

## **VEDANTA LTD – CAIRN INDIA MERGER: WIN –WIN FOR BOTH?**

**Mr. Hitesh Punjabi**

*Assistant Professor*

*Finance at Chetana's Institute of Management and Research*

**Mr. Rabindra Singh**

*Assistant Professor*

*Finance at Chetana's Institute of Management and Research*

### **Vedanta Ltd – Cairn India Merger: Win –Win for Both?**

“The Merger of Cairn India and Vedanta Limited consolidates our position as India's leading diversified natural resources champion, uniquely positioned to support India's economic growth. This marks a significant step towards achieving our stated long term vision of a simplified group structure with alignment of interest between all shareholders for creation of long term sustainable value”

**-Mr Anil Agarwal,Chairman of Vedanta plc**

“The merger with Vedanta Limited will generate additional value for our shareholders and de-risks Cairn India by providing access to a portfolio of diversified Tier-1, low cost, long-life assets, to deliver significant near term growth. The financial strength of the enlarged group will ensure greater access to capital to further Indian oil & gas development.”

**-Mr Mayank Ashar,CEO of Cairn India**

### **Introduction**

On June 2015, India's biggest diversified natural resources company, Vedanta Resources plc, announced plans to merge two of its businesses — India's largest private miner, Vedanta Ltd (Vedanta), and oil and gas exploration and production firm Cairn India Ltd. Under the scheme for each equity share held, the minority shareholders of Cairn india will receive (a) one equity share of VEDL and (b) one 7.5% redeemable preference shares (RPS) in Vedanta with a face value of Rs 10, which will be redeemable at par after 18 months. The transaction will require approval of majority of the minority shareholders (Vedanta cannot vote in Cairn), and other regulatory approvals 4). The transaction is expected to be closed in Q2CY16. Shareholding of Vedanta PLC in Vedanta India would fall to 50.1% from 62.9% pre-merger. The merger of wholly owned foreign subsidiaries i.e. Bloom (and its step down subsidiaries such as TSML which hold debt pertaining to acquisition of CAIR) will be considered at later stage.

## Background Note

### Cairn India

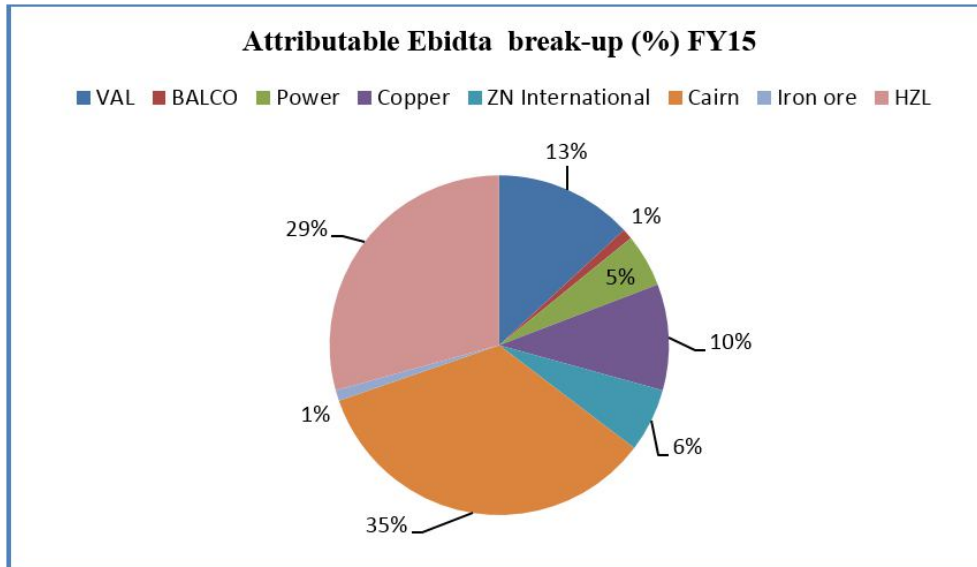
Cairn India is one of the largest independent oil & gas exploration and production companies in India. It operates 27% of India's domestic crude oil production and to date has opened 4 frontier basins with numerous discoveries. Cairn India has a portfolio of 9 blocks - one block in Rajasthan, which contains multiple assets, two on the west coast and four on the east coast of India and one each in Sri Lanka and South Africa. Oil and gas is currently being produced from Rajasthan, Ravva and Cambay. It is listed on the BSE and NSE in India.

Cairn India had gross assets of \$10.7 billion as of 31 March 2015 and profit before tax (before exceptional items) ("PBT") of \$1.2 billion for the year ending 31 March 2015. Vedanta Limited had gross assets of \$8.6 billion as of 31 March 2015 and PBT (before exceptional items) of \$2.0 billion for the year ending 31 March 2015.

### Vedanta India Ltd

Vedanta India is a subsidiary of Vedanta Resources, the London-listed metals and mining group. Vedanta India is a globally leading diversified resources company with presence in oil & gas (through 58.9% stake in Cairn India), zinc-lead-silver (through 64.9% stake in HZL and 100% stake in erstwhile zinc-lead business of Anglo American), copper, iron ore, aluminium and commercial power (largely in standalone business but in subsidiaries as well). The company was formed through the merger of Sterlite Industries into Sesa Goa along with acquisition of additional 38.8% stake in Cairn which was consummated in August 2013 and announced in February 2012. Cairn has stakes in the following producing blocks: 70% in Rajasthan RJ-ON- 90/1, 22.5% in Ravva and 40% in Cambay block CB-OS/2. In its largest field in Rajasthan, the gross proved & probable Hydrocarbons Initially In Place (HIIP) stands at 6 bnboe. VEDL is the largest non-ferrous metals player in India with presence across all key base metals, viz. aluminium (0.8mtpa), copper (0.4mtpa) and zinc lead (1.0mtpa). The company entered the nonferrous metals sector as a pure play copper producer and through several strategic acquisitions acquired aluminium as well as zinc-lead assets. VEDL has ventured into commercial power generation business in India. It has a 2,400MW power plant (in Orissa) and is in the midst of adding another 1,980MW capacity (in Punjab). The company has iron ore mining assets in Goa and Karnataka (with reserves/resources of 433mt).

Business	Capacity	Expansion
Oil(Cairn)	225kbpd	0
Refined Zinc+ Lead(HZ)	1008ktpa	200ktpa
Silver(HZ)	500tpa	0
Refined Zinc+MIC(Zinc Int)	400ktpa	250ktpa
Copper(Sterlite)	405ktpa	0
Aluminium(VAL)	500ktpa	1250ktpa
Aluminium(Balco)	245ktpa	325ktpa
Power(SEL)	2400MW	0
Power(TSPL)	0	1980MW
Iron Ore(Sesa Goa)	7.8mtpa	0



### The Deal

The merger is a non-cash deal. For every share held, shareholders of Cairn will get 1 equity share and one 7.5% redeemable preference share in VEDL with face value of Rs 10 redeemable at par after 18 months. This will lead to additional issue of 752mn equity shares (~25% dilution) and 752mn preference shares of VEDL.

- Post the merger, Vedanta Resources Plc's ownership in VEDL will reduce from 62.9% to 50.1%.
- The transaction is expected to be completed by Q2CY16.

### Computation of revised promoter stake on merger with Cairn India, (%)

		No. of shares(mn)	No. of shares(mn)
<b>Swap ratio (X) - (A)</b>		<b>1.1</b>	<b>1</b>
Vedanta shares outstanding	62.90%	2,965	2,965
Promoter's stake in Vedanta		1,864	1,864
Cairn shares outstanding		1,875	1,875
<b>Cairn India shareholding</b>			
Promoter stake (Vedanta)	59.90%	1,123	1,123
Minority stake (B)	40.10%	752	752
<b>New Vedanta shares to be issued (A x B) - (C)</b>		827	752
Vedanta - new shareholding			
Existing shares		2,965	2,965
New shares to Cairn minorities		827	752
<b>Total shares outstanding</b>		<b>3,792</b>	<b>3,717</b>
Shares with promoters		1,864	1,864
<b>Promoter stake (%)</b>		<b>49.2</b>	<b>50.1</b>

Source: BSE, Company

### Merger approval likely to be completed by Q2CY16

Management had given guideline for the approval of merger approval will be completed by Q12016, but due to delay in approvals from SEBI, now management expects the process to be completed by Q2 2016.

The proposed merger will require the following approvals: i) Stock Exchanges (BSE, NSE) and regulator (SEBI), ii) Majority (>50%) of minority shareholders at CAIR and VEDL, iii) Simple majority of all shareholders of Vedanta PLC, iv) High Court, v) Indian oil ministry and vi) Foreign Investment and Promotion Board (FIPB). The unresolved tax dispute between Cairn Energy/ Cairn India and the Government of India might delay the approval process.

### Transaction timeline

Key Events	Expected Date
BSE, NSE and SEBI approvals sought	Q2 2015
BSE, NSE and SEBI approvals	Q3 2015
Vedanta plc posting of UK Circular	Q3 2015
Application to High Court in India	Q3 2015
Vedanta plc EGM	Q3 2015
Vedanta Limited and Cairn India shareholder meetings	Q4 2015
Foreign Investment Promotion Board approval	Q4 2015
High Court of India approval	Q1 2016
MoPNG approval	Q1 2016
Transaction completion	Q1 2016

Source: BSE, Company

### Rationale for Acquisition

- Diversified Tier-I portfolio de-risks earnings volatility and will drive stable cash flows through the cycle.
- Improved ability to allocate capital to the highest return projects across the portfolio.
- Greater financial flexibility to sustain strong dividend distribution.
- Cost savings by centralising various operations and economies of scale.
- Cost savings and potential re-rating to benefit all shareholders
- The transaction will contribute to further the streamlining of internal processes and improved productivity beyond the previously announced \$1.3 billion.
- Stronger balance sheet will allow for the overall cost of capital to be reduced.
- Consistent with stated corporate strategy to simplify the group structure.
- Being part of a larger entity will allow Cairn India to benefit from increased economies of scale and improved free float & trading liquidity
- Earnings will be de-risked through increased diversification, offering exposure to a larger, more resilient and diversified commodity mix.
- Offers Cairn India shareholders exposure to Vedanta Ltd's well invested Tier-I, structurally low cost,

longer-life assets, including best in- class zinc platforms, which have significant latent capacity ramping up.

- Retains proven management team and decision-making framework, retaining the Cairn India brand.

### Material improvement in capital structure; win-win for both

Some Analyst are of opinion the transaction will materially improve the fungible flows of cash/debt across diversified set of commodities. Net Debt to EBITDA will improve from 12x earlier to 5.0x among the fungible cash flow businesses. CAIR shareholders will now get additional exposure to low cost high quality diversified set of metals and power business thereby reducing the risk to single commodity. Accumulated cash on CAIR's balance sheet will now yield better returns. There will be no more need for VEDL to service interest payments through dividend from subsidiaries. The merger will help in optimizing the capital structure of group and reducing cost of funding. The merger is a win-win for the shareholders of both VEDL and CAIR.

	Pre-Merger	Post Merger
	FY16E	FY16E
<b>EBITDA</b>	<b>60,791</b>	<b>110,786</b>
Standalone	53,497	53,497
Zinc-Int	7,294	7,294
Cairn		49,995
Bloom		
<b>Net Debt</b>	<b>727,404</b>	<b>555,032</b>
Standalone	375,791	375,791
Zinc-Int	-75,097	-75,097
Cairn		-172,372
Bloom	426,710	426,710
<b>Net Debt / EBITDA</b>	<b>12</b>	<b>5</b>

Source: Analyst Research Report

### SYNERGIES

The merger would give Vedanta, which had been struggling to reduce its debt, access to cash held by Cairn India. It would also make Vedanta Resources less complex, with its subsidiaries coming down to four from nine in 2011.

As far as Cairn India was concerned, the deal would help diversify earnings from oil and gas to electricity and an array of commodities from copper to zinc to aluminum. The shareholders of Cairn India would also gain from Vedanta's asset base and output-increase forecast compared with Cairn India's moderate output-growth plan

### A WIN-WIN DEAL?

Some mutual fund advisors felt that the Vedanta-Cairn India merger was a win-win solution for both the companies. While Vedanta would get access to Cairn India's cash reserves and could retire its debt, Cairn

India's shareholders would benefit from Vedanta's ₹82.59-billion cost-saving plan (marketing and procurement benefits). Once the merger was completed, it would also simplify the Vedanta group's complex structure.

Proxy advisory firm Institutional Investor Advisory Services (IIAS) also described the proposed merger as “fair”. The combined entity would have a diversified product portfolio, which would enable Cairn India to ride the cyclical downturn of oil prices and result in stable cash-flows for it. In addition, Cairn India would get access to Vedanta's low-cost, longer life-cycle assets.

On the other hand, some analysts said Cairn India's shareholders would get a raw deal from the merger. They felt the company's share prices had declined in February 2015 owing to weak global crude oil prices. Before the merger was announced in June 2015, shares of Vedanta Ltd stood at ₹181.25, while Cairn India's shares for the same period were trading at ₹236.98.

Soon after the merger was announced in June 2015, shares of Cairn India rose by 3.5 per cent to ₹187.15 on the BSE, while Vedanta's shares rose by 2.8 per cent to ₹189.2. However, after a few hours, Cairn India was down 2 per cent at ₹177, while Vedanta was down 1.4 per cent at ₹181.5. The share price also reflected that the Vedanta-Cairn India merger buzz was being negatively viewed by Cairn India's shareholders.

### **Minority Shareholder Approval major hurdle for the merger**

Advisory firms and mutual fund experts felt that Vedanta's merger with Cairn India was meant to tackle its debt issues and possibly create a global natural resources giant to rival BHP Billiton and Rio Tinto. However, the deal met with huge resistance from Cairn India's minority shareholders, who felt that only Vedanta would benefit from the merger and that Cairn India would end up inheriting the problems of Vedanta, which was fighting environmental activists over an aluminum project in Odisha.

According to industry sources, Life Insurance Corporation of India (LIC), one of the largest institutional shareholders with a 9.1 per cent stake in Cairn India, would seek clarifications on the exact nature of the deal and how cash reserves from Cairn India would be used to cut debt at Vedanta. Another minority shareholder and independent Scottish oil and gas exploration and production company, Cairn Energy, with a 10 per cent stake in Cairn India, also had to vote to approve the merger. Experts said the voting by LIC and Cairn Energy in favor of the merger would be crucial in deciding the fate of the merger.

The meltdown in the Chinese market, which led to a decrease in global commodity prices, hit the possibility of a Vedanta-Cairn merger. It was reported that Vedanta's share price would drop more sharply than that of Cairn

India if commodity prices remained weak or declined further. Industry experts felt that, in such a situation, there was the possibility of the minority shareholders of Cairn voting against the merger.

**LIC and Cairn PLC will hold the key to scheme approval:** Under the new company's act, such deal will require the approval by majority of minority. Cairn PLC with a 9.8% stake and LIC with a 9.1% stake in Cairn India, almost 50% of minorities and their approval will be critical for the deal to go through.

(INR/share)	Worst case X=60	Base case X=45	Best case X=20
Rajasthan	89	89	89
Ravva	3	3	3
Cambay	3	3	3
Exploration upside (BH, RJ)	65	65	65
<b>Value of operating assets</b>	<b>161</b>	<b>161</b>	<b>161</b>
Cash & Cash Equivalents @ X% discount	46	64	93
Gross debt	0	0	0
Net debt	-46	-64	-93
<b>Fair value</b>	<b>207</b>	<b>224</b>	<b>253</b>
CMP	134	134	134
Upside (%)	54%	67%	89%
Swap Ratio*	2.4	2.6	2.9
Vedanta CMP	87	87	87

Source: Company, Analyst Reports

## Exhibit

### Net debt at the parent Vedanta Resources Plc and its various subsidiaries

Net debt (US\$ mn)	Mar-13	Sep-13	Mar-14	Sep-14	Mar-15
<b>Vedanta Resources Plc</b>	<b>6,334</b>	<b>8,005</b>	<b>8,307</b>	<b>7,473</b>	<b>7,673</b>
<b>KCM</b>	<b>751</b>	<b>711</b>	<b>723</b>	<b>813</b>	<b>738</b>
Vedanta (India)	4,748	4,518	4,585	4,889	4,439
Zinc International	-197	-188	-169	-189	-137
Zinc India	-4,045	-3,886	-4,345	-4,478	-4,937
Cairn India	-3,102	-3,299	-3,912	-2,732	-2,857
Balco	687	619	679	734	766
Talwandi Sabo	705	721	831	939	1,013
TSMHL	2,628	1,173	1,181	1,514	1,670
Others	103	97	53	100	90
<b>Vedanta (India) Consolidated</b>	<b>1,526</b>	<b>-245</b>	<b>-1,097</b>	<b>777</b>	<b>48</b>
<b>Total</b>	<b>8,616</b>	<b>8,463</b>	<b>7,920</b>	<b>9,055</b>	<b>8,460</b>

Source: Vedanta website

**Cairn India Holding – LIC+ Cairn Plc 19% stake out of 40% non promoter shares**

<b>Carin India - Top Holders</b>	<b>%Stake</b>
Vedanta Ltd. ( Direct+Indirect)	59.9
Cairn Energy Plc	9.8
Life Insurance Corp. of India	9.1
Dimensional Fund Advisors LP	0.7
The Vanguard Group, Inc.	0.7
BlackRock Fund Advisors	0.7
Mellon Capital Management Corp.	0.6
ICICI Prudential Asset Management Co. Ltd.	0.6
HSBC Global Asset Management (Hong Kong) Ltd.	0.5
Grantham, Mayo, Van Otterloo & Co. LLC	0.4
Mondrian Investment Partners Ltd.	0.3
Templeton Asset Management Ltd. (Hong Kong)	0.3
Eastspring Investments (Singapore) Ltd.	0.3
Unigestion SA	0.3
APG Asset Management NV	0.2
Nordea Investment Management AB (Denmark)	0.2
Norges Bank Investment Management	0.2

Source: BSE, Company

**Scenario Analysis of Cairn-VEDL Merge**

The minority shareholders (>50% approval required) will reject Cairn-VEDL merger in the current form with an “effective swap ratio” of 1.2:1 (Cairn shareholders will receive 1 share of VEDL+ 7.5% VEDL preference share with a face value of INR10). LIC and Cairn PLC, which hold 9.1% and 9.8%, respectively, of the stock representing 47% of Cairn's minority shareholding, are likely to demand a higher swap ratio.

We have worked on a scenario analysis on the merger to derive Cairn's fair value assuming 20%/45%/60% discount (best/base/worst case) to the company's FY16 cash. Even in our worst case scenario (“high probability” of merger and therefore a 60% discount to cash), we derive Cairn's fair value at Rs 207/share, implying swap ratio of 2.4 at VEDL's current stock price at Rs 87.



EBITDA (US\$ mn)	2013	2014	2015
Vedanta Resources Plc	0	1	-1
KCM	257	156	-4
Vedanta (India)	577	510	795
Zinc International	1203	214	181
Zinc India	295	1173	1220
Cairn India	2440	2347	1477
Balco	62	53	60
Talwandi Sabo	0	-1	22
TSMHL	0	0	0
Others	54	26	-7
<b>Vedanta (India) Consolidated</b>	<b>4631</b>	<b>4334</b>	<b>3745</b>
<b>Total</b>	<b>4888</b>	<b>4491</b>	<b>3741</b>

Source: Vedanta quarterly press release

### FY15 proforma key balance sheet items and ratios remain unchanged

Particulars	Vedanta Ltd. consolidated (Rs. cr)	Vedanta Ltd. consolidated pro-forma (Rs. cr)
EBITDA	22,226	22,226
Operating profit	15,074	15,817
Profit after tax	10,183	10,927
Minority interest	5,127	2,489
Attributable to equity holders	5,060	8,442
EPS	Rs. 17.1	Rs. 22.7
Gross Debt	77,752	77,752
Cash	46,212	46,212
Net Debt	31,540	31,540
Interest expense	5,659	5,659
Outstanding shares (mm)	2,965	3,717
	<b>Credit Metrics (x)</b>	
Net Debt / EBITDA	1.4X	1.4X
EBITDA / Net Interest	6.8X	6.8X

Source: Vedanta FY15 Annual Report

### Merged entity debt and cash break-up

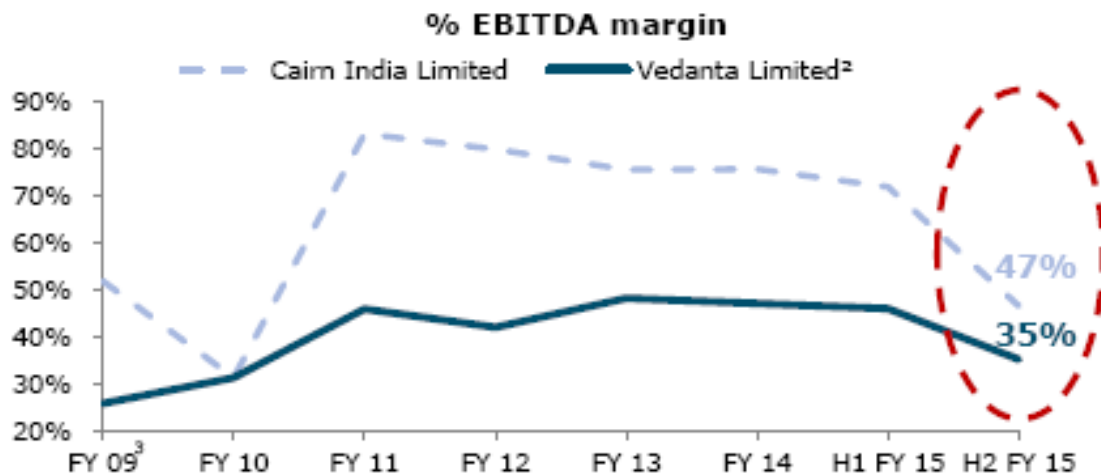
(INR mn)	March 31, 2015		
	Debt	Cash	Net debt
Sesa Sterlite Standalone	376,360	8,400	367,960
Zinc India	0	271,920	-271,920
Zinc International	0	8,570	-8,570
Cairn India	0	170,400	-170,400
Balco	54,560	20	54,540
Talwandi Sabo	65,410	1,520	63,890
Cairn acquisition SPV	268,500	540	267,960
Others	12,690	750	11,940
Sesa Sterlite Consolidated	777,520	462,120	315,400

**Approvals required for completion of the merger**

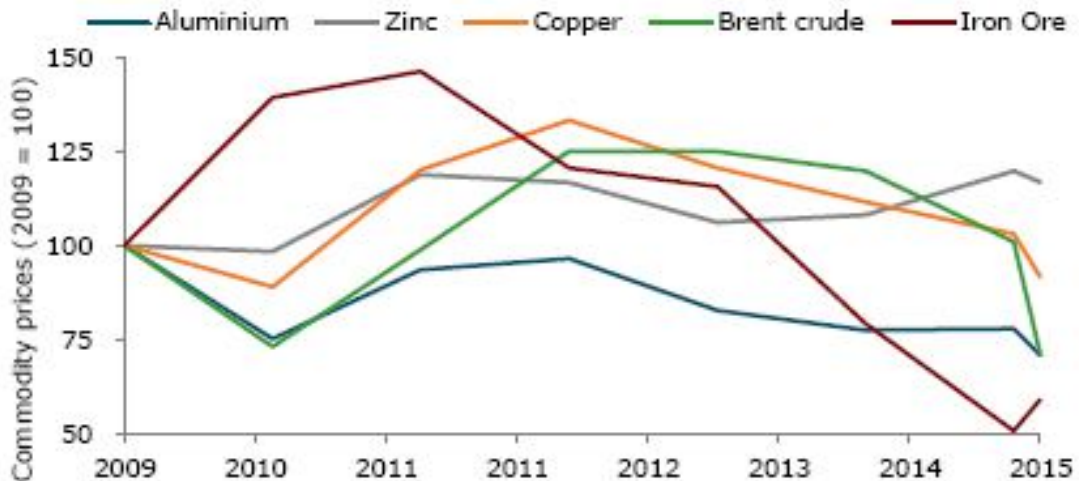
**Transaction approvals required**

1. Stock exchange (NSE and BSE) and SEBI approvals
2. High court and other regulatory approvals in India for Scheme of Arrangement
3. Majority of minority shareholders in Cairn India and Vedanta Limited (Listing req.)
4. 75% of present and voting - VEDL and Vedanta PLC can vote (Court scheme)
5. MoPNG approval
6. Foreign Investment Promotion Board approval

Source: Vedanta Press release



**Balanced exposure to a basket of commodities**

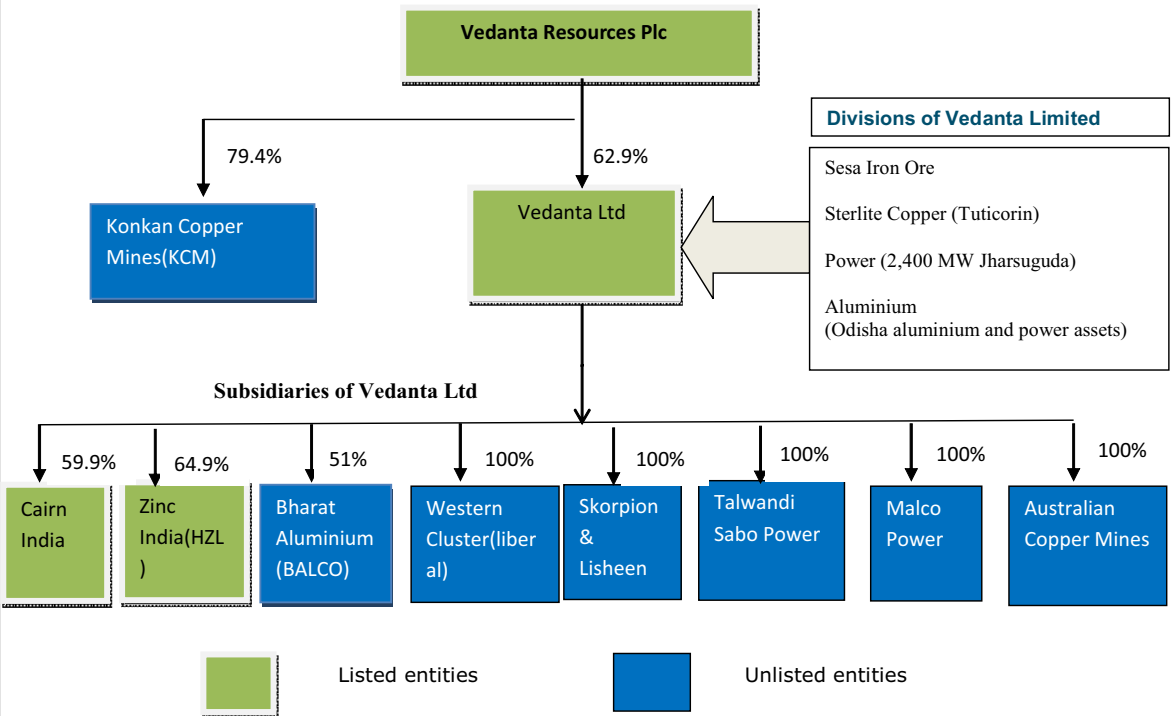
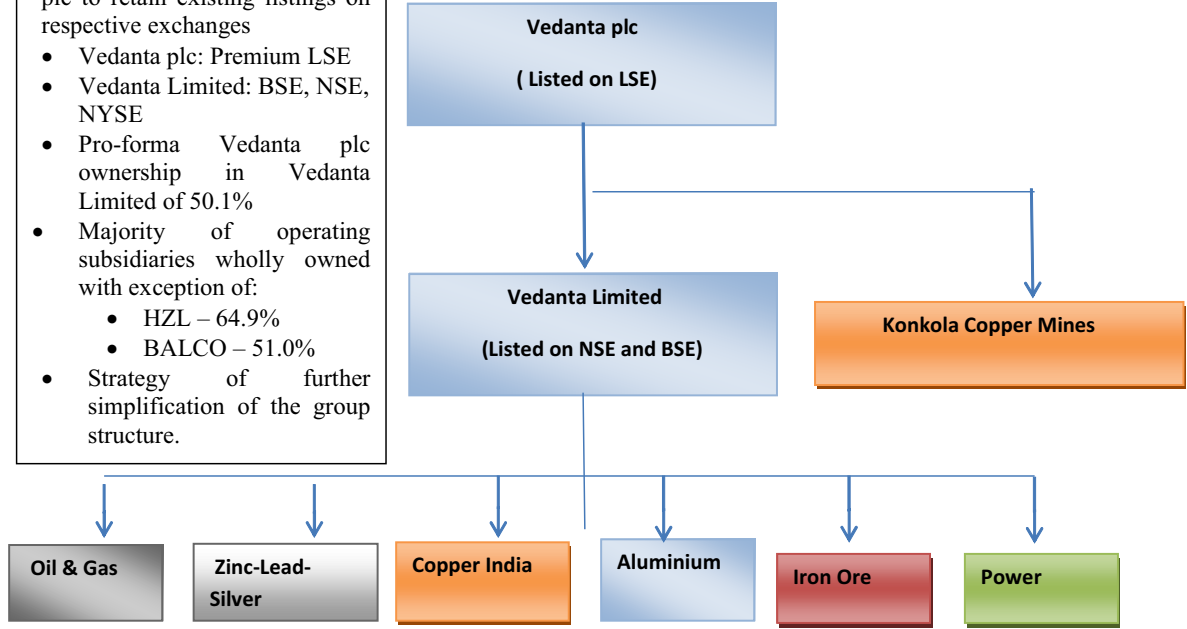


Source: Vedanta Presentation/Cairn India Presentation, vedanta website

### Simplified group structure

Vedanta Limited and Vedanta plc to retain existing listings on respective exchanges

- Vedanta plc: Premium LSE
- Vedanta Limited: BSE, NSE, NYSE
- Pro-forma Vedanta plc ownership in Vedanta Limited of 50.1%
- Majority of operating subsidiaries wholly owned with exception of:
  - HZL – 64.9%
  - BALCO – 51.0%
- Strategy of further simplification of the group structure.



**Questions for Discussion**

Q.1) Imagine you are a mutual fund manager and have been asked to vote on the Vedanta-Cairn India merger. Share your views on how you would vote on this issue. Justify your decision with logical reasoning.

Q.2) Is this merger value accretive for shareholders of Cairn India and Vedanta?

Q.3) What is the Rationale for this Merger?

Q.4) What are the key variables required for this merger to be successful?

Q.5) Do you think Mr Anil Agarwal- Vedanta ltd will revise the Swap ratio of the merger? Justify the same

**WORKS CITED**

1. Earning Presentation, Cairn India, <https://www.cairnindia.com/>
2. Merger Presentation Cairn India, <https://www.cairnindia.com/>
3. Press Release, Cairn India, <https://www.cairnindia.com/>
4. Scheme of Arrangement, Cairn India, <https://www.cairnindia.com/>
5. Vedanta Ltd, FY15 Annual Report, <http://www.vedantalimited.com/>
6. Vedanta Ltd, Valuation Report, <http://www.vedantalimited.com/>
7. Vedanta Ltd, Q2FY16 Conference Call Transcript, <http://www.vedantalimited.com/>
8. Vedanta Ltd, Edelwiss research report.
9. Vedanta Ltd, Motilal Oswal research report.
10. <http://www.vedantalimited.com/>
11. <https://www.cairnindia.com/>
12. <http://www.bseindia.com/>
13. <http://www.business-standard.com/>
14. <http://economictimes.indiatimes.com/>