45 Years of Leadership

Control Premiums in Majority Stake Sales Transactions

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PREFACE

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The value of a company can be estimated, but cases are usually not about the value of a company but about the value of Equity stake in a company. Equity Shares may be subject to a premium or discounts, depending upon whether they represent controlling or minority interests. To borrow from George Orwell, *"all shares are equal, but some are more equal than others"*.

Controlling Equity Shareholders have the ability to elect directors or appoint management; Set levels of management compensation and other perks; Determine cash dividends/distributions; Set company policies or business course; Purchase or sell assets; and Determine when and how to sell the company.

The ownership of a non-controlling interest in a company does not have the ability to unilaterally direct the items above, which generally makes it less valuable than a controlling ownership interest. The full range of premiums has been anywhere from double or more the market price, while some controlling interests were acquired at discounts from the publicly traded market prices.

Before a final conclusion of value can be rendered, the nature of the ownership interest being valued must be considered. The value of an ownership interest is influenced by many of its characteristics, including marketability and control, which can have a meaningful impact on the concluded value of an ownership interest.

Introduction To Control Premium

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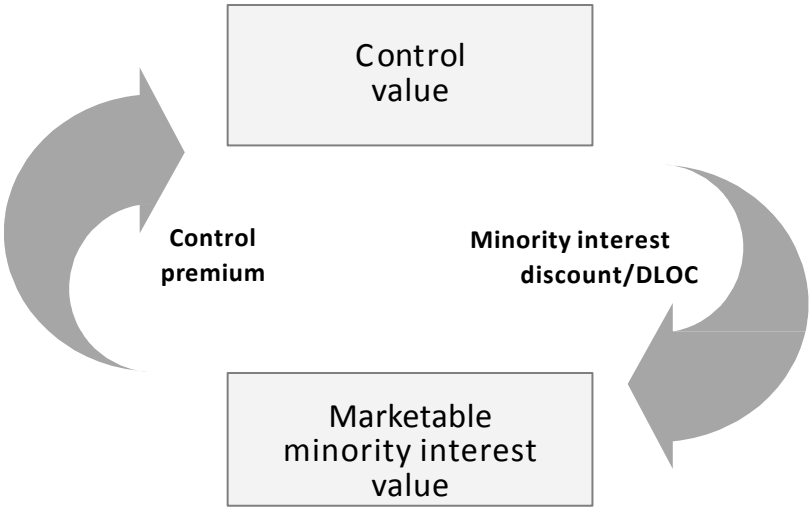
Control premium is the difference between the pro-rata controlling interest and the pro-rata non-controlling interest. It is thus quantified as the excess of the price for a controlling stake in the target company being acquired over its publicly traded share price.

Control Premium is the extra amount a buyer has to pay (compared to buying a minority stake), if they are buying a controlling stake.

Discount for lack of control (DLOC) is the discount a buyer gets for buying a minority stake (compared to buying a controlling stake) to compensate them for the fact they don't have control of the company.



The above relation can be expressed in the mathematical expression as below:

Formula:-

(1+Control Premium)*(1-DLOC)=1

i.e. Control Premium=(1/(1-DLOC))-1
i.e. if Control Premium is 25%, DLOC is 20%

Quantification Of Control Premium

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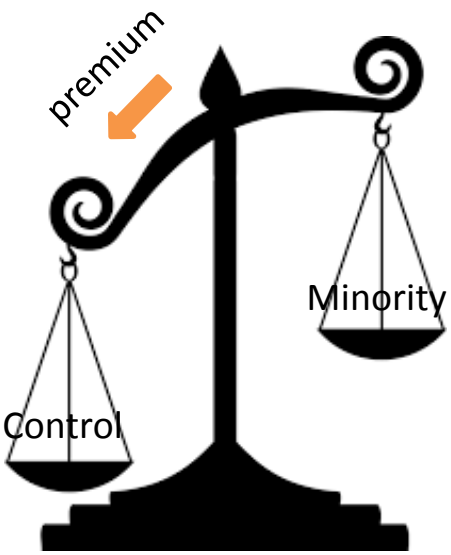
- Assessing the right value of a target company is one of the most important aspects of any M&A transaction. The value of target, in addition to several factors like quality of management, financial performance and future outlook, also depends on whether a controlling stake is being acquired in the target or a minority stake.

- Traditionally it has been observed and widely accepted that an investor, on a per share basis, would be ready to pay a premium to buy a controlling stake in the company versus buying a minority stake.

- One of the most common practices of arriving at control premiums involves relying on the data from actual transactions based on differences between prices at which publicly traded companies are acquired and the pre-acquisition announcement prices of the same stock.

- For developed countries, typically a period ranging from one day to two-month average is considered. In India, where news/rumours of an impending transaction typically float around long before an official announcement, a longer period is suitable.

- Accordingly, the average of 2-week and 26-week prices prior to the public announcement of the offer can be considered.



Quantification Of Control Premium

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- Control premiums are only applicable in valuations where one is starting with lack of control value and is trying to arrive at control value.
- Therefore, when approaches and methods applied during a valuation exercise result in a control value, a control premium may not be applied.
- On the contrary, when a non-controlling value is the result of the business valuation approaches and methods applied, a control premium may be applied.
- Refer to adjacent table to determine which valuation method is appropriate for control/minority valuation.

Method	Ideal for	Valuation
Net Asset Value method		
Net Asset Value (Fair Value)	Control value	Equity value
Net Asset Value (Book Value)	Minority value	
Comparable Transaction Multiples method		
Comparable transactions involving acquisition of majority stake	Control value	Enterprise value Equity value
Comparable Companies Multiples method		
EBIT, EBITDA multiple	Minority value	Enterprise value
P/E, Book value multiple		Equity value
Discounted Cash Flow method		
FCFF	Control value	Enterprise value
FCFE		Equity value

- Income and Market approach can produce value that may be either minority or control, and the valuer must decide which level of value model best fits the specific case at hand.

Transactions Involving Control Premium

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TIMKEN

ABC Bearings Limited

In July, 2017 Timken India Ltd. offered shareholders of ABC Bearings Ltd, five shares of Timken India for eight shares held in ABC Bearings, in an all-stock deal.

The deal implies a **77% premium** to current market price of ABC Bearings Ltd.

vedanta

CAIRN

In June, 2016 Vedanta Ltd. offered minority shareholders of Cairn India Ltd, one equity share and four redeemable preference shares for each share held in Cairn India.

The deal implies a **20% premium** to the 30-days volume weighted-average price of Cairn shares.

Transactions Involving Control Premium

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In August, 2017 Essar Oil completed sale to Rosneft-led consortium. Essar Oil's former minority shareholders will get additional INR 75.48 per share over and above the delisting price of INR 262.80 paid earlier.

The deal implies a **28% premium** to the delisting price of Essar Oil shares.

In January, 2017 JSW Cement Ltd agreed to buy the entire promoter holding in cement maker Shiva Cement Ltd and launch an open offer to acquire another 32% from the company's public equity shareholders.

The deal implies a **27% premium** to the 30-days volume weighted-average price of Shiva Cement shares.

Transactions Involving Control Premium

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IndusInd Bank

BHARAT Financial Inclusion Ltd

In October, 2017 IndusInd Bank entered into INR 15,486 crore all-stock deal with Bharat Financial Inclusion Ltd (BFIL), wherein a shareholder will get 639 shares of IndusInd Bank for every 1,000 BFIL shares held.

The swap ratio works out to be a **12.6% premium** to Bharat Financial shareholders over two-week volume weighted average price.

Reliance Industries Limited

Balaji Telefilms

In July, 2017 Reliance Industries Ltd (RIL) board approved to pick around 24.9% stake in Balaji Telefilms Ltd by acquiring 2.52 crore shares for around INR 413 crore.

The deal implies a **22% premium** to the 60-days volume weighted-average price of Balaji Telefilms shares.

Transactions Involving Control Premium

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RANBAXY
LABORATORIES LIMITED

In April, 2014 Sun Pharmaceutical Industries Ltd offered shareholders of Ranbaxy Laboratories Ltd 0.8 shares of Sun Pharma for each Ranbaxy share they own, in an all-stock deal.

The deal implies a **18% premium** to Ranbaxy's 30-days volume-weighted average share price.

In November, 2014 Kotak Mahindra Bank acquired control of ING Vysya Bank, where ING Vysya shareholders will get 725 shares of Kotak for every 1,000 they own, in an all-stock deal.

The deal implies a **16% premium** to the 30-days volume weighted-average price of ING Vysya shares.

Transactions Involving Control Premium

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In November, 2017 Torrent Pharmaceuticals announced acquisition of Unichem Laboratories' portfolio of 120 brands in India and Nepal, and a manufacturing facility in Sikkim, for INR 3,600 crore.

At INR 3,600 crore, Torrent is paying 4.2 times Unichem's FY17 domestic revenues.

- Unichem's domestic formulations business recorded revenues of INR 856 crore in financial year 2016-17, and accounted for over 60 per cent of the company's revenue.
- As can be seen, the deal implies a control premium for acquiring 100% stake in the domestic business of Unichem Laboratories.

Control Premium in India

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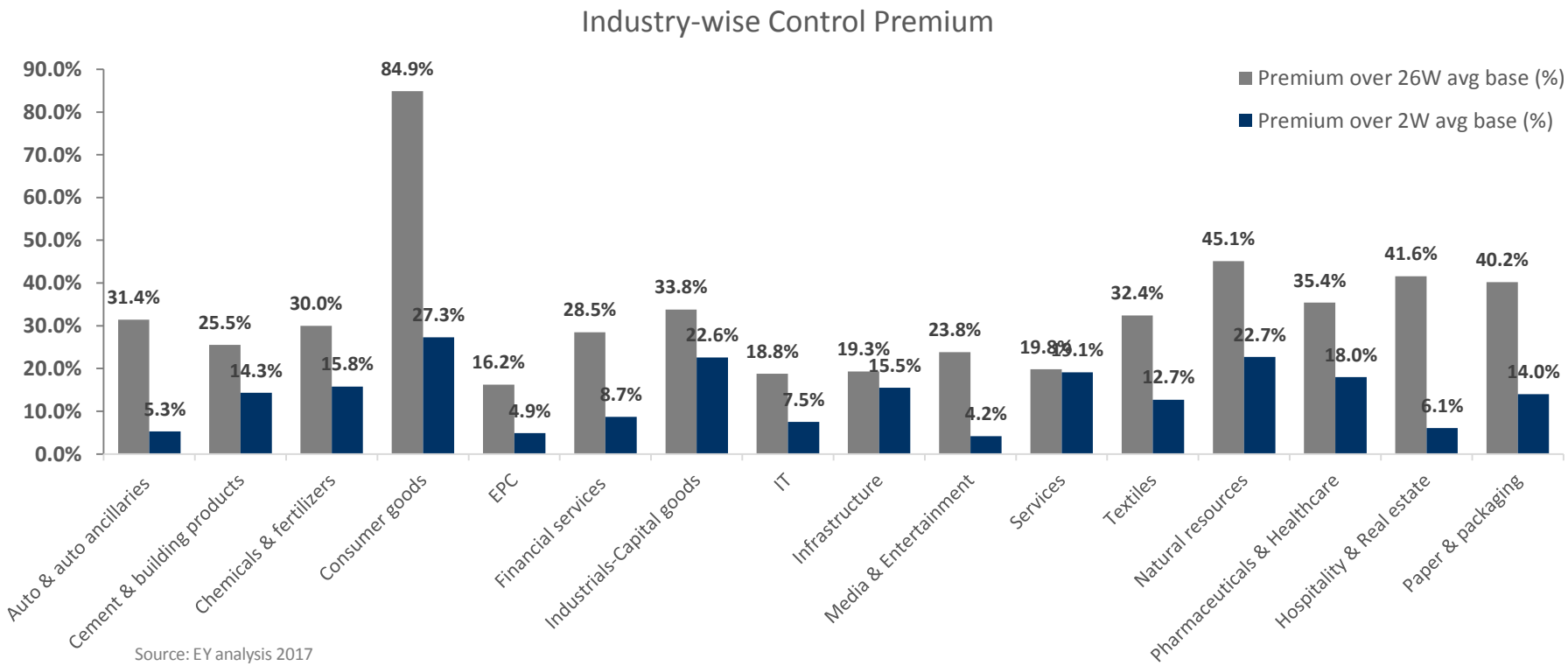
Indian scenario

- In recent EY analysis 2017, of open offers between FY03 and FY17, each of which had an offer size exceeding INR 10 million; 373 transactions were identified, of which 303 transactions (81%) exhibited above nil control premium.
- The average of 2-week and 26-week prices prior to the public announcement of the offer was considered as the "base price."
- The highest premiums were observed in the consumer goods industry, while the lowest were in the EPC industry.



Source: EY analysis 2017

Control Premium in India

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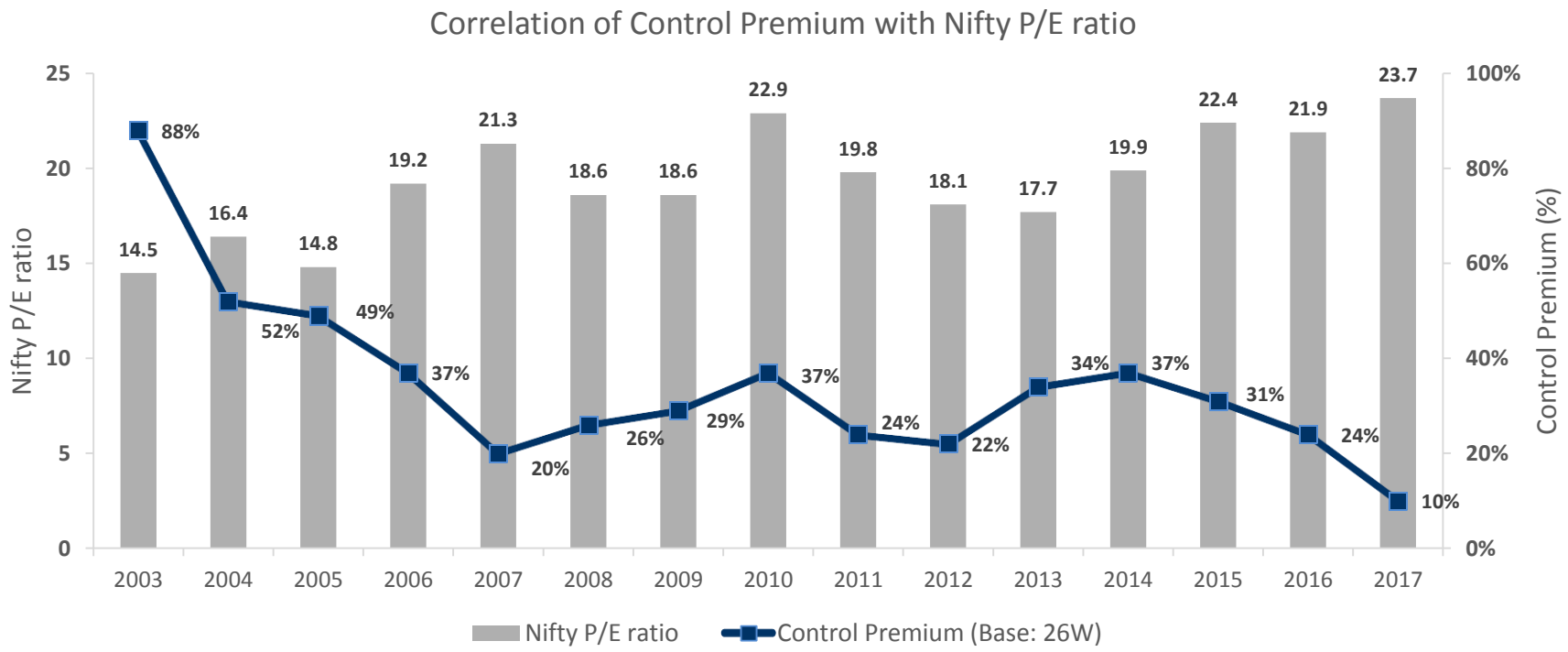
Correlation

There was strong negative linear correlation between control premiums and movement in the Nifty P/E ratio. Control premiums came down with rising markets and vice-versa.



Source: EY analysis 2017 & www.nseindia.com

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