



L&T overtures: Will Mindtree Promoters' mind?

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EXECUTIVE SUMMARY

- Larsen & Toubro limited ('L&T') has entered into a definitive agreement with Mr. V.G. Siddhartha to purchase stake of approx. 20% held by him along with his related entities in Mindtree Limited.
- L&T further, intends to buy 15% stake in Mindtree from open market. This triggered the condition for [public announcement of the open offer](#).
- L&T has proposed an open offer to existing shareholders of Mindtree to purchase 31% of shares of the Company.
- Promoters of Mindtree, view this action of L&T as a **Hostile takeover** which is unprecedented in the IT industry.
- SES views that there may be two possible scenarios in the present case:
 - **Case 1: L&T is able to buy stake of upto 50% of more in Mindtree.** However, for this to happen, the existing shareholders of Mindtree will have to view the stake purchase by L&T as disadvantageous to the Company thereby, tendering their shares at a lucrative offer price of ₹ 980/-. Though, this is contrary to the [L&T's statements](#) which is very positive of its investment in Mindtree. If L&T is able to gain a majority stake, either the promoters of Mindtree will have to get along with L&T or exit the Company. Their exit could possibly harm the relationship with existing clients since the promoters of Mindtree are deeply involved in the management of the Company.
 - **Case 2: L&T is unsuccessful in gaining majority control of the Company and remains as the largest shareholders.** This would mean that Promoters of Mindtree will have to get along with L&T or be at loggerheads with one of the largest shareholders. Both of these are going to put the existing promoters in an uncomfortable position. This would again mean that the Mindtree Promoters might have to align their strategic vision with that of largest shareholder so that the business does not suffer.

One will have to wait and watch how things pan out. However, in both the cases, SES views that there is going to be some hiccups before things are stabilized which would mean some sort of volatility.

- Unlike a brick and mortar company, an IT Company is built from its employees and its relationship with clients. From media reports, there appears a growing discomfort within the employees of Mindtree who are viewing L&T actions as hostile. SES is of the view that this discomfort would only be addressed when L&T comes out with its strategic vision with the acquisition and how it proposes to take it forward with existing Mindtree Promoters who have built the Company from scratch. Whether, departure of Mindtree promoters would affect employees' morale and client relationships negatively? The effect of such negative impact on Company's profitability vis-à-vis the benefits by acquiring Mindtree is a question that L&T would have to face from both sets of shareholders.
- Regulation 26 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ('SEBI Takeover Code') lists down certain obligation of the Target Company. One of the obligations include that after receiving the Details Public Statements ('DPS') from the Acquirer, the independent directors of the Target Company must provide reasoned recommendations on such open offer, and the target company shall publish such recommendations. Such recommendation will have to be published by the Target Company at least 2 days prior to the tendering period.
- SES is of the view that at this point when DPS is not available, neither SES, nor the Independent Director of Mindtree have the complete knowledge of L&T's future plans and actions. Without such knowledge, any suggestion to shareholders would be like shooting arrows in the dark. All that the Company can do, is wait for L&T to come out with its plan so that shareholders are able to take a more informed decision or Independent Directors are able to provide a comprehensive view on the offer.

Therefore, one will have to wait for the L&T to disclose its DPS with respect to the Mindtree Acquisition.



BACKGROUND

Companies involved: Mindtree Limited (Target of Hostile Takeover) and **Larsen & Toubro Limited** (Acquirer).

Mindtree Limited is a global IT consulting and services company. Mindtree is a brain child of ten IT professional which started its operation in 1999. Mindtree's shareholding pattern just after being listed on stock exchange on 12th December 2006 reflects that the promoter shareholding as on 31st March 2007 was also 30.34%.

The shareholding of Promoters reduced further, after exit of one of its founders Mr. Ashok Soota who had held almost 10% of Company's share upon listing and sold all of his shares in the year 2011 to Non-Promoter shareholders. This reduced the promoter shareholding to 20.11% as on 31st March 2011. Promoters of Mindtree currently hold approx 13% of the equity share capital. Whereas, an investor Mr. V.G. Siddhartha along with his related entities holds approximately 20% in Mindtree Limited. This would indicate that Mindtree was nothing but a sitting duck for any raider with cash.

On 18th March 2019, Larsen and Toubro announced that the Company is going to acquire a significant stake in Mindtree in an all cash transaction subject to regulatory approval ([Link 1](#)). The news for such an attempt by L&T was floating around for few days now.

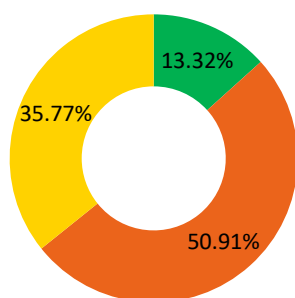
L&T has stated in a [Press Release dated 18th March 2019](#) which was published on the stock exchange that "Larsen & Toubro Limited (NSE: LT, BSE: 500510), one of India's leading engineering, technology and construction conglomerate, has today entered into a **definitive Share Purchase Agreement (SPA) with Mr. V G Siddhartha and his related entities** namely, Coffee Day Trading Limited & Coffee Day Enterprises Limited, to acquire 20.32% stake in Mindtree, a global technology services and digital transformation company. L&T will purchase this stake at a price of ₹ 980 per share, aggregating to approximately INR 32.69 billion."

Along with acquiring stake of Mr. V.G. Siddhartha, L&T has also placed an order with its broker for on-market purchase of up to 15% of share capital of Mindtree at a price not exceeding ₹ 980 per share thus triggering an open offer as per SEBI SAST Regulation.

Given the intention of L&T to acquire control of Mindtree Limited if the SPA and purchase order of 15% shares is successful, the shareholding of L&T would exceed 25% threshold of the SEBI Takeover Code. Therefore, it is mandatory for L&T to give Open Offer in compliance with Regulation 3(1) and 4 of the SEBI SAST Regulations.

Mindtree issued an announcement on 18th March 2018 with the details of [Open Offer](#). Pursuant to execution of the SPA, and market order for share purchase and with the intent to acquire majority stake in Mindtree, L&T made public announcement of an open offer to the shareholders of Mindtree to purchase up to an additional stake of 31% of the equity shares of Mindtree at a price of ₹ 980 per share in cash.

SHAREHOLDING PATTERN



■ Promoter ■ Public - Institutions ■ Public - Others

Shareholding Pattern 31 Dec 2018

The further break up is as follows:

Promoters	13.32%
Institutions	50.91%
Mutual Funds & Alternate Investment Funds	9.59%
Foreign Portfolio Investors	40.18%
Financial Institutions/ Banks	0.80%
Government	0.34%
Non-Institution	35.77%
V G Siddhartha & Related Entities	20.43%
Other Retail shareholders	15.34%



MAJOR PUBLIC SHAREHOLDERS (DEC' 18)		MAJOR PROMOTERS (DEC' 18)	
Coffee Day Enterprises Limited	10.65%#	Krishnakumar N	3.72%
Nalanda India Fund Limited	8.87%	Subroto Bagchi	3.10%
Coffee Day Trading Limited	6.45%#	Susmita Bagchi	1.64%
Amansa Holdings Private Limited	2.77%	N S Parthasarathy	1.43%
V G Siddhartha	3.33%#		

It should be noted that Mr. Siddhartha is Promoter of Coffee Day Enterprises Limited ('CDEL') and Coffee Day Trading Limited ('CDTL'), subsidiary of CDEL. The aggregate shareholding of all 3 works out to be around **20.43%** as on 31st December 2018 of the total share capital of the Company, which is almost **153%** of the total equity of the Promoters of the Company.

Mr. V G Siddhartha (together with CDEL and CDTL), was the largest shareholder of the Company.

BOARD PROFILE

Director	Classification	Association
EXECUTIVE DIRECTOR		
Krishnakumar Natarajan	EDP(C)	19
N S Parthasarathy	EDP	4
Rostow Ravanan	EDP (CEO & MD)	4 (19)
NON-EXECUTIVE DIRECTOR		
Subroto Bagchi	NEDP	19
INDEPENDENT DIRECTORS		
Apurva Purohit	LID(W)	4
Milind Sarwate	ID	2
Akshaya Bhargava*	ID	2
Bijou Kurien	ID	>1

Abbreviations: C - Chairman, P - Promoter, W - Woman Director, ED - Executive Director, NED - Non-Executive Director, ID - Independent Director, LID - Lead Independent Director

It can be observed that all the major promoters who were also the founders are Directors on the Board of the Company. Mr. Krishnakumar Natrajan is the founder Promoter Executive Director as well as the Chairman of the Board.

The Board has around 50% representation of Promoters, however, the Promoters only hold about 13.32% of the Share capital. Clearly, the Board representations were disproportionate to the Promoter shareholding in the Company.

Mr. V.G. Siddhartha was also a non-executive Director on the Board very recently. He resigned from directorship on 9th March 2018.

HOSTILE TAKEOVER- SES VIEW

L&T has signed a deal with Mr. V.G. Siddhartha to acquire 20.3% of shares of Mindtree Limited. They plan to increase their stake to 66% by acquisition of 20.3% from Mr. V. G. Siddhartha, additional 15% from open market and additional 31% via open offer to shareholders of Mindtree Limited.

Under a friendly takeover wherein the management of the Target Company and that of the Acquirer are on same side and takeover is undertaken amicably. Therefore, there is no hostility among the acquirer and Promoters of the Target Company.

However, in the present case the Board of Mindtree had no role to play in the acquirer's decision to overtake or buy significant stake in the Company. Infact, the Promoters of the Company along with the Board are trying to defend the takeover by attempting for a buy back of Company's shares.

It may be noted that as per the SEBI Takeover Code, the Company may undertake a buy back only before the tendering period. Any buy back during the offer period would require a special resolution by the shareholders. However, any proposal for undertaking buy back can potentially be blocked by L&T since it holds 20% equity in the Company.

The Board has an option to undertake a buyback of up to 10% of the Total Share Capital and Free Reserves of the Company before Offer Period without any shareholders' approval, however, this will translate to only buying back of 1.50% of the entire share capital of the Mindtree. Though, a higher offer price under the buyback (significantly above ₹ 980/-) may force L&T to revise its bid upward, however, according to SES, as the Company could buy back only 1.50% equity in such case, it may not make much difference to the takeover by L&T.



The Promoter's of Mindtree have stated that *"A hostile takeover by Larsen & Toubro, unprecedented in our industry, could undo all of the progress we've made and immensely set our organization back. We don't see any strategic advantage in the transaction and strongly believe that the transaction will be value destructive for all shareholders."* This statement only indicates that the promoters do not appreciate such an action by L&T. To the contrary, L&T is of the view that such an investment would be beneficial to the shareholders of Mindtree as per their press statements.

A decade earlier L&T had tried to acquire Satyam however, in final bid Tech Mahindra quoted a better price and walked away with Satyam. If one looks at the Satyam's case, the Company had been scam struck by its promoters, the shareholders and stakeholders of the Company were desirous of a change in the promoter and management of the Company to bring back the Company to its former glory. However, in the present case, Mindtree is a Company which has been brought from the ground up by its existing promoters who appear to have done their job well. The Company is well supported and backed by Institution shareholders as per the media reports. This also indicates from the Institutional shareholding % in the Company. The promoters of the Company have claimed that the institutional shareholders are strongly in favour of existing promoters. This appears to be true because there has been no major upside spurt in the share price of Mindtree once L&T had put out the open offer.

INTELLECTUAL & HUMAN CAPITAL

SES is of the view that unlike a Brick and Mortar Company, Mindtree Limited operates in the space of IT Consulting. In the IT industry the organisation's core assets are its employees which are its intellectual capital and relationship with its clients. The success and failure of an IT Company resides in the utilisation and stability of these two assets.

It can be observed from the Board and Company's history that the promoters of Mindtree have been very involved in the growth of the Company. They still retain major senior positions and are involved in day to day management of the Company. This also indicates that they would have deep connections and relationships with major clients of Mindtree. If L&T is expecting to add Mindtree as another feather in its Cap, it will have to retain and build stronger relationship with the Clients of Mindtree.

In this peculiar case, what has to be watched is the attitude of L&T towards the employees and senior management of the Company. The investment will make sense only if L&T is able to retain the senior management and employees of Mindtree along with the existing relationships with the clients of Mindtree. If L&T does not build a health relationship with Mindtree's Promoters, it could lead to a loss of clientele.

Mindtree promoters have outrightly made clear of their opposition to the L&T bid to takeover. Further, in their [press statement](#), they have gone ahead to state that *"We believe it's in the best interests of our shareholders, Mindtree Minds, and our organization overall to continue opposing this takeover attempt. In addition, there has been a large outpouring of sentiment from Mindtree Minds online at #MindtreeMatters expressing their strong desire to retain our culture and our independence."*

Whether, such a tweet trend is created on word of Promoters, or are these genuine sentiments of employees of Mindtree? Only time will tell. However, L&T will have to be wary of any growing discomfort within senior management as they are trying to acquire an IT Company. After all, the growth and success would only depend on how the intellectual asset of the organisation is not compromised in this deal. Shareholders have to watch and wait if there is any sort of marriage between the existing promoters and L&T, as retention of clients as well as employees would become paramount in the current situation.

WILL THE TAKEOVER HELP L&T GAIN CONTROL?

SES views that there are two possible scenarios in the given case:

Scenario 1: L&T acquires majority control by open offer of more than 50% shares of the Company.

SES is of the view that for the L&T to acquire majority control via open offer, either shareholders will have to view L&T's investment in Mindtree as not favourable of the Company or L&T would have to convince Institutional stakeholders to sell their stakes to L&T.



Reason behind SES's analogy is that Retail Shareholders will sell stake in Mindtree only if retail investors view the stake purchase by L&T as detrimental to the Company's future. Simply because why would someone want to sell a valuable share today if they can foresee a better price in the future. If existing shareholders view that L&T's investment will lead to a better future growth and potential, it is highly unlikely that they would tender shares. Secondly, for institutional shareholders the ticket value offered by L&T which is ₹ 980 per share, is not very high premium to the closing price of ₹ 946 per share (as on 18th March 2019). Is it attractive enough for Institutional Shareholders only time will tell? If media reports and Promoters of Mindtree are to be believed, then it appears that Institutional Shareholders are standing in support with the existing promoters. This would mean that it would be even harder for L&T to attract them to tender their shares.

Since, the retail shareholders in the Company hold 15.34% equity, therefore, all may not tender their shares. L&T may have to rely on Institutional Shareholders to sell stake in order to acquire additional 15% stakes from open market.

Scenario 2: If the L&T is unable to acquire majority stake of the Company

SES is of the view that this scenario becomes more dangerous than the first scenario. If the shareholder's view L&T's investment as strategically beneficial to Mindtree, then the shareholders may not wish to tender shares in the open offer. If L&T is unable to secure deals to purchase more stake from institutional shareholders or from the Market then it stands in control of 20% shares purchased from Mr. V.G. Sidhartha and around 1% which its Subsidiary L&T Mutual fund indirectly holds.

In this Scenario, neither the promoter nor L&T would be able to gain control of the strategy of the Company or hold enough Board strength as well. There is high chance that promoter may dump their shares if they find it difficult or have to fight restraint from L&T.

OPERATING MINDTREE AS AN INDEPENDENT ENTITY

L&T in its press release stated that *"While Mindtree would remain an independent listed entity, L&T would extend support to Mindtree in its business going forward. Mindtree will benefit from access to larger client base and wider product offerings under a common parentage giving higher returns to shareholders of Mindtree. Commenting on the occasion."*

However, the Promoter of Mindtree fear that such a hostile takeover will not be beneficial to the Mindtree culture and would be disadvantageous to its clients and may erode shareholders value. They have gone to the extent of stating that they condemn and remain unconditionally opposed to takeover bid by L&T.

Considering the way things are panning out in a unfriendly manner, one cannot rule out a situation, where the existing Promoters along with senior management start a new venture as they will not have any non-compete clause.

It appears logical from that the Promoters statements that they do not view L&T's involvement in the Company as harmonious and strategically good for the Company. Therefore, L&T would want that Mindtree remains an independent listed entity. This would only mean that it would remain a separate listed entity from L&T's other IT business companies such as L&T Infotech Ltd and L&T Technology Services Ltd. However, the reins of the Board would be in hands of L&T. This would only mean that either the existing promoter will have to get along with L&T or exit the Company.

SES VIEWS

For the open offer to be successful shareholders will have to tender shares for L&T be able to gain a majority stake. To convince the shareholders, L&T would have to come out with a plan to show how it is better fit for Mindtree than the existing promoters. SES is of the view that, L&T is in a catch 22 situation here; if L&T depicts a very rosy picture and the shareholders believe that L&T would unlock value for Mindtree, then they would not tender shares. If L&T shows a gloomier picture then shareholders and its own Board would be question their poor decision making. As the clouds of a takeover are still looming, only time will tell, if L&T is able acquire majority stake in Mindtree by its open offer. One needs to look at the fate of existing Promoters of Mindtree before making any judgement about the tender offer.

SES understands that a lot is expected from the Independent Directors of Mindtree, however, this is one case where SES finds that if Independent Directors are not equipped to give any opinion or guidance. SES is of the view that for expressing opinion



two vital ingredients are information and competence, assuming all independent directors have competence, however they lack having full and complete information. At best they have one sided information from Mindtree promoters and management side. Unless they have information from L&T's perspective, they cannot give a considered opinion which is actionable. They would not have any information from L&T unless they were acting hand in glove with the raiders which SES feels cannot be the case otherwise, they could be accused of unethical actions. Therefore, no one for certain, can guide the shareholders as of now.

A lot will depend on how institutional investors will view the deal at ₹ 980 per share since there is not enough upside for them when compared to the market price. If L&T is unable to acquire majority and is left with just 37% equity including L&T MF vis a vis shareholding of 13% with existing promoters will lead to a very uncomfortable position. The key still lies with the Promoters of Mindtree and without their cooperation, L&T may not get requisite share and if it is successful in getting shares it may not be able to hold on its flock.

Presently even, SES cannot make any recommendations or view given no future guidance from L&T in the present scenario. The only party in this scenario which can provide answers to majority of questions is L&T.



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