



## HOSTILE TAKEOVER OF L& T ON MINDTREE – CREATING VALUE FOR THE ORGANISATIONS

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### 1. INTRODUCTION

In the year 2019 the Indian IT industry was abuzz with the news of a hostile takeover. Larsen and Toubro, which is one of the largest and the most iconic information technology firms in the country is trying to forcefully acquire Mindtree which is a medium-sized information technology company. But hostile takeover is said to be one where a company by going to the target company's shareholders or by fighting to replace management to get acquisition, which resulted due to the news which is abuzz about how Mindtree promoters do not want to sell to L&T and how L&T is trying every trick in the book to acquire this company.

On the prima facie, L & T Mindtree takeover seems to be a “grave threat to the unique organisation collectively built over 20 years” has been tweeted by Mr. Subroto Bagchi, co-founder and member of the board of Mindtree Ltd when he resigned from the board of

Directors. But L & T 10733 crore takeover bid cannot be termed as hostile since the 20% stake shareholder V G Siddharatha approached us with an open offer to buy 31 % along with brokers to picking up 15% stake which adds to 66.32% stake the takeover was as per norms making it a strategic financial value addition to the group.

L& T was driven by the same greed that most hostile takeovers are fuelled with, however the reality is that Mindtree acquisition bid has less to do with the attractiveness of Mindtree as a target company, instead the takeover was drove by various regulatory actions and internal financial conditions. How much deleterious hostile takeover may be considered there are many positive outcomes too. A bid of hostile takeover compels the management to work efficiently, true value of business comes to fore, shareholders get a.n opportunity to sell their stake at a good premium.

## 2. COMPANY ORIGINS AND BACKGROUND

**L&T GROUP:** L & T Ltd was founded by two Danish engineers Holck- Larsen and Kristian Toubro, L& T has been one of India's largest enterprises with a conglomerate spread in engineering, constructions, manufacturing, IT and financial services. With revenues of nearly US\$20 billion and an employee base of over 44000 globally, the widely diversified Group was ranked 500 on Forbes list of 2000 largest and most powerful public limited companies of the world. L & T Ltd was one of the first company in the IT space to award ESOP due to which L&T Employees Trust held 13.38% stake in L&T.

L& T group flagship established in 1997 L & T infotech as a wholly owned subsidiary of L&T. L&T though was set up to retain top talent within the Group and reduce attrition to the IT sector, has rapidly stepped up on the value chain, acquiring new skill sets and upgrading processes and platforms which is been seen due to the presence in 32 countries. L&T Infotech ltd the IPO issue was oversubscribed by 11 times.

**MINDTREE Ltd:** MindTree was set up in the year 1999 by group of ten veterans of Indian IT industry, which later was described by the New York Times as a different kind of company "value based, socially sensitive" entity. To infuse more funds to growth in the inorganic IT market, the group raised \$ 9.5 million from the US venture fund Walden and a young local venture capital firm founded by V. G Siddharath that had profitably backed Infosys Ltd. The group spread out its branches

to achieve a target of \$ 1 billion by 2014, by acquiring various Indian R & D centres for producing mobile handsets, which did not find any success, after incurring huge losses Mind

tree exited the products line. The company leadership was at stake due to the inefficient decisions to grow, resulting in exit of Soota, a key co-founder.

V G Siddharatha bought out the Soota stake and became single largest shareholder of Mind tree ltd. After this strategic move from the board the entire business was divided into two business units Information Technology and Product Engineering Services, which stepped the growth of the company and performance improved by 2016. The group acquired many companies and by the end of 2018 the total revenue stands at \$ 846.8 millions. The share price was over ` 1000 per share in April 2018 hitting new heights in stock market and gathering more storms

## 3. BACKGROUND OF THE TAKE OVER

L&T has found itself in a position where it has a lot of excess cash. The company wants to channel this cash into creating higher growth rates. The software industry provides one of the highest rates of return in India. This is the reason why L&T has decided to make an acquisition in the software space, and Mindtree came into the picture.

**Excess Cash and the Failed Buyback Bid:** L&T currently has more than \$2 billion in cash reserves. The company is expected to add another \$1.5 billion in terms of free cash flow by the year 2020. This excess cash is currently invested at a rate of 5%. This is obviously dragging down the overall return on equity for the company. "Mindtree was not the first choice for L&T when it came to deploying these additional funds. Instead, the company wanted to buy back outstanding shares from the market. This \$1.5 billion bid was foiled by the Securities and Exchanges Bureau of India (regulator). The regulator did not allow the

buyback offer to go through. SEBI objected because, after the buyback, the debt to equity ratio of L&T would have crossed 2:1. This is against the compliance norms laid down by SEBI

As per L&T, initially, Cafe Coffee Day founder VG Siddhartha who was facing pressures of liquidity approached them offering to sell his stake in the company in March 2019. Interestingly, Siddhartha was the single-largest non-promotor shareholder having 20.32 per cent stake in Mindtree.<sup>7</sup> L&T offered him Rs 980 per share, which approximately amounted to Rs 3,269 crores. This offer was vehemently opposed by the management of Mindtree which set stage for a hostile acquisition.

In March 2019, Chairman of L&T AM Naik in his address to the media had explained how the acquisition of Mindtree was a value addition. The Indian conglomerate already has a listed IT company - L&T Infotech - which focuses on BFSI verticle whereas, Mindtree largely focuses on clients from hospitality and retail sector. So, a takeover would mean an expansion of L&T's information technology business.

In a normal scenario, when a company tries to acquire another, it can offer to gain control if it owns 25 per cent stake of the company it is trying to acquire<sup>8</sup>. However, L&T did not own 25 per cent ownership of the company. So, L&T used a loophole in the Securities and Exchange Board of India's (SEBI's) Takeover Code.

The Indian conglomerate used Section 3, Clause 1 along with Section 4 of the securities regulator's takeover code, which entitles L&T to make an open offer to acquire public shareholding in the company.

As per this section, those with a 25 per cent stake or more cannot take over a company unless an open offer has been made to acquire shares of a company with a public announcement. However, the takeover code also says whether or not one holds shares or voting rights in the company, one is not eligible to take control unless a public announcement of an offer to acquire those shares is made. This allows L&T to make an open offer, without owning 25 per cent shares in the IT major

#### **4. TAKEOVER – LEVERAGED AND PLANNED UTILISATION OF RESOURCES**

The deal started when L&T bought 20.32 per cent shares in Mindtree from Cafe Coffee Day founder VG Siddhartha for almost Rs 3,269 crores in March 2019. Following this, it made an on-market purchase of around 15 per cent capital shares.

L&T made an open offer for an additional 31 per cent stakes which started on June 17 and concluded on June 28, 2019. On July 2, 2019, Mindtree said in its regulatory filing, "We wish to inform that Larsen & Toubro Limited has acquired equity shares to an extent 60.06 per cent of the total shareholding of the company and has acquired control and is categorised as promoter pursuant to Sebi... Regulations, 2018."

**Table 1: Mindtree Financial Performance Pre and Post Takeover from 2015 to 2020**

|             | REVENUE( INR IN MILLIONS)               | EBITDA( INR IN MILLIONS)     | NET PROFIT( INR IN MILLIONS) | EPS ( BASIC)          |
|-------------|---|------------------------------|------------------------------|-----------------------|
| FY 2020- 19 | 70215                                   | 10645                        | 7541                         | 45.94                 |
| FY 2019-18  | 54628                                   | 7405                         | 5701                         | 34.39                 |
| FY 2018-17  | 52364                                   | 7181                         | 4186                         | 24.93                 |
| FY 2017-16  | 46730                                   | 8210                         | 5525                         | 32.95                 |
| FY 2016-15  | 35619                                   | 7092                         | 5363                         | 32.07                 |
|             | Market capitalisation( INR IN MILLIONS) | Net worth ( INR IN MILLIONS) | ROCE( INR IN MILLIONS)       | ROE( INR IN MILLIONS) |
| FY 2020- 19 | 109158                                  | 33061                        | 31.28%                       | 26.90%                |
| FY 2019-18  | 109606                                  | 27414                        | 27%                          | 21.40%                |
| FY 2018-17  | 76107                                   | 25771                        | 22.40%                       | 16.80%                |
| FY 2017-16  | 126543                                  | 24149                        | 33%                          | 25.00%                |
| FY 2016-15  | 109158                                  | 20124                        | 37.80%                       | 29.40%                |

**Table 2: Mindtree vs L &T Group of Companies**

|             | Revenue ( INR IN MILLIONS) |             | PAT MARGIN |             |
|-------------|----------------------------|-------------|------------|-------------|
|             | Mindtree                   | L & T Group | Mindtree   | L & T Group |
| FY 2020- 19 | 70215                      | 97481       | 10.7       | 16          |
| FY 2019-18  | 54628                      | 77326       | 10.4       | 15.2        |
| FY 2018-17  | 52364                      | 65009       | 8          | 14.6        |
| FY 2017-16  | 46730                      | 58709       | 7.4        | 13.4        |
| FY 2016-15  | 35619                      | 47816       | 6.3        | 12.1        |
|             | EBITDA Margin              |             | ROE MARGIN |             |
|             | Mindtree                   | L & T Group | Mindtree   | L & T Group |
| FY 2020- 19 | 15.2                       | 23.03       | 24.9       | 40.2        |
| FY 2019-18  | 13.6                       | 22.78       | 21.4       | 31.8        |
| FY 2018-17  | 17.6                       | 20.96       | 16.8       | 34.6        |
| FY 2017-16  | 16.6                       | 20.01       | 12.3       | 32.4        |
| FY 2016-15  | 15.5                       | 19.2        | 10.56      | 29.6        |

Note: Authors Computation

## 5. PAYMENT OF RETURNS

L&T was not left with too many other options either. The company has already been paying excess dividends. The dividend paid in the year

2016 was a mind-boggling 33% of the annual profit of the company. The problem with raising dividends is that they set expectations for the future. Hence, if dividends are raised now, they cannot be reduced in the future without a sharp reaction from the market. This is the reason why L&T did not choose to take the dividend route.

### 5.1 Offloading Non-Core Assets:

L&T is also under pressure to increase its return on equity. The company's return has fallen from 24% to as low as 9% in the past decade. L&T has stabilized its ROE at a respectable 15% at the moment. However, the shareholders are hungry for more. This is why L&T is being forced to sell off non-core assets and deploy the proceeds in high margin business like the software industry.

### 5.2 Why Mindtree

L&T group's core business—large infrastructure projects such as airports, bridges and power plants—generates profit after tax (PAT) of around 7 per cent. Over the last few years, the group have been giving more fillip and push to services business. These businesses are more profitable and we are able to see PAT of 15-16 per cent. From an overall portfolio point of view, it makes sense to grow the business faster. Mindtree was one of the earlier companies to sense and seize the opportunities in new digital technologies like artificial intelligence, automation and machine learning. In the January-March 2019 quarter, digital technologies accounted for 49 per cent of the company's revenue as compared to TCS

There are other synergies across services verticals. For instance, L&T Infotech has a strong presence in banking, financial services

and insurance verticals, which contributed 47 per cent of its revenue and is followed by manufacturing (15.9 per cent).<sup>11</sup> On the other hand, at Mindtree, it is hi-tech and media (39.6 per cent), and retail and consumer packaged goods that were the strong contributors.

## 6. CREATION OF VALUE FOR L&T

The acquisition will help L&T add several large clients to its IT services portfolio. "Over the next 1-2 years, the acquisition of Mindtree would add significant scale, plug the gaps in LTI's portfolio and add new large clients (Hermes, The Carlyle Group and Microsoft) and enhance the digital capabilities and presence in infrastructure management space and cloud within the L&T group."<sup>13</sup>

Finding new leaders and a plan of action to retain existing managers at Mindtree will be a critical focus area for the L&T management. In the quarter ended March 2020, growth was driven by a sequential rebound in travel, acceleration in retail and manufacturing, and continued traction in communication, media and technology.<sup>14</sup>

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