Vedanta Delisting – Bid without the Fear of Missing Out!

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DELISTING FINAL STEP – REVERSE BOOK BUILDING (RBB)

Vedanta Resources Ltd (VRL) has given a Public Announcement (Click here to view) to kick start the Reverse Book Building (RBB) process in order to delist Vedanta Ltd (Vedanta) from Stock Exchanges with following steps & timelines:

- Bidding commences on **5th Oct, 2020** and closes on **9th Oct, 2020.**
- The **Floor Price** determined in accordance with SEBI Delisting Regulations is **₹ 87.25/- per equity share.**
- The **Book Value is determined at ₹ 89.38/-** based on the Consolidated Financial Statements as on 31st Mach, 2020.
- The closing market price as on **1st Oct, 2020 is approx. ₹ 137/- per share**.
- 52 weeks high / low – **₹ 166.10** / **₹ 60.20**
- 3 years high / low – **₹ 355.70** / **₹ 60.20**

SES Comment: Investors must ignore floor price, book value and 52-week low price as the same does not reflect true value of Vedanta shares.

BACKGROUND:

SES in its Report titled 'Vedanta Delisting Offer' dated 13th May 2020, has termed the delisting proposal of VRL as being opportunistic and unfair as the offered price at ₹ 87.50/- per share is well below the fair value of Vedanta. However, notwithstanding such indicative price, SES had recommended shareholders to vote in favour of the delisting proposal, as finally the price is determined through the Reverse Book Building (RBB) process which is in control of public shareholders, therefore, public shareholders have freedom to offer shares at a price which they feel is fair.

Therefore, first advice of SES to shareholders is that, do not be guided by what is floor price, what is book value given, what is market price or what is their purchase price. Just remember one thing that, you must offer shares at a price which you feel is fair. Please also do not be afraid that if you offer a higher price and delisting happens at a price lower than what you offered, you may be left out. **No, not at all, as SEBI Delisting Regulations guarantees that the acquirer must offer to buy shares from all remaining shareholders at discovered price in case delisting offer is successful.** (Annexure A provides an illustration as how price is determined in case of RBB process) Click here to view

Therefore, first lesson is do not under bid for 'Fear of Missing out' (FOMO).

SES has already published various Reports on Vedanta in connection with the Delisting proposal which can be accessed in the following manner:

S. No.	Particulars	Brief Content	Weblink to access the Report
1	Research Report dated 13th May 2020	Initial evaluation of the proposal of VRL to delisting Vedanta at an indicative price of ₹ 87.50/- per share	Click here
2	Proxy Advisory (PA) Report dated 5th June 2020	Detailed analysis of the Delisting proposal including an in-depth valuation undertaken on various parameters	Click here
3	Research Report dated 28th Sept 2020	Vedanta failing to pass on ₹ 12.18/- dividend to its shareholders, that is received from Hindustan Zinc Ltd (HZL)	Click here

This Report is limited to guiding investors for fair price for bidding.

BRIEF EXECUTIVE SUMMARY

Million-dollar question is what is the ideal bid price?

- **Promoters have tried many tricks to keep expectation of public shareholders muted:**
    - Indicative Price at ₹ 87.50;
    - Floor Price at ₹ 87.25;
    - Write off of ₹ 17,400 crores resulting in Consolidated Book Value less than ₹ 90.
    - Did not pass HZL dividend to shareholders, although promised in Dividend Distribution Policy (DDP).

- **<u>Facts that shareholders must keep in mind while bidding are:</u>**
  - Market was unperturbed by ₹ 17,400 crores write off; as it is a book loss and doesn't impact cash flow.
  - Current Market Price stable at ₹ 135+ and does not reflect true value given the current market situation and holding company discount.
  - Shareholders must keep in mind that the promoters are buying it because they believe in future of the Company
  - Each Vedanta shares has 0.74 HZL share embedded, which itself is valued at ₹ 145+, therefore minimum price is ₹ 145, if one takes all other Vedanta assets at ZERO, which is not the case.
  - Shareholders should not underbid, remember presently Vedanta shares are traded at holding Company discount of HZL shares. Otherwise, why Vedanta would trade at less then embedded price of HZL?
  - Ideally Vedanta can remove holding company discount of HZL share by de-subsidiarization. Presently Vedanta would not want to de-subsidiarize HZL, as Promoter's equity would reduce to close to 32.5% (64.5% in HZL will gets distributed amongst promoter and public almost equally) and with Govt holding 29.54% and LIC holding 1.97%, promoters would lose edge. Therefore, post delisting if HZL is hived off Promoters would own close to 65%, thus giving them direct control, removing holding company discount.
  - Lastly, HZL dividend of close to ₹ 12/- share of Vedanta at a yield of 5% post tax (25%) itself gives a price of ₹ 180/- share, without valuing other business. If one adds remaining business total value will move up.
  - Therefore, by delisting, promoters are going to have 100% in business, removing holding company discount and access to cash of HZL. As a result, for all their gains promoters must pay premium to shareholders
  - SES in its PA Report dated 5th June, 2020 had calculated valuation of Vedanta from various methods in range of 'market price', 'sum of parts of Vedanta Businesses', 'Book Value', etc. The value had ranged between ₹ 236- ₹ 310 per share
  - Therefore, SES recommends that shareholders must offer their shares in keeping the range ₹ 236 - ₹ 310 in mind. Even if one offers a discount to highest price for uncertainties, depressed economic environment, etc and gives a discount of 20-30% the fair range comes to be anywhere between ₹ 200 - ₹ 250 at least considering the value that is seen in the business.

Negative Sentiments:

It is age old technique that if you want to buy something, first undervalue and then create negative environment so that seller is convinced that the thing is not valuable, here shareholders are motivated to tender their share at throw away price. Already news items have started appearing about likely price of delisting, as if the newspapers know mind of investors. According to SES, fact is that the interested parties are probably revealing their mind through newspapers.

Just ask to yourself a question, why promoters are buying and taking risk, if future was that bad? Will they sell their shares at floor price/ book value? Certainly not. So why investors should?

Factors to be considered while placing the Bid

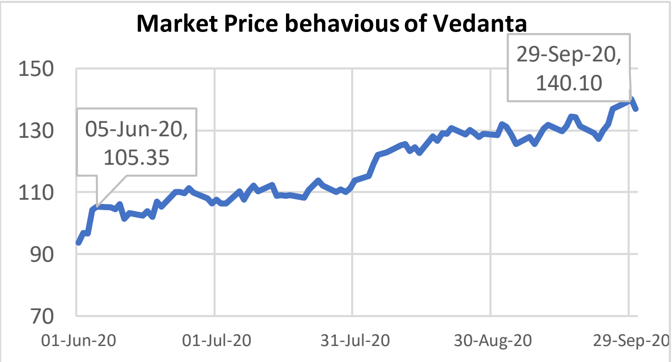
Although, the floor price is fixed at ₹ 87.50/- per share and the consolidated book value is disclosed as ₹ 89.38. One must keep the following points while placing their bid to tender share. Although, SES is not a valuation expert, however, the following points are worth considering, so as to take an informed decision.

1. Current Market Price is ₹ 137

Equity share of Vedanta closed at ₹ 137 per piece on 1st Oct 2020. Therefore, one must not get too much influenced by the lower book value or floor price announced by the Company in relation to the delisting process. The share price of the Company has remained quite stable despite a ₹ 17,400 crore write off in the 4th quarter of FY 2019-20.

Write-offs amounting to ₹ 17,400 Crores: Genuine or an accounting gimmick?

While, the Investors Presentation and conference calls transcripts and Annual Report presented a very rosy picture of the state of affairs of the Company, the Company wrote off almost ₹ 17,400 crores (₹ 15,900 crores owing to Oil & Gas alone) which was more than 40% of the then market capitalization of Vedanta of ₹ 39,000 crores. **The write-off was announced on 6th June 2020 and the Market reaction in indicated in the below graph. Absolutely unperturbed to say the least.**



SES is of the opinion that a huge write off generally results in share price to plunge almost immediately, however, the market realized that write off is not a cash loss, but a mere book loss. And does not impact going concern assumption of business, it is mere revaluation. The question is what was the need to write off?

The Company in its own presentation has stated that in Oil Business at Brent Oil Price of $40 per barrel will give IRR of 35%. Therefore, long term effect of write off is not there.

Further, the global oil prices have recovered from its decade lows in March 2020, and are trading at approx. $40 per barrel currently, will the Company write back the impairment?

To SES, write off was aimed to cause negative sentiment.

Write-off impacted the Book Value: Another negative news

Write off of ₹ 17,400, depressed the book value substantially and as per Company's disclosure, the consolidated book value is approx. ₹ 89.38 per share.

Why the Company has disclosed a certified book value? Before, we further analyze the impact of the write-off, it is vital to understand the importance of book value in the delisting process.

As provided in SEBI Delisting Regulations, in case the Promoters reject the RBB Price, they can give a counter offer which as per law cannot be lower than the consolidated book value of the Company. Therefore, the book value after write off has come very close to floor price, making it easier for promoters to make a counter offer.

2. Does Floor price or Book value reflect true value of Vedanta?

One of the jewels in the crown that needs to be given more attention is the cash rich Hindustan Zinc Ltd (HZL). The present market capitalization of HZL is more than ₹ 85,000 crores. Based on the market cap of HZL, the value of HZL embedded in Vedanta is approx. ₹ 55,000 crores, **translating into ₹ 148 per equity share, almost 70% higher to Floor price and 65% higher to book value.**

Vedanta shares have unpaid HZL dividend of ₹ 12.18/ share, which promoters have not paid to its shareholders

In May, HZL paid dividend amounting to close to ₹ 7,000 crores to its shareholders, out of which approx. ₹ 4,500 crores was received by Vedanta. According to the Dividend Distribution Policy of the Company, entire dividend received by Vedanta from HZL (other than special dividend) is to be passed on to its own shareholders as it is.

Research Report dated 28th Sept 2020 had highlighted the issue. Click here to read the entire Report.

Recent activity of Promoters for raising resources

HZL raised ₹ 3,250 crores through NCDs after paying ₹ 7,000 as dividend

HZL has recently issued Non-Convertible Debentures (NCDs) and raised money to the tune of ₹ 3,250 crores. HZL being a cash surplus Company which pays hefty dividends to its shareholders, SES is unable to understand that why suddenly such significant amount of money is being raised through borrowings. To give perspective, only 4 months back, HZL had paid an interim dividend to its shareholders amounting to close to ₹ 7,000 crores.

Therefore, SES is unable to comprehend that if the Company did require funds, then why did it declare ₹ 7,000 crores of dividend in May.

Either it is a case of absolute absurdity in financial management or is there a plan which shareholders are unaware?

Was the dividend by HZL paid only shore up cash in Vedanta?

The above question assumes importance since Vedanta did not pass on the dividend received from HZL to its shareholders, which is contrary to what is stated in the Dividend Distribution Policy of Vedanta. Assuming that Vedanta gets delisted this year, the entire dividend of ₹ 4,500 will be taken by the Promoters, when approx. ₹ 2,250 was to be passed on to the public shareholders of Vedanta.

Is HZL actually in need of money?

Current Assets as on 31st March 2020 stood at close to ₹ 25,000 crores, out of which ₹ 4,000 crores are liquid assets comprising of cash, inventories and receivables.

Although, Sept quarter results are not published as of now, however, the PAT earned in June quarter has remained in line with that of the March quarter profits. There is no sign of any sudden slump in the business of HZL.

SES is of the opinion that the shareholders must seek answer from the Company regarding the sudden issuance of NCDs.

Vedanta Ltd. raises ₹ 10,000 crores by pledging its stake in HZL

According to the BSE Corporate Announcement (Weblink) made by HZL, Vedanta has tied up a long-term syndicated loan facility for ₹ 10,000 crores (‘Facility’) with State Bank of India. The entire stake of 64.92% of the Vedanta’s stake in HZL is encumbered while 14.82% is pledged against the money so availed / to be availed. The remaining 50.10% shares are under negative pledge, restricting the Promoters to sell such shares, ensuring that the HZL do not get de-subsidiarised.

Vedanta Resources also raised ₹ 10,500 crores for the delisting purpose

Promoters of Vedanta (Weblink of Corporate Announcement) have also raised a sum of around ₹ 10,500 crores to be utilized for the delisting purpose. While there is exclusive disclosure that this sum shall be utilized towards the Delisting of Vedanta, there is lack of clarity in other cases.

Conclusion

While, SES has given guidance as to what is a fair bidding price. However, it is up to the shareholders to do proper analysis and not succumb to negative news floating around. Promoters of the Company are experienced businessmen and would love to minimize cost of acquisition. It is well within their rights to do so.

And shareholders also have their right to seek a fair price, it is on this point there is a conflict between promoter and public shareholders. Shareholders must protect their value.

SES as a Proxy Advisor and a Corporate Governance Research Firm, feels that it is its fiduciary duty, to analyze the business and provide guidance to the shareholders to place their bid accordingly.

ANNEXURE A

Reverse Book Building

Reverse Book Building (**RBB**) is a mechanism to determine the share price in case of Delisting of equity shares of a Company from Stock Exchanges.

It involves the following steps:

1. Determining the floor price based on latest market price behaviour of the Company as per the SEBI Delisting Regulations.
2. Shareholders holding shares who wish to participate in the Delisting process of the Company, tender their shares, by bidding on or above the floor price.
3. The bid price indicates the price at which the shareholders intends to sell his shares to the Acquirer (Promoter in the extant case).
4. Once the tendering period ends, all the bids are aggregated from lowest to highest.
5. Acquisition to start from the lowest bid, till the time acquirer reaches 90% of the share capital of the Company.
6. The final bid, at which the Acquirer holding reaches 90%, becomes the price determined by book building (RBB Price).
7. The Acquirer has an option to accept the RBB price so determined, or reject the same.
8. In case, the price is accepted by the Acquirer, every shareholder who tendered their shares on or below the RBB price, are paid the RBB price by the Acquirer.
9. Shares tendered by those bidding above the RBB price, shall have an option to tender their shares to the Promoters within a period of 1 year at the RBB price, or keep their shares with them (Unlisted share after delisting).
10. If the Acquirer rejects the RBB Price, then, he has an option to give a counter price, which cannot be less than the book value of the Company.

The Acquirer needs to take his shareholding to 90% in order to successfully delist the Company from Stock Exchange.

Illustration: A Company has a share capital of 100 shares in the following manner and the Promoter intends to delist the shares from Stock Exchanges:

- 55 shares (55%) is held by the Promoter and
- remaining 45 shares (45%) are held by 5 public shareholders (A, B, C, D & E) holding 9 shares each.
- Assuming the Floor price is determined at ₹ 120. And the public shareholders bids are as follows:

Name of shareholder	Bid Price (in ₹)	Cumulative Promoter shareholding post acquisition of public shares	Bids accepted / rejected
A	120	64%	**Price ignored**
B	150	73%	**Price ignored**
C	180	82%	**Price ignored**
D	220	91% **(90% acquired)**	**₹ 220 is the RBB price**
E	300	100%	**Price ignored**

The Promoter shareholding reaches eligible number (90%) after acquiring shares of 'D'. Therefore, the **RBB price determined shall be ₹ 220.** While, the price of 'E' is rejected, he still has an option to accept ₹ 220 has his offer price.

In case Promoter accepts the RBB price (which is ₹ 220), then, he would need to acquire the entire shareholding of **A, B, C & D** at ₹ 220 irrespective of their bids, for successful Delisting.

Since, the bid of '**E**' were not accepted due to higher bid price, therefore, 'E' may either hold the shares (of an Unlisted Company) or tender his shares to Promoter at ₹ 220, within a period of 1 year.

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DISCLAIMER: MR. JN GUPTA ALONG WITH HIS WIFE HOLDS SHARES IN BOTH VEDANTA AND HZL.

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