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Case Study

The Shipping Division of a Publicly Traded Company

Service(s) offered: **Fair Market Valuation and Regulatory Impact Analysis**

Sector/Industry: **Marine Transportation**

Fair Market Valuation of a Corporate Restructuring involving the Merger of a Subsidiary

The client, a publicly traded conglomerate (Client), with interests in engineering, shipping and logistics, real estate and IT, was in the process of evaluating various strategies to streamline their corporate structure.

One of the strategies under evaluation was the merger of the Client's shipping subsidiary (Company) with its parent company. They approached Nexdigm to help determine the valuation of the shipping subsidiary and the Client; and evaluate the regulatory implications of the corporate restructuring.

Approach

Nexdigm's approach was divided into the following phases.

Phase I – Preparation of a Business Plan

Phase II – Valuation of the Shipping Subsidiary

Phase III – Broad Level Valuation of the Client

Phase IV – Evaluation of the Regulatory Impact of the Merger

Phase I - Preparation of a Business Plan

We established a preliminary understanding of the industry by referring to proprietary databases & research reports. A top-down approach was undertaken to understand the future outlook of the global shipping industry.

After an in-depth understanding of the operations of the shipping subsidiary, key drivers, competition, and identifying the micro/macro economic factors that affected the business, key performance parameters, and applicable tax laws (Chapter XII-G of Income Tax Act), we proceeded with the preparation of the business plan.

Phase II - Valuation of the Shipping Subsidiary

The Company's capital structure had Redeemable Preference Shares (RPS) and equity shares. We first valued the RPS followed by equity.

Preference Shares

We followed the guidelines prescribed by FIMDA to value the RPS. As the RPS had a 0% dividend payout, we valued the RPS as zero-coupon bonds using the Yield to Maturity method.

Equity Share

We then evaluated the valuation approach and identified the Discounted Cash Flow (DCF) method, Comparable Transaction Multiple (CTM) method and Net Asset Value (NAV) method as suitable methods to value the business.

Discounted Cash Flow Method

Based on the business plan, we arrived at the free cash flows of the Company and thereafter estimated the cost of capital after analyzing the listed peers. Based on this, we arrived at the present value of future operations.

Comparable Transaction Multiple

We analyzed the Indian shipping industry for mergers and acquisitions, and arrived at the relevant valuation matrix. The fact that there was a recent transaction involving the shipping subsidiaries proved to be an added benchmark. Based on the above analysis, we arrived at the value using the EV/Sales and EV/EBITDA multiples.

Net Asset Value (NAV)

Considering the asset intensive nature of the business, we also considered the NAV method. The net assets of the business were adjusted with the fair value of the vessels to arrive at the value.

After giving due weightage based on facts and circumstances; we arrived at the value of the Company. Then, backing out the value of the RPS from the overall value of the Company, we arrived at the Equity and the resultant value of the Client's equity stake.

Phase II – Broad Level Valuation of the Client

The Client was listed on the stock exchange, and the Promoter Group (Promoter) of the Client held shares in the Client as well as the Company. In addition, there was cross-holding between the Client and the Company on account of past mergers and acquisitions. With this background, we needed to evaluate the regulatory implications of the merger of the Company with the Client.

To do so, we needed to arrive at the value of the Client to evaluate the impact of the merger on the Promoter shareholding of the Client. For the same, we considered Market Capitalization Method and Sum-of-the-Parts (SoTP) methods.

Market Capitalization Method

- Market Capitalization was deemed important since the Client was a listed entity, and SEBI regulations inadvertently mandate a 2-week or 26-week weighted average volume price for most transactions involving listed entities shares.
- Considering that the shares were infrequently traded, we considered market capitalization as the floor of our valuation range

Sum-of-the-Parts-Method (SoTP)

- As is the case with most holding companies, the market capitalization is seldom reflective of the fair value of the company's operations and its holdings. There, we also considered a broad level SoTP value of the Client.
- The Client had already had a few of its key holdings valued for management planning; those along with the valuation of the shipping company and a broad level valuation of its residual investments culminated in the SoTP value of the Client.
- The SoTP served as the cap of our valuation range

Phase IV – Evaluation of the Regulatory Impact of the Merger

Based on the valuation of the Company and a valuation range of the Client, we estimated the resultant pact on Promoter shareholding at various intervals of the range.

Once we had a clear indication of the revised Promoter shareholding, we proceeded with the analysis of the regulatory impact at the different intervals.

At the near-end of the Client's valuation range, the Promoter shareholding was increasing beyond 75%. This led the merger to trigger/violate some of the key laws, rules, and regulations including:

- Securities Contracts (Regulations) Rules, 1957
- S.E.B.I. (Substantial Acquisition of Shares & Takeover) Regulations, 2011
- S.E.B.I. (Delisting Of Equity Shares) Regulations, 2009
- Listing Agreement

Based on the above, we recommended that in the scenario where the merger resulted in the Promoter shareholding to increase beyond 75%, there was a remote possibility of the High Court approving the merger scheme

At the far-end of the Client's valuation range, no major law was triggered/violated, but as the merger involved Promoters, a super majority approval was needed.

Impact

We arrived at the valuation of the Client and its shipping business, analyzed the impact of their merger on Promoter shareholding, and presented the client with our analysis detailing the impact of the merger from the perspective of myriad laws and regulations applicable to listed companies.

Thus, we assisted the Client in assessing the holistic impact of the proposed corporate restructuring.

For more information on this case study, please write to us at:

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You can also visit our website to know how our services resulted in tangible business benefits:

www.nexdigm.com