De Merger

Ultimate Value Unlocking Tool

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We often come across words having multiple functional essences in different subjects. One such word is “Merger”, in legal parlance. Though being a singular word it has plural concepts envisaged in it. No matter even if we creatively devise various strategies for amalgamation / merger, it is governed by the principal rules stated in Sec 391-394 of the Companies Act. Of the rest, one such strategy is “Demerger”; which is a very prominent concept, practiced in the corporate world, for striving success.

The expression “Demerger” is not expressly defined in the Companies Act, 1956 albeit it is a by-product of the definition “Arrangement” as defined in Sec.390 of the Companies Act, 1956. In demerger, a company transfers one or more of its undertaking / division into another newly formed company or existing company at a pre-decided share exchange ratio or any other agreed consideration. The dissecting company is known as “Demerged Company” and the new company, thus formed, is known as the “Resulting Company”.

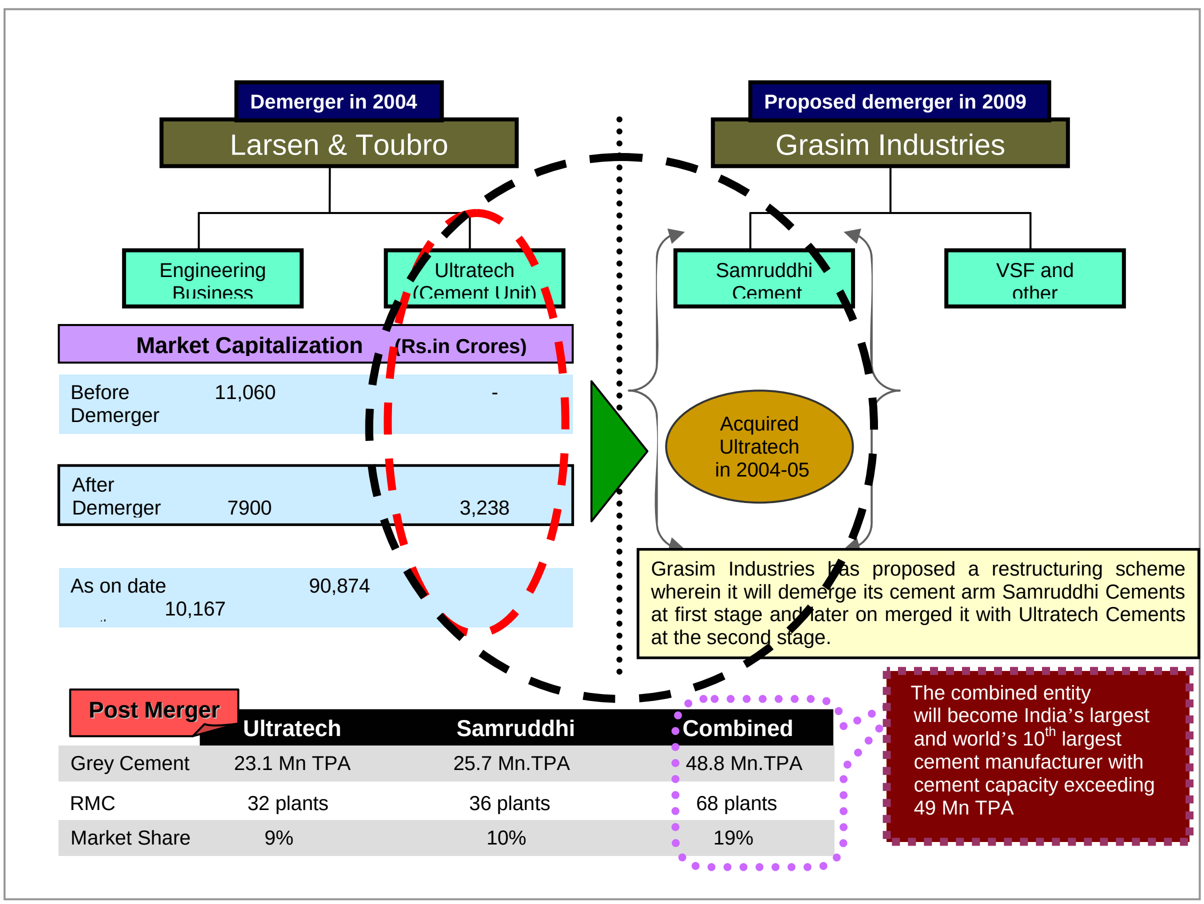
In simpler words i.e. Company “A” is having business activities in varied industries demerges / dissects one of its various activities, for strategic reasons, into a separate company, say Company “B”. Company “A” is called “Demerged Company” and company “B” is said to be “Resulting Company”.

The key legislations influencing the transaction structure, for a demerger, are Companies Act, Direct and Indirect tax, Stamp duty, Listing guidelines, FEMA regulations, etc.

The decision of demerger by a company is subjective to the socio-economic scenario encompassing the company.

Of the various attributes triggering such a strategic corporate action a few are enumerated below as;

- Family settlements (Demerger of Reliance Industries)
- To make managerial resources available for better business opportunities (Demerger of Bharti Enterprises)
- Increasing segment focus (Demerger of Ultratech Cement by Larsen & Toubro)
- Creating a platform to have financial flexibility i.e. capital infusion for future growth (Demerger of Samruddhi Cement by Grasim)



- Facilitating informed decision making to the investors as the market price would reflect the performance of the underlying business (Restructuring of Zee Telefilms)

- Taxation benefits i.e. carry forward of losses and unabsorbed depreciation (Demerger of Jindal Iron & Steel Company)
- Selling off unwanted business activities (Business Restructuring by Hindustan Unilver)
- Simplifying the organisation structure (Business Restructuring by Bajaj Auto)

Here, is a **classic illustration** (please refer the box) of value creation through demerger. Larsen & Toubro had demerged its cement divison (Ultratech Cement) in 2004 to concentrate on its core line of business i.e. engineering and construction. Upon demerger, Ultratech cement was acquired by Grasim Industries at an agreed consideration and open offer was made to shareholders of Ultratech.

As we know, Grasim Industries had a multifaceted business structure which is getting simplified as per recent announcement. As a re-organistaion strategy, it has proposed to demerge its cement business, from the parent organisation, and list Samruddhi cement as a separate company. Later on, it also proposes to merge Ultratech and Samruddhi to reap the benefits of economies of scale and portray itself as the largest cement manufacturer in India and 10th largest around the globe.

Over a period of years, corporates have devised various concepts of demerger like spin-off, split-up, divestures etc. but the same requires to be implemented with abundance of caution, after analysis of the various aspects, so as to create value to the corporates and the shareholders.

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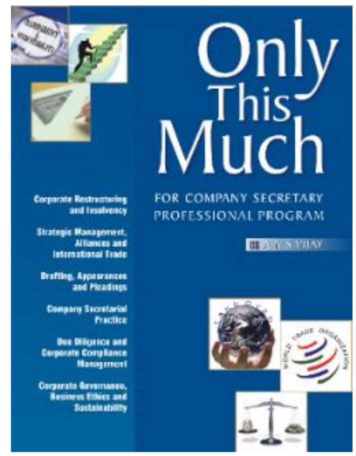

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