Mindtree Acquisition by L&T – A first in 'hostile' Takeovers

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Abstract
"....to live the nightmare that the builders have arrived with the excavators, bulldozers, chainsaws, cranes and the impeccably drawn up blueprint to raze Mindtree" this was the impassioned plea to Mindtree employees, from Mr. Subroto Bagchi, one of the founder members of Mindtree the IT Products and Services company in India.

Merger and Acquisitions have been the way of the industry to consolidate and diversify. Indian industry has had several such situations where companies have merged with other companies willing and acquired other companies with full consent of the acquired company.

In many ways the Larsen and Toubro's acquisition of Mindtree stakes has been a rough ride for both companies, so far. There have been olive branches from L&T to Mindtree, with the business media underplaying the viciousness of Mindtree by stating that it is arranged marriage which may turn into love. The case illustrates, - probably- the first hostile acquisition in Indian Business industry, the journey of Mindtree acquired by L&T from the initial stage to the situation today.

Introduction:

Neither L&T nor Mindtree need any introduction. But bringing in some chronological events historical in the lifespan of the two organizations will give the reader a clearer picture and bring some clarity in the current imbroglio- ic situation.

Larsen & Toubro or L&T as it is known started in 1938 in India. It is public knowledge that two Danish engineers, Henning Holck-Larsen and Søren Kristian Toubro started as a representative of Danish manufacturers of dairy equipment. Over a period, from the Indian independence, L&T has diversified into several verticals from Realty to Finance to Information Technology. Mr. A.M Naik is the Chairman of the L&T from the time of his appointment to the post in the year 2003.

Diversification

Keeping in line with the diversification DNA of L&T, L& T Infotech (Now rechristened LTI), the Information Technology Services a wholly owned subsidiary of L&T was founded in 1996. It was the brainchild of Mr. A. M Naik. Taking a look at the past of L&T both in terms of diversification and acquisition – the company has a significantly important history.

According to a report published in March 2018, L&T has 93 subsidiaries, prominent among them are *L&T Infrastructure Engineering Ltd*; *L&T – Construction Equipment Limited*; *L & T Mutual Fund L&T Finance*; *L&T Technology Service*; *L&T Valves L&T General Insurance* and *L&T Special Steels and Heavy Forgings Pvt Ltd* to name a few. L&T has 8 Associate companies, and more than 3 score in each of its joint ventures and joint operations companies. The sound financial foundation, and the thirst for venturing into newer pastures of businesses and industry is part the company's natural progress towards keeping with the times of innovative business models.

Thus, it is not the first time L&T has been in the Mergers & Acquisition (M&A) scenario. Quite a few acquisitions have been made by L&T. In January 2019, L&T Infotech (a subsidiary of L&T) acquired Ruletronics. Ruletronics, enables businesses to digitally evolve, by providing state-of-the-art business process management and customer relationship management solutions leveraging its 'Pega' Platform. In Sep 2018, L&T acquired Graphene, a Bengaluru-based semiconductor manufacturing company for $930 million. November 2017 saw L&T Infotech acquire Syncordis, a leading core banking implementation services provider. In Oct 2007, L&T acquired Tamco a Malaysian switchgear manufacturing company. Tamco was acquired for $112 million. Tamco has branches in Taiwan, Singapore and Australia. Thus L&T is not new to M&As.

Take Over:

AM Naik, Executive Chairman of the L&T Group, in January 2019 told media persons that the group is indeed looking at acquiring a stake in Mindtree but the Bengaluru-headquartered firm was one of the many options the firm was evaluating as an acquisition target.

L&T also reportedly held discussions with Mindtree to become the majority stakeholder. However, this was not successful as the latter rebuffed the offer owing to difference in cultural ethos between the two companies (L&T Infotech and Mindtree).

L&T Mantras to Mindtree – “Pyar Love and Dil”

It was a “wooing” time for Mindtree from L&T. Mr. S.N. Subrahmanyan, L&T MD and CEO said, “Please understand, this ‘hostile’ word is not for us. We believe in ‘Dil’ (Heart) and ‘Pyar.’(Love). We have not attempted any hostile takeover on anyone. It was a significant shareholder (V.G. Siddhartha) of Mindtree, who has persuaded us to invest in Mindtree and that’s what we have done. We have invested our very hard-earned money where there is lot of emotion, passion, sweat, blood and tears are involved. So we see it with Dil and Pyar.” (sic). This was a day after acquiring 20.32% stake in Mindtree, that L&T was attempting to court promoters, employees and other stakeholders of the IT firm. This, even as Mindtree’s promoters unconditionally opposed L&T’s ‘hostile’ takeover.

Genesis of the ‘Hostile’ Takeover

It started with V.G Sidhartha selling his stakes in Mindtree to L&T. The deal itself was a complicated one. Siddhartha was facing a liquidity squeeze. He was forced to sell his stake that was triggered because of payment defaults by Infrastructure Leasing and Financial Services Ltd (IL&FS) in August 2018. This led to his creditors calling in their loans against which Siddhartha, almost the entire holding in Mindtree had been pledged. Thus the Mindtree promoters ran the risk of losing control of the company they founded. For Siddhartha, the repayment deadlines were fast approaching. A need to monetize his holding in Mindtree at the earliest was imperative. The buy-back offer Siddhartha made was, first, to the Mindtree founders themselves. Unfortunately, Mindtree could take up his offer due to various reasons. While there were at least more than half-a-dozen private equity (PE) firms which were ready to Siddhartha’s stake worth Rs.3,330 crores. At least a dozen PE players (read about them here and here), sovereign funds and long-term funds were only too happy to buy his stakeworth ₹3,000 crore, a senior executive of Mindtree said on condition of anonymity.

The catch was that Siddhartha’s shares had already been pledged to the banks, and, for any sale to take place, the potential buyer needed to pay for the un-pledging of the shares before buying them or at least agreeing to an arrangement wherein the shares stayed with the banks even while the transaction to sell them was underway.

Siddhartha stated in specific email query response: "I would like to state clearly that the shares that are held by me and my companies in Mindtree have been pledged with a single lender for ease of selling the same post all prerequisite approvals are obtained. As a matter of policy we have not and do not intend to sell fully or partly any shares in the subject company or seek a loan against such security from the interested purchaser till all regulatory approvals are obtained."(sic)

Thus, beginning December 2018, a dozen PE and sovereign funding firms met with Siddhartha, and the management of Mindtree to understand the outlines of the asset they were buying into, a deal could not be struck as none of the firms were ready to pay unless the shares were transferred. This was because most of them were huge multinational companies, where, their charter itself would have barred them from doing so.

Before the buying of shares by L&T in February 2018, a global PE firm was quite close to finalizing the deal with Siddhartha, following a series of meetings. It is reported that Mindtree itself was not averse to this idea, and all their other promoters had even agreed to its terms, including a position on the board to the PE firm. But this fell through. because it was not willing to get into the complicated mechanics of the transaction. Four months later, in August 2018, the IL&FS crisis came to the fore when one of Siddhartha's group companies failed on its debt payments.

Siddhartha, facing huge financial pressure, decided to sell his stake to L&T, leaving Mindtree susceptible to a hostile takeover. While L&T finally agreed to buy Siddhartha's stake at a declared price of ₹980 per share, the earlier offer, which was quite evidently favored by the Mindtree promoters, was ₹975. It is quite safe to presume Siddhartha was agreeable to the more complex transaction, given the fact that the details of the pre-deal transactions between L&T and Siddhartha are not known.

Café Coffee Day VG Siddharta's role in the Hostile TakeOver

The Café Coffee Day owner Mr. V.G Siddhartha held around 28% share of Mindtree in 2019 Mr. Siddhartha wanted to liquidate his shares (See Exhibit 1). In 1999, Ashok Soota the co-founder of Mindtree, brought in Siddhartha when the ten co-founders including Subroto Bagchi, Ravanan Rostow and KK Natarajan were putting together Mindtree.

According to CNBC-TV18, Siddhartha had invested Rs 340 crore for stakes in Mindtree since 1999, and now having sold his 20.4 % stake to L&T, he had taken home an enormous profit of nearly Rs 3,000 crore after 20 years.

As an erstwhile investment banker, Siddhartha's background became useful, and it is said that he pitched in time and again with his stakes increasing, whenever Mindtree needed it. In 1999, when Mindtree was just a fledgling company, Siddhartha invested close to Rs 44 crores thereby buying a 6.6 percent stake in Mindtree. In 2011, Siddhartha bought another 5.57 percent and 2.05 percent stakes for Rs 85 crore and Rs 40 crore, respectively. Not long after that in 2012, he up-ed his stake to an additional 6.84% by investing Rs 171 crore. Roughly this would mean an internal rate of return of 20.43 percent p.a. The point to have noted here, at this juncture is, could Siddhartha raised funds elsewhere for doing away with his financial problems rather than selling his stake of Mindtree. This would have been very beneficial to Mindtree given the situation that it has landed into.

The flipside of this point is why could Mindtree have not done the same? Given the stability of the firm, the exports revenue and the client spread it had, Mindtree, could have raised funds having foreseen the circumstance it was leading itself into. Not able to raise the capital was a bane for Mindtree.

It was reported that with the Mindtree stake sale, helping him to clear debts, Siddhartha may perhaps don the role of an investor, again.

L&T has been in a similar situation but with role reversals. Not very long back in history, A.M Naik, Chairman, L&T faced me a similar situation and wriggled out of it with alacrity and strategy. The late Dhirubhai Ambani in 1987, managed to seize substantial stake in the cash-rich L&T and then launched a hostile takeover bid in 1989. Fortunately for A.M Naik, political and other developments guaranteed that Reliance remain a passive shareholder. In his biography, "The Nationalist", A.M Naik recalls how he got a call from one of the head of the Cement division of L&T saying that the company owner has changed. The stake held by Reliance in L&T was bought over by the Birlas. The culmination of these momentous events led to the determination of A.M Naik's bid to keep L&T independent. He protected it from any future takeover efforts by setting up the L&T employees welfare foundation that ultimately bought off the Birla's stake. Birlas got L&T's demerged cement business that added to their cement production capacity. According to A.M Naik, The Welfare Foundation relieved L&T of a non-core asset-heavy business. Thus it made L&T an AAA rated company thereby cutting out debt equity ratio considerably. In management terminology it was a win-win for all, according to A.M Naik. Unfortunately, there was no such luck awaiting the promoters of Mindtree.

Mindtree & L&T - Software Project Portfolio

The portfolio of software projects that Mindtree executes and manages, is in the arena of data analytics, cloud, infrastructure management, and application development and maintenance. It has a strong base in terms of its market and clients. While it may not have figured in the list of top IT companies in India it has established itself as a player of reckoning, not to forget it was the company chosen for the Aadhar Card IT implementation by the Government of India.

While on the other side L&T, a company of long standing, deals with a very diversified portfolio, that encompasses construction, mining, electric and automation, engineering, hydraulics, metallurgy and power, among a plethora of other industry sectors. L&T Infotech (LTI), is their technology subsidiary of L&T, deals with mobile, social, analytics, IoT and cloud journeys, among others.

Industry indications were that, L&T is sitting on enormous cash pile of ₹15,000 crore. and is on the lookout for acquisitions. It is said that the company wanted to utilise the cash reserves for acquiring Mindtree. L&T aspired for a synergetic merger with Mindtree. Also, the acquisition is expected to expand L&T's IT service business and increase value for L&T Infotech's shareholders, expand the client base and strategically broad-base its revenue model by widening its portfolio of software projects.

Hostile Takeover:

Why is the L&T acquisition of Mindtree labelled hostile? A few perspectives to understand the hostility in the acquisition process. Acquisition is a process by way of which a firm or an individual acquires controlling interest/shares in another firm. Acquisition can be friendly or hostile. A friendly acquisition is one in which management of the target company or controlling group sells its controlling shares to another group in agreement with its board of directors, Stake holders, Shareholders with their consent. Acquisition can be through the market route also. If management of the target company is unwilling to negotiate a contract

with prospective acquiring company, the acquiring company can directly approach the shareholders of the target company by making an open offer. This is called as Hostile takeover.
A hostile takeover is the acquisition of one company (called the target company) by another (called the acquirer) that is accomplished by going directly to the company's shareholders or fighting to replace management to get the acquisition approved.

The other methods are of taking over are - Mergers & Acquisitions, Leveraged Buyout, Spin offs, etc. through which Corporate restructuring may be done.

Post-independence, India has seen several Mergers. The Indian Government brought in several policies for a balanced economic development and to limit the convergence of economic power at a single location. Policies such as introduction of MRTP Act, FERA Act Industrial Development and Regulation Act-1951, etc. made hostile takeover almost impossible. When one studies the industry takeovers it can be observed that very few Mergers & Acquisitions and Takeovers have taken place in India before the liberalization in 1991. With globalization of the economy, especially after liberalization the corporate sector has been exposed to severe domestic and global competition. With the recession raising its ugly head now and then, and the falling demand has resulted in the overcapacity of many industry sectors, in turn has hurt the economy. Companies thus, have strategically started to consolidate in the areas of their core competency and divest those businesses where they do not have any competitive advantage. This has ushered the era of corporate restructuring through Mergers and Acquisitions in India. Banks in India have started doing it although the reasons for it may be Non-Performing Assets.
Mergers and acquisitions (M&A) activity in India has booming. In 2007 India saw the largest inbound deal in India’s history – Vodafone acquired Hutchisson Essar, India’s fourth largest mobile phone company at a whopping $11.1 billion. With Tata Steel’s $13.2 billion dollar acquisition of the European steelmaker, Corus, also in 2007, a series of acquisitions of foreign companies by Indian corporate enterprises happened in quick succession. In India any takeover must comply with the (Stock Exchange Board of India, (SEBI) provisions of (Substantial Acquisition of Shares and Takeover) Regulations, 1997 (“Takeover Code”). As mentioned earlier, Hostile Takeovers is a type of method used for Corporate Restructuring. In India, hostile takeover is a much-feared word, may be since it is not a democratic and civil method and somewhat unpleasant for the management of a target company.

Lessons Learnt
It is observed by lawmakers, that Mindtree’s unusual shareholding pattern was a major factor that facilitated L&T’s hostile takeover. The four promoters of Mindtree together held 13.32% of its shares. While it was serendipitous for L&T, to have acquired the coffee baron V.G. Siddhartha’s 20.32% stake in Mindtree, it proved to be the first of the calculated moves from L&T, in the takeover process. By buying the foreign portfolio investor Nalanda Capital of its entire 10.61% stake in the company, L&T gained a greater stake in Mindtree. This was followed by an order to purchase an additional 15% stake before an open offer for buying 31% voting shares in consonance with the requirements of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011 under its regulations.

DVRs as a Protectionist Mechanisms for Hostile Takeovers
Differential Voting Rights are an alternative to the usual rule of one share-one vote. There is unequal economic ownership of shares. DVRs can be of two types - shares with fractional

voting rights (FR shares) and shares with superior voting rights (SR shares). Hostile takeovers can be kept at bay, with this mechanism of shareholding, since a large proportion of voting rights remain firmly with the company founding members. Thereby allowing the founding members to raise funds without weakening their hold over their company. This allows the promoters to raise capital without any dilution in their control. But, the twin class of shareholdings has met with a lot of opposition from institutional investors.

In India, Tata Motors have explored this method of shareholding. But such class of shares are prevalent in the US, Canada, Hong Kong and Singapore. In the case of Mindtree, due to the joint, paltry shareholding of the promoters' it meant that the company's control effectually was in the investors' hands who it seemed were not very eager to hold on to their shares in a situation of a hostile takeover. May be this could have been circumvented if Mindtree's shareholding type allowed the founders to 'control' their stake by virtue of their voting power. It is opined that the large role, the founding members have in developing a company, they have a moral and emotional bonding to retain their control stake in the company, at least in the initial phase. That said, a benchmark for Corporate Governance should be observed keeping in mind the minority shareholders' interest.

Bringing about a change in the policy of shareholding votes could avert such future situations.

Governance – Cultural Differences:

So why the opposition from the Mindtree promoters to the takeover? It is a timeless situation of founders not being able to gilet go of their emotional connect with the company. Founders always will look at their company that they created from scratch as their progeny. Basically, this is an emotional reaction to the deal.

An emotional appeal to the employees of Mindtree, from Mr. Subroto Bagchi, the Founder of Mindtree, who hastily resigned his cabinet rank position in the Odisha Government, did not help. L&T has always maintained that after the acquisition controlling stakes in Mindtree, it will maintain Mindtree as a separate entity / Unit. His appeal to 'Hold the Tree' was more of resistance and Rhetoric to bring forth the cultural differences that the companies have which may pose difficulties for the 'Mindtree Minds' as he refers to the Mindtree employees in the merger and acquisition.

The Mindtree founders, built an organization culture which rewards and recognises its employees who perform. Culture of an organization also means that it cares for its employees primarily, and its stakeholders, in whatever form. A familiar bond among the employees, is the common thread in any organizational behaviour. The employees can relate to the culture. It was this culture, reading between the lines of Bagchi's letter brought forth. The glaring difference in the culture of Mindtree and L&T was the bone of contention for the founders of Mindtree. And this made the takeover the first instance of a hostile takeover among companies that make India's $170 billion IT industry.

Though culturally and the kind-of-projects-wise both the companies are different, it does not suggest or show L&T in a negative light or as guilty. But the Mindtree employees and stakeholders can certainly question the continuance of the cultural governance standards, and they can put their foot down to preserve and maintain it. And this is where it could be a thorny issue for the management of L&T. But then having got into the act of acquiring Mindtree, L&T's task is cut out - of convincing the Mindtree employees and the promoter group. Because without the support of the employees & stakeholders, to the deal, it may end up as a lose-lose deal for L&T. Notwithstanding all these emotional turmoil, Mindtree, formed a panel to evaluate the open offer and for the deal to go through.

PostScript - Points to Ponder -

1. On 19th Aug 2019, The Indian Government brought a change in its Companies Act. As an impetus to startups, the government relaxed norms for shares with differential voting rights that will help companies to retain control while raising equity capital. With the amendment to the rule, companies can now have up to 74% Differential Voting Rights (DVR) shares of the total post issue paid up share capital. The limit was revised from 26%. Had this been implemented 6 months earlier, Mindtree would have hugely benefitted.
2. Mindtree will continue to maintain it separate identity, thereby also maintaining its cultural identity of governance. It was very recently that it became Mindtree – A L&T Group Company (as it is referred to now).
3. Mr. V.G Siddhartha of CCD missing from 29th July 2019 committed suicide, alleged he jumped from a bridge near Mangaluru. Has this whole takeover episode having some bearing on this? If he had been alive, maybe he would have up-ed his stake in Mindtree an averted this hostile takeover.
4. With most of the founding members of Mindtree exiting from the company post-acquisition, Mr. Debashis Chatterjee, was appointed CEO and MD, former President at Cognizant took over as the CEO of Mindtree, with the primary intention of bringing in continuity, stability and profitability in the company.
5. Mr. Dayapatra Nevatia (ex- managing director and director of delivery for advanced technology centres in India, Accenture) as the Chief Operating Officer in March 2020, to ensure the company gets into its next phase of customer-centric growth.

Exhibit - 1

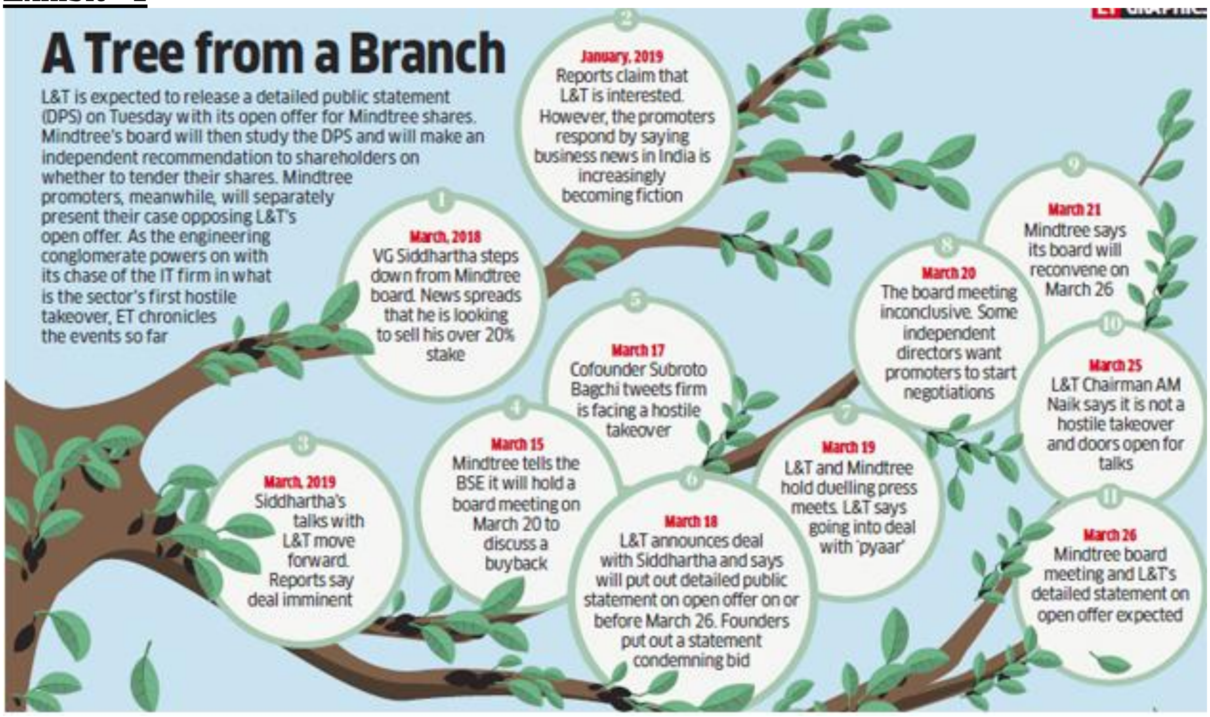
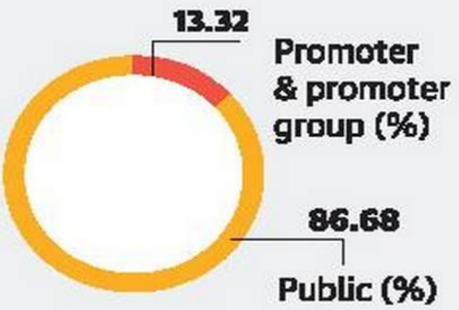


Exhibit 2

Numbers at play

Promoters of Mindtree hold less stake than necessary to hold out against acquirers. Its numbers and clientele, though, are alluring



Shareholding pattern for Mindtree at the end of Dec. 2018

Source: BSE, company website

PERFORMANCE METRICS

Head	Dec. 2018	FY18
Revenue (₹cr.)	1,787.20	5,325
Net profit (₹cr.)	191.30	624.9
Headcount	19,908	17,723
EPS (₹)	11.64	37.69

<u>Exhibit - 3</u>

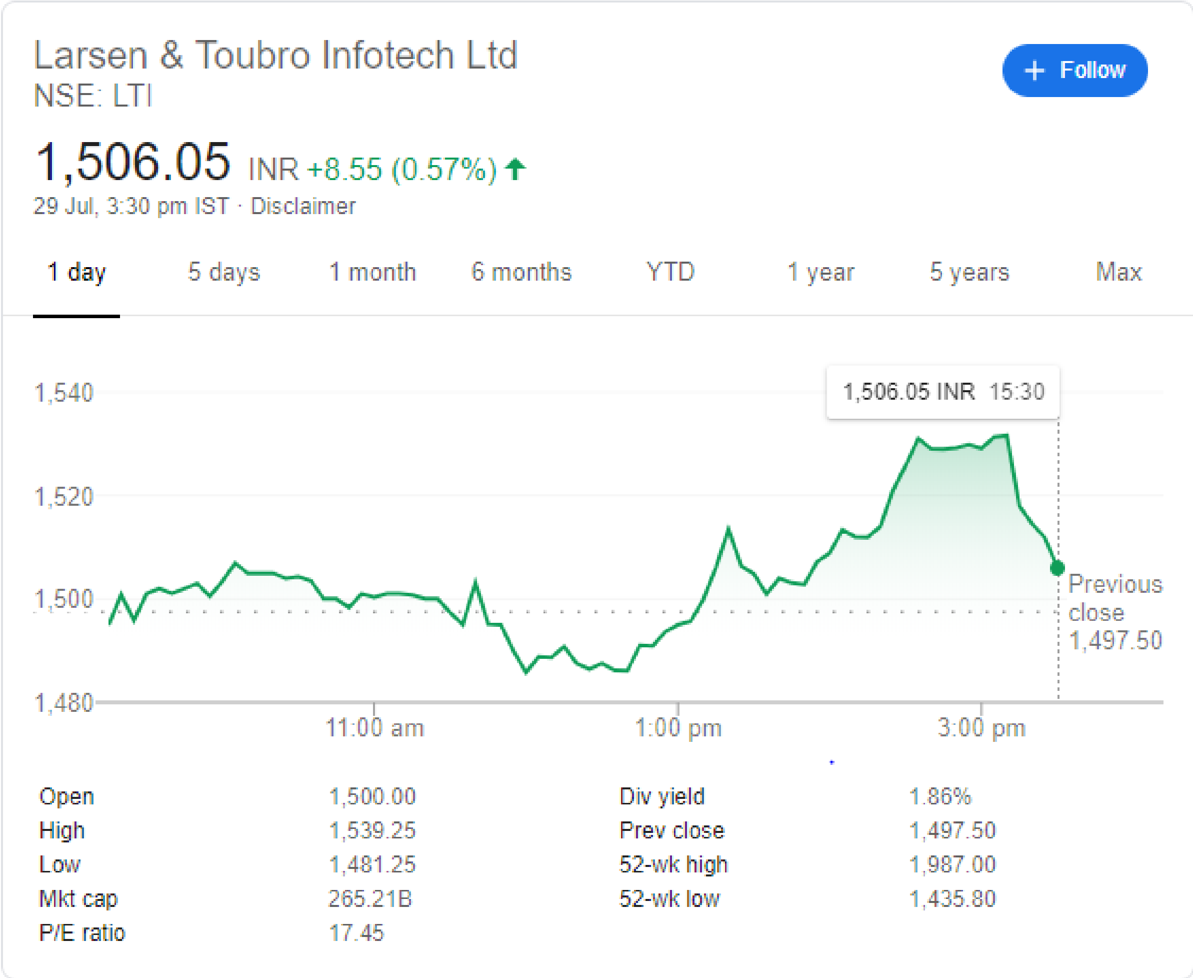


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Exhibit 4


MindTree Ltd
NSE: MINDTREE
+ Follow
700.90 INR +10.95 (1.59%)
29 Jul, 3:30 pm IST · Disclaimer
1 day
5 days
1 month
6 months
YTD
1 year
5 years
Max
689.95 INR Fri, 26 Jul
1,000
900
800
700
600
Feb 2019
Apr 2019
Jun 2019
Open 690.00
High 704.50
Low 688.35
Mkt cap 115.29B
P/E ratio 16.75
Div yield 1.85%
Prev close 689.95
52-wk high 1,183.80
52-wk low 652.05

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