

PROJECT REPORT

ON

" DEMERGER "

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Registration No : 320363172/08/2006

CERTIFICATE

This is to certify that the Project Report entitled “Demerger” being submitted by Mr. Rahul Biyani towards partial fulfillment of Apprenticeship Training as prescribed by the Institute of Company Secretaries of India is a record of bonafide work carried on by him under my supervision.

Place: Hyderabad

Date : 28th April, 2014

Mr. G. Raghu Babu
Company Secretary
(Membership No: 2820)

ACKNOWLEDGEMENTS

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Date : 28th April, 2014
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I. KINDS OF CORPORATE RESTRUCTURING:-

Corporate restructuring can be broadly divided into the following:-

- Financial Restructuring – re-organization of capital, buy-back, CDR
- Acquisitions, Mergers, Joint ventures and Strategic alliances
- Technological restructuring – Alliances for technical expertise
- Market Restructuring – Product / Market segments
- Organizational Restructuring – Internal structures and Procedures

FINANCIAL RESTRUCTURING CAN TAKE EFFECT IN THE FOLLOWING MANNERS:-

Acquisition:

A corporate action in which a company buys most, if not all, of the target company's ownership, stakes in order to assume control of the target firm. Acquisitions are often made as part of a company's growth strategy whereby it is more beneficial to take over an existing firm's operations and niche compared to expanding on its own. Acquisitions are often paid in cash, the acquiring company's stock or a combination of both.

Merger:

Combining of two or more companies whereby the identity of one or more is lost and the result is a single enterprise. One company is taken over by the other company and only the company taking over remains in existence.

Merger is restricted to a case where the assets and liabilities of the companies get vested in another company, the company which is merged losing its identity and its shareholders becoming shareholders of the other company.

Amalgamation:

Two or more existing companies amalgamate and a new company is formed. As such all existing companies amalgamating disappears and a new company comes into the existence.

Amalgamation is an arrangement, whereby the assets and liabilities of two or more companies become vested in another company (which may or may not be one of the original companies) and which would have as its shareholders substantially, all the shareholders of the amalgamating companies.

Demerger:

It is a business strategy in which a single business is broken into components, either to operate on their own, to be sold or to be dissolved. A demerger allows a large company, such as a conglomerate, to split off its various brands to invite or prevent an acquisition, to raise capital by selling off components that are no longer part of the business's core product line, or to create separate legal entities to handle different operations.

Slump Sale:

Transfer of a whole or part of business concern as a going concern; lock, stock and barrel.

"DEMERGER basically means DIVORCE"

FORMS OF DEMERGER:

- Divestitures: Sale of a segment of Company to outsider for cash / securities.
- Spin off: Holding Company distributes its own shares in controlled subsidiary company to its shareholders on pro-rata basis as a dividend in non cash form.
- Equity carved out: Only some shareholding of subsidiary company is sold out to public and parent company continues to hold control over subsidiary company.
- Split off: Shareholders of parent company get share in the subsidiary company in exchange of their shares in parent company.
- Split up: Parent company ceases to exist and shares are divided into two parts.

PARTIAL DEMERGER:

Part of undertaking / division of existing company is separated and transferred to new company. Existing company remains in existence.

COMPLETE DEMERGER:

- Existing company is dissolved by passing Special Resolution.
- All divisions are transferred to new companies.
- Shareholders of dissolved company are issued shares in new company in pre-determined exchange ratio.

II. IMPORTANT TERMS (JARGONS) USED IN DEMERGER:

1) DEMERGED COMPANY / RESULTING COMPANY:

A Demerger results in the transfer by a company of one or more of its undertakings to another company. The Company whose undertaking is transferred is called the DEMERGED COMPANY.

The Company (or the companies) to which the undertaking is transferred is referred to as the RESULTING COMPANY.

According to Sub-section (19AAA) of Section 2 of the Income-tax Act, 1961, demerged company means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

According to Sub-section (41A) of Section 2 of the Income-tax Act, 1961, resulting company means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

2) APPOINTED DATE:

It is the date on which assets and liabilities of the transferor company vest in and stand transferred to the transferee company.

- Accounts on the appointed date form the basis for valuation of shares and determination of share exchange ratio.
- Appointed date is relevant for the purpose of assessment of income of the transferor and transferee companies.

The appointed date signifies the basic condition to be satisfied before a restructuring exercise is recognized as demerger for the purposes of tax laws.

The other way of looking at Appointed Date is to consider the date as the demarking line to rearrange the affairs of the companies before the date so that, thereafter there arises no need to revisit as to which of the assets have to be kept with the demerged company and that with the resulting company. This will cover tangible, intangible assets as well as human resources, their retirement dues etc. The assets will also include assets held on lease, hire-purchase, assets used by the executives and key personnel in their residences etc. If the demerger is followed by any infusion of fresh capital by foreign partners in the resulting company, then every single item of asset, liability, key personnel etc. will become very important and assume lot of significance and lack of proper planning in the initial days will create unavoidable issues arising at a later date. In the case of liabilities, it is better to record all the liabilities in the books of accounts so that the split is done in the proper way. This is especially true for contingent liabilities.

3) EFFECTIVE DATE:

It is the date on which scheme is Complete & Effective, i.e certified copy of the High Court order is filed with Registrar of Company or the last of the approvals obtained.

From the effective date demerger becomes effective and Transferor Company stands changed/dissolved.

4) RECORD DATE:

It is the cut out date on which details of owners or share holders for the Companies are taken for the purpose of Corporate action.

5) EXCHANGE RATIO:

The valuer determines the value of demerged undertaking and the value of the original company and in the process after considering all the relevant data fixes the exchange ratio which later is incorporated in the Scheme of Arrangement placed before the High Courts for its approval.

III. REGULATORY FRAMEWORK – Demerger :-

- ✓ COMPANIES ACT 1956
- ✓ INCOME TAX ACT
- ✓ TAKEOVER CODE
- ✓ SALES TAX PROVISIONS (AS PER STATE REGULATION)
- ✓ STAMP DUTY PROVISIONS (AS PER STATE REGULATION)
- ✓ STOCK EXCHANGE GUIDELINES
- ✓ SEBI REGULATIONS - LISTING / RELISTING

DEFINITION OF DEMERGER:

The Term Demerger is not defined in the Companies Act 1956.

Sections 390 to 396A contain provisions regarding Compromises, Arrangement and Reconstruction.

Demerger is an arrangement whereby some part / undertaking of one company is transferred to another company which operates completely separate from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company.

Demerger under Section 2(19AA) of the Income tax Act means the transfer, pursuant to a scheme of arrangement under section 391 to 394 of the Companies Act, 1956 by a demerged company of its one or more undertakings to the resulting company in such a manner that:-

- i) All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of demerger;
- ii) All the liabilities relating to the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the liabilities of the resulting company by virtue of the demerger;
- iii) The property and the liabilities of the undertaking or undertakings, being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
- iv) The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis (except where the resulting company itself is a shareholder of the demerged company);
- v) The shareholders holding not less than three-fourth in value of shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger; otherwise than as a result of the acquisition of the property or assets of the demerged or any undertaking thereof by the resulting company;

- vi) The transfer of the undertaking is on a going concern basis.
- vii) The demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

STAMP DUTY:

Stamp Duty is a state subject in India. While some of the States in India have enacted their own Stamp Acts others have adopted the Indian Stamp Act, 1899 [ISA] with their state amendments. Stamp Duty is levied on Instrument(s). The term instrument is covered under the definition of Conveyance in ISA and it has also been given a separate definition under ISA. "Conveyance" includes a conveyance on sale and every instrument by which property, whether moveable or immovable is transferred and which is not otherwise specifically provided for by Schedule. "Instrument" includes every document, by which any right or liability is, or purports to be, created, transferred, limited, extended, and extinguished or recorded.

As per Section 394(2) of the Companies Act, 1956 when an order passed by a High Court under Section 394(1) of the Companies Act 1956, provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to and vest in, and those liabilities shall be transferred to and become the liabilities of, the transferee company; and in the case of any property, if the order so directs, freed from any charge which is, by virtue of the compromise or arrangement, to cease to have effect.

Since there is no specific mention of the order of High Court passed under section 394(1) in the ISA as an instrument to be stamped and the fact that the High Court confirms the scheme of merger and a major role is played by the stakeholders of the transferor and transferee companies to approve the scheme of merger, led to the question that whether such an order is required to be stamped.

Although High Courts in India have led to contrary views with regard to payment of Stamp Duty on such an order but the Supreme Court of India has held that an order under Section 394(1) is liable for payment of Stamp Duty.

'conveyance' (an instrument by which property is transferred), to include 'every order made by the High Court or Tribunal under Section 394 of the Companies Act, 1956 in respect of the amalgamation or reconstruction of companies'.

In Andhra Pradesh, Maharashtra, Gujarat, Karnataka, West Bengal, Rajasthan and Madhya Pradesh, Stamp duty is to be paid on the court orders. Other states follow The Indian Stamp Duty Act.

The Supreme Court in Hindustan Lever's case held that 'an order under section 394 of the Companies Act is an instrument or a document transferring a right in the instrument and when a consent decree itself is considered as an instrument liable for to stamp duty, the same view should be applied in this case also.

In the case of Gemini Silks Limited and Gemini Overseas Limited [Calcutta High Court]

"An order sanctioning a scheme of reconstruction or amalgamation under Section 394 is covered under the Indian Stamp Act and therefore liable to stamp duty.

The Registrar of Companies shall not take on record an order sanctioning a scheme until the same has been duly stamped. The department of this Court is directed to engross the final order sanctioning a scheme under Section 394 of the Companies Act on an appropriate stamp paper and thereafter the order should be placed for final signature."

IV. DEMERGER CHECKLIST/STEPS TO DEMERGER:

Generally the following steps are adopted in a demerger process:

1. To prepare the draft scheme of Demerger
2. To get the valuation report for the purposes of Shares Exchange Ratio
3. To obtain fairness opinion from merchant banker on the valuation report (clause 24 of the listing agreement)
4. To inform the Stock Exchanges for holding Board Meeting for approving the Scheme of arrangement
5. To hold Board Meeting for taking note of the valuation report and share exchange ratio, draft scheme of amalgamation and authorizing someone to sign all the application, petition, affidavits etc. on behalf of the company.
6. To file draft Scheme of arrangement with the Stock Exchanges at least a month before presenting it to the Court (clause 24 of the listing agreement) along with auditor's certificate confirming the compliance of AS-14 and other related documents.
7. Filing of application before the Hon'ble High Court under section 391 of the Act for convening/dispensing with the meetings of shareholders and creditors of the applicant companies
8. Whether joint application/petition (ie by all the companies together falling under jurisdiction of one High Court) possible? - Yes, there is no restriction.
9. Order of the High Court for convening of the meetings of the shareholders/creditors under Rule 69 of the Company (Court) Rules, 1959 and appointment of Chairman
10. To finalize the draft notice of meetings of the creditors/shareholders in Form 36 and advertisement of the notice of the meeting in Form 38
11. To get the notice of the meeting approved from the Chairman appointed by the Court & Registrar of the High Court
12. To get the explanatory statement approved from the Chairman & Registrar of the High Court. (In case of listed company, explanatory statement should also comply with the Listing agreement)
13. To get notices along with the explanatory statement printed
14. To send the notice (Form 36) individually to the shareholders / creditors by the Chairman or under the name of the Chairman by the Company within 21 clear days of the holding of the General Meeting [along with copy of the Scheme, Explanation Statement, Form of Proxy (Form37) and also by way of advertisement in two newspapers, one in English and other in vernacular language circulating in the area where registered office of the Company is situated]
15. To give advertisement in the newspaper at least 21 clear days before the date of the meeting (Advertisement in Form 38)
16. Chairman to file affidavit stating that the directions regarding the issue of notice of advertisement & dispatch of notices have been complied with (at least 7 days before the date of the meeting)
17. To convene meetings of the shareholders/creditors - Pass the resolution with requisite majority and arrange for filing of Chairman's Report as per directions of the Court.
18. To file petition for obtaining sanction of the Court for the scheme along with all Annexures at the High Court for confirming compromise/arrangement (Form 40) (within 7 days of filing report)
19. Publication in the newspapers of the notice of petition

20. To follow up with the Regional Directorate(RD),Registrar of Companies (ROC) and Official Liquidator(OL) for submitting their reports that affairs of the Transferor Company and Transferee Company are not prejudicial to the interest of the members or to public interest
21. To ensure that RD and OL submit the report with the High Court before the final date of hearing as per guidelines by MCA.
22. To file certified true copy of the order within 30 days with the Registrar of Companies
23. To annex copy of the order of every copy of the Memorandum of the Company

❖ DUTY OF COURT:

From the decisions of the various courts, the following position emerges, with regard to the duties of the courts while sanctioning the scheme of Demerger:

Where a scheme of compromise or arrangement is presented to the court for sanction under Section 391, the court should examine it, apart from any specified objection from three broad angles:

- a) Whether Statutory provisions have been complied with;
- b) Whether the class of shareholders are fairly represented;
- c) Whether the arrangement is such as man of business would reasonably approve.

❖ ACTIVITIES FROM COURT ORDER TILL RECORD DATE

1. Acknowledgement of receipt from ROC and certified true copy of court order to be filed with the Stock Exchange.
2. Notice to Stock Exchange for Record Date to determine eligibility to receive shares of the Resulting Companies and voluntarily give advertisement of the Record Date in National Dailies (30 day notice).
3. Agreement with CDSL and NSDL for admitting its securities.
4. Printing of stationery - Allotment Advice, Share Certificate, Envelopes.
5. Application seeking exemption for relaxation of Rule 19(2)(b) from SEBI through the designated Stock Exchange
6. Application to Stock exchange for in - principle approval for listing of shares
7. Designated Stock exchange to forward the application to SEBI for approval under Rule 19 (2)(b) of SCRA Rules
8. Prepare Information Memorandum (IM)
9. Compliance with clause 49 - prerequisite for listing
10. File Information Memorandum with BSE and NSE
11. Stock Exchange to receive SEBI Approval and give In-Principle approval for listing of shares of the resulting companies.
12. Keep share certificates, covering letter, envelop of the resulting companies ready for printing.
13. Keep text and stationery ready for intimation of corporate actions for the Resulting Companies
14. Letter relating to cost of Acquisition to be sent to Shareholders

❖ ACTIVITIES FROM RECORD DATE TILL LISTING:

1. Procure details of Register of Members from R&T agent as on Record Date
2. Prepare list of eligible shareholders of the resulting companies, including details of the shareholding
3. Hold Board Meeting of Resulting Companies for allotment of shares
4. File Form 2 with ROC

❖ COMPLIANCES RELATING TO DEMERGER:

1. Resulting Companies to submit the Corporate Action Forms to depositories and pay fee for the same
2. Printing of share certificates, cover letter, envelopes and Dispatch of Share certificates or demat credit of equity shares of the resulting companies.
3. Dispatching share certificate
4. Send intimation to the shareholders of each of the resulting companies regarding the corporate Action
5. Application to Stock exchange, attaching dispatch certificate/demat credit certificate and copy of advertisement, for trading permission
6. Publication of the Advertisement (as per Schedule 28 of SEBI DIP Guidelines) in one English daily, Hindi Daily and Regional Daily
7. Trading of shares at Stock Exchange

❖ DOCUMENTS TO BE FILED ALONG WITH COMPANY APPLICATION IN HIGH COURT:

Application is to be filed with the High Court where the Registered Office is situated for directions to convene a meeting for considering the draft Scheme of Demerger or for dispensing with the meeting. The following documents are necessary at this stage:

1. Judge's Summons under Order XIV read with Rule 67 (or Rule 9, 11(b) & 19) read with Sections 391 to 393 and 394 of the Companies Act (to be filed in Form No. 33 of the Companies (Court) Rules, 1959).
2. An affidavit in support of summons in Form No. 34 of the Companies (Court) Rules, 1959.
3. Memorandum and Articles of Association of the company.
4. Latest Audited Balance Sheet.
5. List of Shareholders (if meetings are to be dispensed with).
6. List of Secured Creditors.
7. Scheme of Demerger.
8. Consent affidavits from all shareholders (if meetings are to be dispensed with).
9. Consent letters from secured creditors.
10. If the company does not have any secured creditor, a certificate to that effect from the statutory auditor must be obtained.
11. Valuation Report regarding share exchange ratio.
12. Extract of the Board Resolution approving the draft Scheme of Demerger.
13. Draft notice of meeting, Explanatory Statement pursuant to Section 393 of the Companies Act, form of proxy (In case meetings are convened)

V. TAXATION ASPECTS OF DEMERGER

1. Sec. 2(19)AA(iv): To qualify as demerger one of the conditions is that the resulting company, as consideration for demerger, issues its shares to the shareholder of the demerged company in proportionate basis. An amendment made w.e.f 1st April, 2013, provides that where the resulting company itself is the shareholder of the demerged company, there is no need to issue shares. Therefore, it shall not be necessary for the resulting company to issue shares to itself.
2. Transactions not regarded as transfer: Sec. 47(vii)(a): Under the current provision, in order for a merger to qualify as a tax free merger, it is required that shares have to be issued by the resulting entity to the shareholders of the merging entity. A proposed amendment to the current Sec. 47(vii) states that if the amalgamated company is itself the shareholder of the amalgamating company, then there is no requirement for the amalgamated company to issue shares to itself.
3. Income from Other sources :Sec. 56(2): Sec. 56(2)(vii): The current provisions provide that where an individual or a HUF receives a sum or asset, without consideration, the value of which exceeds Rs.50,000/- then such sum shall be treated as income from other sources and taxable in the hands of the donee.
However, there is an exception where the sum or asset is gifted by a relative of the individual or HUF, as defined by the said section. The meaning of relative[□] has been extended by a proposed amendment whereby individual member of the HUF will be included within the ambit of relative of the receiving HUF. Therefore, if a member gives a gift to the HUF there shall be no tax on such gift under the head income from other sources. However, if the HUF makes a gift to the individual the same shall not be tax exempt as an HUF will not be treated as a relative of its individual members.
4. Share premium in excess of FMV of share treated as Income from other sources Sec. 56(2)(viib): A key tax proposal relating to curbing tax avoidance has been made in relation to issue of shares in excess of the fair value by closely held companies. Share premium received by private company or unlisted Company over the "fair market value" on subscription of shares is proposed to be taxable as income from other sources in the hands of the issuer company.
However, there is an exception for consideration for issue of shares received by a venture capital undertaking from a venture capital company or fund.

VI. FINALISATION OF ACCOUNTS

In spite of lack of guidance in accounting standards, accounting for demerger is uniform across the globe. Neither the International Financial Reporting Standards (IFRS)-3 Business Combinations nor AS-14 has Accounting for Amalgamations in India – specifically dealt with accounting for demergers. But accounting for demerger is quite simple as it does not result in a purchase or sale transaction but is just a division of an existing entity, the demerged company. There is no reason to restate the carrying amount of assets and liabilities.

Therefore, demerger is accounted for at the recorded book values of the assets and liabilities transferred to the new entity. The face value of new shares has no economic significance. In a demerger, the new company issues shares to all shareholders of the demerged company

without receiving cash. On issuance of shares by the new company, for all practical purposes the share of the demerged company is split into two shares. In a demerger, a new company is formed and all the assets and liabilities of an undertaking of the demerged company are transferred to the new company. This new company, which has an economic and legal identity separate from the demerged company, issues shares to shareholders of the demerged company.

As a result, a substantial number of shareholders of the demerged company become shareholders of the new company.

VII. VALUATION ASPECTS:

1. One of the most important part of the Demerger Scheme is the process of valuation and involves:
 - Evaluating the value of the merging company or its business and / or of its shares
 - Evaluating the securities of the issuing company on a stand along basis
 - Determining the Exchange Ratio for the securities so as to ensure fair consideration.
2. The report is subject to scrutiny by the lending and investment institutions, Regional Director, Official Liquidator
3. Approval of the Scheme and the Valuation Report by majority of the shareholders and creditors does not mean that the court is bound to treat the same as final. The court can view it from the test of fairness.
4. On some occasion, the Court does appoint independent valuers where dissenting shareholders or creditors make a strong case for such an action.
5. Valuation not required in case of merger of WOS

Methods of Valuation used in Corporate Restructuring:

- Earnings based methods.
- Asset based Methods
- Market value of shares (Stock Market quotations)

Methods of Accounting:

- The pooling of interest method
- Purchase Method

VIII. COURT CASES AND VIEWS ON DEMERGER:

a. Can the unissued authorized capital of Transferor Company become the authorized capital of transferee Company without payment of stamp duty and filing fees?

High Courts have held diverse views on this subject. Where the scheme had such a provision the Gujarat High Court in Safal Realty Pvt. Ltd held that no stamp duty or filing fees are to be paid and it is not necessary to follow the procedure under section 94/97 of the Act. The Delhi High Court in Ashim Investment Co had similar views.

However, the Calcutta High Court in Areva T& D (I) Ltd has taken a view that the authorized capital can be combined but the filing fees is required to be paid to the Central government in accordance with schedule X of the Companies Act 1956.

b. What is the position of Mergers, amalgamations and demergers, where the transferor company is registered with BIFR under Sick Industries Companies Act which also has powers to order mergers, amalgamations and demergers as part of rehabilitation?

The Divisional Bench of Mumbai High Court in the case of Ashok Organic Industries Ltd. & Precision Fasteners Ltd held that once reference to BIFR is made Company Court has no further jurisdiction under section 391-394. However, the Gujarat High Court in Phlox Pharmaceuticals Ltd held a contrary view that when a sick company although registered with BIFR where all legal proceedings have been suspended, the same is not applicable to proceedings under section 391-394 and the Court can entertain such a petition as there are apparently no contradiction between the powers of BIFR and those of the company Court.

c. What is the position of mergers, amalgamations and demergers when the transferor company is before the debt recovery tribunal and / or the SARFESI Act has been revoked?

The Gujarat High Court in Core health Care Ltd held that the Company Court has jurisdiction on an application under section 391-394 notwithstanding that the Company is before the Debt Recovery Tribunal or the SARFESI Act has been revoked.

d. Can shareholders oppose the exchange ratio arrived at by Chartered Accountants? Are there any observations of Supreme Court on valuation?

As observed by the Supreme Court in Miheer H. Mafatlal (1996, the following 4 factors which had to be kept in mind in the valuation of shares:

1. Capital Cover
2. Yield
3. Earning Capacity
4. Marketability

For arriving at the fair value of share, 3 well known methods are applied:

1. The manageable profit basis method (the earning per share method)
2. The Net worth method or break up value method and
3. The market value method"

In Vajram Hotel & Resorts Pet. Ltd has held that authorities like Regional Director, Official Liquidator have no local standing in opposing the exchange ratio which is approved by

members and it reiterated the position that the court will not sit on judgment on exchange ratio.

e. Is valuation by Chartered Accountants necessary to fix the exchange ratio?

The Mumbai high Court in the case of Advance Plastics Pvt. Ltd has held that there is no requirement under section 391-394 that the exchange ratio should be determined by the Chartered Accountant and the Company can arrive at the exchange ratio which if approved by the shareholders would be in order.

f. Can the Court order crediting the reserves arising out of amalgamation/demerger to General Reserve as opposed to Capital Reserve which is provided as per AS-14 of Institute of Chartered Accountants of India?

The Gujarat High Court in Sutlej Industries Ltd and Torrent Power AEC Ltd approved the creation of general reserve and held that the same is not contrary to the provision of the Companies Act and which can be utilized for declaration of dividend, bonus shares and adjustment of losses.

It should be noted that the Accounting Standard 14 has specified that the difference should be credited to Capital Reserve account.

g. Can the change of name of the transferee company after the amalgamation be part of scheme without following the procedure for change of name under section 21 Companies Act 1956?

It is held by Delhi High Court in UFO Movie Ltd that the change can be affected without resorting to the procedure under section 21 of Companies Act 1956 but the same need not be construed as waiver from payment of stamp duty and filing fees.

h. Whether consent of Stock Exchange is required before filing Companies Application / petition?

The Madras High Court in Pentamedia Graphics Vs. Bombay Stock Exchange (BSE) held that the NOC from the BSE is not necessary for filing the scheme under section 391-394 Companies act 1956. Similar view is held by Gujarat High Court in Torrent Power AEC Ltd.

i. Whether the demerger schemes are in the nature of avoidance of capital gains tax?

The Calcutta High Court in the case of SREI Infrastructure Finance Ltd held that such scheme does not amount to avoidance of capital gains tax.

j. Whether reduction of capital can be a part of the scheme without separately following the procedure of section 100 to 102 Companies Act 1956?

The Delhi High Court in SIEL Ltd held that reduction of capital can be part of the scheme without resorting to separate procedure under section 100 to 102. This is the position presently accepted by all courts.

IX. CHANGES IN SHARE HOLDERS WEALTH AFTER DEMERGER

CASE-1 TELEVISION EIGHTEEN INDIA LIMITED

Demerged Company : Television Eighteen India Limited

Resulting Company : Network 18 Fincap Limited

Effective Date : 27th September 2006

Eligibility Date : 24th November 2006

Scheme of Demerger :

The shareholders will get the Equity shares of the Resulting Company i.e. Network 18 Fincap Limited in the ratio of 12 equity shares of Rs 5/- each for every 10 shares of Rs.10/- each held by them in the Company. Subsequently, 14 equity shares of Rs.5/- each of Television Eighteen India Limited will be issued in lieu of every 10 equity shares of Rs. 10/- each held by the members of the Company.

Shareholders' Wealth:

Table-1A

Pre-Demerger: Shareholders' Wealth in Television Eighteen India Limited

| Company | Equity Shares | Average pre-demerger Share Price | Shareholders' Wealth |
|-----------------------------------|---------------|----------------------------------|----------------------|
| Television Eighteen India Limited | 100 | Rs. 616.61 | Rs. 61661.00 |

Table-1B

Post-Demerger: Shareholders' Wealth in Television Eighteen India Limited

| Company | Equity Shares | Average post-demerger Share Price | Shareholders' Wealth |
|---|---------------|-----------------------------------|----------------------|
| Television Eighteen India Limited | 140 | Rs. 639.20 | Rs. 89488.00 |
| Network 18Fincap Limited | 120 | Rs. 432.97 | Rs. 51956.40 |
| Total Shareholders' Wealth After Demerger | | | Rs. 141444.40 |

From Table-1A and 1B, it is seen that there has been increase in the shareholders wealth of Television Eighteen India Limited after demerger by 129.39%.

CASE-2: GREAT EASTERN SHIPPING COMPANY LIMITED

Demerged Company : Great Eastern Shipping Company Limited
Resulting Company : Great Offshore Limited
Effective Date : 16th October, 2006
Eligibility Date : 8th November 2006

Scheme of Demerger :

The shareholders will get the Equity shares of the Resulting Company i.e. Great Offshore Ltd in the ratio of 1 equity share of Rs 10/- each credited as fully paid-up in cash for every 5 equity shares of Rs 10/- each held by the members of the Company. Subsequently 5 Equity shares of the Company shall be reduced to 4 Equity shares of Rs 10/- each.

Shareholders' Wealth:

Table-2A

Pre-Demerger: Shareholders' Wealth in Great Eastern Shipping Company Limited

| Company | Equity Shares | Average pre-demerger Share Price | Shareholders' Wealth |
|--|---------------|----------------------------------|----------------------|
| Great Eastern Shipping Company Limited | 100 | Rs. 256.36 | Rs. 25636.00 |

Table-2B

Post-Demerger: Shareholders' Wealth in Great Eastern Shipping Company Limited

| Company | Equity Shares | Average post-demerger Share Price | Shareholders' Wealth |
|---|---------------|-----------------------------------|----------------------|
| Great Eastern Shipping Company Limited | 80 | Rs. 209.41 | Rs. 16752.50 |
| Great Offshore Ltd | 20 | Rs. 703.81 | Rs. 14076.50 |
| Total Shareholders' Wealth After Demerger | | | Rs. 30829.00 |

From Table-2A and 2B, it is seen that there has been increase in the shareholders' wealth of Great Eastern Shipping Company after demerger by 20.26%.

CASE-3: ZEE ENTERTAINMENT ENTERPRISE LIMITED

Demerged Company : Zee Entertainment Enterprise Limited
Resulting Company : Zee News Limited and Wire and Wireless India Limited
Effective Date : 22nd November 2006
Eligibility Date : 16th December 2006

Scheme of Demerger :

Shareholders of the Company received 45 shares of Zee News Limited and 50 shares of Wire and Wireless India Limited for every 100 shares held in the Company.

Shareholders' Wealth:

Table-3A

Pre-Demerger: Shareholders' Wealth in Zee Entertainment Enterprise Limited

| Company | Equity Shares | Average pre-demerger Share Price | Shareholders' Wealth |
|--------------------------------------|---------------|----------------------------------|----------------------|
| Zee Entertainment Enterprise Limited | 100 | Rs. 291.72 | Rs. 29172.00 |

Table-3B

Pre-Demerger: Shareholders' Wealth in Zee Entertainment Enterprise Limited

| Company | Equity Shares | Average post-demerger Share Price | Shareholders' Wealth |
|---|---------------|-----------------------------------|----------------------|
| Zee Entertainment Enterprise Limited | 100 | Rs. 277.09 | Rs. 27709.00 |
| Wire and Wireless India Limited | 50 | Rs. 89.11 | Rs. 4455.50 |
| Zee News Limited | 45 | Rs. 40.32 | Rs. 1814.40 |
| Total Shareholders' Wealth After Demerger | | | Rs. 33978.90 |

From Table-3A and 3B, it is seen that there has been increase in the shareholders' wealth of Zee Entertainment Enterprise Limited after demerger by 16.48%.

CASE-4: CAMLIN LIMITED

Demerged Company : Camlin Limited

Resulting Company : Camlin Fine Chemical Limited

Effective Date : 17th December 2006

Scheme of Demerger :

The shareholders will get the Equity shares of the Resulting Company i.e. Camlin Fine Chemicals Limited in the ratio of 1 equity share each credited as fully paid-up in cash for every 1 equity share each held by the members of the Company.

Eligibility Date : 19th February 2007

Shareholders' Wealth:

Table-4A

Pre-Demerger: Shareholders' Wealth in Camlin Limited

| Company | Equity Shares | Average pre-demerger Share Price | Shareholders' Wealth |
|----------------|---------------|----------------------------------|----------------------|
| Camlin Limited | 100 | Rs. 186.91 | Rs. 18691.00 |

Table-4B
Post-Demerger: Shareholders' Wealth in Camlin Limited

| Company | Equity Shares | Average post-demerger Share Price | Shareholders' Wealth |
|---|---------------|-----------------------------------|----------------------|
| Camlin Limited | 100 | Rs. 135.09 | Rs. 13509.00 |
| Camlin Fine Chemicals Limited | 100 | Rs. 53.95 | Rs. 5395.00 |
| Total Shareholders' Wealth After Demerger | | | Rs. 18905.00 |

From Table-4A and 4B, it is seen that there has not been any significant difference in shareholders' wealth of Camlin Limited before and after the demerger as there has been increase in earnings of shareholders' wealth by 1.14%.

Observation:

From the above studies it is observed that, the samples under study excluding Camlin Limited have shown significant difference in the shareholders' wealth before and after demerger. In other words, share holders' wealth has been appreciated corresponding to demerger. In 80% of the sample, there was negative synergy in their diversified business. Thus, due to demergers or spin-off the companies were successful in getting proper valuation of their various diversified businesses.

X. DEMERGER EXAMPLES:

1. **Ruchi Infrastructure Ltd [15-Nov-2013] ANDHRA PRADESH**

Demerging Company / Division : Ruchi Infrastructure Ltd - oil refining business

Resulting Company - Ruchi Soya Industries Limited

Rationale / Scheme:

Sale and transfer of the oil refining business of the Company being run at its plant situated at Kakinada, in the State of Andhra Pradesh to Ruchi Soya Industries Limited.

The oil refinery business proposed to be sold and transferred includes land, building, the refinery plant and its associated liabilities, oil storage tanks, the net current assets, long term foreign currency loans and other liabilities.

2. **United Spirits Ltd [09-Nov-2013] TAMIL NADU**

Demerging Company / Division : United Spirits Ltd - Distillery Division

Resulting Company - Enrica Enterprises Private Limited

Rationale / Scheme:

Transfer of business pertaining to the Company's distillery at Poonamallee to Enrica Enterprises Private Limited as well as franchising of its brands in Tamil Nadu.

The Franchise Agreement with the Enrica Enterprises Private Limited pursuant to which the Enrica Enterprises Private Limited will bottle the Company's brands and in consideration for this bottling arrangement, the Company will earn royalty income.

3. TML Industries Ltd [30-Oct-2013]

Demerging Company / Division : TML Industries Ltd - Chemical business

Resulting Company - Excel Crop Care Limited

Rationale / Scheme:

Chemical Business of TML Industries Limited will be demerged and transferred to Excel Crop Care Limited.

Integration of the business of Chlorpyrifos (CPP). After withdrawal of Endosulfan from the domestic market in 2011, the Company has been focusing on various other insecticides to regain its market presence.

CPP is the largest selling organo-phosphorous insecticide globally. CPP has emerged as one of the major insecticide products for the Company and has partly captured Endosulfan share in the domestic market.

TML Industries Limited (TML) is the sole Indian merchant manufacturer of NaTCP, a major raw material for CPP. The Company has been sourcing its NaTCP requirements from two sources - TML and imports from China. The proposed integration of NaTCP manufacturing facility of TML with the Company would lead to backward integration for the Company's CPP production and improve product margins as also give better market standing.

4. Aurobindo Pharma Ltd [12-Sep-2013]

Demerging Company / Division : Aurobindo Pharma Ltd (Injectables Unit IV)

Resulting Company : Curepro Parenterals Limited

Rationale / Scheme:

To strengthen and provide focused growth to the injectables business, transfer of Injectables Unit IV as a going concern to Curepro Parenterals Limited, a wholly owned subsidiary of the Company

5. Anil Ltd [03-Sep-2013]

Demerging Company / Division : Corn Wet Milling and Bio-Business of Anil Limited.

Resulting Company: Anil Life Sciences Limited

Rationale / Scheme:

Composite Scheme of Arrangement and Amalgamation between Anil Bioplus Limited and Anil Infraplus Limited and Adella Enterprise Private Limited and Anil Limited and Anil Life Sciences Limited.

The Scheme envisages the following:

- Merger of Anil Bioplus Limited ('ABL') and Anil Infraplus Limited ('AIL') with Anil Limited;
- Merger of Adella Enterprise Private Limited ('Adella') (The promoter holding company) with Anil Limited
- Demerger of Corn Wet Milling (CWM) and Bio-Business of Anil Limited to Anil Life Sciences Limited ('ALL'), currently a wholly owned subsidiary of Anil Limited

6. Mahindra & Mahindra Ltd [13-Aug-2013]

Demerging Company / Division : Mahindra Trucks and Buses Limited (Trucks undertaking)

Rationale / Scheme:

Demerger of the Trucks Undertaking of MTBL and transfer and vesting thereof into the Company and other consequential matters.

1. MTBL's Trucks Undertaking comprising of entire undertaking, business activities and operations pertaining to the Trucks business would be demerged into the Company and the

undertakings, businesses, activities and operations other than the Trucks business would be carried on by MTBL.

2. The Appointed Date of the Scheme would be April 01, 2013.

3. All assets and liabilities of MTBL pertaining to the Trucks Undertaking to be transferred to and recorded by the Company at book values.

4. As an integral part of the Scheme, MTBL also proposes to re-organise its Share Capital and Share Premium Account by setting off the entire existing accumulated losses incurred by MTBL.

5. The Company holds the entire equity share capital of MTBL and accordingly, there would be no issue of Shares by the Company pursuant to the Scheme.

7. Larsen & Toubro Ltd [22-May-2013]

Remarks: L&T Hydrocarbon Engineering Ltd (Subsidiary of Larsen & Toubro Ltd)
Demerging Company / Division: Hydrocarbon Independent Company undertaking
Hydrocarbon business)

Rationale / Scheme:

Arrangement between Larsen & Toubro Limited and L&T Hydrocarbon Engineering Limited, a wholly owned subsidiary of the Company ('LTHE') and their respective Shareholders and Creditors which inter alia envisages business transfer of the Hydrocarbon Independent Company undertaking along with related assets and liabilities of into LTHE and other consequential matters under the provisions of Sections 391 to 394 of the Companies Act, 1956. The Company currently holds 100% of the paid-up Equity Share Capital of LTHE. Considering the growth opportunities in the Hydrocarbon sector, the need for strengthening managerial bandwidth etc, it is considered desirable to presently keep LTHE as a wholly owned subsidiary of the Company.

The salient features of the proposed Scheme are as under :

1. The Company's Hydrocarbon Business engaged in providing and undertaking design to build engineering, procurement and construction solutions on turnkey basis in oil & gas, petroleum refining, chemicals & petrochemicals and fertilizer sectors, pipelines, which include front end design through engineering, procurement, fabrication, project Management, construction and installation up to commissioning services would be transferred into LTHE for a total consideration of Rs. 1760 crore to be paid in cash by LTHE.

2. The Appointed Date of the Scheme would be April 01, 2013.

3. All assets and liabilities of Hydrocarbon business along with other related assets and liabilities will be transferred to LTHE at book values.

4. There would be no issue of Shares by LTHE to the Shareholders of the Company pursuant to transfer of Hydrocarbon business. Larsen & Toubro Ltd has submitted to BSE a copy of Result of the Poll conducted in the Court Convened Meeting dated August 12, 2013 for approving the Scheme of Arrangement between Larsen & Toubro Limited and L&T Hydrocarbon Engineering Limited, and their respective shareholders and creditors, pursuant to Clause 35A.

Simultaneous Merger and Demerger - example:

In year 1993, takeover of Hyderabad Allwyn Ltd by Voltas Ltd was done and later demerger took place. Hyderabad Allwyn Ltd was a sick company registered with BIFR. It had primarily three lines of business:

- Fabrication of bus bodies (Auto Division)
- Manufacture and sale of refrigerators and steel furniture.
- Manufacture and sale of wrist watches.

The scheme provided that with effect from April 1, 1993 Hyderabad Allwyn Ltd would be merged with Voltas and simultaneously the watch undertaking would be transferred out to Allwyn Watches Ltd with effect from April 7, 1993. The scheme also provided for leasing out the auto division to Allwyn Auto Ltd for a period of five years. Thus, a merger-cum-demerger was achieved with the full support and concurrence of the financial institutions and the same was approved by BIFR.

XI. CONCLUSION:

WHY DEMERGER:

Demerger is undertaken basically for two reasons. First as an exercise in corporate restructuring and the second is to give effect to kind of family partitions in case of family owned enterprises. A de-merger is also done to help each of the segments operate more smoothly, as they can now focus on a more specific task.

Family partitions: Demergers:

Dhirubhai Ambani Group : - Mukesh Ambani and Anil Ambani.

Reliance Industries demerged to:- Reliance Industries and

Reliance Communications ventures ltd

Reliance Energy Ventures Ltd

Reliance Capital Ventures Ltd

Reliance Natural Resources Ltd

Rahul Bajaj Group : - Kushagra Bajaj and Rahul Bajaj

Bajaj Auto Ltd demerged to Bajaj Auto Ltd and

Bajaj Finserv Ltd

Bajaj Holdings & Investment Ltd

Demergers due to Synergies:

1. **Dismantling of conglomerates:** Historically, demergers were used to dismantle conglomerates after it became apparent that the costs of running such organizational structures outweighed the benefits in the economic environment. The dismantling of conglomerate's argument is widely based on the idea of removing inefficient organizational structures and hence the elimination of negative synergies.

2. **Organizational improvements:** From an organizational perspective, value can be created through the elimination of misfits in the strategic focus or organizational properties of the organization. In addition, the reduction of the size of an organization leads to an over-proportional reduction in information losses within the hierarchy.

3. **Capital market improvements:** More focused units might improve access to the capital market or attract a new set of investors, thereby eliminating barriers to growth from a capital market perspective.

4. **Corporate Governance improvements:** Value creation through improvements in the role and function of the head office, improvements in the structuring of managerial incentives and more effective market based governance mechanisms due to increased transparency.

DISADVANTAGES OF DEMERGER:

Normally, mergers create synergy through cross-selling services, opening new markets, creating stronger brand identity, absorbing excess capacity and eliminating redundant costs. All of these require change and commitment.

Discussing the potential for that commitment and investment to end in a demerger is not conducive to an effective team-building environment. The easier it is to unwind the merger, the less likely the parties will be to work out their differences and keep the firms together.

Firms surviving a de-merger are likely to be, at least for some time, weaker than they were before the demerger. In extreme cases, viability of one or both firms may be at stake.

After all they say, UNITY IS STRENGTH/ UNITED WE STAND AND DIVIDED WE FALL.

SUCCESSFUL DEMERGER RATIONALE:

$$AB < A + B$$

Sum of the separate entities is greater
than the combined entity

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