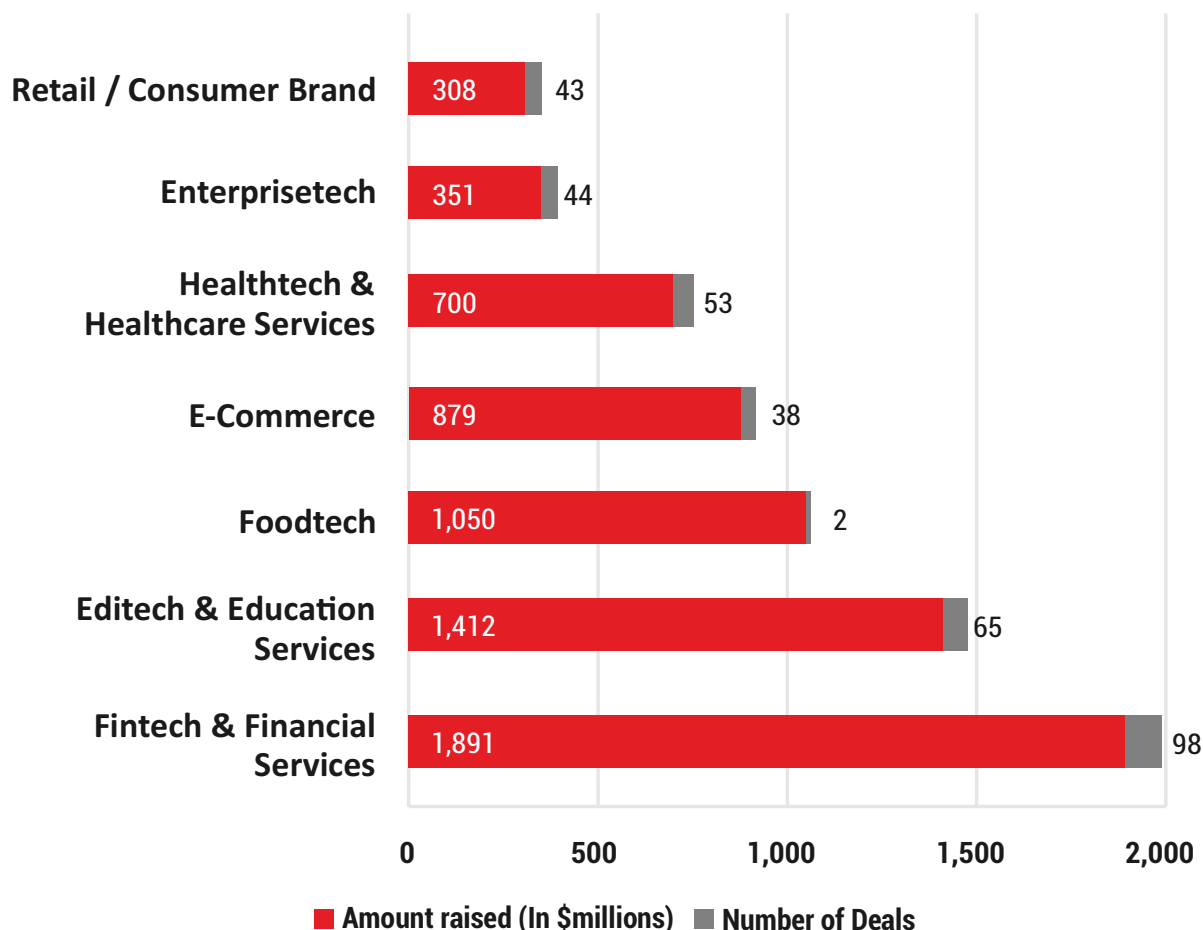
Source: VC EDGE

THE UPSURGE IN STARTUP FUNDING IN THE RECENT PAST

Sector-wise Activities

Edtech and Fintech sectors have grabbed most of the funding in the first half of the H1 2021, as these were the two main beneficiary sectors along with E-commerce and Foodtech which got the largest boost from COVID. The COVID has jumped forward the digital adoption for at least 2-3 years. We continue to believe the growth in these sectors will continue as they are still a fraction of the overall market, we believe some of these companies have the capability of expanding their services in the overseas markets.

H1 2021 Sector-wise Funding Activity



Source: YourStory Research

OUTLOOK

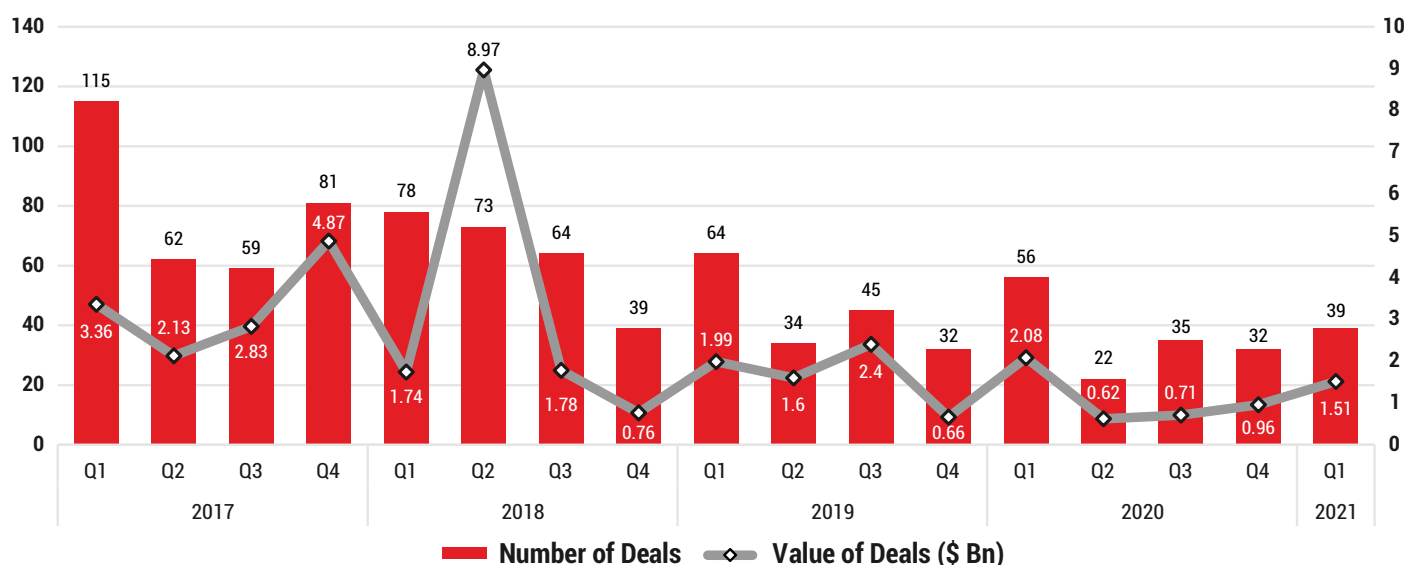
We expect the Startup ecosystem continue to boom in India in the coming years, there would be ups and downs in the way, but Indian entrepreneurs will continue to build stronger companies for the future year. We expect the activities across all the segments to rise as more money is getting invested in the new-age companies. We will see funding activity pick up in new sectors like deep tech, space tech as the investors have raised money to back the new age innovators.

The EXIT Activities

Private Equity Exit activity and value showed an increase of 22% and 57% respectively when compared to Q4 2020. However, exit trends hit their five-year low both in terms of activity and exit value, on a Y-o-Y basis. The reason is investors are becoming more furious to unlock their current investments, as current market conditions are not favorable for the return they are looking for on their investments. As the whole market scenario has been changed due to COVID-19

PE Exits: Decline in Activity

Deals Overview



Source: VC Edge

However, as the Indian startups are gearing up to provide the exit to the investors through listing on the Indian stock exchange which is being considered as a watershed moment for the Indian Startup ecosystem. The EXIT is one of the most important parts for the growth of any Venture Capital-backed ecosystem, as Venture firms investing in any country must eventually show that their investments in the country result in actual cash returns rather than just other investors marking up their investments.

OUTLOOK

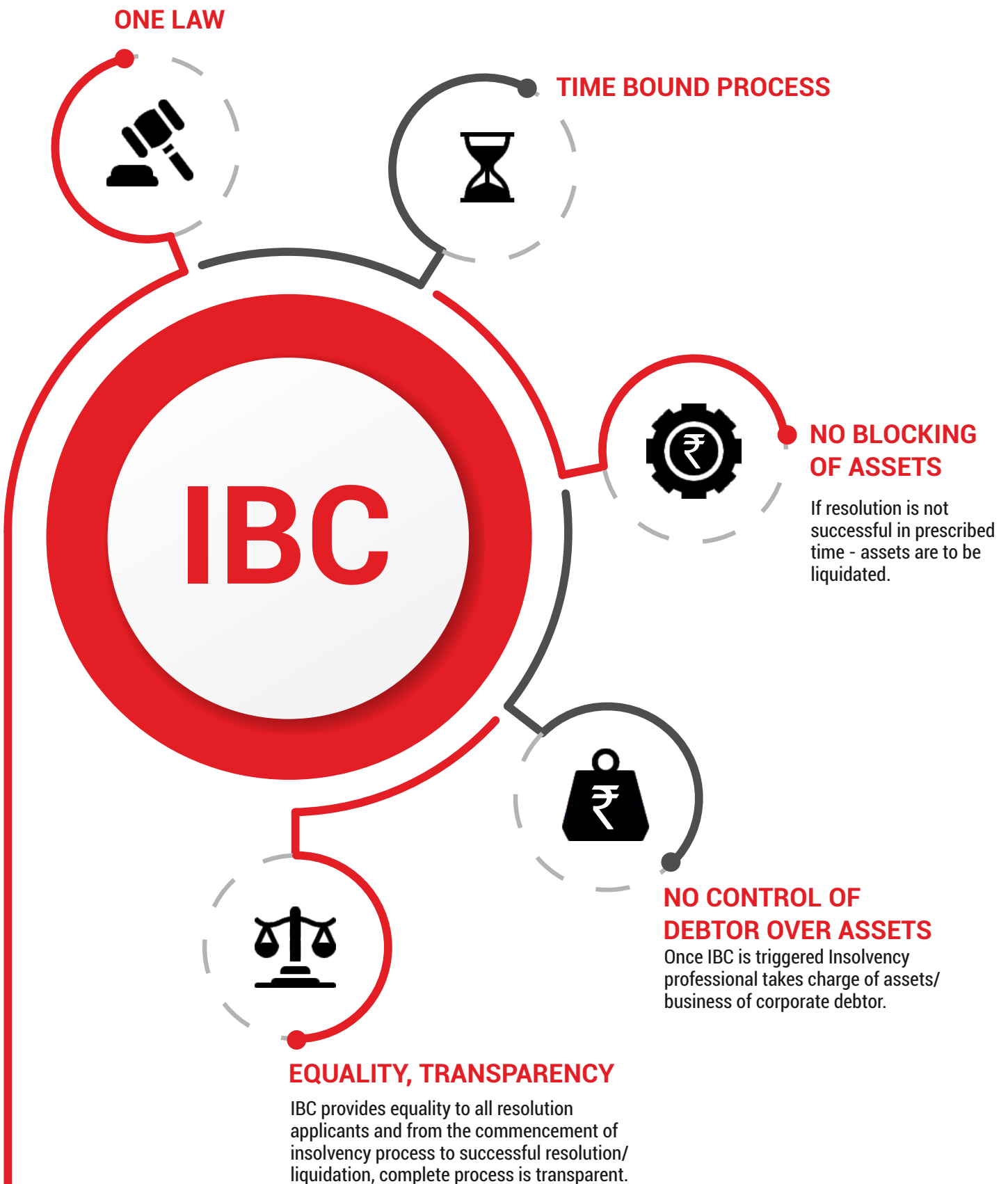
The recent listing of Zomato paves the way forward for the next generations of startups to list on the Indian stock exchanges. We will soon see more start-ups like Paytm, Mobikwik, Nykaa line up for listing. We also expect the consolidation to continue in the sector like ed-tech which has seen a large amount of funding across various startups which will also provide the exit to the investors.



A hand is shown holding a large, textured coin, possibly a commemorative piece, over several stacks of smaller, standard coins. The scene is set against a dark, blurred background, creating a sense of depth and focus on the currency. The lighting highlights the metallic surfaces of the coins.

IBC TRANSACTION TRENDS

KEY FEATURES OF IBC



DIRECT & INDIRECT IMPACT OF IBC

Direct Impact

The table below exhibits the performance of NPA resolution since the inception of IBC:

Year / Quarter	Admitted	Closure by	CIRPs at the end of the Period	Year / Quarter	Admitted	Closure by
		Appeal/ Review / Settled	Withdrawal under Section 12A	Approval of Resolution Plan	Commence -ment of Liquidation	
2016 - 17	37	1	0	0	0	36
2017 - 18	706	94	0	20	91	537
2018 - 19	1156	149	97	79	305	1063
Apr - Jun, 2019	301	53	32	26	96	1157
Jul - Sep, 2019	596	57	51	34	156	1455
Oct - Dec, 2019	637	114	60	42	153	1723
Jan - Mar, 2020	444	95	58	39	137	1838
Apr - Jun, 2020	84	13	27	20	26	1836
Jul - Sep, 2020	96	25	35	35	81	1756
Oct - Dec, 2020	107	8	30	24	83	1718
Jan - Mar, 2021	212	8	21	29	149	1723
Total	4,376	617	411	348	1,277	1,723

In the span of 4 years, apart from successful resolutions, IBC implementation has encouraged corporate debtors to opt for settlements with their creditors due to fear of losing control of their businesses. Of the total 4,376 admitted cases, 617 cases, i.e. 14% cases are under appeal/review/settled while 411 cases, i.e. 9% have been withdrawn under section 12A.

Indirect Impact

IBC has proved to be a potent tool for bad loan resolution as debtors have started settling their dues with the creditors prior to admission via NCLT for debt resolution. More than 14,000 cases involving defaults in excess of Rs. 5 Lakh Crore were withdrawn by July 31st 2020 from various branches of NCLT before applications were admitted.

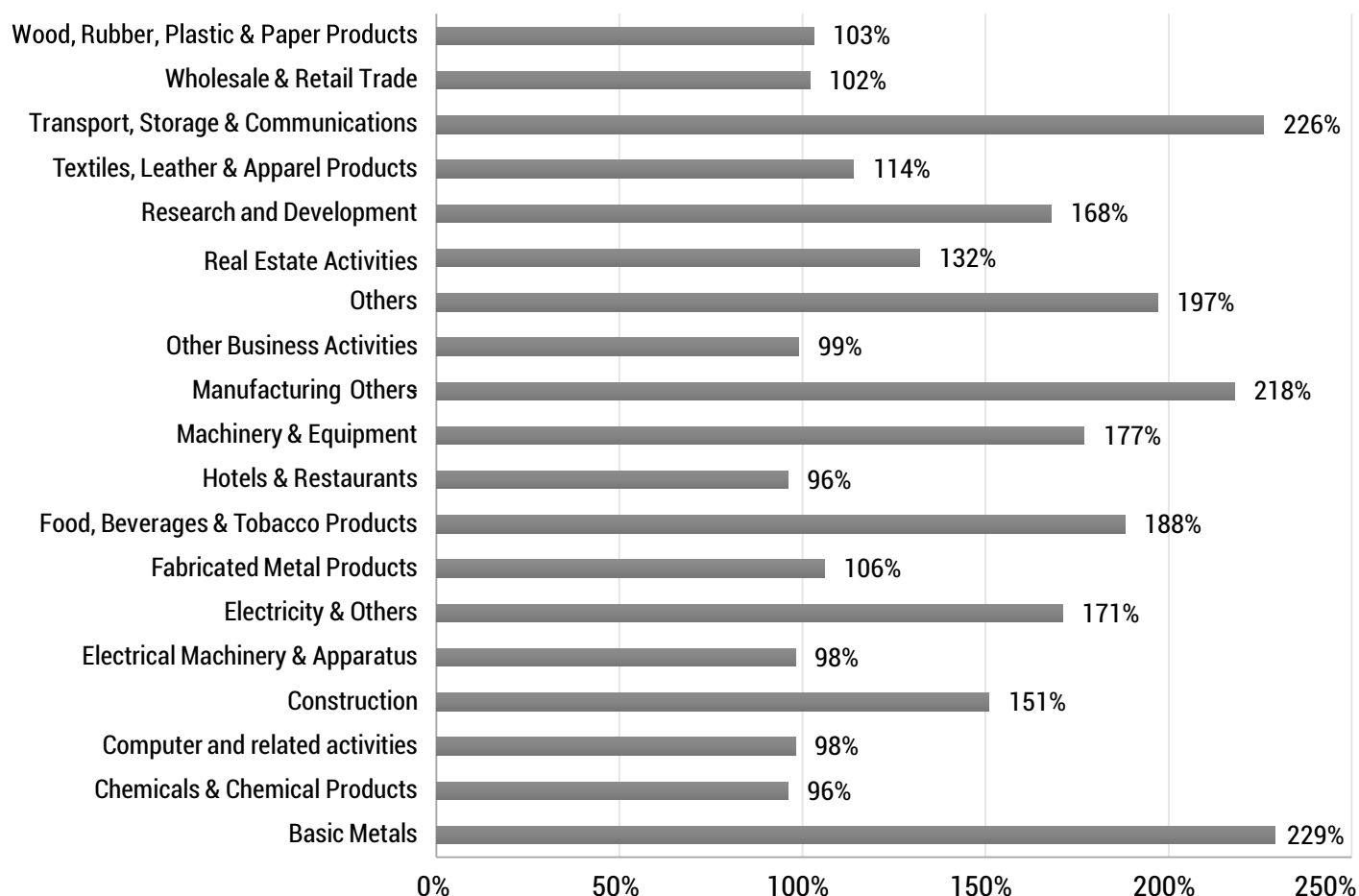
Liquidation Value Vs Realizable Amount

Liquidation value is the average of the liquidation values estimated by the appointed registered valuers under CIRP.

Summary of Liquidation Value generated against submitted Realizable Amount offered is tabulated below:

Sectors	Number of Companies	Liquidation Value (Rs. in Cr)	Realizable Amount (Rs. in Cr)	Ratio of Realizable Amount to Liquidation Value (%)
Basic Metals	47	51,402	1,17,816	229%
Chemicals & Chemical Products	22	1,781	1,709	96%
Computer and Related Activities	02	4,342	4,273	98%
Construction	32	23,148	35,057	151%
Electrical Machinery & Apparatus	05	124	122	98%
Electricity & Others	14	3,240	5,528	171%
Fabricated Metal Products	06	447	475	106%
Food, Beverages & Tobacco Products	27	3,494	6,572	188%
Hotels & Restaurants	12	585	560	96%
Machinery & Equipment	14	710	1,253	177%
Manufacturing-Others	18	4,650	10,124	218%
Other Business Activities	29	1,172	1,160	99%
Others	27	1,709	3,373	197%
Real Estate Activities	09	1,058	1,397	132%
Research and Development	01	19	32	168%
Textiles, Leather & Apparel Products	20	5,772	6,564	114%
Transport, Storage & Communications	12	4,313	9,749	226%
Wholesale & Retail Trade	19	2,538	2,596	102%
Wood, Rubber, Plastic & Paper Products	26	1,701	1,751	103%
Total	342	1,12,205	2,10,112	

Ratio of Realizable Amount to Liquidation Value



Sector-wise Ratio of Realizable Amount to Liquidation Value



The sectors such as "Basic metal", "Transport, Storage and Communication" and "Manufacturing others" saw high interest by Resolution applicants offering a substantially higher Amount (200% and above) as compared to its estimated Liquidation Value.

Conclusion

Since the law was enacted in 2016, IBC has become a chosen option for resolution of Non-Performing Assets. Compared to other mechanisms for debt recovery like DRT, CDR, SARFAESI Act etc., IBC is proving to be a better tool for debt recovery. Though there were delays in resolution of the bad loans, but they were initial hiccups and can be treated as teething troubles as the IBC law is only 4 years old and still evolving.

The resolutions in IBC were sector agnostic wherein about 72.76% (Rs. 1,52,873 crores) of the total Realizable amount was contributed by the "Basic Metals" and "Construction" sectors. Moreover, Rs. 1,77,418 Crores out of the total realizable amount of Rs. 2,10,112 Crores was contributed by the top 31 companies.

The CIRPs yielding resolution plans have been realizing on average, 190% of the liquidation value of the existing assets, for its creditors.

Though IBC is still in its initial stage, this law has already resulted in encouraging financial discipline and inducing bad debtors to pay off their debt.

With continuous improvement of IBC Laws and with the feedback from all stake holders and resolution in timely manner, IBC in the long run can lead to ease of doing business in India and can be a vital tool in the future for not only bad loan Resolution but also for business re-organization.



A grayscale photograph of a legal desk. In the foreground, a hand holds a pen over a document. To the right, a gavel and a scale of justice are visible. The background shows a stack of books and a lamp. The text "LEGAL & REGULATORY" is overlaid in the center.

LEGAL & REGULATORY

M&A Deal Structure, Legal & Documentation Issues

OVERVIEW

M&A transactions are financial transactions critical for strategic growth of Companies and involves various structures, timelines and outcomes. Prevalent economic, legal, social and political environment plays an important role in shaping, strategizing, negotiating, consummating and integrating any Merger and Acquisition Transactions.

M&A Transactions are always complex in nature and requires great amount of planning, strategizing and careful negotiations to close them successfully. Various legal and technical factors are required to be considered which requires expert assistance to minimize risks and enhance economic viability and success ratio.

M&A industry around the globe has seen several ups and downs and the ongoing COVID-19 pandemic has not left it untouched. Although after initial setback, Covid-19 has created several transaction opportunities especially in the sectors that remained insulated or thrived during the pandemic, like pharma (Reliance Retail acquisition of Netmed), information technology (Facebook investment in JIO), data services etc. and the sectors which were significantly impacted like retail, opened options for consolidation and expansion at lowest valuations (Reliance acquisition of Future group, ITC acquisition of Sunrise).

For any M&A transaction to be successful,

An M&A transaction involves many steps and take anywhere from 6 months to several years to conclude. Once a target entity is identified and initial contacts and conversations goes well and valuations agreed upon, further critical points and crucial elements of the proposed deal should be discussed, deliberated and agreed at the initial stage only, for the proposed transaction to be successful.

This article deals with the key stages through which a deal goes through post initial closing-in and the major issues to be dealt in during these stages which need deliberation and detailed discussions encompassing the following:

- 1. Finalization of Deal Structure & Consideration Payout**
 - 1.1. Suitable Deal Structure
 - 1.2. Mode of Payment : Cash or Equity
 - 1.3. Timing of Payment / Escrow modalities
- 2. Undertaking Financial, Legal and Commercial Due Diligence**
- 3. Execution of definitive Agreements.**
 - 3.1. Sellers' / Target Company's Representation and Warranties
 - 3.2. Indemnification by Seller / Target Company
 - 3.3. Liability - Joint or Several
 - 3.4. Non-compete and Non-solicitation

1. FINALIZATION OF DEAL STRUCTURE & CONSIDERATION PAYOUT

One of the most crucial and complicated steps in the M&A process is properly structuring the deal and payout modalities. There are many factors to be considered, such as applicable laws, tax implications, forms of financing, approvals required etc. Following are the widely available structures and issues needing deliberation at the initial stage of structuring and finalizing:

1.1. Suitable Deal Structure

Deal Structure is fundamental for any transaction and many deals are called off right after initial negotiations because parties fail to decide upon a mutually agreeable deal structure. In a Transaction landscape, there are three possible ways to structure a deal i.e. Asset Acquisition, Share/Stock purchase, and Merger between two or more organizations.

- **ASSET ACQUISITION:** Under asset acquisition way of transaction, the acquirer purchases the assets of the target company and is considered best deal structure if seller prefers cash transaction. Herein, acquirer has flexibility to choose which assets it wants to acquire and which not and the selling company can choose to continue as the corporate entity even after sale along with unsold assets and liabilities. Although in case of Asset acquisition, the acquirer is unable to acquire non-transferrable assets like goodwill and the transaction may also subject both acquirer and seller with higher tax obligations.
- **STOCK /SHARE PURCHASE:** In Stock purchase, instead of assets, target company's shares, either all or majority, are acquired by the acquirer. This is to say that the control of target company's assets and liabilities are acquired through share purchase transaction. In case of share purchase, the tax implications are minimized (especially for the seller). The share purchase transactions are less time consuming in terms of negotiation and conclusion, although in case of any uncooperative minority shareholder, it can derail the process or can even prove to be a deal breaker.
- **MERGER:** In contrast to the acquisition, merger or merged entity is a result of an agreement between two separate corporate entities to come together (amalgamate) and emerge as new consolidated entity. Merger is less complicated in comparison to other transaction methods although in case of Merger, all the liabilities and assets of the transferor company becomes that of Transferee Company.

The acquirer and target company have varying and conflicting legal interests and considerations qua each proposed structure. It thus become imperative to identify and address key issues while negotiating a specific deal structure.

Some initial discussion points which enable parties to decide their deal structure can broadly be classified as: (i) Transfer of Liabilities, (ii) Existing Contracts, (iii) shareholder's approval, and (iv) tax consequences as discussed below:

i. Transfer of Liabilities

Under a share purchase, the target company's liabilities continue with the target company by operation of law, unless contractually negotiated and sellers agree to indemnify. Similarly, the surviving entity i.e. the transferee company in merger will assume by operation of law all liabilities of the other entity. However, in an asset sale, basis the negotiations, parties can decide amongst themselves the treatment of liabilities and there is no statutory obligation. Thus, only those liabilities that are designated as assumed liabilities are assigned to the acquirer while the non-designated liabilities remain obligations of the seller.

ii. Existing Contracts

Target Companies existing contracts may have several kinds of restrictions and parties need to review and understand these contracts carefully before finalizing the structure of deal. The restriction on assignment may require incorporating a pre-closing condition in case of asset purchase although in case of share purchase or merger, assignment restriction may not apply unless there is specific restriction on assignment upon change in control or by operation of law, respectively.

iii. Shareholder's Approval

The parties have to evaluate and assess the requirement of shareholder's approval as per the applicable regulatory provisions. It is also to be assessed that where shareholders' approval is required, whether parties to the transaction can obtain such approval with ease or may face challenges with respect to minority shareholder approval. In case of asset sale, board of directors of the sellers can grant approval for asset sale without obtaining shareholder's approval if the corporate limits so permits. In case of Share Purchase, if seller is a body corporate, shareholder approval may be required and likewise in case of mergers again approval of the shareholders of both the entities are to be obtained.

iv. Tax Consequences

While determining a deal structure, assessment of probable tax liability on the proposed structure is quintessential. The applicable tax liability may break or make a deal. Generally in case of asset purchase, the seller is subject to capital gain tax although in case of slump sale, exemptions can be availed. In case of share purchase, transactions if executed at value lower than, fair value may result in taxability in hands of both seller and buyer. As per existing provisions of taxation, capital gain is exempted in case of merger transactions if in compliance with applicable provisions.

1.2. Mode of Payment : Cash or Equity

The method of payment as against the proposed transaction is also one of the decisive factor for both the parties to close a deal. The two most prevalent payment modes are either cash or equity.

- **CASH** : the easiest way to make payment is through Cash. It is most liquid and least risky and there is no doubt as to the true market value of the receivables. Cash deal can easily outbid an equity or other than cash deals. The cash deal may be beneficial to seller but buyer has to ensure several factors like, its cash surplus, working capital requirements, availability of credits/loan etc. and can impact acquirer capital structure or debt rating.
- **EQUITY** : Another manner of making payment for a transaction is by way of equity of the acquirer, issued to seller or the shareholder of the seller at a determined value and in ratio relative to the target company value. The issuance of equity benefit acquirer by improving its debt rating and reducing cost for future debt financing. However, other factors like deal structuring, need of shareholders approvals, statutory approval, etc. will be needed. Although despite need of various approval, issuance of equity provide more flexibility in terms of deal structuring.

1.3. Timing of payment/escrow modalities

Initial deal discussion and negotiation should clearly indicate any contingency to be factored in the payment of the purchase price of the transaction, including provisioning any escrow. Parties may negotiate and decide that a part of the total purchase price amount is held in an escrow to provide recourse for an acquirer in the event there are breaches of the representations and warranties made by the target company or upon the occurrence of any contingent event or liability. Although escrows are standard in M&A transactions, the terms of an escrow vary significantly. The amount of consideration to be kept in escrow as well as the escrow period will vary from case to case and depend upon the negotiations between the parties. Negotiations can also break down on the composition of the escrow- whether it will be all cash, only stock or a combination of both.

2. DUE DILIGENCE

Due Diligence is a process of verification, validation and investigation of relevant facts and information of the Target Company. Due Diligence enables the acquirer to take an informed decision and to assess the nature and extent of the seller's contingent liabilities, problematic contracts, pending litigation, intellectual property issues, etc. and reduces the risk of the acquirer. With ever changing economic dynamics, evolving legal environment and increased dependency on information technology and data, it has also become pertinent to investigate financial statements, issues of data breach and cyber security, compliances under employment laws and ensuring no labor unrest including sexual harassment liabilities etc.

Specialized diligence activity is required where Target Companies are working in regulated industries like telecom, banking, insurance and financial sector etc. In case of listed companies, compliances of securities regulator and stock exchange rules and regulations are also needed.

Summarized herein below are the most significant financial, legal and business due diligence lookout points:

i. Financial Matters

The Acquirer to assess all the Seller's historical audited financial statement (for past 3 to 5 financial years) and any observation of auditor on the going concern status of the entity. To evaluate other related financial matters as well as reasonableness of the target's projections of future performances; status of internal control over financial reporting; working capital requirement to continue running the business and estimated capital expenditure and other investment needs for the growth of the business. To consider the condition of tangible assets and liens thereof (if any). Status of indebtedness and guarantees, receivables, doubtful accounts and aging of receivables etc. Assessment of any related party transactions in the past are also to be made.

ii. Technology and Intellectual Property

The nature and quality of Intellectual property of the Target Company plays important role in decision making by the Acquirer. The due diligence to ensure the persistence of domestic and international Patents, available trademarks, the steps taken by the seller to protect its IPRs, dependency of seller's business on IPRs. It is also necessary to ascertain whether seller is infringing anyone else's IPR or if its own IPRs being infringed and actions taken by seller to protect the same. The technology being used by the seller, the licenses available for the same, whether the licenses upto date.

iii. Material Contracts

One of the most critical component of due diligence is to review all the existing contract and commitments of the target company. It is important to review all the guarantees, loans and credit agreements, contracts with customers, suppliers, dealers and distributors, any subsisting joint venture, partnership, share purchase, shareholder agreements; any indemnification agreement, employment agreement, exclusivity agreement, lease agreements etc.

iv. Labor, Employee and Management Issues

Workforce is quintessential for every Organisation. It is important for acquirer to understand the quality of Target Company's management including the Organisation structure and biographical information. The effectiveness of sexual harassment and discrimination policies and any pending disputes/issues thereunder. Summary of all past and present labor disputes including any specific lockdowns and slowdowns and their frequency. The Human Resource policy and other employment policies. Compensations, bonuses, accrued and unpaid incentives etc.

v. Litigations

It is essential for acquirer to understand, assess and evaluate all the filed/ ongoing or threatened litigations, arbitrations, claims and disputes in the target company, their possible outcome and future estimated liabilities and any existing insurances covering such claims.

vi. Cyber Security and Data Privacy

It has become increasingly important for an acquirer to fully investigate and enquire into any probable cyber security or data privacy risk and liabilities posed thereof. It is essential to review target company's privacy policies (existing and past), information security policies, data classification policy, data protection procedure if any etc.

vii. Taxations

Tax diligence (both direct and indirect) is one of the most critical aspect for any acquirer and it is imperative to assess historical and present tax liabilities, carryforwards, refunds etc. Any pending notices, tax litigations and probable contingent liabilities and withholding tax compliances by the companies.

viii. Insurance

In any acquisition, acquirer will want to undertake a review of key insurance policies of the target company to assess coverage, pending claims and claim history of various nature, including asset insurance, general liability insurance, director responsibility insurance, cyber security insurance, employees general and health insurances, key man insurances, worker's compensation insurance etc.

ix. Corporate Records

For a body corporate, it is crucial to maintain all organization documents and corporate records in good and proper condition. Some of the records like charter documents, shareholding records, minute books (shareholders and directors) are to be maintained since inception and some like financial books, tax records have to be saved and kept for such number of years as prescribed under applicable statutes. These records are necessary to be reviewed and assessed carefully to ensure that actions of the company are duly validated and recorded any future risk in this respect can be mitigated.

x. Legal Compliances and Filings

It is also important for an acquirer to assess the extent of statutory compliances the entity is subjected to and the status of compliances and future contingencies (for non-compliance, if any). For a company or LLP registered in India, it is quintessential for its operations to be in compliance with provisions of Companies Act 2013 or LLP Act 2008. Other compliances and reporting's under other statutes including Taxations (direct and indirect), labor law approvals and compliances (now replaced with new labor codes of 2019 and 2020), approvals and filings under environment laws and other sector specific laws (telecom, aviation, insurance etc.). In case of listed companies, compliances under Securities Regulator (SEBI) and Stock Exchanges are also to be ensured. Any non-compliance can result in heavy monetary and non-monetary penalties and have to be accounted in by the acquirer before formulating any decision.

xi. Environmental Issues

Regulators as well as public at large is becoming more and more cautious of environment and impact of industrial establishment on the surrounding environment. Therefore it is becoming increasingly important to ensure that there are no existing or prospective environmental issue which target company may face. Apart from the necessary approvals, permits and licenses needed under various applicable environment laws which must be ensured to be in place and valid, it is also essential to ascertain any future risk involved with respect to the hazardous substances being used, any contractual obligations relating to environmental issues, sensitivity of the people residing in the proximity, pending indemnification etc.

xii. Properties

Land and building whether owned or leased are quintessence and elemental to the businesses. It is thus important for acquirer to review all the properties whether owned or leased including review of property documents, title reports, sale documents for any conditions, deeds of trust or mortgages, governmental conditions on the property (if any) etc.

xiii. Customers and Sales Data

It is vital for acquirer to ascertain and fully understand the seller's customer base and level of concentration of top customers as well as sales pipeline, existing contracts with the top customers and renewal due date

xiv. Other Business and Commercial Issues

Depending on nature of business, the acquirer will also want to evaluate production related matters like list of suppliers, inventory etc., marketing related matters like strategies and arrangements with distributors, dealers etc. and competitor analysis understanding the principal current and anticipated competitors, advantage and disadvantage of target company products over competitor products, their market penetration etc.

3. EXECUTION OF DEFINITIVE AGREEMENTS

Parties go through detailed discussions and negotiation process to ensure both sides get best deal possible and agreed terms are recorded with precision. Besides the basic understanding and terms and conditions of any deal which is otherwise agreed between the parties and recorded in the definitive agreement, some key clauses, which entail discussions and negotiation before incorporating in the agreements include the following:

3.1. Sellers'/ Target Company's Representations and Warranties

Framing the detailed and accurate representations and warranties in definitive agreements are vital for all M&A transactions. The acquirer expects agreements to include detailed representations and warranties by the target company/seller with respect to matters such as authority, capitalization, intellectual property, tax, financial statements, compliance with law, employment, agreements and material contracts. It is equally critical for the target company/seller to carefully review these representations as breaches of representations and warranties can quickly result in triggering of indemnification claims from the acquirer.

Target company or sellers are sometimes wary of the provisioning having general statements like *"no rep or warranty contains any untrue statement or omits to state a material fact necessary to make any of them not misleading"* under this clause to reduce their indemnification obligation which such broad statement can entail, but without such a representation an acquirer often will question whether the target company is withholding any information.

Acquirers and sellers/ target company also deliberate and struggle with the clause of appropriateness of knowledge qualifiers throughout the representations (adding the language *"to the best of knowledge"* for example, *"to the best of sellers knowledge, seller's intellectual property has not infringed the rights of any other third party"*), but the acquirer will want exhaustive risk to lie with the target/seller.



3.2. Indemnification by Seller/Target Company

Indemnification is always highly negotiated and one of most intensely discussed clause in any M&A transaction. Wherein acquirer want the scope of the indemnification to be widespread and go beyond representations and warranties, sellers/target company desires it to be limited in scope as well as for limited time period. Extensive and wide ranged indemnity may result in substantially reducing return for sellers from the transaction and may also result in indemnity exceeding beyond consideration if adequate capping is not negotiated and captured. The seller/target company attempts hard to cap the indemnity claim amount to escrow amount. It is also common to have a few exceptions to this cap like, claims resulting from fraud and/or intentional misrepresentation and are often capped at the overall purchase price. In order to avoid the nuisance of disputes over small amounts, there is typically a minimum claim amount which must be reached before which the acquirer may seek indemnification.



3.3. Whether Liability Joint or Several in case of more than one seller or stakeholder

In extension of Indemnity clause, the liability arising with respect to indemnification, will be whether joint or several, (in case transaction includes multiple sellers or target stakeholders) is another issue that require deliberation between the parties. As most transactions involve multiple target stockholders, one of the primary issues to consider regarding indemnification, from the acquirer's perspective, is to what extent each of the target's stockholders will participate in any indemnification obligations. Under joint liability each target stockholder is individually liable to the acquirer for 100% of the future potential losses. However, if the liability is several, each target stockholder pays only for that target stockholder's relative contribution to the losses. It is obvious that acquirer will always desire to make each of the seller/target stockholder responsible for the full amount of any future claim although, the counter party will insist upon the liability to be several.

3.4. Non-compete and Non-Solicitation

It is common for most M&A transaction to have non-compete and non-solicitation clause in the definitive agreement. The clause is a promise by the seller/ shareholders of target company, not to compete or solicit, for a certain post-closing time period or after termination of employment with the target/acquirer, to (i) enter into defined business that is competitive with the target's/acquirer's, or (ii) attempt to solicit customers and/or employees of the target/acquirer. While the clause is fiercely demanded by the acquirer, it is also important to note that the enforceability of such restrictions requires that the restrictions should be (i) for reasonable time and scope/jurisdiction, and (ii) supported by justifiable consideration. It is not necessary that the non-compete consideration to be always accounted for separately as it can entail tax liabilities for the parties involved. Consideration in M&A transactions involves the sale of a business and payment to the seller typically a material amount of consideration, therefore courts generally have deemed such consideration adequate for purposes of enforceability of the non-compete clause subject to the reasonableness of scope and duration.

CONCLUSION

M&A deals are complicated, time consuming and costly processes with many unknown contingencies. Every deal is unique with varying factors and comprises different stakeholders that negotiate, conduct and ideally benefit from the transaction. For making a deal success, it is necessary that parties should work with pre-defined strategy and spending time upfront as to zero-in the desired goals. To enable a quicker deal closure and avoid issues and smoother negotiations, it is best to engage professionals and experts with considerable experience of closing complex deals.





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