Share Swap

Why in news?

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Hindustan Unilever (HUL) announced the merger of Glaxo SmithKline Consumer (GSK Consumer) with it, in a deal that has been structured as a share swap.

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What is a share swap?

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- When a company pays for an acquisition by issuing its own shares to the shareholders of the target company, this is known as a share swap.
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- The number of shares to be issued in lieu of their existing holdings to the target company is called the swap ratio.
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- Swap ratio is determined by valuing the target company after looking into metrics such as its revenues and profits, as well as its market price.
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- If the target company is listed, the market value of its shares is often a key consideration to arrive at the right price to be paid.
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- Paying a premium linked to a market value usually indicates healthy prospects and high potential, while a discount could indicate a distress sale.
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What are the advantages?

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- **Sharing risks** - In a cash deal, if the acquirer has paid a premium and the synergies don't materialise, shareholders of the acquiring company alone bear the fallout.
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- In the case of share swap, shareholders of the target company will also

become shareholders of the merged entity.
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- So, the risks and benefits of the expected synergy from the merger will be shared by both the parties.
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- **Less borrowing costs** - In a share swap, there is no cash outgo involved for the acquirer, saving the acquirer borrowing costs.
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- The acquirer companies, in turn, can put their cash to use for investments in the business or for other buyouts.
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- **Creating Goodwill** - Issuing fresh shares could lead to reduction in promoter holding and dilution in earnings for shareholders of the acquiring company.
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- However, the acquiring company can benefit from lower taxes, if there is goodwill created out of the merger which it writes off over the years.
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- Goodwill arises when the acquisition price is higher than the value of assets and liabilities of the acquired company.
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What does the HUL-GSK deal show?

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- The merger with HUL values the total business of GSK Consumer Healthcare at Rs.31,700 crores.
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- Shareholders will receive 4.39 HUL shares for each GSK Consumer share held, according to the share swap ratio.
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- The valuation is based on a premium of 5% on the 15-day weighted average stock price of GSK Consumer.
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- Thus, HUL is paying close to the market price of the GSK Consumer stock whose consumer goods stocks have had a good run in the market.
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- HUL too has good long-term prospects with a diversified product portfolio and market leadership in several categories.
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- Hence, GSK Consumer shareholders have got a fair deal.
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- Earnings per share (EPS) is the portion of a company's profit allocated to each share of common stock.
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- From the HUL side, the acquisition will immediately add to the Earnings Per Share despite the equity dilution of about 8% from the share swap.
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Are the share swaps taxable?

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- In case of a share swap, when shareholders of the acquired company are given shares of the acquirer company as part of the deal, this is not considered a transfer of shares.
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- Hence, capital gains tax will not arise in the hands of the shareholders (including minority shareholders) of the acquired company.
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- The tax liability will arise only when the shares of the merged entity are sold.
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Source: Business Line

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