# Vedanta's delisting – discovering the right price

*After having approved the delisting of Vedanta Limited from the Indian stock exchanges, the next step is for investors to arrive at the right price, through a reverse book building process. While IiAS refrains from making price recommendations, indicators suggest that the delisting price of 3.5x – 4.5x the floor price of Rs. 87.25: at the same time, shareholders will do well to remember that there is a price beyond which they risk turning away the promoters.*


Vedanta Resources Limited (VRL), the controlling shareholder of Vedanta Limited, on 12 May 2020 announced its decision to delist Vedanta Limited (Vedanta) from the Indian stock exchanges.

Shareholder approved the delisting of Vedanta's equity from the Indian stock exchanges in its June 2020 postal ballot, which is in keeping with IiAS' recommendation. Despite the floor price being low, and almost opportunistic, at Rs. 87.25, IiAS argued that the reverse book building process protects investors rights.

The next step is price discovery under the reverse book building process.

**Exhibit 1: Voting outcome for June 2020 postal ballot – Voluntary delisting of Vedanta's equity shares**

| Promoter/Public | No. of shares held (mn) | No. of votes polled (mn) | % of Votes Polled | No. of votes in favour (mn) | No. of votes against (mn) | % of votes in favour | % of votes in against |
|---|---|---|---|---|---|---|---|
| Promoters | 1,863.6 | 1,863.6 | 100.0% | 1,863.6 | 0.0 | 100.0% | 0.0% |
| Institutional holders | 1,251.2 | 1,090.1 | 87.1% | 929.9 | 160.2 | 85.3% | 14.7% |
| Others | 602.4 | 195.9 | 32.5% | 146.4 | 49.5 | 74.7% | 25.3% |
| **Total** | **3,717.2** | **3,149.6** | **84.7%** | **2,939.9** | **209.7** | **93.3%** | **6.7%** |

*Source: www.iiasadrian.com*

**What is the right price?**

Under the reverse book building process, the price at which VRL can acquire public shareholding that takes VRL's shareholding to at least 90% of the paid-up capital will be the discovered price. Following the price discovery, VRL can either decide to accept the discovered price, reject the discovered price, or make a counter-offer that cannot be below book value.

A quick analysis of some data points suggests that the discovered price should be much higher than the floor price.

1. **Book value of Rs. 89.38 per share effective 31 March 2020 announced by VRL is significantly lower than the Rs. 193 per share book value (consolidated) reported in the annual report**

   Based on annual report disclosures, Vedanta's book value on 31 March 2020 aggregated Rs. 193.0 per share, after accounting for the Rs. 176.36 bn impairment loss. This impairment loss relates largely to Vedanta's oil and gas assets. While indeed the COVID crisis had depressed oil prices, these have since bounced back to a large extent. In September 2020, VRL announced that Vedanta's 31 March 2020 consolidated book value is Rs. 89.38 per share – we expect the company will have subsequently written down more of the assets, and is possibly done to anchor the counter-offer price under the delisting regulations. Shareholders must question the nature and timing of these asset write downs. Commodity prices are bouncing back and once the global economic environment stabilizes, it is likely that the assets will be revalued upwards. Further, we raise concern over subsequent devaluation of the book value after the financial statements have been audited.

2. **Vedanta's 64.92% equity in HZL is valued at Rs. 160 per share**

   HZL's market capitalization is significantly higher at Rs. 921 bn, against Vedanta's Rs. 509 bn. Vedanta's current market capitalization is lower than the value of its 64.92% equity holding in HZL – which is estimated at Rs. 598 bn. The market has attributed a large holding company discount to Vedanta's equity in HZL – and rightfully so given how the company has decided to deviate from its dividend policy and not distribute Rs. 45 bn received from HZL as interim dividend for FY20.

If investors were to simplistically factor in the two data points above, it suggests that the discovered price should be at around 3.5x-4.5x the floor price: the current trading price at Rs. 137.0, is at 1.6x the floor price.

**Discovered price vs. floor price**

The floor price is determined by SEBI regulations and is weighed by the range of the recent stock price, which was low at the time of the announcement – as the market factored in the impact of the COVID 19 crisis. However, delisting of an equity must factor in the intrinsic value of the business. In the past, the discovered price has been significantly higher than the floor price, as we expect will the case for Vedanta too. But shareholders will do well to remember that there is a price beyond which they risk turning away the promoters.

**Exhibit 2: Difference between floor price and discovered price in the six delisting attempts**

| Particulars | Year | Status | Floor Price | Discovered price | Premium to floor price |
|---|---|---|---|---|---|
| Hexaware Technologies Limited | FY20 | Ongoing; discovered price accepted | 264.97 | 475.00 | 79% |
| Linde India | FY19 | Rejected | 428.50 | 2,025.00 | 373% |
| Polaris Consulting | FY18 | Completed | 370.00 | 480.00 | 30% |
| Claris Lifesciences Limited | FY18 | Completed | 351.60 | 400.00 | 14% |
| Essar Oil | FY16 | Completed | 146.10 | 338.30 | 132% |
| Essar Shipping | FY16 | Completed | 93.70 | 133.00 | 42% |

*Source: BSE, IiAS Research*

**How likely is it for VRL to accept a higher discovered price?**

IiAS believes the group's need to access the cash flows of its listed companies is dire – and driven centrally by the burgeoning debt burden at the holding company and the consequent repayment pressures. The promoters have not injected any equity into the business in over ten years, even as turnover, on a consolidated basis, increased from Rs 66.7 bn in FY10 to Rs 844.5 bn in FY20 (through organic and inorganic expansion). Transactions have been funded using debt.

The aggregate debt across the group (Vedanta, VRL and other holding companies) is estimated at $17bn in March 2020[1]. The debt build-up was on account of the acquisition of a stake in Anglo American and the delisting of VRL. Repayment pressures on the group are high - around $1.9bn will need to be refinanced[2], which includes a $670 mn bond due in June 2021[1].

Cash generation for the group is through the operating subsidiaries, Vedanta and its 64.92% subsidiary Hindustan Zinc Limited (HZL). Since both these are listed, the access to cash flows generated by these companies requires shareholder approval.

In the past, the group has undertaken transactions bypassing shareholder approval to access cash in these companies. The 2015 $125 mn loan by one of Cairn India's subsidiaries to one of Vedanta's subsidiaries is one such transaction[3]. In December 2018, Vedanta's overseas subsidiary Cairn India Holdings Limited (CIHL) paid a part sum of $200 mn (Rs. 14.31 bn) towards purchase of an economic interest in a structured investment in Anglo American PLC from Volcan Investments Limited (Volcan). The ownership of the underlying shares, and the associated voting interest, remained with Volcan.

[1] *Source: Standard and Poor's Bulletin on Vedanta Resources Limited dated 13 May 2020*
[2] *Source: Moody's rating action on Vedanta Resources Limited dated 24 March 2020.*
[3] *At the time of this transaction, Cairn India was not merged into Vedanta and was a separately listed company in India.*

In the first quarter of FY21, Vedanta's overseas subsidiaries have extended loans aggregating USD 307 mn (Rs. 27.23 bn) to VRL (repayable in June 2021) under the guise of better cash management.

Past mergers and acquisitions can be attributed, to an extent, to improve financial flexibility of the group and manage debt repayments. The August 2013 merger of Sesa Goa into Sterlite Industries Limited (Sterlite) created a combined balance sheet that had better credit metrics. The 2016 merger of Cairn India with Vedanta Limited once again allowed Vedanta's debt-heavy balance sheet to leverage on Cairn's cash-heavy balance sheet.

The Vedanta group's long-term ability to repay debt is clearly hinged on its ability to access Vedanta's cash flows. By Vedanta's delisting and therefore owning 100% of its equity (from the current 50.14%), VRL's consolidated EBITDA will likely double, and it will have full access to Vedanta's share of HZL's dividend. It will also give the group the financial flexibility to merging the businesses.

**What investors must do**

The market in the aggregate will be better-off if some companies are not listed. Notwithstanding their past experience with such businesses, investors still need to engage vigorously with those that are choosing to delist.

We believe the group has a dire need to delist Vedanta and will likely accept a higher discovered price. IiAS recommends investors must actively participate in the price discovery of Vedanta as there is still some upside from the current market price, even as they exercise caution and balance it against the price at which the promoters will walk away.

**Exhibit 3: Regulation Snapshot: Reverse book building process under SEBI (Delisting) Regulations, 2009**

In the Reverse Book Building (RBB) process, the shareholders bid online the prices at which they would be willing to sell the shares. Schedule II of the SEBI (Delisting) Regulations, 2009, lays down the process.

Under the RBB process, the promoter/acquirer shall appoint a Merchant Banker and also a trading member for placing bids on the online electronic system. The Merchant Banker and promoter shall make a public announcement and dispatch a letter of offer to the public shareholders along with a bidding form. Shareholders may approach the trading member for placing offers on the on-line electronic system with the bidding form. The shareholders desirous of availing the exit opportunity are required to tender their shares to the trading members prior to placement of orders.

The final offer price shall be determined as the price at which shares accepted through eligible bids, that takes the shareholding of the promoter group/acquirer to 90% of the total issued shares of that class excluding the shares which are held by a custodian and against which depository receipts have been issued. If the price discovered under the mechanism is not acceptable to the promoter/acquirer, the promoter/acquirer may make a counter offer to the public shareholders within two working days of the date of the price discovery. The counter offer price shall not be less than the book value of the company as certified by the merchant banker.

If a counter offer has been made, the offer to delist will be successful only if the post-offer promoter shareholding taken together with the shares accepted at the counter offer price reaches 90% of the total issued shares of that class excluding the shares which are held by a custodian and against which depository receipts have been issued.

**Exhibit 4: Top five non-promoter shareholders on 30 June 2020**

| Name of the investor | No. of shares | % of voting rights |
|---|---|---|
| LIC of India Health Protection Plus Non-Unit Fund | 23,66,93,475 | 6.37 |
| ICICI Prudential Equity Arbitrage Fund | 17,89,54,673 | 4.81 |
| HDFC Equity Fund | 11,15,69,427 | 3.00 |
| SBI Arbitrage Opportunities Fund | 4,31,45,079 | 1.16 |
| PTC Cables Private Ltd | 4,27,30,200 | 1.15 |
| **Total** | **61,30,92,854** | **16.49** |

Source: BSE

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