

Hero honda demerger

People



ABSTRACT THE JOINT VENTURE

A joint venture between Hero Group and Honda Motor Company was established in 1984 as the Hero Honda Motors Limited at Dharuhera Haryana. Hero is the brand name used by the Munjal brothers for their flagship company Hero Cycles Ltd. Honda is world's largest selling two wheeler company based in Japan. Munjal family and Honda group both own 26% stake in the joint venture Hero Honda motor Corporation.

However the Hero Honda group was set for a split at the end of 2010. After the split Munjal family will buy Honda Motor's 26% stake for around \$1 billion, or a little less than half the current value of the stake in the stock market. The Japanese auto major will exit the JV through a series of off market transactions by giving the Munjal family an additional 26% share. Honda, which also has an independent fully owned two wheeler subsidiary (Honda Motorcycle and Scooter India (HMSI)) will exit Hero Honda at a discount and get over \$1 billion for its stake.

The discount will be between 30% and 50% to the current value of Honda's stake as per the price of the stock. The Munjal family plans to compensate Honda through high royalty payouts, which could double to nearly 6% of net sales. However, key financial institutions have objected to this move, saying that the deal could favour the Munjals but be detrimental to other shareholders. Honda will continue to provide technology to Hero Honda motorbikes until 2014 for existing as well as future models. And after 2014 both companies Honda Motorcycle and Scooter India and Hero Motor corporation will compete with each other.

Hero group will have full access of the overseas market as well and Honda group can compete full fledged in Indian market In this project report we have analyzed strategic motives behind the deal, differences which led to the fall of joint venture, legal and regulatory implications of the deal (through various disclosure requirements and new licensing agreements).

WHY THIS PROJECT IS WRITTEN AND WHAT IS DISCOVERED

Hero group is world's largest selling bicycle company and Honda motor cop. Is world's largest two wheeler company. This was India's most successful joint venture.

Merger of these two companies one Indian and one foreign company has to go with lots of legal regulations and strategic business implications. Demerger of these companies has to deal with many legal regulations and this merger has been taken based on changing business strategies and markets. Key concerns that this project has dealt with are. How much successful the joint venture was? Reasons of success of the JV. What are the main clauses in MOU signed by the two companies? What lead them to demerger? What is the mode of exit from demerger? Will open offer be required to make by hero group? Mode of funding by hero group to acquire 26% share of Honda group. Does the investment by Investors in hero group require prior Government or FIPB approval? What are the discloser requirements under proposed share transfer?

INTRODUCTION PROBLEM STATEMENT

Analysing legal, financial and strategic issues in demerger of two companies involving an Indian and a foreign company. The demerger involves many key

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issues to deal with before it will go on demerger. The legal issues has some key components like

- Open offer under takeover code.
- Prior government approval or FIPB approval. Disclosure requirement by Hero group under takeover code and under SEB guidelines.
- Mode of acquisition of shares.
- Tax implications on Honda group Japan. Mode of financing by hero group to take 26% shares of Honda group is also a point of concern the key area of emphasis on it are
- Bridge Financing
- Funding from private equity investors Business strategies of both companies involved also came as lead to demerger the key issues in it are
- India is a liberalised economy now.
- Honda is third largest two Wheeler Company in India.
- Vendor issue to supply parts.
- Export market.

Latest and successful technical capabilities of Honda motors and the reliability of Hero Group with pan India presence made an effective combination. Honda motors technical expertise provided better fuel efficient motorcycles and was easily sold through Hero Group' s deep distribution network. Absence of any major competitor in the initial years helped the Company make the best of the growing market demand for motorcycles. With the decrease in price difference in comparison with scooters, that were

the more popular choice earlier, the Company was able to successfully stabilize in the Indian market.

Fallout of the joint venture all begin with personal interest coming into picture more than the joint venture. On December 26th 2010 when in a joint press conference both companies made public, selling of HM Japan' s holding of 26% in the Company to Hero Group. Company also disclosed a Memorandum of Understanding signed between the Company, HM Japan and Hero Group pursuant to which the parties would enter into a new license agreement. This proposal was rolled out keeping with the plan and taking the first step in the phased process of the HM Japan' s exit from the Company.

This decision meant curtains for the 26 year old Indo-Japanese partnership.

MATERIALS AND METHODS

The research methodology applied in this project has been of secondary research because most of the data required for analysis is easily available on internet. Since the objective of the project is to explore the strategic motivations behind the deal, various legal implications arising from the deal and how the legal issues were handled, the annual reports of Hero Honda Motor corp. and websites of various regulators who had a bearing on the deal was of great help.

We have analyzed the annual reports of Hero Honda Motor comp for years 2010-11 and 2011-12 to get the facts of the demerger and the company's opinion about the demerger. Because the pre-demerger company Hero Honda Motors Ltd. was also a listed entity the information regarding various

MOUs signed between Hero Honda Motors Ltd. and Honda Motors Co. for transfer of technology or other assets is available on BSE website. The websites of regulators like RBI and SEBI also provides for regulations regarding permissible route of acquisition, foreign parties providing finance for the deal and legal ; regulatory aspects of the deal.

For further complete and updated information on the demerger deal we have read the articles regarding the deal from leading newspapers like The Economic Times, The Times of India and Business Standard. The equity research reports of ICRA have also proved instrumental in providing long term implications of the transactions between Hero Honda Motors Ltd. and Honda Motors Co. Japan. Moneycontrol. com has also been useful to get important information for investors as a result of the deal. The information thus obtained from these sources has been classified into commercial information and legal ; regulatory information.

Where the commercial information tracks the past record of the company, strategic motivations of demerger, splitting and transfer of assets, post demerger structure of the company and post merger asset sharing or asset transfer agreements.

ANALYSIS

We have analyzed this demerger deal right from pre formation of joint venture stage to post termination of the joint venture. This covers the structure of the company before and after demerger, strategic aspects of the deal, and Legal ; Regulatory considerations of the deal and transition challenges for both the companies as a result of demerger.

DEMERGER Hero Honda Demerger| Company (India)| Hero Honda Motors Ltd. | Seller (Japan)| Honda Motor Company Ltd. | Buyer (India)| Hero group through Hero Investments Private Ltd. | Proposed Transaction| Buyout of 26% stake of Hero Honda Motors Limited by HPIL as currently held by Honda Motor company Ltd. | Brief introduction of the companies' party to the deal Hero Honda Motors Ltd: Company is a joint venture between the Hero Group of India (through Hero Investments Private Limited and Bahadur Chand Investments Private Limited) and Honda Motor Company Limited of Japan.

The Company was incorporated on January 19, 1984 and is headquartered in New Delhi. Company is the world's largest two-wheeler company in terms of sales volumes, a position that it has been holding for the last 9 consecutive years. Company has 3 manufacturing facilities, located at Gurgaon (Haryana), Dharuhera (Haryana) and Haridwar (Uttarakhand) with an aggregate capacity to produce 5.4 million vehicles per annum. It has an extensive sales and service network pning around 4,500 customer touch points and ability to increase reach in new geographies and growth markets has proven to be very beneficial for the company.

Honda Motor Company Limited ("HM Japan"): Established in 1948, Honda has remained on the leading edge by creating new value and providing products of the highest quality at a reasonable price, for worldwide customer satisfaction. In addition, the Company has conducted its activities with a commitment to protecting the environment and enhancing safety in a mobile society. The Company has grown to become the world's largest motorcycle manufacturer and one of the leading automakers.

With a global network of 466* subsidiaries and affiliates accounted for under the equity method, Honda develops, manufactures and markets a wide variety of products, ranging from small general-purpose engines and scooters to specialty sports cars, to earn the Company an outstanding reputation from customers worldwide. Hero Group (“ Hero Group”): Hero Group is a vast conglomerate of companies owned by the Munjal family, either in the form of collaborations, joint ventures or fully-owned subsidiaries with a turnover of more than INR 100 billion annually (app. USD 2. 2 billion). These companies have a presence largely in automobiles, automobile components, finance, bicycles, real estate and steel business. It began with the establishment of Hero Cycles Limited, based in Ludhiana, Punjab. The business was started by the four Munjal brothers establishing a bicycle spare parts business in Amritsar in the year 1944. By 1975, Hero Cycles Limited became the largest bicycle manufacturer in India. Over the years, they started moving into other fields, most notably the motorcycle sector and the Hero Group now consists of more than 18 companies.

The Hero Group besides being the world’s largest manufacturers of bicycles, motorcycles and chains to this date, has in recent year also diversified into newer segments like Information Technology, IT Enabled Services and Financial Services Hero Investments Private Limited (“ HIPL”): HIPL is a non-banking financial company registered with Reserve Bank of India (NBFC) and is part of the Munjal-family owned Hero Group. Recently in July 2010, pursuant to a family arrangement, all of Hero Cycles Limited shares in the Company were transferred to HIPL, which is held by partnership firm Brij Mohan Lall Om Prakash.

Along with Bahadur Chand Investments Private Limited, HIPL is one of the promoters of the Company. Bahadur Chand Investments Private Limited (“BCIPL”): Bahadur Chand Investments Private Limited is part of the Hero Group and is also one of the promoters of the Company. It is an investment company primarily involved in the promotion and assistance of the Hero Group of companies and also actively involved in investments in the Group companies. This company too is held by the partnership firm Brij Mohan Lall Om Prakash Pre termination Scenario

This part would primarily deal with the formative years of the Company, the key commercials of the joint venture and the reasons for split between Hero Group and HM Japan. Shareholding pattern pre termination: Formation of Joint Venture 1. Market dynamics before the joint venture between Hero Group & HM Japan: Subsequent to independence and until the 1980s, foreign companies were not permitted to enter the Indian market. These restrictions were relaxed to a certain extent in the mid 1980s when foreign companies were allowed to enter the market through minority joint ventures.

This period saw the setting up of numerous joint ventures along with foreign companies, and the Company was one such example. This joint venture provided HM Japan an entry route to Indian market and was incorporated in 1984. 2. Hero Group’s position before the joint venture: Prior to the joint venture, Hero Cycles Limited had established itself as one of the major manufacturers of bicycles in India and manufactured close to 16, 000 bicycles a day. In the process, they had nurtured an excellent network of dealers and distributors to serve India’s expansive markets.

This would go on to be one of the critical factors for the Company's success in India and was something that most other companies had not achieved to that by that time. 3. HM Japan looks for a partner to enter into India: HM Japan was already renowned for its technological expertise in the automobile and motorcycle manufacturing sector and was looking for a suitable partner in India. Their initial plans called for an entry into the two-wheeler market as well as the electric generator market and accordingly Kinetic Engineering Limited was their first choice for partnership in India.

They entered into a joint venture in 1984 but this was terminated in 1998. Hero Group was their next choice for their motorcycle venture 4. Why did HM Japan select Hero Group for the joint venture? The Hero Group through their company Hero Cycles Limited had made a mark for themselves in the Indian market. Hero was a well-known and respected brand name and an association with Hero would make the entry into Indian market a lot easier for HM Japan. Hero Cycle Limited's engineering capabilities, their know-how, experience in handling large volume production and their extensive distribution networks were also attractive factors in their favour.

Their tight focus on financials and raw material processes also made them a suitable partner for HM Japan 5. How was the joint venture formed? Hero Group first signed the technical agreement with HM Japan in June 1984. This agreement was renewed in 1994 and again in 2004. The joint venture was in the nature of HM Japan providing technical know-how, setting up manufacturing facilities and future research and developments assistance. In consideration for this technological support, HM Japan would receive a lump sum fee of USD 500, 000 and 4% royalty on spare parts.

At the beginning, both partners held a 26% stake in the equity of the Company. Another 26% was sold to the public and the rest was held with financial institutions. An important restriction under the agreement prevented Hero Group from collaboration with any other foreign player or allowing the Company to export its products. Hence, right from the beginning, the target for the Company was only limited to the Indian market

6. Most successful joint venture of India: Over the year, Company has grown consistently, earning the title of the world's largest motorcycle manufacturer after having manufactured 1. million vehicles in 2001. They have retained this distinction till date and have an annual sales volume of over 2 million motorcycles, also owning Hero Honda ' Splendor' which is the world's biggest motorcycle brand. They have successfully penetrated markets across the nation with over 5, 000 outlets. In the last financial year 2009-2010, the company had total unit sales of 4, 600, 130 two-wheelers, a total net operating income of INR 158. 605 billion (app. USD 3. 52 billion) and a growth of 28. 1%

7. Reasons for the success of this venture:

Sound and proven technical capabilities of HM Japan and the reliability of Hero Group made an effective combination. HM Japan's technical expertise provided better fuel efficient motorcycles and was easily sold through Hero Group's deep distribution network. The fact that there were no major competitors in the initial years helped the Company make the best of the growing market demand for motorcycles. With the decrease in price difference in comparison with scooters, that were the more popular choice earlier, the Company was able to successfully stabilize in the Indian market.

Fall of Joint Venture It all began when the Company, Hero Group and HM Japan, in a joint press release dated on December 16, 2010, conveyed the decision to terminate the celebrated joint venture. The parties made public, the fact of selling of HM Japan' s holding of 26% in the Company to Hero Group. Further, on the same date, Company also disclosed a Memorandum of Understanding (MOU) signed between the Company, HM Japan and Hero Group pursuant to which the parties would enter into a new license agreement.

This decision meant curtains for the 26 year old Indo-Japanese partnership.

1. Key clauses in the MOU signed between both the parties: In a meeting held on December 16, 2010, the board of directors of the Company approved the new licensing arrangement with HM Japan concurrent with the Hero Group' s proposed acquisition of 26% stake held by HM Japan in the Company. 6 The highlights of this new arrangement (as per the press release from the Company) are given below7: All existing products of the Company to continue

The fresh licensing agreement with HM Japan to provide new models to the Company Company will have the freedom to export to new markets Company will have the independence to set-up its own research and development (R&D) and new product development capabilities and acquire technology No change in ongoing operations Process for smooth transition was finalized between the parties Name of the Company and the brand name to be changed over time Subsequently, vide a disclosure made on January 24, 2011, Company confirmed that HM Japan and the Company had executed the final binding licensing greements on January 22, 2011

with respect to existing products and new products following the MOU of December 16, 2010, which had been approved by their respective boards of directors. 2. What are the main reasons for the split? In spite of being the largest two-wheeler manufacturer in the world and riding on one of the most successful joint ventures, it seems like both the partners have had some misgivings. Key reasons that could have played a role in this historic descent are discussed here: i) Supply of components: HM Japan asked the Company to increase the supply of components ordered from HM Japan which led to disagreement between two parties for the first time. HM Japan wanted to increase its royalty from the sales of components in the joint venture, but has been unable to do so because the bulk of the sales of almost 60%, are contributed by relatively older bikes " Splendor" and " Passion" for which the components are relatively standard and the profit margins are less (ii) Reluctance to share key technology: More stringent emission norms are set to kick in by 2015 for two-wheeler makers in India.

The new Bharat Stage IV norms (BS-IV), to be imposed across India for two-wheelers by then, would be very different from the Bharat Stage III norms (BS-III) applicable today. Manufacturers are expected to make technical changes to their vehicles accordingly. Industry sources say that HM Japan and other global two-wheeler makers are investing heavily on upgrading technology to comply with new emission norms in different parts of the world. While the Indian two-wheeler market will move to BS-IV (corresponding to Euro-IV) in 2015, the European region will be upgraded to Euro-V in the same period.

HM Japan knows that better fuel injection systems are required to meet the next level of emission standards in India. HM Japan has invested heavily in making its products more fuel-efficient and it is aware that it does not stand to gain much by sharing this crucial technology with the Company. This seems to be one of the reasons why HM Japan opted to end its 26-year-old alliance with the Hero Group (iii) Brand confusion: Analysts feel that the expansion of Honda Motorcycle and Scooter India Private Limited (HMSI) and the overlaps between the two companies (i. e.

HMSI and the Company) is hurting the Company. They also feel that this is leading to brand confusion because the products of both the companies are out in the market and they seem to believe that the consumer is getting confused as to which is the real ' Honda' (iv) Distrust between the two companies: Certain board members also feel that there has been preferential treatment that has been given to HMSI when it comes to product and technology. They feel high-margin products seem to have found out their way into the HMSI stable whereas the low-margin products seem to have gone the way of the Company. v) Bar on exports hurt the long term growth of the Company: The board members also feel that the bar on exports for the Company is not an equitable arrangement. So far, the joint venture did not permit the Company to set foot overseas. An industry peer such as Bajaj Auto Limited exports about 30% of its motorcycles in a year. As a consequence, under the MOU and the new licensing agreement, Company won' t have geographic constraints. (vi) Liberalization of FDI norms: The regulatory restrictions did not permit foreign investments in the 1980s.

Joint ventures were a necessity at the time, done more from legal compulsions rather than commercial aspirations. Today, there are fewer restrictions. Global companies in most sectors, seeking to enter India, can make pure commercial decisions for themselves, if they want to set up a 100% subsidiary in India or enter through a joint venture. Companies with a strong network and international operating experience may like to come into India through a 100% stake and this is what HM Japan is aiming for.

Termination of Joint Venture

Offshore Japan 9.75% 38.04% 8.67% 17.33% + 26% . 21% 26% INDIA
 Financial Institutions Individual Promoters BCIPL Hero Honda Motors Limited
 Bain Capital India Private Investors Lathe Investors Private Limited Honda
 Motor Company Limited HIPL Others 1. Mode of Exit: As mentioned further
 above, the parties initially made it clear that the termination of the joint
 venture will happen by way of the acquisition of the full 26% holding of the
 Company held by HM Japan by HIPL.

On March 8, 2011, HIPL made a filing to the BSE and NSE as required under Regulation 3(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (Takeover Code) thereby disclosing that it proposes to acquire the entire 26% shareholding of the Company, currently held by HM Japan, on or about March 22, 2011. As a consequence of such an acquisition, the Hero Group, through its subsidiary HIPL, will consolidate its holding in the Company to 43.33%. In combination with BCIPL, Hero Group will, thus, indirectly hold 52% in the Company. . Mode of Funding the Deal: Hero Group announced on March 8, 2011 that HIPL will be acquiring the 26% shareholding of the Company from HM Japan for a deal size of INR 38.418

billion, which breaks into INR 739. 97 (app. USD 16. 44) per share of the Company. The announced purchase price is at a sharp discount than the market price of the shares of the Company. Interestingly, on the date of announcement of the deal size, the share price of the Company on the stock exchange in India is almost double than the acquisition price per share.

HIPL has sourced the funds for the said acquisition of 26% stake of the Company in the following form: (i) Bridge Financing: HIPL has pledged its entire shareholding of 17. 33% in the Company in order to bridge finance its buyout of HM Japan' s 26% stake in the joint venture. HIPL has pledged: (a) 10, 741, 798 shares representing 5. 379% of stake in the Company towards Axis Trustee Services Limited; (b) 11, 935, 331 shares representing 5. 977% of stake in the Company towards IL&FS Trust Company Limited; and (c) 11, 935, 331 shares representing 5. 977% of stake in the Company towards IDBI Trusteeship Services Limited.

The above mentioned shares have been pledged by HIPL to issue short term debt, through non-convertible debentures expiring in 3 months, to fund the purchase of the shares of the Company from HM Japan. Insurance companies, Non-banking financial companies and mutual funds have bought the short-term bonds of the Company. (ii) Funding from private equity investors: Preceding the pledge of shares of the Company by HIPL, HIPL had made an application to the Foreign Investment Promotion Board (FIPB) in respect to foreign investment in HIPL by certain private equity investors for the purpose of acquisition of the stake of the Company held by HM Japan.

As the consideration involved is in excess of INR 12 billion (app. USD 266. 66 million), and the investment requires prior FIPB approval, the same needs to <https://assignbuster.com/hero-honda-demerger/>

be approved by the Cabinet Committee on Economic Affairs (CCEA), in addition to the FIPB. Subsequent to the approval from the CCEA and FIPB, HIPL would repay the short term debt raised from the debenture holders from the funds invested by the Investors in HIPL. 3. Who are the offshore private equity investors investing in HIPL? : Dr. Brij Mohan Lall Munjal, Chairman of the Company, confirmed that HIPL has signed definitive agreements with private equity firms BC India Private Investors II, an affiliate of Bain Capital LLC, and Lathe Investment Private Limited, a wholly owned subsidiary of Government of Singapore Investment Corporation (Ventures). HIPL proposes to fund the acquisition by issuing securities to the Investors worth INR 45 billion (app. USD 1 billion). BC India Private Investors II has agreed to pick up 70% of the investment and the balance 30% will be held by Lathe Investment Private Limited. 4. What is the speculation regarding payment of royalty under the new licensing arrangement? As was expected, HM Japan will end up selling its 26% stake to the Hero Group at a substantial discount to the market price. To offset this, there is a speculation that the Company would now have to pay higher royalty amounts till 2014 as an arrangement under the new licensing agreement entered between the parties on January 22, 2011. In addition, experts say the Japanese automaker's royalty from the Company will 'most likely' be subject to corporate tax in Japan. Interestingly, on December 18, 2010, Japan's Nikkei daily reported that HM Japan would divest its stake to its Indian partner for INR 54 billion (app.

USD 1.2 billion) when the current market value of its holdings is nearly INR 99 billion (app. USD 2.1 billion), that is, at a discount of nearly 45% to the

market. However, as per a report, HM Japan's royalty from the Company is expected to jump three-fold, from the present 2.6% of total sales to 8%. This will last 3 years till 2014 when the technology pact between the two partners expires. At present, this royalty outgo is around INR 4.2 billion (app. USD 93.33 million), which will triple to nearly INR 14 billion (app. USD 311.11 million) per year, for the next 3 years.

In the process, HM Japan will get over INR 40 billion (app. USD 888.88 million), as pre-tax royalty. However, the Hero Group has denied any increment in rate of payment of royalty to HM Japan and the licensing agreement signed between the two groups on January 22, 2011 seeks to keep the royalty rate at around 2.3-3%.

5. What are the consequences of HM Japan exiting the joint venture? How does it impact on the future of the Company? : Continuation of support from HM Japan in the form of a licensing agreement related to technology transfer for new products is expected to provide the Company an adequate time to put in place long term alternatives for technology support. On the business side, notwithstanding the cessation of joint venture agreement, the Company may be considered to have the ability to protect its market share and product franchise over the short to medium term benefitting from the Company's management's knowledge of the Indian consumers, Company's wide distribution network, an established supply chain besides strong relationship enjoyed by the Company with its dealers and vendors.

The impact on the Company over the longer term would depend on the Company's ability to forge alternative technology tie-ups and sustain the confidence of all stakeholders. Overall, with the exit of HM Japan, the

Company would need to scale up its product development initiatives, which may impact its return indicators going forward. Nevertheless, the Company could benefit from expanding its presence in overseas markets through exports and/or by establishing production facilities overseas, something it could not do earlier because of the restrictions under the joint venture agreement with HM Japan.

Given the high competitive intensity in overseas markets on account of presence of many players from India, China, Japan etc, Company's ability to increase penetration in new geographies and at the same time maintain profitability would be tested in the coming years. Legal and regulatory considerations: 1. Will HIPL be required to make an open offer under the Takeover Code?

Under the Takeover Code, the open offer requirements are triggered in the following three situations: (i) 15% shares or voting rights: When an acquirer acquires shares or voting rights which entitles it to exercise 15% or more of the voting rights in a listed company. (ii) Creeping acquisition limit: When an acquirer, who holds 15% or more, but less than 55% shares or voting rights in a company, acquires, additional shares or voting rights entitling him to exercise more than 5% of the voting rights of a company, in a given financial year. (iii) Voting Control: When an acquirer acquires control over the target company, irrespective of whether or not there has been any acquisition of shares or voting rights. However, Regulation 3 of the Takeover Code provides certain exemptions from the open offer requirements one such exception is inter se transfer of shares amongst "qualifying promoters"; provided that the transferor promoter as well as the transferee promoter has

been holding shares in the target company for a period of at least 3 years prior to the proposed acquisition.

Since, shares of the Company are proposed to be purchased by HIPL from HM Japan, and both HIPL and HM Japan have been named as promoters in the shareholding pattern disclosed to the stock exchanges for the past 3 years, the inter se transfer of shares amongst them should not trigger the open offer requirements under the Takeover Code. 2. Does the investment by Investors in HIPL require prior Government / FIPB approval? Regulation 4. 6. of the Consolidated Foreign Direct Investment Policy, released on October 1, 2010 (FDI Policy) provides the guidelines for foreign investment into investing companies. Regulation 4. 6. 4 (iii)(a) of the FDI Policy states that - foreign investment in ' Investing Companies' will require the prior Government / FIPB approval, regardless of the amount or extent of foreign investment. Since, HIPL is holding the shares of the Company and is registered as a NBFC as per the list of non deposit accepting NBFCs on the RBI website, foreign investments in HIPL will require prior FIPB approval.

Further, as per Regulation 4. 9. 1(ii) of the FDI Policy, the recommendations of FIPB on proposals with total foreign equity inflow of more than INR 12 billion (app. USD 266. 66 million) would be placed for consideration of CCEA. From the press release dated February 23, 2011 issued by the Government of India, Ministry of Finance, Department of Economic Affairs, (FIPB Unit) it is clear that HIPL had applied to FIPB for approval of induction of foreign equity upto INR 45 billion (app.

USD 1 billion), and the matter has now been recommended for the consideration of CCEA. 3. Will the Investors be required to make an open

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offer under the Takeover Code? Since, acquisition of stake in HIPL by the Investors will only give it an indirect holding of less than 15% in the Company, and it does not seem that the Investors would be acquiring control of the Company, the Investors may not be required to make an open offer under the Takeover Code. . What will be the disclosure requirements in respect of the proposed transfer of shares of the Company? Disclosures by HIPL: (i) Under Takeover Code: Since, post the acquisition, the shareholding of HIPL would entitle it to more than 14% shares / voting rights in the Company, HIPL will need to make a disclosure under Regulation 7(1) of the Takeover Code to the Company and to the stock exchanges where shares of the Company are listed.

Further, since the acquisitions will be under Regulation 3(1)(e), and the acquisition will be more than 5%, HIPL will be required to notify the stock exchanges where the shares of the company are listed, for information of the public, of the details of the proposed transactions at least 4 working days in advance of the date of the proposed acquisition. ii) Under SEBI (Insider Trading) Regulations, 1992: Since, HIPL is currently holding more than 5% shares in the Company, and pursuant to the Proposed Transaction it will acquire more than 2% of the total shareholding in the Company, HIPL will need to make a disclosure under Regulation 13(3) of the Insider Trading Regulations to the Company

Disclosures by the Investors (i) Under Takeover Code: Since, post the acquisition, PE Investors, will get an indirect holding of close to 13% in the Company, the Investors will need to make a disclosure under Regulation 7(1) of the Takeover Code to the Company and to the stock exchanges where

shares of the Company are listed. Disclosures by the Company i) Under Takeover Code: Since, Company' s shares are acquired in a manner referred to in Regulation 7(1) as mentioned above, Company needs to disclose to all the stock exchanges on which the shares of the Company are listed, the aggregate number of shares held by each of such persons referred above, within 7 days of receipt of information under Regulation 7(1). (ii) Under Insider Trading Regulations: The Company shall within 2 working days of receipt of information under Regulation 13(3) from HIPL as mentioned above, disclose the same to all the stock exchanges on which the Company is listed.

. What will be the mode of acquisition of shares of the Company by HIPL? From the shareholding pattern on the BSE website as on December, 2010, it appears that the shares of the Company held by HM Japan are in physical form. If the transfer of shares takes place in physical form, a stamp duty of 0.25% of the value of shares shall be applicable; however, no stamp duty shall be applicable, if the shares are transferred in dematerialized form. If the shares are in dematerialized form, the transfer may take place either off the floor of the stock exchange or on the floor of the stock exchange.

As mentioned above, an off the floor of the stock exchange transfer may lead to higher tax implications compared to an on the floor of the stock exchange transfer. On the floor of the stock exchange, the transfer can take place in two ways, i. e. (i) by way of a block deal and (ii) by way of a bulk deal. Block deal: A block deal is execution of large trades through a single transaction. For this purpose, stock exchanges are permitted to provide a separate trading window.

Block deal will be subject inter alia to the following conditions (a) The said trading window may be kept open for a limited period of 35 minutes from the beginning of trading hours i. e. the trading window shall remain open from 9. 15 am to 9. 50 am. (b) The orders may be placed in this window at a price not exceeding +1% from the ruling market price / previous day closing price, as applicable. (c) An order may be placed for a minimum quantity of 5, 00, 000 shares or minimum value of INR 50 million (app. USD 1. 11 million). (d) Every trade executed in this window must result in delivery and shall not be squared off or reversed. e) The stock exchanges shall disseminate the information on block deals such as the name of the scrip, name of the client, quantity of shares bought/sold, traded price, etc to the general public on the same day, after the market hours. Since, the proposed consideration price for the transfer of the shares of the Company is INR 739. 9735 (app. USD 16. 44) and the prevailing market price on March 10, 2011 is INR 1, 537, it is unlikely that the condition (b) mentioned above would have been satisfied. 6. Why is HIPL issuing debentures of minimum maturity of 3 months and not less?

From reports dated February 28, 2011, it appears that HIPL is raising short term debt through non-convertible debentures expiring in 3 months, for which it has pledged the shares of the Company as collateral. The group is raising debt because funds from private equity firms will take some time and HM Japan wants an early exit. But why is the term of the debentures for 3 months and not shorter? The RBI had issued directions (NCD Directions), to regulate the issuance of non-convertible debentures of original or initial

maturity up to 1 year and issued by way of a private placement (NCDs) by corporate.

The NCD Directions provides that the NCDs shall not be issued for maturities of less than 90 days from the date of issue. The exercise date of option (put/call), if any, attached to such NCDs, also shall not fall within the period of ninety days from the date of issue. Therefore, in light of the NCD Directions, HIPL is prohibited from issuing NCDs of maturity less than 3 months. 7. What will be disclosure requirements in case of pledge of shares of the Company to raise loans by way of NCDs?

By HIPL: HIPL, being a part of the promoter group of the Company, shall within 7 working days from the date of creation of pledge on shares of the Company held by it, inform the details of such pledge of shares to the Company under Regulation 8A(2) of the Takeover Code. By the Pledges: Since, the term acquirer under Regulation 7(1) of the Takeover Code has been clarified to include a pledgee, other than a bank or a financial institution, therefore, the Pledges in whose favour the shares of the Company are pledged, and the threshold of 5%, 10%, 14% etc. re crossed, shall make disclosure to the Company and to the relevant stock exchange within 2 days of creation of pledge. By the Company: Company shall disclose the information received by it under Regulation 8A(4) of the Takeover Code to all the stock exchanges on which its shares are listed. 44 Further, the Company shall also disclose to all the stock exchanges on which the shares of the Company are listed, the aggregate number of shares held by each of such persons referred above within 7 days of receipt of information under Regulation 7(1) of the Takeover Code . Will the recently notified merger

control regulations affect the Proposed Transaction? On March 4, 2011, the Government of India, Ministry of Corporate Affairs notified the much debated provisions of the Competition Act, 2002 (Competition Act) relating to combinations? namely Sections 5 and 6. Although notified as of March 4, 2011, these provisions are to take effect from June 1, 2011 (Effective Date) giving all those subject to the same, a period of 3 months to tie loose ends and complete unfinished transactions before getting entangled in the web of the Act.

Since, the merger control provisions will come into force from the Effective Date, and the proposed acquisition of the shares of the Company is to take effect on March 22, 2010, the acquisition may not be subject to the filing / approval requirements under Sections 5 and 6 of the Competition Act. However, if the subscription of the shares of HIPL by the Investors does not take place before June 1, 2011, due to delay in approval by the CCEA or otherwise, it is likely that the Investors would be hit by the notifications regarding merger control provisions as mentioned above.

However, vide its notification on March 4, 2011 the Government of India has exempted the acquisitions of small enterprises whose turnover is less than INR 7.5 billion (approx USD 167 million) or whose assets value is less than INR 2.5 billion (approx USD 56 million) from the definition of combination as defined under Section 5 of the Act. Therefore, if HIPL does not breach any of the exemption thresholds as mentioned above, the Investors will be exempted from the approval requirements under the Competition Act, even if the Proposed Transaction closes post June 1, 2011. . Would HM Japan have required any prior approval while setting up its subsidiary HMSI in India?

Press Note 18 (1998 Series) issued by the Department of Industrial Policy & Promotion provides that “ automatic route for FDI and/or technology collaboration would not be available to those who have or had any previous joint venture or technology transfer/trade-mark agreement in the same or allied field in India”.

Since, both HMSI and the Company are in the same / allied fields, and HMSI was set up post 1998, it is likely that HM Japan may have obtained Government / FIPB approval prior to or at the time of setting up its subsidiary.

CONCLUSION

Through our analysis we have seen that demergers are as complex as mergers or sometimes even more complex than mergers.

The following were the key motivations and reasons behind the demerger: Lack of trust between the two companies whether it was related to supply of components or regarding the sharing of technology Honda motors can now successfully sell products branded solely with Honda marquee Hero will get to fulfil its unrealized dream of exploring lucrative export markets Liberalized FDI norms also favoured demerger because now Honda could setup wholly owned company The financing of the deal as in analysis part we saw was carefully structured to satisfy the legal and regulatory requirements which led HPIL to pledge its shares for short duration of three months, a period for getting approval for a foreign investment firm investing in an Indian investment firm. The major issues arise in the demerger are mainly regarding sharing or transfer of the assets of the pre demerger company. The

following clauses were included in MOU to address those issues: All existing products of the Company to continue

The fresh licensing agreement with HM Japan to provide new models to the Company Company will have the freedom to export to new markets Company will have the independence to set-up its own research and development (R&D) and new product development capabilities and acquire technology No change in ongoing operations Process for smooth transition was finalized between the parties Name of the Company and the brand name to be changed over time The disclosure and compliance requirements under SEBI insider trading rule, Takeover code, RBI, BSE and FIPB are heavy because company (pre demerger) is a listed entity and is a joint venture between Indian and a foreign firm. The involvement of foreign PE investors further made the issue complex.

But all the legal, strategic and regulatory requirements have been carefully taken care of and clearly complied by both the companies and a clear and dispute free framework has been adopted regarding sharing of assets like brand name and technology.

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