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THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
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MERGERS AND ACQUISITIONS GUIDE

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Preface

This guide is aimed at providing considerations and guidance when considering acquiring or merging with another company. The guide is targeted at small and medium entities without dedicated internal resources that specialises in these transactions. Granted the complexity of these transaction, each company would still need to consider specific terms pertaining to the transaction and consider consulting where necessary.

Every effort is made to ensure that the content of this guide is correct and aligned with legislation as at the date of this guide. This guidance is given to members and associates of SAICA purely to assist them with the subject matter of this guide, however, SAICA does not warrant that this guide deals with every aspect relating to the subject matter. SAICA shall have no liability to any members, associates and/or any third party for any claim of any nature whatsoever which may arise out of the use of and/or reliance on the contents of this guide. Members, associates and/or any third party hereby waive any rights to any claim of any nature whatsoever which may arise out of the use of and/or reliance on this guide, and further indemnifies SAICA against any claim of any nature whatsoever. Members and associates should keep abreast of legislative developments, related guidance issued by regulators and any case law relevant to the subject matter. If there is any conflict between the contents of this guide and the aforementioned legislative developments, related guidance issued by regulators and any relevant case law, members and associates must comply with the latter.

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Abbreviations and Definitions

"Acquiring party" refers a person who, as a result of the transaction, would directly or indirectly acquire or establish direct or indirect control or increased control over all or the greater part of a company, or all or the greater part of the assets or undertaking of a company;

"Affected transaction" as defined in section 117 (1) (c) of the Companies Act as:

(i) a transaction or series of transactions amounting to the disposal of all or the greater part of the assets or undertaking of a regulated company, as contemplated in section 112, subject to section 118(3);
(ii) an amalgamation or merger, as contemplated in section 113, if it involves at least one regulated company, subject to section 118(3);
(iii) a scheme of arrangement between a regulated company and its shareholders, as contemplated in section 114, subject to section 118(3);
(iv) the acquisition of, or announced intention to acquire, a beneficial interest in any voting securities of a regulated company to the extent and in the circumstances contemplated in section 122(1);
(v) the announced intention to acquire a beneficial interest in the remaining voting securities of a regulated company not already held by a person or persons acting in concert;
(vi) a mandatory offer contemplated in section 123; or
(vii) compulsory acquisition contemplated in section 124;

"Basic Conditions of Employment Act" is Basic Conditions of Employment Act ("BCEA"), Act 75 of 1997, as amended.

"BEE Commission" refers to a statutory body established by section 13B of the B_BBEE Act, Act 46 of 2013

"Cautionary Announcement" refers to any announcement published for attention of shareholders on the company information that may affect the share price, through approved platforms such as SENS.

"Competition Commission ("CC")" means a statutory body established in terms of Section 19 of the Act

"Compliance Certificate" refers to the certificate of compliance issued by the TRP to the merged parties or entity and upon successful application to TRP to the latter's satisfaction of the acquisition process

"Companies Act" refers to Companies Act, Act 71 of 2008,

"Competition Act" refers to the Competition Act, Ac 81 of 1998,

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"Concentration" in the competition law context refers to the extent to which one or few firms dominate market/s or sector/s of the economy.

"Confidential information" as defined in the Competition Act, 81 of 1998 refers to "trade, business or industrial information that belongs to a firm, has a particular economic value, and is not generally available to or known by others.

"Divestiture" refers to a form of remedy ordered by the competition regulatory authorities against the merging parties at any stage of competition consideration, as a means of limiting risk of anti-competitive behaviour.

"Due Diligence" in this context refers to verification processes at financial and non-financial levels during the mergers and acquisition ("M&A") process.

"Foreign Acquiring Firm" as defined in the Act, means an acquiring firm "incorporated, established or formed under the laws of a country other than the Republic; or whose place of effective management is outside the Republic.

"ICT" refers to Information and Communication Technology and as regulated under the Electronic Communications Act, Act 36 of 2005,

"Market Power" as defined in the act, means the power of a firm to control prices, to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers. In the context of merger analysis, may be defined as the ability to increase prices profitably, reduce quality, reduce innovation, or reduce consumer choice from pre-merger levels for a significant period.

"Regulated company" include the Limited (Public and listed) and State-Owned Companies (to the extent that they are not exempted) and as defined in the Companies Act.

"The Act" refers to Competition Act, Act 89 of 1998,

"The Tribunal" means the Competition Tribunal as established by section 26 of the Act.

"Trade Union" means a trade union registered in terms of section 96 of the Labour Relations Act ("LRA")

"TRP" refers to the Takeover Regulation Panel, established by section 196 of the Companies Act

"Stock Exchanges" refers to any licensed stock exchange, including the:

Johannesburg Stock Exchange Limited (JSE),
A2X (Pty) Ltd (A2X),
4 Africa Exchange (Pty) Ltd (4AX),

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ZAR X (Pty) Ltd (ZARX) and
Equity Express Securities Exchange (Pty) Ltd (EESE)

"Stock Exchange News Service ("SENS")" an approved news platform for announcement relating to company shareholders.

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1. Introduction

1.1 What is a merger

1. When a firm buy some or all its shareholdings (otherwise referred to as the at stock/ shares) or assets of another, the transaction is termed an “acquisition”. If all of a firm is acquired, the two firms are said to have “merged”. A merger may occur through a purchase or lease of shares and assets, joint ventures and/or pure amalgamation of firms/businesses.

In a **share purchase transaction**, the shareholders transfers shares to the Acquirer in exchange for an agreed-upon method of payment. If the Target is a company, this is effected by a stock purchase agreement signed by the Buyer, the Sellers’ shareholders and sometimes the Seller itself.

A lease / securities/ script lending is the practice of loaning shares of stock, commodities, derivative contracts, or other securities to other investors or firms. Such derivatives include short positions where the lender anticipates a gain on the loaned shares which the owner is less willing to take the associated risk.

A stock purchase in many ways is the simplest form of acquisition. Assuming that all of the outstanding stock of the Seller is acquired by the Buyer/ Acquirer, the Seller becomes a wholly owned subsidiary of the Buyer, and the Buyer effectively acquires control of all of the assets and, as a practical matter, assumes all of the liabilities of the Seller. No change is made in the assets or liabilities of the acquired business as a direct consequence of the acquisition of the Sellers’ stock.

In an **asset purchase**, the Seller transfers all of the assets used in the business that is the subject of the sale which include intangible assets such as contract rights, leases, patents, trademarks, and so on.

The disadvantages of an asset sale are its potentially high tax costs (transfer duty, VAT and etc).Such tax burden however will not necessarily be applied to intra-group transactions as section 44 of the Income Tax Act accommodates for areas of relief. Secondly, an asset transaction is usually more time-consuming and significantly costly because of legal and regulatory complications. For example, transfer of ownership may involve lengthy administrative delays. Thirdly, many intangible assets and leases might not be assignable without the consent of the other party to the transaction. And lastly, loan agreements of the Seller must also be carefully reviewed to ensure that the asset transaction will not trigger default provisions.

A merger is a transaction in which one company is legally absorbed into another, and the surviving company succeeds to all of the assets and /or liabilities of the absorbed company. After the merger, either the Seller or the Buyer (or its subsidiary) can be the company that survives the merger.

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2. The Companies Act stipulates a unique test to be met during the acquisition process which is provisioned to take place to include disposal of all or the greater part of the assets or undertaking of a company's amalgamation /merger and or takeover agreement, or a scheme of arrangement. Ultimate control is not an element for a takeover filing process under this Act.

3. In terms of this said Act, a regulated company is only permitted to dispose of all or a greater part of its assets or undertaking unless approved by a special resolution of such affected transaction. Such transactions are ultimately finalised upon issuance of a compliance certificate that would be issued by the Takeover Regulation Panel, upon satisfactory adherence of all conditions of the TRP, which would include the successful filing of the transaction with the Competition Commission.

4. Amalgamation, merger or takeover offer or agreement between two or more companies are permitted to merge if after such merger, each merged company will satisfy the solvency and liquidity tests, namely the regulated "willing and able" test.

5. There should be an agreement setting out the terms and means of effecting the merger that should include among others; the proposed Memorandum of Incorporation of any new company to be formed by the merger; directors; conversion of securities; consideration to be received if securities are not to be converted; the manner of payment of any consideration; details of the proposed allocation of the assets and liabilities of the merging companies; details about subsequent information and the estimated cost of the proposed merger. The board of each merging company must satisfy the solvency and liquidity tests, before submitting the merger agreement for consideration at a shareholders meeting in accordance with Section 115. The notice of the shareholder's meeting must include a summary of the merger agreement.

1.2 What is acquisition of control?

6. The Competition Act defines a merger to have taken place when one or more firms directly or indirectly acquire or establish **direct or indirect control** over the whole or part of the business of another firm.

7. A firm is said to control another firm when it owns more than 50% of the issued share capital of another firm; and/or has majority votes in general meetings; and/or can appoint or veto the appointment of majority directors; and/or has the ability to materially influence the policy of the firm.

8. Several Competition Tribunal ("Tribunal") and Competition Appeal Court ("CAC") decisions have related to acquisition of control.

Bulmer SA (Pty) and Stellenbosch Farmer's Winery Group ("SFW") / Distillers Corporation (SA) Ltd and Others; and Distiller Corporation (SA) Ltd / Bulmer SA (Pty) (08/CAC/MAY/01) 2001 ZACAC.

This case is significant in that a distinction was made between direct and indirect control and it addressed the issue of the merging parties forming part of a single economic entity. In making its determination of whether the parties where part of a single economic entity, the Tribunal in this instance found that it was necessary for shareholders to have a "common controlling mind" in order for the ultimate change of control argument to succeed. This was found to be lacking pre-merger and hence the Tribunal held that the proposed transaction was notifiable. The CAC dismissed the argument that only where ultimate control changes it is the case that a merger has occurred and is notifiable. The CAC held that the definition of a merger should be widely construed and could include the transaction as contemplated in the case in point. The CAC found that the merging parties were separate legal entities pre-merger and therefore the transaction was held to fall within the meaning of section 12(1) of the Act.

Ethos Private Equity Fund IV and Tsebo Outsourcing Group (Pty) Ltd (30/LM/JUN03) [2003] ZACT 51 (3 OCTOBER 2003)

This case is significant in that it reaffirmed the principle that a firm can be controlled by more than one person at the same time and established the principle that a firm will be deemed to have sole control of another firm if it acquires more than 50 percent of the shareholding of that firm, irrespective of the fact that there was no de facto change of control. Although a shareholder may be deemed to have acquired control by virtue of an acquisition of a majority stake there could still exists factual 'joint control' at the same time. The Tribunal found that the proposed transaction amounted to a merger and that it was thus notifiable. The Tribunal found that there are certain "bright lines" set out in the Competition Act, which when crossed, constituted a merger. Although Tsebo only increased its shareholding from 49.9% to 53.8%, the transaction was a merger.

Competition Commission and Edgars Consolidated Stores Ltd (Edcon) and Retail Apparel Group (RAG) (95/FN/Dec02) [2003] ZACT 19 (24 March 2003)

This case is significant in that direction was given by the Tribunal in terms of what constitutes the "whole or part of a business" as contemplated in Section 12 of the Act. The Tribunal noted that the acquiring firm intended to the secure the book debt of the target firm because it gave it access to a significant client base which was likely to boost Edcon's market share. The Tribunal in this case held that the acquiring firm was acquiring, "more than a bare asset that would enhance its competitive position" in the relevant market and hence the merger was notifiable to the Commission

1.3 Three broad categories of mergers

9. Mergers are commonly categorized as horizontal, vertical, or conglomerate.

10. Horizontal mergers involve direct competitors or firms that sell substitutes. Examples include a merger between two bakeries in a small town or two supermarkets in a small town. Horizontal mergers usually attract the attention of competition authorities, because they are associated with a reduction in the number of competitors servicing a market and may result in an increase in market power of the firms that remain in the market. In some cases, even if market power increases, the detrimental effect of the increase may be offset by efficiency gains associated with the horizontal merger.

11. A merger is categorised as a vertical merger if it involves firms and their suppliers, customers or other firms that sell complements. Examples include a merger between petroleum refiner and firm operating a chain of retail gasoline stations and a merger between a flour milling firm and a bakery. Accordingly, vertical mergers involve firms that may be in a customer-supplier relationship. A vertical merger does not necessarily result in any reduction in the number of competitors servicing a market, vertical mergers are more likely to be associated with efficiency gains. However, it is also possible for vertical mergers to increase market power at various stages of the supply chain.

12. Conglomerate mergers involve firms that do not sell substitutes or complements. In other words, there is no economic relationship between the acquiring and the acquired firm. The firms are neither in a horizontal or vertical relationship.

1.4 Merger history

13. Figure ***1*** shows the number of merger notifications to the Commission over the last 20 years. Merger thresholds, as detailed on paragraphs below, determine whether a merger is classified as large, intermediate, or small, for the purposes of determining the process of approval by the competition authorities. On mergers categorised as large mergers, the Commission makes a recommendation to the Tribunal on whether a merger should be approved (with or without conditions) or prohibited. Small mergers do not need to be notified to the Commission, but the Commission may require notification of a small merger if it considers that the merger might lead to a substantial lessening of competition or might not be in the public interest. *(Section 9 of this document deals with mergers and acquisition thresholds)*

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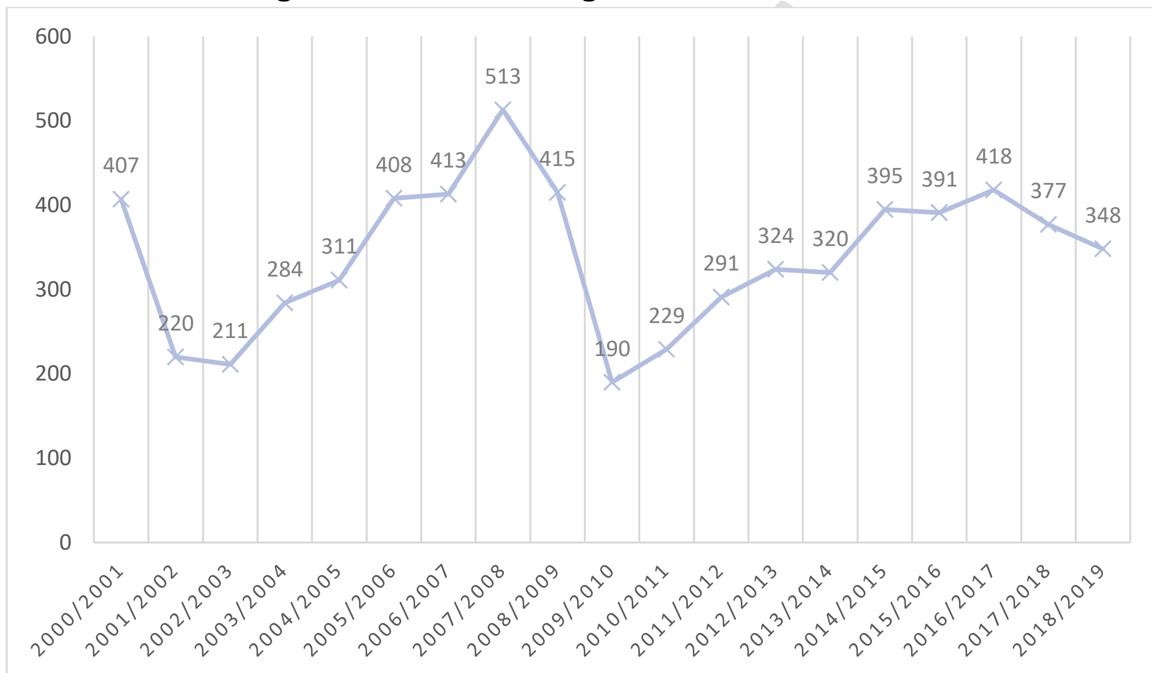
14. The merger thresholds as applied by the Commission were first determined in the years 2000 and implemented in 2001. The thresholds were subsequently amended in 2009 and then again in 2017. The sharp fall in the number of mergers notified as shown in Figure ***1*** corresponds to the revision of merger thresholds (potentially exacerbated by the global financial crisis of 2009). The majority of mergers raised no substantial lessening of competition and are routinely approved without conditions. Figure 2 shows the number of prohibited mergers by the Commission.

Figure 1: Number of mergers notified to the Commission



Source: Competition Commission Annual Reports

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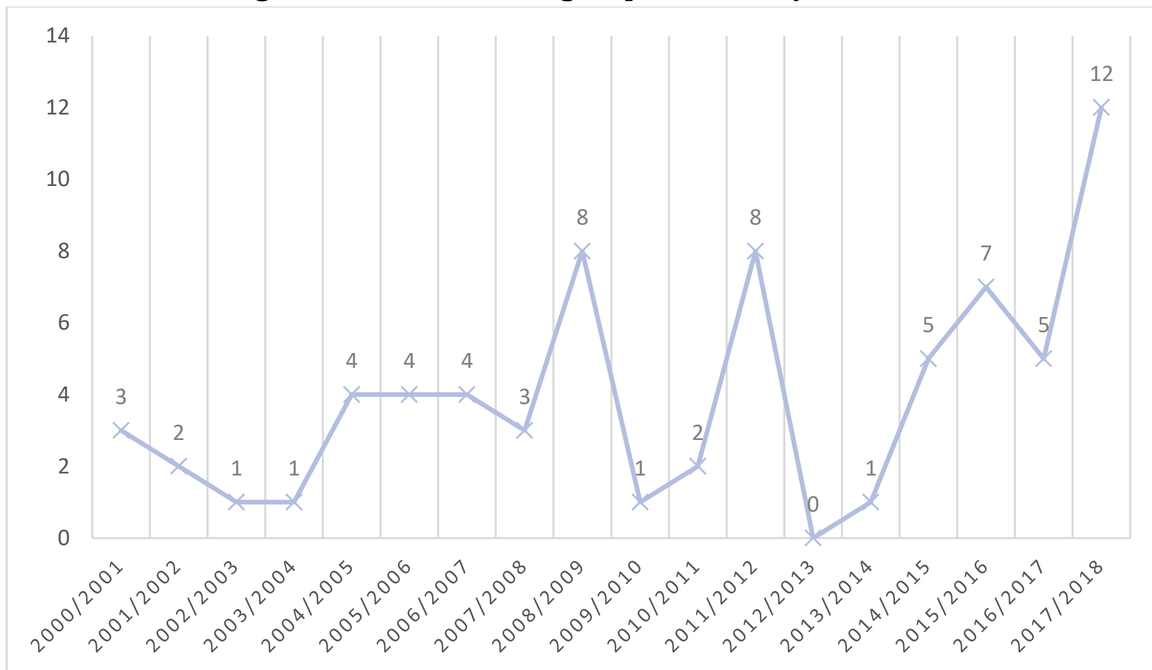
Figure 2: Number of mergers prohibited by the Commission



Source: Competition Commission Annual Reports

15. If the Commission prohibits or conditionally approves an intermediate merger, any party to the merger may request the Tribunal to reconsider this decision. Following the Tribunal's decision, any party to the merger may request the CAC to reconsider this decision. Table 1 shows the number of Tribunal decided merger cases over the last two decades. Only 12 mergers have been prohibited by the Tribunal, out of 1537 cases decided. The vast majority of the mergers have been approved (or conditionally approved).

Table 1: Number of merger cases decided by the Tribunal

	Total decided merger cases	Approved without conditions	Approved with conditions	Prohibited
1999/2000	14	14	0	0
2000/2001	35	29	4	2
2001/2002	42	38	3	1
2003/2004	62	57	4	1
2004/2005	60	51	9	0
2005/2006	62	55	7	0
2006/2007	100	86	12	2
2007/2008	85	79	5	1
2008/2009	98	89	8	1
2009/2010	102	98	4	0
2010/2011	52	48	4	0
2011/2012	85	69	15	1
2012/2013	76	57	19	0
2013/2014	97	82	15	0

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2014/2015	102	84	18	0
2015/2016	133	105	28	0
2016/2017	105	85	19	1
2017/2018	125	88	37	0
2018/2019	102	78	22	2
	1537	**1292**	**233**	**12**

Source: Competition Tribunal Annual Reports

16. In the last 20 years, in only two instances ((1) the proposed *Mondi Ltd and Kohler Cores and Tubes* (a division of Kohler Packaging Limited merger and (2) the proposed *Imerys South Africa (Pty) Ltd and Andalusite Resources (Pty) Ltd* merger) has the CAC confirmed the decision of the Tribunal to prohibit a merger. In three other cases, the CAC overturned the Tribunal's decision to prohibit the mergers.[1]

2. Motives for mergers as part of the organisational strategy

2.1 Introduction

17. All mergers have at the core of their motivation, the same reason: the acquiring entity believes that the acquired firm is worth more than the acquired company's owners believe the firm is worth.

18. The following paragraph discusses several reasons that commonly motivate for mergers.

2.2 Efficiency gains motives

19. One of the most common reason advanced in favour of a mergers is that the merger will increase economic efficiency. Economies of scale may result from any merger but are most common in horizontal mergers. As a result of a horizontal merger, the combined size of the two firms allows cost savings to be realised. Cost savings in this case may be in the form of production costs or marketing costs savings. A merger can also result in cost savings as result of economies of scope.

20. Cost savings in horizontal mergers may include the following:

    a. Rationalisation. Suppose two firms own a number of plants, each operating at a different marginal cost. The differences in marginal cost might be due to differences in the technologies employed or differences in the scale of production. Following a merger, a firm may take the decision to shift production from a high-cost plant to a low-cost plant. Rationalisation may also mean that some plants are closed down.

[1]See the following cases*: (1). Medicross Healthcare Group (Pty) Lt and Prime Cure (Pty) Ltd (Tribunal case number 55/CAC/Sept05); (2) Schumann Sasol (South Africa) (Pty) Ltd and Price's Daelite (Pty) Ltd (Tribunal case number 10/CAC/Aug01); and (3) Pioneer Hi-Bred International and Another v Competition Commission (Tribunal case number 113/CAC/Nov11)*

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b. Economies of scale. These are realised when the long-run average cost decreases as the scale of operation increases. Economies of scale may arise when the productive assets of the two firms are integrated.

c. Research and development. When the two firms integrate their research and development, this may allow cost savings linked with the avoidance of unnecessarily duplicating effort. Diffusion of a new technology may be achieved more efficiently in an integrated firm.

d. Purchasing economies. A merger may increase the bargaining power of the merged firm, which may allow it to extract lower prices from its suppliers. The merged firm may also be able to extract discounts.

21. Vertical mergers can allow firms to take advantage of technological complementarities or reduce the transaction costs associated with coordinating different stages of production. A firm might gain a better understanding of production processes if it is vertically integrated.

22. Conglomerate mergers may improve efficiencies by taking advantage of synergies in production or distribution.

2.3 Market power motives

23. All three types of mergers can increase market power under some conditions. However, horizontal mergers are more likely than either vertical mergers or conglomerate mergers to result in serious increase in market power concerns or anticompetitive concerns. A horizontal merger may result in merged firm with a larger market share, or it may allow the merged firm to eliminate its close competitor. These possibilities may allow the merged firm to increase prices, reduce quality and output without worrying about the reaction of other competitors in the market. Put differently, because horizontal mergers increase concentration in a market, when there is an increase in concentration, there is also a possibility that market power will also increase. Further, a horizontal merger may make it easier for the remaining firms in the market to collude, if it eliminates a firm that can be described a maverick firm. These outcomes may create concerns for competition authorities.

24. Vertical mergers may increase barriers to entry into a market or raise the rivals' costs (perhaps by allowing the merged firm to reduce rivals access to distribution or suppliers). When this happens, vertical mergers may create or increase the merged firm's market power.

Tribunal prohibits merger between the two largest steel drum manufacturers in South Africa

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The Competition Tribunal (Tribunal) prohibited a merger between Greif International Holding B.V. (Greif) and Rheem South Africa (Pty) Ltd (Rheem) in South Africa. In terms of the proposed transaction, Greif would acquire a majority interest in Rheem. Both Greif and Rheem are suppliers of industrial packaging products which include knock-down drums for export, large steel drums and steel pails. Rheem has manufacturing facilities in Prospecton (Durban), Alrode (Johannesburg) and Cape Town. Greif's main production sites are in Vanderbijlpark and in Mobeni.

On 17 March 2017, the companies notified the intermediate merger to the Competition Commission (Commission). On 13 June 2017, the Commission - after investigating the matter -prohibited the proposed intermediate merger on grounds that the merger would constitute a near monopoly in the market for the manufacture and supply of large steel drums. On 03 July 2017, the merging parties applied to the Tribunal for a reconsideration of the matter.

The proposed merger was previously notified to the Commission and prohibited in 2004. The basis for the Commission's prohibition in those circumstances are materially the same in the current matter. The Commission found that it was likely that the merged entity would be able to unilaterally increase prices and remove an effective competitor from the market.

The rationale for the merger according to Greif was twofold and related to both empowerment and investment. In terms of empowerment Greif required a partnership with a new partner in order to improve its B-BBEE status. For Greif the merger offered it the opportunity to realise synergies across the production facilities of the merged entity by more efficiently utilising capacity. The realisation of these synergies would enable Greif to further invest in the South African market as well as introduce new product lines for expansion into Africa, which would also have a positive effect on employment. From Rheem's perspective, the proposed merger offered it the opportunity to address a long term decline in its business as a result of the decline in demand. Rheem submitted that it would likely become loss-making and would exit the market within the next five years.

Greif and Rheem argued that the merger would not lead to substantial lessening of competition and that there were alternative suppliers in the market. They also argued that any potential competition concern would be cured by the behavioural and/or structural remedies they had proposed.

The Tribunal heard evidence from a number of witnesses, including experts, and engaged extensively with Greif and Rheem on whether a potential remedy could be found to address the Commission's competition concerns. Their proposed remedies were canvassed with various stakeholders in the market. However, despite the different remedies proposed, no appropriate remedy was tendered which would cure the substantial lessening of competition that would arise as a result of the proposed transaction.

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The Tribunal has therefore prohibited the proposed merger.

2.3 Financial motives

25. In some cases, a merger may be motivated by speculation that the "whole is worth more than the sum of its parts". When a large conglomerate goes on a purchasing spree and makes a number of good purchases, its stock value will rise, and so, will its price/earnings ratio.

Tribunal conditionally approved the sale of Burger King SA

The Tribunal approved with conditions the merger whereby ECP Africa Fund IV LLC & ECP Africa Fund IV A LLC (collectively, "ECP Africa Fund") acquired Burger King (South Africa) RF (Pty) Ltd ("Burger King SA") and Grand Foods Meat Plant (Pty) Ltd ("Grand Foods"). Burger King SA and Grand Foods are owned by Grand Parade Investments Ltd ("Grand Parade").

According to ECP Africa Funds, the proposed transaction represents an opportunity for it to invest in a high-growth target in line with its investment strategy and group mandate. From GPI's perspective, over the last two years, it has undergone a process of restructuring its business with the main aim of reducing the discount to its intrinsic net asset value and unlocking value for shareholders. GPI's board has decided that the best way to do this is through a controlled sale of assets. The sale of GPI's interests in Burger King and Grand Foods Meat Plant is in line with this value-unlock strategy.

The intermediate merger was initially prohibited by the Competition Commission ("the Commission") on public interest grounds that the shareholding of historically disadvantaged persons ("HDPs") in Burger King would decrease from more than 68% to 0% as a result of the merger. There were no employment concerns since the merger parties gave an unequivocal undertaking that there will be no retrenchments as a result of the merger. In addition, the transaction did not raise any competition concerns.

Following the prohibition, the merging parties entered into discussions with the Commission and the Department of Trade, Industry and Competition ("the dtic"), seeking to remedy concerns around the effect of the merger on the promotion of a greater spread of ownership and increasing levels of ownership by HDPs and workers in firms in the market, a specific public interest ground in terms of section 12A(3)(e) of the Act.

The merger parties subsequently approached the Tribunal for a reconsideration of the Commission's decision. A revised set of merger conditions, reflecting a joint position between the parties and the dtic, was proposed. This was not opposed by the Commission.

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During an online hearing, the Tribunal heard submissions from the merger parties, the Commission, the dtic and SACTWU, a union representing workers at Grand Foods, the meat plant which primarily supplies Burger King SA with burger patties. After considering the submissions and the subsequent amended merger conditions addressing issues raised at the hearing (and containing a set of public interest commitments), the Tribunal has approved the transaction. Below, is a summary of the merger conditions.

Merger conditions

As a package, the merger conditions address the several public interest issues. The conditions involve, inter alia, the following:

1. Expansion commitments: involving (1) an investment of no less than R500 million in terms of capital expenditure; (2) increasing the number of Burger king outlets in South Africa from 90 to at least 150; (3) in addition to current permanent employees, employing no less than 1250 HDPs as permanent employees in Burger King SA, increasing the value of the payroll as well as employee benefits (in respect of the 1250 employees) by an amount of no less than R120 million;
2. Commitments relating to South African suppliers: involving local procurement and to improve compliance with the Enterprise Supplier Development element of the merger parties' Broad-Based Black Economic Empowerment ("B-BBEE") scorecard. Details of this have been claimed as confidential by the merger parties.
3. Commitments relating to an employee share ownership program ("ESOP"): In the context of worker empowerment, this will provide an effective 5% interest to workers in Burger King SA; and
4. A commitment to divest the meat plant: the acquiring group shall seek to conclude the meat plant disposal. The transaction must be notified to the Competition Commission for consideration, even if it is classified as a small merger. Among other obligations, Burger King SA must preserve and maintain the economic and competitive value of the meat plant in accordance with good commercial practice – and it must conclude a supply agreement with the meat plant or the meat plant purchaser in terms of which it will continue to procure inputs from the meat plant.

In addition, the conditions contain an express provision that the merged entity will not retrench any employees as a result of the merger.

2.5 Risk reduction motives

26. The old saying: it's foolish to put all your eggs in one basket, diversification may be a motivation of some mergers as managers adopt a risk reduction strategy, particularly conglomerate mergers. For a merger to reduce risk, the acquiring firm's profits must not be perfectly correlated with the acquired firm's profits. For example, a merger between two steel making firms will not reduce risk in the event of a depressed market for steel.

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2.6 Empire building motives

27. Another motivation for mergers may be a desire on the part of managers or individuals to build financial empires. This may seem strange at first glance, but some mergers are motivated by efforts at self-aggrandizement.

2.7 Failing firm motives

28. For firms at the brink of bankruptcy, an attempt to find a buyer to bail out the firm may be the motive for a merger. For a successful firm, acquiring a failing firm may provide a possibility of short-term advantage, such as using the losses of the failing firm to offset its own tax exposure.

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Competition Tribunal prohibits merger between Imerys South Africa (Pty) Limited and Andalusite Resources (Pty) Limited

The Competition Tribunal ("Tribunal") prohibited the proposed acquisition by Imerys South Africa (Pty) Limited ("Imerys") of Andalusite Resources (Pty) Limited ("AR"). In terms of the proposed transaction, Imerys intended acquiring the entire issued share capital of AR. Imerys is controlled by a French company, Imerys Refractory Minerals Glomel SA (formerly known as Damrec SAS).

Imerys and AR are involved in the mining, processing and sale of andalusite. These two parties are the only miners and suppliers of andalusite in South Africa. Andalusite forms part of the alumina-silicate group of compounds. Alumina-silicates possess heat-resistant properties and are widely used in the production of refractories for high-temperature industrial processes. In the metallurgical industry, refractories are used in applications where a supporting furnace structure must be protected from the temperature required for the metallurgical process, or where heat loss must be limited. Refractories are important to the local steel production industry.

There are currently two main andalusite deposits mined in South Africa, one near Burgersfort in eastern Limpopo and the other at Thabazimbi in western Limpopo. Imerys has mines and plants at both ore deposits (Annesley at Burgersfort and Rhino at Thabazimbi); AR has a mine and plant at the Thabazimbi deposit.

Both Imerys and AR, more specifically, mine and supply fine and medium grade (0-3mm) andalusite, which they supply to producers of refractories both in South Africa and abroad.

According to the merging parties the principal rationale for the proposed merger, was to enhance the merging parties' ability to compete more effectively in the various export markets in which they sell andalusite. The merging parties, more specifically, contended that the merged entity's ability to compete more effectively in these export markets will be enhanced through inter alia the sharing of know-how and expertise, the sharing of fixed costs and operational efficiencies and the optimisation of sales channels.

The proposed acquisition represents a so-called "two to one" merger, i.e. it would lead to a monopoly in the mining, processing and sale of andalusite in South Africa, and also a near-monopoly in the global sale of andalusite. Barriers to entry in the mining, processing and sale of andalusite in South Africa are high and there is no realistic prospect of new entry in the foreseeable future in this area.

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The proposed transaction therefore involves a permanent structural shift in the andalusite market reducing the number of participants in South Africa from two to one, resulting in a substantial prevention or lessening of competition. Moreover, the proposed transaction raises significant public interest concerns, specifically from a small business and an industrial sector perspective.

The matter, which is an intermediate merger, was notified to the Competition Commission ("Commission") in January 2015. During its investigation the Commission received numerous concerns from both producers and end-users of andalusite-based refractories regarding the effects of the proposed merger. In particular, producers and users were concerned that, as a result of the proposed merger, they would be deprived of a competitive choice between Imerys and AR, and that the merged entity would increase the price of andalusite and/ or divert andalusite sales from South Africa to export markets.

The Commission, after investigating the proposed merger, prohibited its implementation on 16 April 2015.

The merging parties then on 04 May 2015 referred the matter to the Tribunal requesting the consideration of the prohibited merger. The hearing took place over several months in 2015 and 2016 and the last submissions from the merging parties were filed on 24 August 2016.

The Tribunal has now prohibited the transaction. Although the merging parties proposed certain behavioural conditions in an attempt to address the concerns, these proposed conditions in our view are inadequate and do not address the structural market change resulting from the proposed transaction. Furthermore, the proposed behavioural conditions are impractical from a monitoring and compliance perspective and would be unduly onerous on the Commission to effectively monitor.

The Tribunal will issue its full reasons for prohibiting the proposed transaction in due course.

29. The age structure of a firm's ownership may in some cases provide a motivation for merger. If a firm is privately owned or controlled by an individual without heirs, then the owner may sometimes search for buyer. In this case, the merger allows the owner to retire on the anticipated future earning of the firm because these earnings are capitalised into the present value of the firm.

The merger for the supply of mining support bags to Mining houses is conditionally approved.

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The Competition Tribunal approved with conditions the intermediate merger in terms of which Timrite (Pty) Ltd (Timrite) acquired the Mining Bag Division of Tufbag (Pty) Ltd (Mining Bag Division). Timrite is a wholly-owned subsidiary of Thebe Investment Corporation and is active in the provision of timber based and non-timber based mining support products. The Mining Bag Division is one of the divisions of Tufbag involved with the designing, jointly with Timrite, and manufacturing of polypropylene-based mining support (PBMS) bags.

Concerns were raised by the Competition Commission, who had prohibited the merger, that the transaction would facilitate and enhance potential market allocative arrangements in the manufacturing and distribution of polypropylene-based mining support (PBMS) bags as well as facilitate the potential loss of competition. In particular, the Commission had found in its assessment that the Purchase and Sale Agreement (PSA) went beyond the supposed intention by ensuring that Timrite and Turfbag did not compete against each other in the market for the manufacture and distribution of PBMS bags, as opposed to only securing supply volumes. Timrite and Tufbag then referred the matter to the Tribunal.

In terms of the rationale for the merger, the merger would allow Timrite to acquire sole ownership of the jointly developed IP and to obtain control of the Tufbag PBMS bag manufacturing facility. In Timrite's view the proposed merger would allow it to achieve backward integration. For Tufbag, the merger represented an exit opportunity as shareholders were seeking to divest of Tufbag's Mining Bag Division in order to manage and develop other assets in the Tufbag's portfolio.

The Commission said it found evidence that Timrite had entered into similar market allocation arrangements with Brits Bag Manufacturers (BBM) and Polystar Tape and Fabric (Polystar) which required the two companies to manufacture specific engineered PBMS bags exclusively for Timrite bearing the Timrite logo and required that BBM and Polystar not deal with other downstream players. However during the hearing the merging parties indicated that they no longer have a manufacturing agreement with BBM and that they had also since received notice of termination of their manufacturing agreement with Polystar.

Conditions to the approval of the merger issued this week will enable competitors of the merged firm to enter or expand into the market and will protect employees from merger specific retrenchments for a period of two years.

In particular, the conditions prevent Future Manufacturing agreements that contain exclusivity supply provisions, other than one aimed at the protection of Timrite's Intellectual Property and Know-how. Future Manufacturing agreements also shall not preclude any third-party manufacturer from manufacturing competing products provided the products do not infringe on Timrite's Intellectual Property and Know-how.

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In addition, for as long as it holds a dominant position, the merged entity must not induce any Input Supplier not to deal with any of its competitors. Employment conditions have also been imposed to prevent any merger related job losses.

Mystic Blue Trading 62 (PTY) Ltd // Rhino Group: 35/LM/Apr/11

The primary acquiring firm is Mystic Blue Trading 62 (Pty) Ltd ("Newco"), a wholly owned subsidiary of Luzupu Trading (Pty) Ltd t/a Masscash Retail ("Masscash Retail"). Masscash Retail is a wholly owned subsidiary of Masscash (Pty) Ltd ("Masscash"), a subsidiary of Massmart Holdings Ltd ("Massmart"). Massmart is a subsidiary of Wal-mart Inc.

The primary target firms are 16 Rhino stores, mostly based in KwazuluNatal and the Eastern Cape. These stores are collectively referred to as the Rhino Group stores. In its conditional approval of this merger, the Competition Tribunal noted the rationale of the transaction of acquiring the Rhino group in two folds:

- To enable the Masscash, the acquiring firm to **realise its strategy of expanding its presence in the retailing of grocery in urban and peri-urban areas.**
- For Rhino group this **was an opportunity for its shareholders to realise a return on their investment and sell the business. This was mainly due to lack of a succession plan within the family as Rhino was a family business.**

3. Potential synergies arising from M&A

3.1 Introduction

30. Mergers can sometimes give rise to efficiencies.

31. Efficiencies arising from the merger may enhance competition in the marketplace. For example, a merger of two of the small firms in a market which three other larger firms may result in efficiency gains that might allow the merged firm to compete more effectively with the larger firms.

32. Efficiencies generated by a merger can also have the effect of increasing consumer and/or producer welfare due to the ability of the merged firm to provide its products or services at lower prices (or better quality) and/or at lower costs, resulting in an overall benefit to society. In fact, significant variable cost savings can result in lower prices, despite a lessening of competition. Even fixed cost savings may lead to future price reductions.

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33. A merger may also create dynamic efficiencies through the creation of new products or innovations. Moreover, there may be resource savings to other parts of the economy, quite apart from the benefits to the consumers and producers directly affected by the merger, for example, those resulting in increased R&D activities. Productive and dynamic efficiencies are often primary rationales for mergers and are critically important for the creation of long-term economic growth and welfare.

34. In this section we first discuss several types of efficiencies before describing how they should be evaluated.

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3.2 Types of efficiencies

35. The different types of efficiencies may broadly be characterised as supply-side efficiencies, such as cost savings, or demand-side efficiencies, such as increased network size. Examples are provided below.

3.2.1 Cost savings

36. A merger may lead to fixed or variable cost saving. In general, competition authorities tend to focus their assessment of mergers on cost efficiencies that lead to reductions in variable costs than reductions in fixed costs. This is because variable cost savings are more likely to result in lower consumer prices and to be achieved in the short term.

3.2.2 Pecuniary or redistributive efficiencies

37. Pecuniary efficiencies are efficiencies that result in a mere redistribution of income from one person to another. In competition assessments, pecuniary efficiencies are considered with some scepticism in the evaluation of the merger. The reasoning behind this principle is that all gains realised pursuant to a merger do not necessarily represent a saving in resources. For example, gains resulting from increased bargaining leverage that enable the merged entity to extract wage concessions or discounts from suppliers that are not cost-justified represent a mere redistribution of income to the merged entity from employees or the supplier; such gains are not necessarily brought about by a saving in resources.

3.2.3 Productive efficiencies

38. Productive efficiencies are perhaps the least controversial category of efficiencies - they are readily quantifiable, often associated with variable costs, and, for the most part, broadly accepted by competition authorities as relevant in the evaluation of mergers. Productive efficiency is optimised when goods are produced at minimum possible cost, and includes: (1) economies of scale (i.e., when the combined unit volume allows a firm to operate at a lower unit cost); (2) economies of scope (i.e., when the joint use of an asset results in a lower overall cost than firms had when they operated independently); and (3) synergies.

39. Production efficiencies leading to economies of scale can arise at the product-level, plant-level and multi-plant-level and can be related to both operating and fixed costs, as well as savings associated with integrating new activities within the combined firms.

40. Examples of plant-level economies of scale include:

    a. specialisation, i.e., the cost savings that may be realised from shifting output from one plant with high marginal cost of production to another lower-cost plant, without changing the firms' production possibilities frontier;
    b. elimination of duplication;

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c. reduced downtime;
d. smaller inventory requirements;
e. the avoidance of capital expenditures that would otherwise be required.
f. consolidation of production at an individual facility; and
g. mechanisation of specific production functions previously carried out manually.

41. Multi-plant-level economies of scale can arise from:

a. plant specialisation;
b. rationalization of administrative and management functions (e.g., sales, marketing, accounting, purchasing, finance, production) and the rationalization of R&D activities; and
c. the transfer of superior production techniques and know-how from one of the merging parties to the other

42. Economies of scope occur when the cost of producing or distributing products separately at a given level of output is reduced by producing or distributing them together. Sources of economics of scope include:

a. common raw inputs;
b. complementary technical knowledge; and
c. the reduction or elimination of distribution channels and sales forces.

43. Synergies are the marginal cost savings or quality improvements arising from any source other than the realisation of economies of scale. Examples include:

a. the close integration of hard-to-trade assets;
b. improved interoperability between complementary products;
c. the sharing of complementary skills; and
d. the acquisition of intangible assets, such as brand names, customer relationships, hard-to-duplicate human capital, functional capabilities (marketing, technological and operational) and "best practices."

3.2.4 Dynamic efficiencies

44. While productive efficiencies are achieved from producing goods at lower cost or of enhanced quality using existing technology, innovative or dynamic efficiencies are benefits from new products, or product enhancement gains achieved from the innovation, development or diffusion of new technology. However, while R&D efficiencies offer great potential because they tend to focus on future products, there may be formidable problems of proof. Innovation efficiencies may also make a significant contribution to competitive dynamics, the national R&D effort and consumer (and overall) welfare.

Pioneer / Pannar seed merger approved by the Competition Appeal Court

After being prohibited by the Competition Commission in 2010 and by the Competition Tribunal in 2011, the proposed acquisition by Pioneer Hi-Bred International ("Pioneer"), a US based multinational seed producer (controlled by Du Pont) of locally based seed company, Pannar Seed ("Pannar") was conditionally approved in May 2012by the Competition Appeal Court ("CAC").

Pioneer and Pannar Seed, competitors within the hybrid maize seed breeding market, appealed against the Competition Tribunal's decision prohibiting their proposed merger. The hybrid maize seed breeding market is composed of three major players – Pioneer, Pannar Seed and Monsanto. The Tribunal argued that were the merger to be allowed, the pool of competitors would be reduced to two and this would prove harmful to potential entrants to the market.

Pioneer and Pannar Seed argued that Pannar could no longer compete effectively owing to a lack of sufficient access to facilities necessary for the exploitation of its germplasm and it was argued that this would eventually lead to Pannar's exit from the market and the loss of a valuable resource in its germplasm. The only way in which its eventual exit could be prevented was by merging with an international hybrid maize breeder – Pioneer.

The CAC strongly criticised the Tribunal's decision, stating that the Tribunal failed to consider the long-term dynamic efficiency gains, which oversight is worsened by the fact that the market in question is dominated by innovation competition. The CAC considered the efficiency gains which the merger would result in – particularly the long-term dynamic (or innovation) efficiency gains – as completely outweighing any short-term anti-competitive effects.

3.2.5 Transactional efficiencies

45. An acquisition can foster transactional efficiency by eliminating the "middle man" and reducing transaction costs associated with matters such as contracting for inputs, distribution and services. In general, market participants design their business practices, contracts and internal organisation to minimise transaction costs and reduce exposure to opportunistic behaviour (e.g., hold-ups). Joint ventures and common ownership can help align firms' incentives and discourage shirking, free riding and opportunistic behaviour that can be very costly and difficult to police using arm's-length transactions.

3.2.6 Demand-side network effects

46. Network effects occur when the customer's value of a product increases with the number of people using that same product or a complementary product. For instance in

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communications networks, such as telephones or the Internet, the value of the product increases with the number of people that the user can communicate with.

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3.2.7 Managerial cost savings

47. Managerial efficiencies arise from the substitution of less able managers with more successful ones. However, managerial skill and imagination often may be difficult to measure, abundantly available through contract, or even unpersuasive as a factor that positively affects competitive dynamics.

48. In practice, managerial efficiencies are disfavored by competition authorities because of the difficulties in establishing that the acquired firm cannot improve its efficiency in ways that are less harmful to competition. In general, competition authorities will discount managerial efficiencies because they are not merger-specific and they represent fixed cost reductions less likely to be passed on to consumers in the short term.

49. The financial literature recognizes the disciplining effect of the "market for corporate control" (i.e. M&A) as a means of weeding out bad management and moving assets to their highest-valued uses. In large public corporations particularly, a failure of management to maximize the profits of the corporation may be a result of internal inefficiency (sometimes referred to as "x-inefficiency"). It is the recoupment of some of these inefficiencies that motivates some transactions, particularly hostile ones. If managerial efficiencies are ignored and certain take-overs are made more difficult, competition policy may reduce the disciplining role of the take-over threat and the transfer of unique, or at the very least, scarce know-how brought to the merger by new management.

3.3 Competition authorities' evaluation of efficiencies

50. Many firms often assert that their proposed mergers result in efficiency gains. To form a view that the claimed efficiencies will enhance rivalry so that the merger does not result in a substantial lessening of competition, competition authorities focus, on the basis of compelling evidence, on the following criteria:

    a. the efficiencies are timely, likely and sufficient to prevent a substantial lessoning of competition from arising (having regard to the effect on rivalry that would otherwise result from the merger); and
    b. the efficiencies must be merger specific, i.e. a direct consequence of the merger, judged relative to what would happen without it.

4. Steps involved in M&A Deals

4.1 Introduction

51. Once a company has made the critical decision to sell or buy, whether regulated by the TRP or not (as some transactions are not regulated by the TRP), such company need to decide how it is going to manage that process.

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52. Section 9 of this document deals with transactions which are regulated by the TPR.

WHAT TRANSACTIONS ARE NOT REGULATED BY TRP?

The TRP regulates "affected transactions" or "offers" as defined in the Act ("mergers and takeovers"). These transactions relates to the acquisition of more 35% of the voting securities of a regulated company, disposal of major assets or undertakings a company, schemes of arrangements, amalgamations or mergers, acquisitions of 5%,10% 15%, or any further multiple of 5% of the issued securities of a company and compulsory acquisitions and squeeze outs. The TRP has no authority to consider the commercial advantage or disadvantages of the above transactions

TRP regulates mergers and takeovers involving a profit company or securities of that company if the company is a public company, a state owned company unless the state owned company has been exempted and or private companies if the memorandum of incorporation of the company so provides or if 10% of the issued securities of the company has been transferred in a period of 24 months before the date of the particular transaction except if the transfer is between related or interrelated persons.

53. There are several critical steps that a Seller or Buyer needs to take in consummating a Merger and Acquisition ("M&A") deal which include, identifying the buyer/seller, approaching and negotiating with potential buyer or seller, conducting valuations and due diligence, entering negotiations, concluding contracts and closing the deal.

54. There are various ways that the buyer and or the seller may use in soliciting a merger transaction, including engagements listed herein.

4.2 Non-disclosure agreements

55. Once the two parties have established that there is a mutual interest in discussing the M&A transaction, as a starting point they usually exchange basic non-disclosure agreements ("NDAs") such as wall-crossing and other binding agreements related to the transaction.

56. Once the NDA has been signed, the Seller will usually share more extensive information with the Buyer, including more detailed financial data and an overview of the business and operations, as well as key assets. This information is usually in various forms of offering and basically a precursor to full due diligence.

57. On companies regulated by the TRP, due to sensitivity considerations and guarding against upsetting the market, the company receiving offer (target firm) and or making same will immediately appoint a minimum of three-member Independent Board ("ÏB") to review the offer either way. All directors appointed offer review will sign confidentiality undertakings, not to disclose information relating to the received offer.

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58. The target firm's offer consideration process by the IB will include appointing an Independent Expert ("IE") by the IB who will in turn prepare an Independent report (IR) advising the latter on the fairness and reasonableness of the offer , for the IB to advise its board.

59. In general terms the NDA provides that neither party will share the information it gets during the process nor use the information for any purpose other than to evaluate the Seller as a possible acquisition and often includes other clauses, such as a bar on actively recruiting the employees of the other party.

4.3 Scheme of arrangement

60. This related to arrangements between the company and the holders of a class of its securities, including a re-organisation of the share capital of the company by way of the following listed aspects relevant on every transaction:

a. a consolidation of securities of different classes;
b. a division of securities into different classes;
c. an expropriation of securities from the holders;
d. exchanging any of its securities for other securities.
e. a re-acquisition by the company of its securities; or
f. a combination of these methods.

4.4 Deal Closer & Negotiations and concluding contracts

61. A negotiation process is an ongoing process of engagement at various stages of the M&A, including the deal negotiations, at board and any level of the company during this process. Example, after the Seller identifies and approaches potential Buyers who express interest in acquisition then the negotiation stage begins. During the negotiation process the Buyer and Seller come together in a direct negotiation and try to reach mutually accepted terms.

62. This includes negotiation at various levels of engagement with different stakeholders such as at Board level, shareholder level, operations level, further stakeholders such as banks, trade unions, landlords on rented properties, regulatory institutions in regulated industries etc.

63. Examples include where the Seller may need to engage at various levels regarding the offer presented by the Buyer and the advice of the IB that is based on the IE's report.

64. Other examples may range from the shareholder related transactions with material effects on the rights of the holders of securities affected by the transaction. In this instance it is necessary to evaluate potential material adverse effects against such share compensation.

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65. In terms of Section 115 of the Companies Act, the arrangement requires shareholder approval by special resolution. A special resolution means a resolution adopted with the support of at least 75% of the voting rights exercised on the resolution. A clearance notice issued by the Takeover Regulation Panel may be required.

66. In many cases, the Seller will ask the Buyer to provide a more formal indication of interest which takes the form of a letter of intent or indication of interest. These documents provide greater detail on the price the Buyer is willing to pay, the structure of the deal it envisions, the assets (if not all) it is seeking to acquire, and the process by which it would propose to complete the transaction.

67. The letter of intent may, in some instances, require the Seller to sign a commitment to exclusively negotiate with the Buyer for a period of time. The goal is to give the parties enough time to completely negotiate a transaction but not block the Seller from beginning negotiations with another Buyer, if it becomes apparent that the deal is not going to go through.

68. Once the letter of intent has been accepted and, in some cases, an exclusivity period has begun, the Buyer and Seller will begin active negotiation that may lead to filing such transaction to relevant regulatory institution as it may amount to a M&A transaction. In most cases, they will pursue a dual-track process, whereby the Buyer simultaneously completes full due diligence and negotiates the agreements.

69. On companies regulated by the TRP the negotiation process will unfold in this following regulated format, where the TRP will oversee and approve all the related stages that are successfully negotiated and implemented.

70. As merging entities are engaging in this transaction and negotiation process towards it, such transaction must be a cautionary announcement may be issued through stock exchanges for attention to shareholders, upon approval by the TRP that the Seller meets the “willing and able” test. This goes to the very core business of the TRP of preserving the market and ensuring that this process does not upset the market.

71. That upon parties agreeing to the offer, the outcome of such negotiated offer including the financial obligation must be submitted at TRP either in a form of cash confirmation (in Escrow) or a bank guarantee amounting to the value of the offer.

4.5 Due diligence

72. A due diligence is a fact-finding exercise which is conducted to create a level of assurance with regards to the representations which have been made by the transacting parties. This process also assesses the potential risks on the proposed transaction by inquiring into all relevant aspects of the past, present, and predictable future of the business to be purchased.

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73. The due diligence process is extremely important as it affects both parties' decision, on terms and price. Due diligence may also be done on the Buyer by the Seller in a transaction in which the Seller's shareholders are to receive stock of the Buyer as part of the Buyer's purchase price in acquiring the Seller.

74. The IE report is also part of due diligence done on parties regulated by the RTP to ensure that parties will meet their obligations.

75. Competition Commission consideration process forms part of due diligence regarding the competitive test of the transaction and as defined in the Competition Act.

In mergers, due diligence activities should, amongst others, include the following:

4.5.1 Financial Due Diligence

76. Largely focuses on assessing the reasonability of assumptions used in projections, financial modelling and management accounts. The exercise includes assessing the validity, accuracy and completeness of the financial statements. In doing this a view can be formed on the financial health of the company.

4.5.2 Management and operations review

77. To determine quality and reliability of financial statements, and to gain a sense of contingencies beyond the financial statements. Recent regulatory and accounting reforms in the United States, in the aftermath of the 2002 law known as Sarbanes-Oxley, made this review somewhat easier, because now corporate leaders have greater accountability for the oversight of internal accounting controls. Sarbanes Oxley Act was a response by the US Congress due to a vast numbers of corporate failures, acts of fraud which resulted in losses of investors moneys.

78. While not law, in South Africa, companies listed on the JSE are required to report in line with the prescripts of the King Code or Corporates Governance. In doing so an entity is benchmarked against its level of Good Corporate Governance. As opposed to being prescriptive, King IV has moved to an apply or explain approach where if principles are not adopted reasons behind not doing so are given

4.5.3 Legal compliance review

79. This focuses on legal considerations throughout the transaction with sole purpose of ensuring compliance to regulations and curbing for potential challenges that may emanate from such transaction.

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4.5.4 Document and transaction review

80. Focused on ensuring that the paperwork of the deal is in order and that the structure of the transaction is appropriate.

4.6 Signing and closing the deal

81. If the Seller and Buyer are able to reach an agreement, complete due diligence, and finalize legal documentation, they will then move on to consummate the deal. In some cases, a deal is closed all at once whereby the Buyer and Seller come together and execute all the legal documents necessary, and payment is made, all at the same time. In many cases, however, there is a need to separate the transaction into two events, the signing and the closing.

82. Closing the deal process include obtaining all the necessary approvals from the regulatory institutions such as the approval of a merger by the Competition Commission and other regulatory institutions. Such regulatory institution approval may be required in addition to the conclusion of the deal from institutions or departments which industries such as Department of Mineral, Energy, Information and Communications Technology where licences and approvals are issued.

83. The signing will usually involve executing all the legal documents necessary but will make final completion of the deal subject to some small list of discrete events or pre-closing conditions. The closing will occur as soon as those events have happened, or those conditions have been met.

84. The idea behind a separate signing and closing is to lock down as much detail of the agreement as possible, subject to only those aspects that cannot happen immediately, such as regulatory filings and regulatory approvals.

85. There is no one standard structure and timeline to the closing process, and details will vary and must be adapted to the nature of the business being sold, the needs of the parties, and often the regulations that apply.

86. On parties regulated by the TRP, the very last process of closing the deal is for the parties submitting an application for certificate of compliance with proof that all the conditions are met and necessary approvals are obtained. The TRP approves and issues the said certificate upon satisfying itself that the merging entities have fulfilled all the set stipulations.

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5. Valuation of the targeted Companies

5.1 Introduction

87. In a M&A transaction, price is the number one concern for both Buyers and Sellers, and ultimately determines whether a transaction can be consummated. Fortunately, there are several established valuation methods used to estimate the price range in which a business can be sold. However, the actual price is only determined by what companies are actually willing to pay and or accepted as marketed related price.

88. The acquiring company will need to gather sufficient financial and market information to make a valuation of the target company. There are a number of approaches for valuing a company, such as:

89. The **asset valuation** that is based on the balance sheet value of the firm's capital assets.

90. The historical earnings valuation is another form of valuation that typically takes financial data from the company's previous three years and assumes the business will generate at least as much cash in future.

91. **Relative valuation**: This approach uses comparable companies in terms of industry, size, capital structure or growth rates where a market value can be obtained to establish a value for the target company.

92. **Net Asset Value (Book value):** The book value or net asset value can be determined by the balance sheet. The total book value of a company's property, for example, can be found under the net PP&E in the assets section of the balance sheet. The book value of the shareholder's interest in the company (not including the minority interest holder) can be found under shareholder's equity:

93. **Example:** Assuming a company; Cleopetra's shareholder's equity value of **R71,315** is the book value of its equity to the shareholders. This value is usually the difference between the Company's assets and its obligations as measured by its liabilities.

94. The equity value of a business is the value of the business attributable to just equity holders; that is, the value of the business excluding debt lenders, minority interest holders, and other obligations. Shareholders' equity, for example, is a value of the company's assets less the value of the company's liabilities. So this shareholders' equity value (making sure non-controlling interest is not included in shareholders' equity) is the value of the business excluding lenders and other obligations; an equity value.

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95. **The market Value (Listed company):** The market value can be defined by its market capitalization, or shares outstanding times share price. Cleopetra, which is currently trading at R73.82 and has 3,365.7 million diluted shares outstanding, has a market capitalization of R248,459.0 million. This is Cleopetra's market value. These values represent the equity value of a business.

96. The market value, or market capitalization, is based on the stock price, which is inherently an equity value as equity investors value a company's stock excluding debt lenders and other obligations.

97. The **Enterprise value** (also known as firm value) is defined as the value of the entire business including debt lenders and other obligations. We will see why, the importance of enterprise value is that it approaches an approximate value of the operating assets of an entity. To be more specific "Debt lenders and other obligations" can include short-term debts, long term debts, current portion of long-term debts, capital lease obligations, preferred securities, non-controlling interests, and other non-operating liabilities (e.g. unallocated pension funds). For complete reference, **enterprise value** can be calculated as:

    a. Equity value
    b. +Short-term debts
    c. +Long-term debts
    d. +Current portion of long-term debts
    e. +Capital lease obligations
    f. +Preferred securities
    g. +Non-controlling interests
    h. +Other non-operating liabilities (e.g. unallocated pension funds)
    i. -Cash and cash equivalents

98. We will explain why subtracting cash and cash equivalents is significant. So, to arrive at enterprise value on a book value basis, we take the shareholders' equity and add back any potential debts and obligations less cash and cash equivalents. Similarly, if we add to market capitalization any potential debts and obligations less cash and cash equivalents, we approach the enterprise value of a company on a market value basis.

Discounted Cash Flow Analysis:

99. The discounted cash flow (DCF) analysis is known as the most "technical" of the three major methods, as it is based on the company's cash flows. The three major methods are 1. The Income Method (DCF), 2. Market Value and 3.Net Asset Value Method. The discounted cash flow takes the company's projected unlevered free cash flow (UFCF) and discounts it back to present value (PV). We typically project the company's cash flows out five to seven years. We then create a terminal value, which is the value of the business from the last projected year into perpetuity. The enterprise value of the business is the sum of the PV of all the projected cash flows and the PV of the terminal value.

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100. **DCF Enterprise Value = Present Value (PV) of UFCF Year 1+ . . .+PV of UFCF year n+PV of Terminal value.**

101. **The DCF analysis has this major advantage over the other three:**

102. It is the most technical. It is based on the company's cash flows from model projections, as opposed to the comparable company analysis, for example, which is mainly driven by market data.

103. **The analysis also has several disadvantages:**

104. The Terminal value. Although the first projected years are based on modelled cash flows, the terminal value accounts for a very significant portion of the overall valuation. That terminal value is based on a multiple or a perpetuity.

105. Model projections. The model projections could be inaccurate; they could be overstated or understated, depending on what is driving the projections.

106. Discount rate. The discount rate may be difficult to estimate. We will go through standard techniques, but these standards do not apply in all situations.

107. Again, as all three valuation methodologies have significant drawbacks, as they do have strengths.

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Example: Valuation of Cleopetra Tutorials using the DCF analysis approach

	FORECAST					
	Feb-18	Feb-19	Feb-20	Feb-21	Feb-22	Terminal
	DRAFT	FORECAST	FORECAST	FORECAST	FORECAST	FORECAST
Net operating profit before taxation	R 48,670,239	R 50,052,695	R 51,493,389	R 52,992,393	R 54,549,947	R 54,549,947
Less taxation (28%)	R -13,627,667	R -14,014,754	R -14,418,149	R -14,837,870	R -15,273,985	R -15,273,985
Net operating profit after taxation (NOPAT)	**R 35,042,572**	**R 36,037,940**	**R 37,075,240**	**R 38,154,523**	**R 39,275,962**	**R 39,275,962**
Add *Depreciation & amortisation*	R 1,710,374	R 1,839,336	R 1,955,403	R 2,059,862	R 2,153,876	R 2,153,876
Less *CAPEX*	R -3,177,500	R -3,000,000	R -3,000,000	R -3,000,000	R -3,000,000	R -2,153,876
Less *working capital changes*	R -9,132,483	R 181,838	R 187,293	R 192,912	R 198,700	R 198,700
FREE CASH FLOW	**R 24,442,963**	**R 35,059,115**	**R 36,217,936**	**R 37,407,298**	**R 38,628,538**	**R 39,474,662**
Discount factor (28 February 2017 valuation)	*0.83*	*0.69*	*0.58*	*0.48*	*0.40*	
DISCOUNTED CASH FLOW	**R 20,363,477**	**R 24,333,082**	**R 20,941,991**	**R 18,019,747**	**R 15,502,392**	

Growth in perpetuity (after forecast period)	**1.0%**
Assumed synergies (net of tax) - as % of total costs)	**0.0%**
WACC (plus or minus)	**0.0%**

DCF VALUATION - 100%	
Value of free cash during forecast period	R 99,160,688
Terminal value	R 84,064,972
Enterprise value (excluding discount per below)	**R 183,225,660**
(Third party debt)/ Net cash on hand	R 41,955,627
Equity value (100%)	**R 141,270,033**
Discounts	*24.3%*
Small stock discount (%)	*16.3%*
Marketability discount (%)	*8.0%*
Equity value (100%) (net of discounts)	**R 107,012,050**
@ WACC of	**20.03%**

EV/EBITDA x			
Feb-18	Feb-19	Feb-20	Feb-21
3.64 x	3.53 x	3.43 x	3.33 x

P/E x			
Feb-18	Feb-19	Feb-20	Feb-21
3.05 x	2.97 x	2.89 x	2.80 x

108. Multiples: Multiples are metrics that compare the value of a business relative to its operations. A company could have a market capitalization of R100 million, but what does that mean in relation to their operating performance? If that company is producing R10 million in net income and we assume that its enterprise value multiple is 10x then its value is 10× the net income it produces. “10× net income” is a market value multiple. These multiples are used to compare the performance of one company to another.

109. Let’s say we wanted to compare this business to another business that also has R100 million in market cap. How would I know which business is the better investment? The value itself is arbitrary in this case unless it is compared to the actual performance of the business. So, if the other company is producing R5 million in net income, its multiple is 20×; its value is 20× the net income it produces. As an investor, I would prefer to invest in the lower multiple, as it is the “cheaper” investment. It is more net income for lower value. So, multiples help us compare relative values to a business’ operations. Other multiples exist depending on what underlying operating metric one would like to use as the basis of comparison; Instead of net income, EBIT, EBITA, and revenue can be used. But how do we determine which are better metrics to compare? Let’s take an example of two companies with similar operations.

(See Table 1.12)

Business Comparison	Company A	Company B
Revenue	10,000.0	10,000.0
COGS	3,500.0	3,500.0
Operating Expenses	1,500.0	1,500.0
EBITDA	**5,000.0**	**5,000.0**
Depreciation	500.0	3,000.0
EBIT	**4,500.0**	**2,000.0**
Interest	0.0	2,000.0
EBT	**4,500.0**	**0.0**
Taxes (@ 35%)	1,575.0	0.0
Net Income	**2,925.0**	**0.0**

110. Let's say we want to consider investing in either Company A or Company B. Company A is a small distribution business, a package delivery business that has generated R10,000 in revenue in each period. This is a start-up company run and operated by one person. It has a cost structure that has netted R5,000 in EBITDA. Company B is also a small delivery business operating in a different region. Company B is also it is also producing R5,000 in EBITDA. However, the current owner of Company A has decided to operate his business out of his home. He parks the delivery truck in his garage, so he has minimal depreciation costs and no interest expense. The owner of Company B, however, has decided to operate his business differently. He has built a warehouse to store the packages and park the truck. This has increased the depreciation expense and has created additional interest expense, bringing net income to zero.

111. If we were to compare both businesses based on net income, Company A is clearly performing better than Company B. But what if we are only concerned about the core operations? What if we are only concerned about the volume of packages being delivered, number of customers, and the direct costs associated to the deliveries? What if we were looking to acquire Company A or B, for example? In that case, let's say we don't care about the debt, the warehouse, or the trucks, as we would sell the warehouse and trucks and pay down the debt. Here, EBITDA would be a better underlying comparable measure.

112. From an operations perspective, looking at EBTIDA, both companies are performing well, and we could have been misled in that case by looking at net income. So, although Market Capitalization / Net Income is a common multiple, there are other multiples using metrics, such as EBIT or EBITDA. However, since EBIT and EBITDA are values before interest is taken into effect, we cannot compare them to market capitalization. Remember: Market capitalization, based on the share price, is the value of a business after lenders are paid; EBITDA (before interest) is before lenders have been paid. So, adding net debt (plus potentially other items as discussed in the enterprise value section) back to market capitalization gives us a numerator (enterprise value) that we can use with EBIT or EBITDA as a **multiple:**

Enterprise Value / EBIT

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Or:

113. Enterprise Value / EBITDA. So, in short, if a financial metric you want to use as the comparable metric is after debt or interest, it must be related to market capitalization—this is a market value multiple. If the financial metric is before debt or interest, it is related to enterprise value—an enterprise value multiple.

5.2 Minority Interest Considerations

114. Making a minority investment in a company can be financially rewarding if timed well but doing so is not without risk. A minority investor will typically have limited control over the management of the company and have no liquid market to sell its shares should it wish to exit. Whether a sophisticated venture capital firm or a high net worth individual, an investor should seek certain rights and protections to safeguard its investment. Minority shareholder rights under a company's constitution are typically limited, so a shareholders agreement incorporating express contractual rights above and beyond those afforded by Irish statute should be executed. Our advisory provides a short overview of these key protections for minority investors.

Anti-dilution

115. A minority investor which invests at an early stage should ensure that its shareholding is not improperly diluted by latecomers. Protection from anti-dilution due to a subsequent issue of shares or other equity interests such as warrants, convertible loan notes or share options, at a price below the price the minority investor paid for its shares, should be sought. This can be achieved by way of price-based anti-dilution protection, where the company may not issue equity interests at a purchase price less than that paid by the initial investor or by the initial investor receiving further shares either by way of bonus issue at nominal value or by subscription at par value.

Board Participation

116. Whilst shareholders own a company, the directors have day-to-day control. Minority investors are unlikely to be able to control the board, however, depending on their negotiating power, they may be able to appoint a director affording it the ability to influence key decisions. Directors have fiduciary duties so with the absence of a robust D&O insurance policy, mere observer status might be a preferred alternative.

Pre-emption Rights

117. Minority investors may insist on the ability to 'follow their money'. Unless dis-applied, shareholders in an Irish company have a right of pre-emption when shares are allotted to any new shareholder. This effectively means the existing shareholders are granted first refusal over any new shares being issued so as to maintain their current shareholding level in the company. These provisions are often dis-applied by the company's constitution so appropriate pre-emption provisions should be set out in any shareholders' agreement.

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Right of First Refusal

118. A minority investor should look for the right of first refusal upon any proposed transfer of shares and seek to have the opportunity to increase its position if desired, especially if they would prefer not to be in business with the proposed third-party purchaser.

Call for Departing Founder/Employees' Shares

119. A minority investor who is not a founder or employee of the company may seek to ensure that the company has the right to acquire any departing founder or employee shares, whether departing voluntarily or not. Typically, the price paid by the company for such shares will depend on the timing of and the reasons for such departure.

Supramajority Voting or Consent Rights

120. Irrespective of whether a minority investor succeeds in having board representation, a minority investor should insist on certain significant matters requiring its consent, or at the very least, requiring supermajority voting. Such actions would typically include changing the nature of the business, share capital changes, a sale of the company or sale/acquisition of a material asset, commencing any equity or debt transaction, starting or settling litigation, approving distributions, entering into transactions with connected parties, increasing any share option pool, changing senior executive compensation, hiring or firing key personnel or dissolving the company.

121. While having a lengthy list of matters requiring its consent might appear reassuring to a minority investor, a balance should be struck to ensure the minority investor is adequately protected but not overly burdened by continuous requests for consent for immaterial or ordinary course matters. Where appropriate, these consent rights would typically be subject to agreed materiality thresholds. Numerous consent rights also increase the risk of deadlock when shareholders cannot agree on a matter requiring consent and deadlock is rarely in the interests of the company or its shareholders.

Information/Access Rights

122. It is essential that a minority investor has sight of the financial information related to the company in order to monitor the performance of its investment. Controlling shareholders and directors will rarely voluntarily disclose information so a minority investor should seek a contractual right to access relevant financial information, including internal management accounts, review the company's books and records and receive financial statements and the operating budget/business plan on a periodic basis.

Drag-Along Rights

123. Drag-along rights are provisions that make it mandatory for a minority shareholder to agree and join the majority shareholders in the sale of a company. In effect, the minority shareholder is "dragged along" and the majority shareholder who is "dragging" the other shareholders must offer the minority shareholders the same price, terms and conditions that the majority shareholder has been offered. While dragalong rights are typically favoured towards majority shareholders in order to prevent a minority shareholder blocking the sale of a majority shareholders shares, such rights are beneficial to minority shareholders as they allow the minority shareholder to be treated the same as the majority shareholder. If a minority shareholder is to receive private securities as payment, it should ensure such securities also provide for minimum investor rights.

Tag-Along Rights

124. Tag-along rights, also known as 'co-sale rights', allow a minority shareholder to participate in any sale of shares in the company by a majority shareholder on the same terms. Such rights are designed to protect the minority shareholders from being left behind with a potentially unfavourable new shareholder and effectively oblige the majority shareholder to include the shareholdings of the minority shareholder in any negotiations. Tag-along provisions are typically drafted so that if the tag-along procedures are not followed then any attempt to buy shares in the company are invalid and cannot be registered.

Put Right/Shotgun Clause

125. In large companies with shares traded on a public stock exchange, investors can easily sell their shares. However, shareholders in privately held close companies (where shares are owned by a small number of persons) cannot as readily sell their shares should they wish. Although not granted to every minority investor, there are protections that might facilitate a minority investor exit. A put option would require either the company or other shareholders to buy out the minority investor in specific situations such as a failure to meet financial targets or the departure of essential personnel. In a similar vein, a "shotgun" clause provides an investor with the right to buy shares or sell shares to another shareholder when a material dispute arises regarding the operation of the company.

Conclusion

126. A minority investor may not succeed in obtaining all of the protections outlined here. The level of concessions obtained from the company will depend on the transaction at hand and the leverage of the parties. However, these protections, while not exhaustive, are some of the more critical considerations for minority investors and should at the very least be considered and explored with the company when thinking of investing. In any event, it is imperative that a comprehensive shareholders agreement is negotiated and executed to ensure a minority investor has the best protection available should plans go awry.

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5.3 Tax implications

127. The Income Tax Act 58 of 1962 contains special rules for asset-for-share transactions, amalgamation transactions, intragroup transactions, unbundling transactions and liquidation distributions.

128. These provisions aim to facilitate mergers, acquisitions and restructurings in a tax-neutral manner. The rules are very specific and generally do not apply when one of the entities in the transaction is not a company.

129. Often the most crucial element to consider when choosing an acquisition vehicle is whether to structure the acquisition through an asset purchase or a purchase of an entity which could be external or a subsidiary. Transactions relating to sale of assets can trigger VAT implications, while income tax implications may come into effect in the cases of acquisitions of entities.

Considerations of the seller

130. The considerations of a seller may differ depending on whether the disposal took place through shares or through the sale of assets. When the assets are acquired by the buyer, for example, CGT may be levied on the capital gain realized on the disposal of the assets. Further, to the extent that any deductions were claimed against the original cost of the assets and the amount realized from the sale of the assets exceeds the tax values thereof, the seller may experience recoupments, which it would have to include in its gross income (as defined) and would be subject to income tax at the normal rate of 27% (Previously 28%) .

131. When the seller does not receive adequate consideration for the disposal of its assets, the transaction may be subject to donations tax at the rate of 20 percent on the difference between the consideration actually given and the market value consideration assuming the transaction was not concluded at arm's length .s58 of the Income Tax Act clarifies this.

     More elaborated per s24BA and S40 CA (Value-Shifting Rules: Where a company acquires an asset from a person in exchange for an issue of shares, and:
     The market value of the asset is greater the market value of the shares, then:
     - The excess amount will be deemed to be a capital gain.
     - The base cost of these shares issued must be reduced in the hands of the person selling the asset by the amount of that excess.
     - Conversely, where the market value of the shares are greater than the market value of that asset:
     - The excess will be deemed to be a dividend that consists of a distribution of an asset in specie that is paid by the company on the date of that issue.

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132. The sale of shares may also be subject to CGT, assuming the shares were held by the seller on capital account. To the extent that the seller disposed of the shares in a profit-making scheme, the proceeds may be subject to CGT. However, the 3-year holding rule in terms of the South African Income Tax Act would deem the proceeds received on the sale of shares held continuously for 3 years to be capital in nature and thus taxable at an effective rate of 22.4 percent (assuming the seller is a company). (This is in line with s9C of the Income Tax Act.)

Considerations of the buyer

133. To the extent that the assets are disposed of, the assessed tax losses of the seller cannot be carried forward into the new company, so the losses would be ring-fenced in the seller and thus lost.

134. When the seller decides to dispose of shares, the tax losses in the company remain in the company, available for future set-off (subject to the changes, as discussed above, that have been announced that propose to restrict the offset of assessed losses carried forward). However, where the SARS is satisfied that the sale was entered into for the purpose of using the assessed loss and that, as a result of the sale, income has been introduced into the company to use the loss, the set-off of the loss may be disallowed in terms of s 103 (2) of the Income Tax Act.

General – Equity Shares

135. Where a merger is to be achieved through the purchase of the equity instruments of the investee, the investor's intention at acquisition will determine whether the acquisition of the equity instrument will be classified as revenue in nature (buy to sell) or capital in nature (buy and hold). In this regard, the Income Tax Act offers no guidance on how to determine the taxpayer's intention at acquisition. The intention at acquisition may be determined through the principles derived from case law such as CIR v Visser & COT v Levy. There are also case law principles that address any changes in intention such as Natal Estates v SIR and CIR v Richmond Estates to name a few. More recently the matter of Capital v Revenue arose in the case SARS v Capstone 556 (Pty) Ltd [2016] ZASCA 2 (9 Feb 2016)

136. The gross dividends earned by the Investor from the investee will be included in gross income in terms of para k of the gross income definition and exempt in terms of Section 10(1)(k). The investor would however be subject to a dividends tax equal to 20% of the gross dividend as contemplated in Section 64E of the Income Tax Act.

137. In addition, the Securities Transfer Tax Act 26 of 2007 levies securities transfer tax of 0.25% on the taxable amount in respect of any transfer of securities. This tax is payable within a prescribed period. Section 8 of the Securities Transfer Tax Act provides circumstances under which the investor would be exempt from the transfer of securities.

138. The transfer of ownership is a financial service as defined in terms of Section 2 of the VAT Act and is therefore an exempt supply in terms of Section 12 of the VAT Act. Consequently, the transfer of shares is not considered to be enterprise activity.

Purchase of investee's instruments is deemed to be revenue in nature for the investor.

139. Where the intention has been determined to be revenue in nature, the investor will enjoy a section 11(a) deduction in respect of the purchase of the equity instruments as the purpose of the acquisition is to produce income. The cost of the shares held at the end of the year of assessment will be added back to gross income in terms of section 22(1) and then deducted in the ensuing year of assessment in terms of Section 22(2) of the income tax Act. If the transaction was funded by a third party through an issue of a debt instrument by the investor, the deduction of any financing costs incurred in respect of the purchase will be prohibited by Section 23(f) as it would be incurred to produce exempt income (i.e. dividends).

140. In the event that the investor is a share dealer, the intention of the acquisition is to hold the shares for the purpose of selling them in a scheme of profit-making. The shares are therefore trading stock and the proceeds from sale will fall into gross income. Therefore, any interest incurred on a debt instrument would be deductible because it is incurred for the purposes of producing income. This interpretation was affirmed in the Drakensberg Gardens Hotel Case and ITC1504. The matter is also dealt with in terms of s 24J.

141. If the investor has held the equity instruments for a consecutive period of three years from the date of acquisition, this will trigger the application of Section 9C which fundamentally changes the nature of the transaction from being revenue in nature to being capital in nature. The consequence of this is that the base cost of the equity instrument will be measured in accordance with the 8th schedule of the income Tax Act and any disposal of the shares will be dealt with in line with the provisions of the 8th schedule.

Purchase of Investor's shares is deemed to be Capital in Nature

142. The manner in which an investor purchases the equity instruments of the investee will determine the provisions of the Income tax Act that are applicable to the transaction. The investor may employ the following methods to purchase the equity instruments of the investee:
    - Cash Purchase, Investor Issues a Debt instrument to finance the purchase of shares.
    - The investor and investee may engage in an asset for share transaction resulting in the investor gaining control over the investee.

Cash Purchase

143. If the investor acquires the shares of the investee through a cash purchase, the cost of the shares will form part of the base cost of the asset. No portion of the cost is deductible in terms of section 11 of the Income Tax Act as the intention at acquisition is deemed to be capital in nature. The disposal of the shares will be dealt with in terms of the 8th schedule of the income Tax Act. It is important to note that there are loss limitation rules detailed in the 8th schedule where shares are disposed of at a loss.

Investor Issues Debt Instrument to Finance the Purchase of Shares

144. In addition to the considerations mentioned in section 1.3.1 above, if the investor issues a debt instrument to fund the acquisition of the shares of the investee, this may trigger the application of Section 24O if certain conditions are met. The conditions that would trigger the application of this section are as follows:

- At least 80% of receipts and accruals to the investee (or other company in which the investee holds at least 70% of equity shares) constitute income in the hands of the investee (or other company) in its latest year of assessment, and

- At the end of the day of that transaction, the investor holds at least 70% of the equity shares in that investee.

145. Should the abovementioned conditions be met, any interest incurred by the investor on the debt instrument used to fund the purchase is deemed to be incurred in the production of income and laid out for the purposes of trade for the investor. The effect of this is that the interest is deductible in the hands of the investor in terms of Section 24J of the Income Tax Act. However, section 23N limits the value of interest that may be deducted in respect of a debt instrument issued to finance the acquisition of the shares of the investee.

Asset for Share transaction

146. An investor may acquire the shares of the investee through an asset-for-share transaction where an investor wishes to dispose of its assets to an investee on a tax neutral basis as consideration for a qualifying interest in the shares of the investee. The structure of this transaction triggers the application of Section 42 of the Income Tax Act, unless:

- The investor and investee agree in writing that this section does not apply,

- The disposal is not considered for the purposes of determining any taxable income or assessed loss of that investor.

- The asset is a debt owing by or share in the investee.

147. One of the requirements of the section is that the market value of the assets disposed of by the investor must be greater or equal to the base cost of the assets or amount taken into account in terms of section 11(a) or Section 22 in the case of inventory. The shares received by the investor in an asset for share transaction will have the same base cost as the original

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assets disposed of. The sale of these shares by the investor within 18 months would trigger capital gains tax.

148. It is important to note that section 42 contains other anti-avoidance provisions which must not be overlooked. Moreover, this section is subject to the anti-avoidance rules contemplated in Section 80A – 80L. Therefore, it could be challenged by SARS where no sound commercial substance can be identified, and it is determined that the transaction was entered into in order to gain a tax advantage.

149. In addition, if Section 42 applies to an asset for share transaction, the investor will be exempt from Securities transfer tax according to Section 8 of the Securities Transfer Tax Act. S8(25) VAT Act states that the investor and investee are deemed to be the same person for VAT purposes where they are both vendors and enterprise assets disposed of to the investee are disposed of as a Going Concern. There is no VAT payable, and the investor does not need to account for output tax.

Tax Implications for Asset purchase

a) Amalgamation transaction

150. Section 44 of the Income Tax Act provides for the tax-neutral transfer of assets in an amalgamation transaction in terms of which one or more of the amalgamated companies involved in the amalgamation transaction ceases to exist after the transaction is concluded. For this provision to apply, numerous requirements must be met. Section 44(13) is important here, as it states that Section 44 will not apply to an amalgamation transaction where the amalgamated companies have not, within 36 months from the date of the amalgamation transaction, taken the necessary steps (provided for in Section 41(4) of the Income Tax Act) to liquidate, wind up or deregister themselves. Section 41(4) provides for numerous procedures in terms of which an amalgamated company may take steps to cease its existence.

151. The incongruency that arises from the law as it currently stands is that Section 41(4) makes no provision for an amalgamated company to cease to exist by means of its deregistration by operation of law. As such, where a company implements an amalgamation transaction under Section 113 and in terms of which the amalgamated companies are deregistered by operation of law, such amalgamation transaction does not qualify under Section 41(4) of the Income Tax Act. Consequently, the amalgamated company will not be entitled to the benefit of a tax-neutral transfer of assets provided for in Section 44 of the Income Tax Act.

152. Section 44 states that parties to an amalgamation transaction will qualify for roll-over relief, whereby certain tax liabilities that would arise in the normal course are deferred, provided that the requirements of section 44 are met.

b) Purchase of assets

153. In the event that the disposal of assets does not constitute an amalgamation transaction as envisaged in Section 44, this would result in other tax consequences.
From an income tax perspective, the disposal of assets by the target company would result in recoupments of previously claimed allowances and attract capital gains tax if the assets are sold at a profit. The base cost of the assets in the hands of the purchaser would be

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measured at the consideration paid for the assets which would typically include costs that were integral to acquire ownership. From a VAT perspective, assuming both the acquirer and acquiree are registered vendors, the disposal of enterprise assets would result in output tax being levied on the transaction.

154. The purchaser is entitled to claim input VAT on the purchase of assets that will be used to make taxable supplies. If the target disposes of assets that are capable of separate operation as a going concern, the supply of these assets may be zero-rated if certain requirements are met. Transfer Duty is also levied on the transfer and acquisition of any property located in South Africa. The purchaser is responsible for paying transfer duty and it is levied on a sliding scale.

6. Financing the deal

6.1 Introduction

156. The range of possible transaction structures are infinite, but the following are some of the basic alternatives:

- All cash transaction, financed from existing cash resources
- All cash transaction, financed by issuing stock
- Stock transaction, merger through exchange of stock
- Mixed stock/cash
- Leveraged cash transaction, financed through debt issue
- Leveraged buyout, majority of equity replaced by debt
- Debt transaction, debt offered to selling company shareholders
- Mixed cash/debt
- Preferred stock

Should stock or assets (generally cash) be given in the acquisition?
Advantages of Giving stock

No cash or financing requirement for acquirer.

- Quick and simple in terms of document preparation. There is a transfer of stock certificates in exchange for immediate or deferred payment.
- In certain cases, stock transactions can be exempt from taxation to shareholders, thus potentially raising the value of the transaction.
- A stock acquisition can maintain the equity-to-assets ratio, and even provide additional capital for further growth strategies.
- Target shareholders share risk of acquisition.
- Minority stockholders may not have appraisal rights.
- Typically, stockholder votes authorizing the purchase or sale are not required.
- May take advantage of acquirer's high stock price.
- Target management has incentive to maintain commitment.

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Disadvantages of Giving Stock

- Can be less attractive to target shareholders.
- The acquirer, in buying stock of the target company, assumes its liabilities, whether disclosed or not.
- Dilution of acquirer shareholder earnings.
- Dilution of ownership/control.
- Risk of conflict after merger.
- If the target is liquidated subsequent to acquisition, much work is needed in conveying the target company's assets as part of the liquidation.

Advantages of Giving Assets

- Acquirer has complete control over the assets it buys and the liabilities it assumes.
- Attractive to shareholders because they value immediately and have no risk.
- Typically, no acquiring company stockholder vote is needed.
- Easier to understand.

Disadvantages of Giving Assets

- Dilution of earnings.
- Difficult to determine the fair value of each asset.
- Current target management may have little incentive to facilitate transaction or maintain commitment after transaction.
- Target company's stockholders must approve.
- State transfer taxes must be paid.
- A cash acquisition can materially lower the equity to assets ratio of the surviving company.
- Creditor agreement may be needed for certain transfers and assignments.
- Must conform to bulk sales laws.

157. If the decision is made to give cash to the targeted company shareholders, some form of equity and/or debt will have to be issued because it is unusual for the acquiring company to have sufficient cash or liquid assets to finance the entire transaction. Debt financing may range from an intermediate-term loan for part of the purchase price to structural debt financing of 90% or more of the price (leveraged buyout). There are many considerations in deciding whether to use leverage and in determining the appropriate amount of leverage.

Advantages of Leverage

- Interest expense is tax deductible.
- Increased return to shareholders.
- Since shareholders' ownership is maintained, there is a lack of dilution.

Disadvantages of Leverage

- Creditors have priority claim on merged company.

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- The greater financing risk may lower the company's stock and bond prices as well as result in increasing costs of financing.
- Possible lowering in credit standing and bond ratings.
- A cash problem may result in default.
- Interest payments lower earnings.
- Interest and principal payments reduce cash flow.

158. Leveraged buyouts are quite popular. A leveraged buyout occurs when an entity primarily borrows money (sometimes 90% or more) in order to buy another company. Typically, the acquiring company uses as collateral the assets of the acquired business.

159. Generally, repayments of the debt will be made from the yearly operating funds flow of the acquired company. A leveraged buyout may also be made when the acquiring company uses its own assets as security for the loan. It may also be used if a firm wishes to go private. In most cases, the stockholders of the acquired company will receive an amount greater than the current price of the stock. A leveraged buyout involves more risk than an acquisition done through the issuance of equity securities.

160. The high debt service requirement drains cash flow during the period that the debt is outstanding. However, once debt is retired, shareholders enjoy ownership of the remaining enterprise. The debt may be reduced rapidly by selling some assets or divisions of the acquired company, if warranted.

The characteristics conducive to a leveraged buyout are:

- The earnings and cash flow of the company must be predictable so they may cover interest and principal payments on the debt financing.
- The growth rate of the firm should exceed the inflation rate.
- There must be a good market share and product line otherwise the firm is vulnerable to an economic decline or competitive actions.
- There should be a good asset base to serve as collateral.
- The assets should not be presently encumbered, and the debt-equity ratio should currently be low.
- There are minimal capital expenditure requirements.
- The company should be liquid so that it has enough cash to meet its debt obligations.
- There is future saleability of the company, if desired.
- Technological change is not a problem.
- Management is highly qualified and is given a significant equity stake.
- The business is selling at a low P/E ratio.

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Preferred Stock Financing

161. One important development in 2001 is the disappearance of the pooling-of-interests merger accounting method, which required the use of common stock. Now, companies must employ purchase accounting, regardless of payment terms. And stock offers no advantage in purchase accounting. This is a method with which the purchasing company treats the target firm as an investment, adding the target's assets to its own fair market value. If the amount paid for a company is greater than fair market value, the difference is reflected as goodwill.

162. Preferred stock is one tool companies may now employ more frequently in financing their acquisitions. Like corporate bonds, preferred shares offer investors a predictable income stream, in the form of dividends that must be paid before any distributions to common shareholders. While those preferred dividends can't be deducted for tax purposes, as interest payments on debt are, preferred shares offer the same equity relief for stressed corporate balance sheets that common stock does.

163. A big advantage of equity is its ability to preserve a transaction's tax-free status for selling shareholders. For an acquisition to qualify as a tax-free reorganization, sellers must maintain a "continuity of interest" in the new business. That's usually accomplished by a common share swap, but preferred shares can also do the trick.

7. Tax considerations Mergers and Acquisitions

164. Whereas it can be appreciated that tax consequences and or their considerations may differ from a global perspective due to the applicable jurisdictions, taking into account negotiated double tax agreements. The considerations applied in this section will focus on the South African perspective.

165. In the applied approach on this section a link will be drawn on the relationship between Income Tax Act, and the Companies Act

166. As South African residents are taxed on a worldwide basis, Double Tax Agreements (DTAs) and Protocols are pivotal to avert cases of double paying on a single transaction. South Africa has a number of DTAs which are updated as such become available, the latest updates can be accessed on the SARS website(s) link included. Double Taxation Agreements & Protocols | South African Revenue Service (sars.gov.za)

Tax structuring and Consideration of General Anti-Avoidance Principles In the British case between Duke of Westminister v IRC, 51 TLR 467, 19 TC, Lord Tomil presided in favour of the Duke, and is famously site for his words:

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> *"Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow tax-payers may be of his ingenuity, he cannot be compelled to pay an increased tax."*

167. Approach to tax planning takes into account the factors which influence tax structuring it ought to be noted that:

- It is prudent that each tax payer base their planning based on independent circumstances and structure its affairs in a manner which will yield the most benefit. e.g. make use of tax credits where appropriate;
- It may as well in certain circumstance be that one of the parties or both to a M & A deal may find themselves on the bitter side of the deal due to a triggered tax which does not have the supporting tax deduction. (A CGT gain may be triggered on the seller, while the acquisition by the buyer would not be deductible for tax purposes);
- Notwithstanding the aforementioned, the transaction rationale should not be detected by tax;
- Early and well timed tax planning has a positive impact in adding value to a deal i.e. when considering a deal, there should be an investment strategy which include an exit strategy which takes into account how the investment will be realised.

Implications of Equity Investments

Here below are the applicable tax implication of investing in equity shares:

Party	**Scenario**	**Reference**
Investor Perspective	Whereas in the case of an investor who holds and disposes shares for the purpose trading, such proceeds of share would for part of gross income. Long-term investments are capital in nature, thus not included in gross income. (most likely in M & A cases) which are long-term deals Dividend returns will be exempt but subject to Dividends tax a rate of 20%	 S 9C ITA; S 10 1(k)(i)

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Investee Company Perspective	Where an investee company receives such transaction does not trigger tax consequence from an Income Tax perspective as such issuance is capital in nature,. This will however be considered for CGT when a disposal is effected. Transaction structuring should keep in mind anti-avoidance provisions which may arise such as in the case of asset acquired as consideration for shares issued (s24 BA). Section 24BA will apply where the sale consideration /amount would different from the consideration that would have applied if the transaction were between independent persons dealing at arm's length. Where the consideration is not arm's length, s24BA would result in the deeming capital, or a deemed dividend in specie paid by the issuing company. e.g. If Individual X holds 20% of the shares in company Y and X disposes of an asset worth R100 to company Y in exchange for shares worth R80, X would still need to account for CGT on deemed proceeds of R100 and not the R80. On the other end, if a person disposes of an asset to Company Y in exchange for the issue of shares by the company and, if the value of the share is	Para 11 (2) b 8th of 8th Schedule

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	worth more than the value of the asset being before the disposal, the company is deemed to have distributed an asset in specie to that person. Thus such distribution may give rise to dividends tax in the hands of the shareholder.	

Table adapted – SILKE: South African Income Tax 2021

Deeming Provisions – Capital Receipts s9C (2)

168. The provisions of the section provide that:

- " Any amount which has been received by a tax payer excluding divided ; and or
- Any expenditure incurred , in respect of an equity share
- Shall be deemed as capital in nature if held for a period of at least 3 years."

169. The associated expenses will therefore not be allowed for deduction under s 11.

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Amalgamations and Mergers

In crystalizing the Tax consideration and M & A, it is important to looking into the definitions as provided:

Companies Act	Income Tax
S1 (Definitions) "An amalgamation or merger" as – transaction, or series of transactions, pursuant to an agreement between two or more companies, resulting in – a. the formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies; or b. (b) the survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new company or companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement". S116 (7) (Implications of an Amalgamation or Merger) "When an amalgamation or merger agreement has been implemented. a. the property of each amalgamating or merging company becomes the property of the newly amalgamated, or surviving merged, company or companies; and	**S 44 (amalgamation transactions)** Against the Companies act the definition is more elaborate, taking into account the approach om SA resident companies and foreign entities which are taxed in accordance to the prescripts of the ITA. Key concepts in this section include amongst other asset for share transactions which if requirements are met can be tax frees

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b. each newly amalgamated, or surviving merged company is liable for all of the obligations of every amalgamating or merging company,	

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8. Public policy toward mergers and the institutions

8.1 Introduction

170. Mergers and acquisitions raise interesting policy questions and are subject to both statute and common law. Even though the Competition Act is the primary enabling legislation to for M&A transaction considerations, for context of this exercise it is vital to mention and broadly detail the role the Companies Act as a vital secondary legislation that also establishes the TRP and its regulated processes for regulated entities in terms of the Act.

8.2 Companies Act and the Takeover Regulation Panel

171. The Takeover Regulation Panel (the Panel) is established in terms of section 196 of the Companies Act with sole purpose of regulating affected transactions on regulated companies in order to ensure market integrity and fairness to shareholders.

8.2.1 Functions of the Panel

172. The functions of the Panel include regulating affected transactions or offers that involve regulated companies. Regulated companies are:

    a. a profit company which is a public company;
    b. a state owned company; and
    c. a private company, but only if the memorandum of incorporation of the company makes provision for the Panel's authority to apply; or if more than 10% of the issued securities of the company have been transferred within a period of 24 months, immediately before the date of a particular affected transaction or offer.

173. The panel also investigates complaints relating to Affected Transactions and Offers that include:

    a. disposals of all or the greater part of assets or undertaking of a company by a regulated company;
    b. amalgamations or mergers of regulated company;
    c. schemes of arrangement between a regulated company and its shareholders;
    d. mandatory offers to shareholders of a regulated company;
    e. compulsory acquisitions of remaining shares of a regulated company;
    f. acquisitions of, or announced intention to acquire 5%, 10% or any multiple of 5% of the issued shares of a regulated company; and
    g. the announced intention to acquire the remaining shares in a regulated company.

8.2.2 Reasons for regulating Affected transactions

174. The Panel must protect shareholders by:

    a. Ensuring integrity of markets and fairness to shareholders during affected transactions;

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b. Ensuring that the necessary information is provided timely to shareholders to make an informed decision during affected transactions;
c. Preventing action by companies intended to impede, defeat or frustrate affected transactions;
d. Ensuring that persons undertaking affected transactions are ready, able and willing to implement the transaction;
e. Ensuring that all shareholders are treated equally and equitably during an affected transaction;
f. Ensuring that all shareholders receive the same information during an affected transaction, and that no relevant information is withheld to shareholders; and
g. Ensuring that shareholders are provided sufficient information, and permitted sufficient time to enable them to reach a properly informed decision about an affected transaction.

8.3 The Competition Act and the Competition Institutions

175. The Competition Act regulates two broad areas of competition:1) mergers and acquisitions, and 2) prohibited practices (anti-competitive conduct). The Competition Act sets up three institutions to regulate competition between firms in the market. These are:

a. the Competition Commission, which is the investigative and enforcement authority
b. the Competition Tribunal, which adjudicates on matters referred to it by the Competition Commission, and
c. the Competition Appeal Court, which considers appeals or reviews against Tribunal decisions.

8.3.1 The purpose of the Competition Act

176. The purpose of the Act is to promote and maintain competition in South Africa to:

a. promote the efficiency, adaptability and development of the economy;
b. provide consumers with competitive prices and product choices;
c. promote employment and advance the social and economic welfare of South Africans;
d. expand opportunities for South African participation in world markets and recognise the role of foreign competition in the country;
e. ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and
f. promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.

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9. Competition considerations, process, and timeframes

9.1 Introduction

177. Merger control seeks to restrict or prohibit mergers, which if allowed would likely substantially prevent or lessen competition and mergers which cannot be justified in terms public interest grounds.

9.2 The classification of mergers

178. Mergers are classified as either small, intermediate or large, depending on the turnover or asset values of the merging firms. Filing fees are payable for every intermediate or large merger filed.

179. According to the Act, it is not compulsory for small mergers to be notified, and no filing fee is prescribed. However, the Commission may call for the notification of a small merger within six months of implementation, if it believes the merger is likely to substantially prevent or lessen competition, or if the merger cannot be justified on public interest grounds. In terms of the guidelines on small merger notifications, the Commission requires any party to a small merger to inform it of that merger if either party is under investigation by the Commission for a contravention of the Act, or if there is an ongoing investigation in the relevant market. The merger thresholds are set out in the table below.

Mergers and acquisition thresholds

Merger Categories	Target firm turnover/ assets	Combined turnover/ assets	Decision making body
Small	<R80 Million	<R560 Million	Commission – optional
Intermediate	>R190 Million	>R6.6 Billion	Commission
Large	>560 Million	R190 Billion	Tribunal

For its operational efficiency, the Commission classifies notified mergers as either phase 1 (non-complex), phase 2 (complex) or phase 3 (very complex) mergers, depending on the complexity of the competition or public interest issues it raises. The tale below shows the maximum allowable timeframes set for merger assessments in the Competition Act.

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Time frames set for assessing mergers of varying complexities

	Small	**Intermediate**	**Large**
	Competition act	Competition act	Competition act
phase 1 (non-complex)	60 days	60 days	40 days with ability to extend period by 15 days at a time
phase 2 (complex)	60 days	60 days	40 days with ability to extend period by 15 days at a time
phase 3 (very complex)	60 days	60 days	40 days with ability to extend period by 15 days at a time

9.3 The evaluation of mergers

180. The Competition Act prohibits mergers that are likely to substantially prevent or lessen competition unless outweighed by efficiency gains or justified on certain public interest grounds. The substantial lessening of competition (SLC) test focuses on increasing market power as the competitive harm to be prevented. Market power, in the context of merger analysis, may be defined as the ability to increase prices profitably, reduce quality, reduce innovation, or reduce consumer choice from pre-merger levels for a significant period. This may arise through the individual decisions of the merged firm and its competitors or through co-ordinated behavior.

The determination of substantial lessening of competition requires that the Commission and the Tribunal consider, among others, the following considerations:

(1) Whether the merger will result in the removal of an effective competitor;
(2) The ease of entry into the market, including tariff and regulatory barriers;
(3) The degree of countervailing power in the market;
(4) The actual and potential level of import competition in the market; and
(5) Whether the business or part of the business of a party to the merger has failed or is likely to fail.

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181. The Commission bears the duty of establishing that a proposed merger is likely to cause a substantial lessening of competition. If that duty is discharged, the merging firms bear the burden of establishing efficiency justifications which ought to be greater than, and offset the effect of the significant lessening of competition.

182. Merger analysis is predictive and requires the employment of an appropriate counterfactual.[2] In merger cases the assessment of the relevant counterfactual is an essential part of the analysis. Essentially this involves a comparison of market outcomes that would prevail without the merger. In many cases, competition authorities usually take the status quo, as the counterfactual to be compared with the scenario that is likely to prevail post-merger. The difference between the two scenarios informs the threshold question – whether the merger would lead to a likely substantial lessening of competition.

183. It is possible for a merger to increase efficiency while competition is prevented or lessened. Efficiencies may be explicitly weighed against any competitive detriment and the combined effects assessed to see if, overall, consumers benefit (or total welfare increases). In such cases, the pass through of efficiencies to consumers depends on the nature of the claimed efficiencies. The Tribunal in the Trident/Dorbyl merger distinguished between 'real' efficiencies in which there is evidence to verify them of a quantitative or qualitative nature, and evidence that the efficiencies will benefit consumers, from less compelling efficiency claim for which evidence of a pass through to consumers should be demonstrated.

Hospital mergers: The Netcare Lakeview transaction

Background:
In late 2017 the Commission prohibited a small merger between Netcare Hospitals and Lakeview Hospital. The Commission argued that the merger would result in: an increase in Netcare's bargaining power; the removal of an effective competitor; and tariff increases at Netcare Lakeview. The parties applied to the Tribunal for a reconsideration of the merger.

Remedy:
The Tribunal was unable to find any evidence that the merger would lessen competition as suggested by the Commission. In order to address the potential pricing harm raised by the Commission, the merging parties tendered a condition in relation to pricing which the Tribunal accepted and imposed. The merger was approved subject to that pricing condition.

[2] See *Life Healthcare Group (Pty) Ltd and Joint Medical Holdings Ltd Case No: 74/LM/Sep11.*

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184. Merging parties bear the burden of proving efficiencies. In the assessment of whether the claimed efficiencies will outweigh the likely anticompetitive effects of the merger, competition authorities consider whether the claimed efficiencies (1) constitute real efficiencies; (2) are verifiable (i.e. are capable of measurement); and (3) benefit consumers. Further, efficiencies are expected to be timely, likely and sufficient to prevent a likely substantial lessening of competition from arising (having regard to the effect on rivalry that would otherwise result from the merger). Efficiency claims must also be merger specific and therefore be a direct consequence of the merger.

Hospital mergers: The Mediclinic Matlosana Medical Health transaction

Background:

Mediclinic Southern Africa and Matlosana Medical Health Services in the North West notified a large merger to the Commission in September 2016. In June 2017 the Commission recommended a prohibition on grounds that it would likely result in higher healthcare prices in the region; the incentive to improve on nonprice factors (i.e. patient experience and quality healthcare) would likely diminish; and it would confer relatively greater bargaining power to Mediclinic vis-à-vis medical schemes. The merging parties denied that competition would be negatively affected.

Remedy:

The Tribunal engaged extensively with the merging parties on whether a potential remedy could be found to address the Commission's competition concerns. The merging parties' proposed remedies were canvassed with a number of medical aids. However, despite different remedies being proposed by the merging parties over several months, no appropriate remedy was tendered that would cure the substantial lessening of competition that would arise from the proposed transaction. The Tribunal therefore prohibited the merger.

185. A merger that is not likely to give rise to a substantial lessening of competition may still be prohibited on substantial public interest grounds. The public interest grounds are limited and include the effect on: a particular industrial sector or region; employment; the ability of small businesses or firms controlled by historically disadvantaged persons to effectively enter into, participate in or expand in the market; a greater spread of ownership, in particular to increase the levels of ownership by historically disadvantaged persons and workers in firms in the market; and the ability of national industries to compete globally.

Concerns raised over IDC's shareholding in two competing firms

In the Ready Right Now (RRN) and Glodina merger the Industrial Development Corporation's (IDC) shareholding in two competing companies (which produce terry towelling products) came under the spotlight.

Background:

The IDC controls the acquiring company, RRN, and Colibri, a direct competitor of Glodina as well as the only upstream business that supplies cotton yarn for knitting and weaving, Prilla. Competitors of Glodina and customers of Prilla raised issues pertaining to information sharing and customer foreclosure. The three companies are all a single economic entity, controlled by the IDC.

Remedy:
The Tribunal imposed a supply condition ensuring that Prilla supplies cotton yarn to all customers on reasonable, non-discriminatory and market-related terms. It is worth noting that by approving the transaction 211 employees of the 564 previously retrenched Glodina workers would be re-employed.

186. The Commission's approach to evaluating public interest considers:

(1) Whether there is likely effect of the merger on public interest grounds;
(2) Whether such effect, if any, is merger specific;
(3) Whether such effect, if any, is substantial;
(4) Whether there are any likely positive effects to justify the approval of the merger; and
(5) Whether there are possible remedies to address any substantial negative public interest effect. Where the effect of the public interest consideration is found to be non-merger specific, the enquiry into that effect stops at that stage. Likewise, where an effect is found to be merger specific but not substantial, the enquiry into that effect will stop at that stage.

Tribunal sets criteria for assessing job losses in a merger

Background:
On 14 October 2010 the Tribunal approved the merger between Metropolitan Holdings Limited ("Metropolitan") and Momentum Group Limited ("Momentum") on condition that the merged entity, MMI Holdings, had to ensure that there would be no retrenchments in South Africa, resulting from the merger, for 2 years after the merger implementation date. This condition however did not apply to senior management. The merging parties were also directed to advise their employees of this condition. This decision followed a hearing before the Tribunal in which the merging parties proposed to limit the number of merger related job losses to 1 000 in the first 3 years after implementing the merger. The merging parties also offered to provide support, such as core skills training to affected unskilled and semi-skilled employees, outplacement support and counselling, and to use their best endeavours to redeploy affected employees within the merged entity.

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The Competition Commission, after assessing the merger, accepted the merging parties' undertakings which had improved on the merging parties' original undertakings and recommended to the Tribunal that the merger be approved subject to the implementation of these support measures. The Tribunal, in its reasons, held that when the merging parties expect that there would be large retrenchments as a result of the transaction the parties had to justify the substantial loss of jobs flowing from the merger. The Tribunal indicated that the following criteria must be satisfied in deciding whether the retrenchments are justified:

1) That a rational process has been followed to arrive at the determination of the number of jobs to be lost, i.e. that the reasons for the job reduction and the number for jobs proposed to be shed are rationally connected; and
2) The public interest in preventing employment loss is balanced by an equally weighty but countervailing public interest for instance where the merger is required to save a failing firm, that justifies the job loss which is cognisable under the Act.

In considering the above elements the Tribunal found that the merging parties had arrived at the figure in an arbitrary manner and had failed to demonstrate that there was a rational connection between the efficiencies sought from the merger and the job losses claimed to be necessary to the merger. It therefore imposed a moratorium on all merger related retrenchments for a period of two years. The moratorium excluded senior employees and voluntary retrenchments or other forms of incentives for employees to resign such as early retirement packages, where the methods chosen were non-coercive.

187. Very few mergers are ultimately prohibited (Figure 2), most mergers that raise competition or public interest concerns are resolved without litigation through agreements on remedies. Remedies may be unilaterally imposed on merging parties by competition authorities or agreed jointly with the merging parties. Remedies are conventionally classified as either structural or behavioural. Structural remedies are generally one-off measures that seek to restore or maintain the competitive structure of the market.

188. Behavioural remedies are normally ongoing measures that are designed to regulate or constrain the behaviour of merger parties. The purpose of remedies is to address possible anticompetitive effects of a merger or negative public interest effects.

189. For example, in the Wal-Mart Inc and Massmart Holdings Ltd merger, following concerns that the retrenchments of 503 employees by a division of Massmart in June 2010 occurred because of the merger, the CAC ordered that the employees retrenched by Massmart be re-employed. In relation to concerns about the effect of the merger on local suppliers to Massmart. The CAC ordered the capital amount of the fund to be increased to R200 million and to be spent over a period of 5 years and that the success of this fund would be measured by the extent to which small and medium sized businesses benefit as a result of the work of the fund.

Tribunal encourages use of customer evidence in merger

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Background:
On 11 February 2011 the Tribunal unconditionally approved the merger between Tsogo Sun Holdings and Gold Reef Resorts. This decision followed an 8-day hearing in which the Competition Commission argued that Tsogo Sun and Gold Reef should only be allowed to merge on condition that they sold Silverstar Casino. The Commission based their argument on their view that Silverstar, which was part of the Gold Reef group at the time, was an effective competitive alternative to Montecasino (part of Tsogo Sun) and the merger would lead to the elimination of Silverstar as a competitor. The Commission submitted that, in the absence of effective competition, this would give the new merged entity an incentive to increase gaming prices or degrade its gaming product offering after the merger.

The merging parties however opposed this view arguing that consumers did not regard Silverstar and Montecasino as competitors and so there would be no need to maintain Silverstar as a "competitive alternative" to Montecasino. The merging parties argued that, after the merger, the merged firm would have no incentives to increase price or reduce the quality of its product offering.

The Tribunal, in its analysis of the case, emphasised the importance of getting the views of affected customers when trying to determine the potential competition effect a merger might have on a defined market. The Tribunal said that in the context of this merger the question of potential substitution between casino gaming and nongaming leisure would have been best answered by the consumers of these services themselves, evidence which was not forthcoming despite the fact that casino gaming is a consumer market. The Tribunal reiterated that it "is highly supportive of the use of economic analysis in merger cases and that well conducted customer surveys can provide very valuable insights into market characteristics and dynamics, as well as customer behaviour and preferences, specifically in differentiated-goods markets."
The Tribunal concluded that, based on the evidence presented to it, it could not determine if the merger would create a material incentive for the merged entity to post merger raise prices (in this context raise so-called casino "hold ratios") or lower the quality of its offer. It therefore approved the transaction without any conditions.

Reporting Consideration and Implications

10.1 Competition Act

190. As per General notice 216 of 2009 published under s11 of the Competition Act, and new determination of merger thresholds was established as follows, and was effective as of 1 October 2017:

THRESHOLDS	COMBINED TURNOVER / ASSET VALUE	TARGET TURNOVER / ASSET VALUE
Lower threshold (**Current**)	R 560 million	R 80 million
Amendments	**R 600 million**	**R 100 million**

191. Consequently, all mergers and acquisitions exceeding a turnover value or asset of R600 million and R 100 million relatively must be reported to the Competition Commission (CompCom).

192. Where the combined annual turnover or assets of both the acquiring and transferred / target firms are valued at or above R6.6 billion, and the annual turnover or asset value of the transferred / target firm is at least R190 million, the merger must be notified to the Comp Com as a large merger.

193. Section 13(2) of the Act makes provision for voluntary notifications in cases of mergers that are below the threshold.

10.2 The Companies Act

194. In terms of the Companies Act, 2008 mergers and takeovers are regulated in terms of Sections 117 to 127 of the Act. In terms of Section 119, the Takeover Regulation Panel is required to regulate all affected transactions, but without regard to the commercial advantages or disadvantages of any transaction, in order to:

a. Ensure the integrity of the marketplace and fairness to the holders of the securities of the regulated companies;

b. Ensure the provision of the necessary information to the shareholders so that they can make fair and informed decisions and the provision of adequate time for shareholders to obtain and provide advice with respect to offers; and

c. Prevent actions designed to impede, frustrate or defeat an offer, or the making of fair and informed decisions by the firm's shareholders. All shareholders are required to be treated equally and fairly and should receive the same information.

195. The Panel is required to issue a clearance notice in relation to affected transactions or grant an exemption. The regulations will generally only apply to public companies but will also apply to private companies if the transfer of shares between unrelated parties exceeds the prescribed percentage (10%). If the regulations apply, then the firm will be defined as a regulated company.

196. The Companies Act, 2008 states that an affected transaction includes:

    (i) the disposal of all or the greater part of the assets or undertaking of a regulated company;

    (ii) an amalgamation or merger if it involves at least one regulated company;

    (iii) a scheme of arrangement between a regulated company and its shareholders;

    (iv) the acquisition or the announced intention to acquire a beneficial interest in any voting securities of a regulated company in terms of Section 122;

    (v) the announced intention to acquire a beneficial interest in the remaining voting securities of a regulated company not already held by a person or persons acting in concert;

    (vi) a mandatory offer in terms of Section 123; or (vii) compulsory acquisition in terms of Section 124.

197. In relation to Section 122, a beneficial interest is indicated if a person, as a result of an acquisition, holds a beneficial interest in securities amounting to 5%, 10%, 15% or any further whole multiple of 5% of the issued securities of that class.

198. The Companies Act, 2008 regulates mandatory offers (Section 123), compulsory acquisitions and squeeze outs (Section 124), comparable and partial offers (Section 125), restrictions on frustrating actions (Section 126) and prohibited dealings before and during an offer (Section 127).

199. Mandatory offers If a person acting alone or persons acting in concert have acquired a beneficial interest in any voting securities issued by a regulated company, and were able to exercise less than the prescribed percentage prior to the acquisition and if after the acquisition of the voting rights they are able to exercise the prescribed percentage of the voting rights, then they will be required to offer to acquire any remaining securities and are required to deliver a written offer within one month of such initial notice. The prescribed percentage will not be more than 35%. Let's put this in plain English. If shareholders acquire shares so that they have 35% or more of the shares of the company, then they will be required to make an offer to the remaining shareholders to buy their shares at the same price. A mandatory offer may also be triggered by a share buy-back.

200. Compulsory acquisitions and squeeze outs If an offer have been accepted by at least 90% of a class of securities of a regulated company, and the offeror wishes to acquire all the remaining securities, then subject to notice, the offeror is entitled and bound to acquire the securities concerned, on the same terms that applied to the original offer.

201. Comparable and partial offers If a company has more than one class of shares, then the offeror would be obliged to make a comparable offer to each class of shareholder if the original offer results in the offeror being able to exercise more than the prescribed

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percentage (35%) of the general voting rights. A person making a partial offer for any class of issued securities of a company must make the offer to all of the holders of that class of securities if the offer could result in the offeror holding shares greater than the prescribed percentage.

11. Public Interest Considerations

202. A merger that is not likely to give rise to a substantial lessening of competition may still be prohibited on substantial public interest grounds. The recent amendment of the act prescribes a compulsory provision for public interest consideration as part of merger consideration and further prohibition on a merger on grounds of failing the public interest grounds.

203. The public interest grounds are limited and include the effect on the following:

- Particular industrial sector or region (regulated industries such as trade and industry);
- Employment to include all labor aspect;
- The ability of small businesses or firms controlled by historically disadvantaged persons to effectively enter into, participate in or expand in the market, this include BEE related considerations and the ICT;
- A greater spread of ownership, in particular to increase the levels of ownership by historically disadvantaged persons and workers in firms in the market to include regulated industries such as mining ; and
- The ability of national industries to compete globally, as related to trade.

204. The Commission’s approach to evaluating public interest considers whether:

(1) There is likely effect of the merger on public interest grounds;
(2) Such effect, if any, is merger specific;
(3) Such effect, if any, is substantial;
(4) There are any likely positive effects to justify the approval of the merger; and
(5) There are possible remedies to address any substantial negative public interest effect.

Where the effect of the public interest consideration is found to be non-merger specific, the enquiry into that effect stops at that stage. Likewise, where an effect is found to be merger specific but not substantial, the enquiry into that effect will stop at that stage.

Tribunal sets criteria for assessing job losses in a merger

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The merging parties were also directed to advise their employees of this condition. This decision followed a hearing before the Tribunal in which the merging parties proposed to limit the number of merger related job losses to 1 000 in the first 3 years after implementing the merger. The merging parties also offered to provide support, such as core skills training to affected unskilled and semi-skilled employees, outplacement support and counselling, and to use their best endeavours to redeploy affected employees within the merged entity.

The Competition Commission, after assessing the merger, accepted the merging parties' undertakings which had improved on the merging parties' original undertakings and recommended to the Tribunal that the merger be approved subject to the implementation of these support measures.

The Tribunal, in its reasons, held that when the merging parties expect that there would be large retrenchments as a result of the transaction the parties had to justify the substantial loss of jobs flowing from the merger. The Tribunal indicated that the following criteria must be satisfied in deciding whether the retrenchments are justified:

That a rational process has been followed to arrive at the determination of the number of jobs to be lost, i.e. that the reasons for the job reduction and the number for jobs proposed to be shed are rationally connected; and

The public interest in preventing employment loss is balanced by an equally weighty but countervailing public interest for instance where the merger is required to save a failing firm, that justifies the job loss which is cognisable under the Act.

205. Very few mergers are ultimately prohibited on public interest grounds, as in any mergers that raise competition or public interest concerns are resolved without litigation through agreements on remedies. Remedies may be unilaterally imposed on merging parties by competition authorities or agreed jointly with the merging parties. Remedies are conventionally classified as either structural or behavioural.

206. Structural remedies are generally one-off measures that seek to restore or maintain the competitive structure of the market. Behavioural remedies are normally ongoing measures that are designed to regulate or constrain the behaviour of merger parties.

The purpose of remedies is to address possible anticompetitive effects of a merger or negative public interest effects.

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the Wal-Mart Inc and Massmart Holdings Ltd merger, following concerns that the retrenchments of 503 employees by a division of Massmart in June 2010 occurred because of the merger, the CAC ordered that the employees retrenched by Massmart be re-employed. In relation to concerns about the effect of the merger on local suppliers to Massmart. The CAC ordered the capital amount of the fund to be increased to R200 million and to be spent over a period of 5 years and that the success of this fund would be measured by the extent to which small and medium sized businesses benefit as a result of the work of the fund.

11.1 B-BBEE Considerations in M&A consideration

207. The necessary care should therefore be taken by the acquirer and as a control, include such matter relating to employees in the list of warranties and indemnities should such information not be included. B-BBEE Considerations and Implications

208. Consideration of the requirements of the Codes of Good Practice on Black Economic Empowerment is a requirement unique to South Africa, considered, where necessary as one of the public interest aspects.

209. The primary purpose of the BBBEE Act and the Codes of Good practice to address the legacy of apartheid and promote the economic participation of Black People the South African economy (as defined in the act).

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210. The Codes use a matrix of elements to assess the empowerment status of an entity based on a list of elements which summaries including their weights as shown below:

Measurement Element(s)	**Targeted Score in points**
Ownership	25
Management Control	19
Skills Development	20
Enterprise and Supplier Development	40
Socio-Economic Development	5
Total Score (including bonus points)	**109**

As adapted from B-BEE Codes

211. From an M & A perspective the two above highlighted elements may be affected depending on the buyers standing as it relates to the measurement element. The impact may either be negative, dilutive or neutral.

212. Certain industries such as Mining through the Department of Mineral Resources have set requirements insofar as compulsory ownership levels. In cases of a Management Buyouts, the acquirer needs to be mindful of the wrong tone it may set where a disproportionate Management structure may emerge from a buyout of a previously black Managed entity.

12. POST-MERGER INTEGRATION

213. Closing the deal is just the beginning. Most acquisitions fail to meet pre-deal expectations, and the real challenge for any company acquiring a business is ensuring that the acquisition delivers the value that motivated the decision to do the deal in the first place. In a low growth environment, management are under increasing pressure from shareholders to focus more attention on how they achieve this.

214. Synergies can be elusive. Where the acquirer and target businesses operate in the same or complementary fields, it is almost always the case that the acquirer will want to integrate the two businesses with a view to saving costs and generating value for its shareholders through meeting synergy targets. But bringing together businesses with different trading relationships, histories and cultures inevitably poses substantial challenges, which can hamper the achievement of those synergy targets — particularly in the short and medium term.

12.1 Transparent and Collaborative Process

215. Any large post-acquisition integration project raises issues of business strategy, process management and technical expertise. Once a theoretical integration plan has been developed, practical implementation issues will prove critical in determining how quickly the plan can be implemented and how soon the benefits of the integration can be realized. Human resource considerations, corporate and tax law issues, and regulatory approval and

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filing requirements should all be built into the planning process itself and not be left to the implementation phase.

216. A well-run integration process can customarily be broken down into seven phases:

- identification of key strategic objectives
- information gathering
- preliminary analysis and development of overall plan
- initial evaluation of overall plan
- development of detailed step lists
- evaluation and approval of detailed step lists
- implementation of steps in final detailed step lists
- Outside advisers are typically engaged throughout the life of the project because of their technical and project management experience and expertise, and because the company's own staff need to focus on day-to-day business operations.

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