

Valuation Insights

Control Premium

September 2014

Authored by **Manish Saxena**, assisted by **Riddhi Mehta**

What is Control Premium?

Assessing the right value of a target company is one of the most important aspects of any M&A transaction. The value of target, in addition to several factors like quality of management, financial performance and future outlook, also depends on whether a controlling stake is being acquired in the target or a minority stake. Traditionally it has been observed and widely accepted that an investor, on a per share basis, would be ready to pay a premium to buy a controlling stake in the company versus buying a minority stake.

This premium is easily observable in transactions where the target is a listed company. For example, in a recent transaction, Sun Pharma bought Ranbaxy for an implied value of approx. INR 455 per share which was at a premium of approx. 20% to Ranbaxy's market price. In another transaction, Baring Private Equity Asia bought a controlling stake in Hexaware Technologies Ltd. for INR 135 per share, reflecting a premium of approx. 12% over its pre-acquisition market price. This premium, as observed in the aforementioned transactions, is often referred to as “control premium” or “acquisition premium”.

Summary of items included in this newsletter

Page 1

What is Control Premium?

Page 2

Why do we need to know about Control Premium?

Page 4

About Grant Thornton

Page 2

What drives Control Premium?

Page 3

Empirical analysis of transactions involving Controlling Stake

Page 6

Contact us

What drives Control Premium?

The acquirer pays a premium for a controlling stake because, unlike a minority stake, the acquirer can generate incremental value from the target by exercising prerogatives of control like ability to change the management, take better decisions for the company, change the capital structure to a more optimal level, etc. Further in case of strategic acquisitions, the acquirer, in addition to aforementioned benefits of control, could also generate incremental value through synergies derived from the target.

In case of the Baring-Hexaware transaction, Baring being a financial investor would have mainly expected to generate operational improvements by virtue of control, though it could have also generated revenue synergies for Hexaware from its portfolio. While in case of the Sun Pharma-Ranbaxy transaction, Sun Pharma mainly expected to generate significant synergies in the form of gaining a leadership position in the branded generics market, cross selling their products, operational synergies from procurement and supply chain efficiencies and also reducing the compliance costs by substituting Ranbaxy's FDA affected products with its own products.

Further, if there are several potential acquirers who are able to generate the aforementioned incremental value from the target, the existing shareholders of the target would have a better bargaining power to realise a larger share of this incremental value. Hence, the quantum of control premium being shared with the existing shareholders is dependent not only on the quantum of incremental value an acquirer expects to generate from the target, but also on the nature and number of potential acquirers. Since these factors vary significantly for each target, one can observe a wide range of premiums being paid in acquisitions ranging from nil to as high as 100%.



Very often in consummation of a deal, Control Premium plays a critical role. The right price determination is generally based on the perceived benefit of the acquirer in owning and managing the company his way.

Darshana Kadakia
Partner, Grant Thornton India LLP

Why do we need to know about Control Premium?

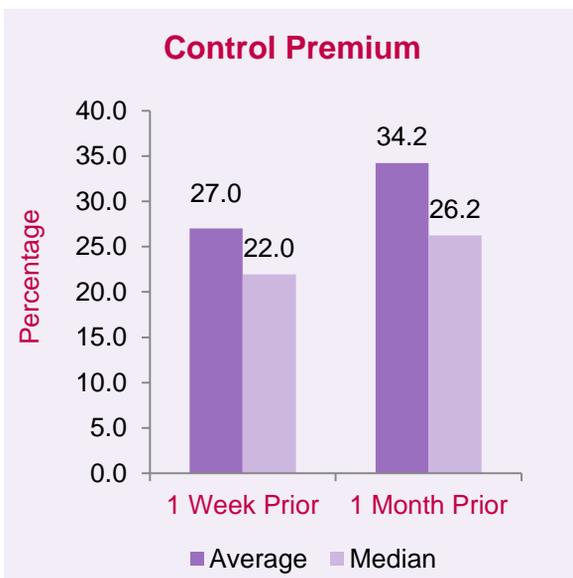
Though the premiums paid in transactions vary significantly, an empirical analysis of the historical premiums in the control transactions can be useful for the acquirer and seller in negotiations. It can also be useful for shareholders of the target in evaluating whether the shares should be tendered in an offer made by the acquirer.

Further, the control premium can become an important input for valuation of privately held companies for non-transaction related purposes e.g. for litigation, regulatory purposes, financial reporting, etc. In these valuations, where there is no willing buyer or a willing seller involved, the control premium data derived empirically could become a very important input in estimating the right value of the business being valued.

An empirical analysis of a transaction involving Controlling Stake.

For the empirical analysis, approximately 90 mid to large transactions carried out in India during the last 10 years involving acquisition of controlling stake in listed targets were identified. The 1 month and 1 week control premium was then calculated for each target by comparing the offer/acquisition price with the market price prevailing 1 month and 1 week prior to the announcement of the acquisition.

As per the chart below, the average 1 month and 1 week control premium paid in these transactions was estimated as 34.2% and 27.0% respectively; while the median control premium was approx. 26.2% and 22.0% respectively.

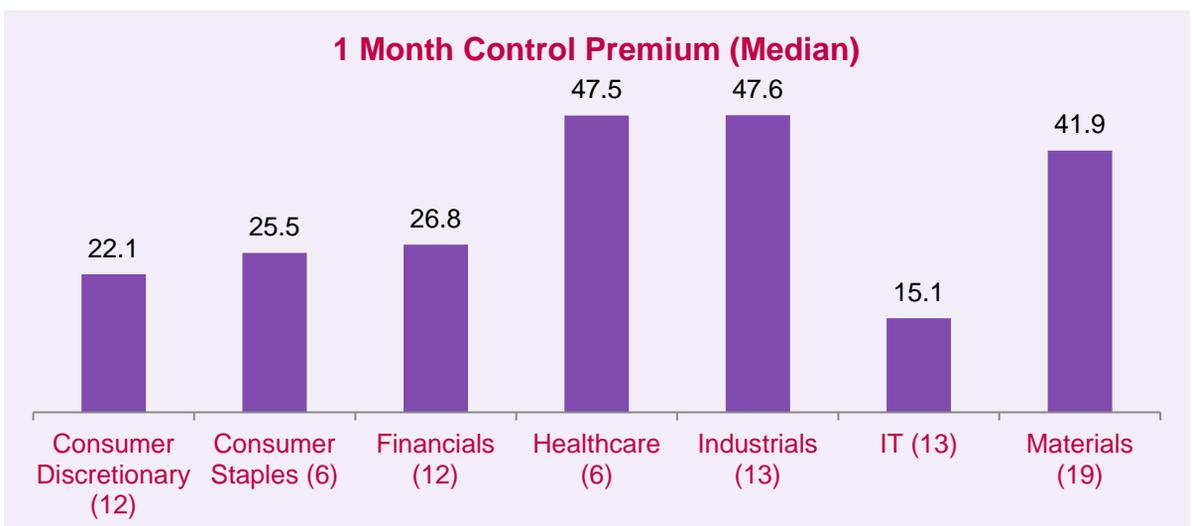


Since the average premium could be influenced by a few outlier transactions, a median was considered as a better measure.

Further, 1 month median control premium was considered as a better measure as 1 week market prices before the transactions could have been influenced by leakage of information on the transaction. Accordingly, based on the median 1 month control premium, the premiums paid in control transactions in India could be broadly considered to be approximately 26%.

An analysis of control premiums across various industries indicates that the control premiums have been lowest in the IT industry while being the highest in the healthcare industry. The higher premiums observed in healthcare, industrial and materials industries could be on account of scarcity of good assets and also due to involvement of foreign acquirers expecting to generate significant synergies from Indian targets.

Though it is difficult to generalise based on the lower number of transactions involving listed IT sector companies, the lower premiums observed in the IT sector might indicate that there are not too many acquirers trying to derive synergistic benefits from Indian IT companies. On the contrary, India IT companies have been acquiring smaller and niche targets outside India.



In a nutshell

To conclude, despite variance across various industries, significant control premiums, with a median of approximately 26%, have been paid historically to buy controlling stake in Indian companies. However, this figure should be considered only as a reference or starting point.

The appropriate premium for any target over the prevailing market price or the pre-acquisition value of the target, should be evaluated based on the industry in which the target operates, an analysis of the incremental value that can be generated from the target by exercising control, the number and nature of potential acquirers for the target and the kind of synergies potential acquirers can generate.

About Grant Thornton International

Grant Thornton is one of the world's leading organisations of independent assurance, tax and advisory firms. These firms help dynamic organisations unlock their potential for growth by providing meaningful, forward looking advice. Proactive teams, led by approachable partners in these firms, use insights, experience and instinct to understand complex issues for privately owned, publicly listed and public sector clients and help them to find solutions. More than 38,500 Grant Thornton people, across over 130 countries, are focused on making a difference to clients, colleagues and the communities in which we live and work.

About Grant Thornton India LLP

Grant Thornton India LLP is a leading professional services firm providing assurance, tax and advisory services to dynamic Indian businesses. "The firm's mission is to be the adviser of choice to dynamic Indian businesses with global ambitions."

With a partner-led approach and sound technical expertise, the Firm has extensive experience across many industries and businesses of various sizes. We provide focused practice groups in a range of industries, sectors and market segments. We have extensive experience in valuation, providing end to end compliance and advisory solutions to several prominent players.

Moreover, with our robust compliance solutions and ability to navigate complexities we help dynamic organisations unlock their potential for growth through global expansion, global capital or global acquisitions. With over 2000 people, the Firm is recognised as one of the largest accountancy and advisory firms in India with offices in New Delhi, Ahmedabad, Bengaluru, Chandigarh, Chennai, Gurgaon, Hyderabad, Kolkata, Kochi, Mumbai, Noida and Pune, and affiliate arrangements in most of the major towns and cities across the country.

We provide meaningful, actionable advice, every step of the way.

About our Valuation Services

Valuation services are required in acquisitions, investments, disposals, buyouts, mergers, restructuring, fair value accounting, statutory/ legal reporting. Grant Thornton's Valuations team has significant experience in providing valuation advice to corporates, funds and institutions for their entire range of requirements. Working as a cohesive global team, our Valuation specialists share ideas, contacts and sector knowledge to help deliver high quality advice to clients.

Following are some of the specialist valuation services that we provide:

- Business valuation
- Valuation of Intangibles
- Private Equity Valuation
- Valuation for Financial Reporting Purposes (US GAAP / IFRS / Indian GAAP)

About "Valuation Insights"

Valuation Insights is a periodic newsletter published by Grant Thornton India LLP, a member firm within Grant Thornton International. This publication is our effort to discuss and address various valuation issues using the best practices and international guidelines. Our team of professionals share their thoughts on the nuances of valuations and its strategic and practical implications. We hope that you will find our newsletter informative and encourage you to look at Grant Thornton as a reliable and valuable solution provider for your valuation needs.

Disclaimer

The information and opinions contained in this document have been compiled or arrived at from published sources believed to be reliable, but no representation or warranty is made to their accuracy, completeness or correctness. This document is for information purposes only. The information contained in this document is published for the assistance of the recipient but is not to be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient. This document is not intended to be a substitute for professional, technical or legal advice. All opinions expressed in this document are subject to change without notice. Whilst due care has been taken in the preparation of this document and information contained herein, Grant Thornton, does not accept any liability whatsoever, for any direct or consequential loss howsoever arising from any use of this document or its contents or otherwise arising in connection herewith.

Our offices in India

NEW DELHI

National Office
Outer Circle
L 41 Connaught Circus
New Delhi 110 001
T +91 11 4278 7070

BENGALURU

"Wings", 1st Floor
16/1 Cambridge Road
Ulsoor
Bengaluru 560 008
T +91 80 4243 0700

CHANDIGARH

SCO 17
2nd Floor
Sector 17 E
Chandigarh 160 017
T +91 172 4338 000

CHENNAI

Arihant Nitco Park, 6th Floor
No.90, Dr. Radhakrishnan Salai
Mylapore
Chennai 600 004
T +91 44 4294 0000

GURGAON

21st Floor, DLF Square
Jacaranda Marg
DLF Phase II
Gurgaon 122 002
T +91 124 462 8000

HYDERABAD

7th Floor, Block III
White House
Kundan Bagh, Begumpet
Hyderabad 500 016
T +91 40 6630 8200

KOLKATA

10C Hungerford Street
5th Floor
Kolkata 700 017
T +91 33 4050 8000

MUMBAI

16th Floor, Tower II
Indiabulls Finance Centre
SB Marg, Elphinstone (W)
Mumbai 400 013
T +91 22 6626 2600

NOIDA

Plot No. 19A, 7th Floor
Sector – 16A
Noida 201301
T +91 120 7109001

PUNE

401 Century Arcade
Narangi Baug Road
Off Boat Club Road
Pune 411 001
T +91 20 4105 7000



Please feel free to get in touch with us for information and assistance for your existing or potential service needs in Valuation.

Darshana Kadakia

Partner

Grant Thornton India LLP

E: Darshana.Kadakia@in.gt.com

David Panna

Partner

Grant Thornton India LLP

E: David.Panna@in.gt.com



Grant Thornton India LLP (formerly Grant Thornton India) is registered with limited liability with identity number AAA-7677 and its registered office at L-41 Connaught Circus, New Delhi, 110001

Grant Thornton India LLP is a member firm within Grant Thornton International Ltd ('Grant Thornton International').

Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered by the member firms independently. For more information or for any queries, write to us at contact@in.gt.com

www.grantthornton.in