



# SBI & Associate Banks Merger - Birds Eye View

Corporate Governance Research  
Proxy Advisory Services  
Corporate Governance Scores  
Stakeholders' Education



Private and confidential  
For limited circulation only  
© Stakeholders Empowerment Services 2012 –  
2013 | All Rights Reserved

## SUMMARY

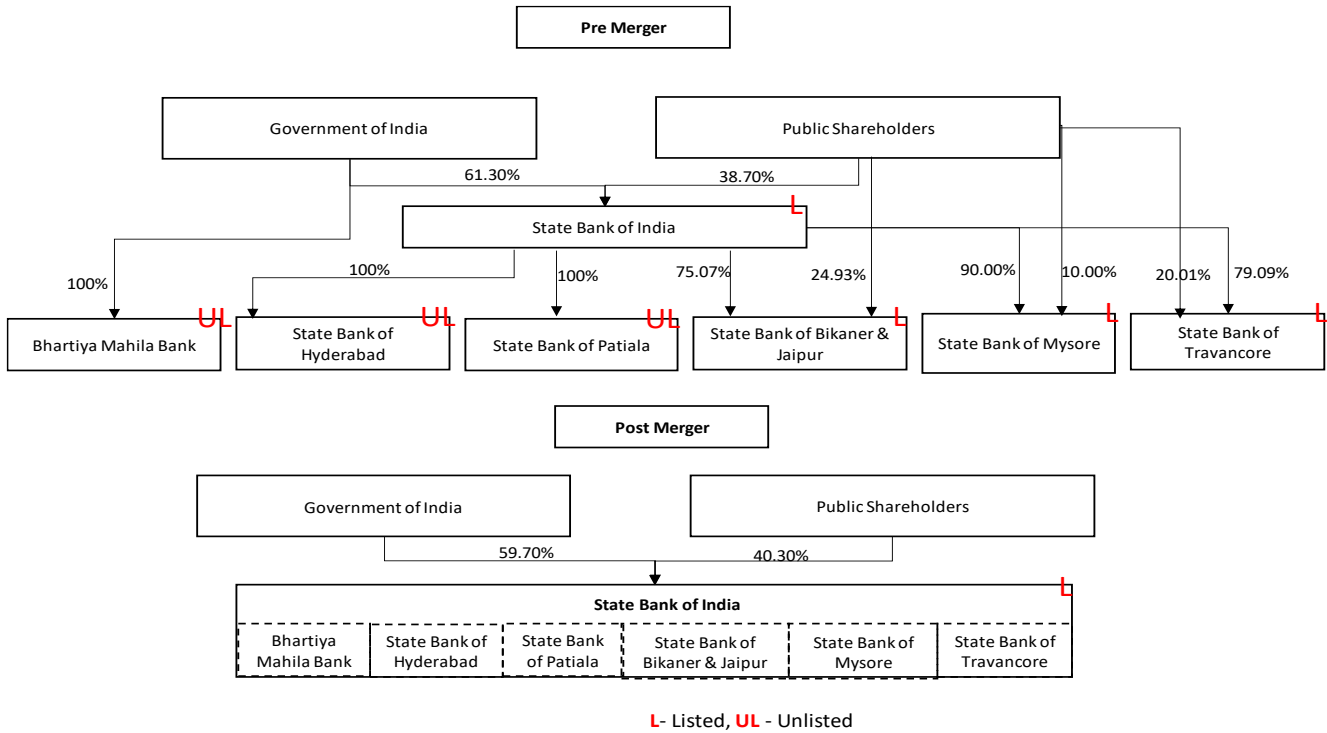
---

- The proposed merger is positive for Subsidiary shareholders, due to favourable ratio based on market price, ignoring speculative spikes. These shareholders will become shareholders of a giant Indian bank.
- Although, SBI shareholders paying premium but will gain due to removal of holding company discount and future cost reduction, cost rationalisation and better operational efficiency.
- The Merger needs approval of Central Government only.
  - The merger neither requires approval of SEBI, Stock Exchanges and shareholders nor does it require approval of the courts. Provisions of SBI Act, 1955 on mergers exempt it from such approvals
- Since, shareholders' approval is not mandatory and is neither proposed by the Banks, hence, this is not a voting advisory but a Report Card on Relative Valuation. SES has also not analysed in details potential benefits of the merger like creation of a Banking Giant, increase in branch network, rationalised costs and avoiding competition.
- A good governance practice would be generally to obtain shareholders' approval. However, it would be against provisions of law. In normal course one would be willing to take risk and obtain shareholder approval. The question is, can the Bank take risk? The answer is simple NO, in view of [Delhi High Court judgement](#) in case of HCL Technologies Ltd. As going against the current law as a shareholder friendly measure, the Bank faces risk of potential legal cases. If such a contingency does materialise, eventuality there could be delays and the Bank may end up losing value for its shareholder, for whose protection the law would have been violated.
- SES has observed that the Bank(s) have provided a mechanism to address shareholders' grievances/concerns, **SES considers this as a shareholder friendly measure**, although it is no substitute for shareholder approval.
- As far as valuation is considered, SES finds that the valuation appears to be fair. SES has observed that the swap ratio provided to the shareholders of the three listed Associate Banks is at a premium of the swap ratio based on daily share price of the Associate banks with SBI for one-year period.
- Further, the spike in the share prices appears to have been ignored as a result it has not vitiated the merger ratio.
- This Report has only analysed three listed subsidiaries of SBI and no other unlisted entities which are being merged.
- Post-Merger Government's equity in SBI will come down marginally below 60%.



**BACKGROUND**

State bank of India (SBI) announced a proposed merger of Bhartiya Mahila Bank Limited (BMBL) (wholly owned by the Government of India) and its (SBI) three listed associate Banks viz. State Bank of Bikaner and Jaipur (SSBJ), State Bank of Mysore (SBM), State Bank of Travancore (SBT), and two unlisted associates viz., State Bank of Hyderabad (SBH) and State Bank of Patiala (SBP) in a [corporate announcement](#) to stock exchange(s) on 18<sup>th</sup> August, 2016. A schematic diagram of the proposed merger is as follows:



As seen from the above schematic diagram the shareholding of Govt. of India in SBI will come down to 59.70% from 61.30% post the merger.



## RELEVANT LAW AND APPROVALS

The proposed acquisition is under the provision of the Section 35 of the SBI Act, 1955 which states that:

35. State Bank may acquire the business of other bank —

*(1) The State Bank may, with the sanction of the Central Government, and shall, if so directed by the Central Government in consultation with the Reserve Bank, enter into negotiations for acquiring the business including the assets and liabilities, of any banking institution. 1[(2) The terms and conditions relating to such acquisition, if agreed upon by the Central Board of the State Bank and the directorate or management of the banking institution concerned and approved by the Reserve Bank, shall be submitted to the Central Government for its sanction and that Government may by order in writing (hereafter in this section referred to as the order of sanction) accord its sanction thereto.*

The sequence of approvals required for the acquisition is as follows:



### Exemptions:

- The proposed acquisition is exempted from approval of Competition Act, 2002 as amended
- SBI Act, 1955 does not provide for approval of shareholders in case of merger / takeover of any bank by SBI
- SEBI circular on Schemes of Merger not applicable
- No need to obtain approval from Stock Exchanges

The SBI Act, 1955 does not require shareholders' approval for the merger of any other bank with SBI. SES is of the opinion that the SBI Act, 1955 is an age old law when nobody even thought of computers and e-voting facility. However, with the changing times the Act should have been amended and shareholders' approval sought through a shareholders meeting as well as e-voting. SES is of the opinion that as a good governance the shareholders' approval should have been taken. However, as shareholder approval is not required in order to have an opinion of the shareholders, the Bank has provided a provision by which the shareholders can voice their grievances to the respective banks regarding the share exchange ratio given they cross a threshold limit as provided in the scheme. **SES is of the view that since the shareholders' grievances will be heard and considered by an expert committee this to some extent mitigates the absence of shareholder approval.**

SES is of the opinion that as far as governance aspects and shareholders' rights are concerned, having multiple laws with diluted rights of shareholders does not reflect good legal eco system. A good legal ecosystem should not differentiate on shareholders' rights etc. regardless of the parent law which governs the Company. The question that can be asked could the Bank go ahead and followed provisions of listing agreement and SEBI instructions on Mergers? Answer is yes it could have gone ahead **but in that case expose itself to legal trouble, jeopardizing the entire merger.** Next question is could the Bank have taken such risk? The answer is in absolute negative. Banks are backbone of financial market and SBI because of its size plays a pivotal role. Any uncertainty of legal outcome would not only cause problems for financial markets but would be detrimental to all stakeholders of Bank including shareholders who would lose value. Ideally for any investor friendly measure neither the courts nor Regulatory Authorities should raise objection even if law does not permit as it would be in public interest, which is logically back bone of legal system. Unfortunately, such is not the case. In a recent [judgement Hon'ble Delhi High Court](#) rejected the request of HCL Technologies Ltd. to provide E-Voting facility in CCM.

Therefore, Bank like SBI cannot take such risks of a court nullifying the merger by following a procedure which is outside the SBI Act. SBI may eventually win at Apex Court, but the damage it might cause to the Bank and its stakeholders and Financial system would be colossal. As a result, proposal cannot be put through shareholders.

Proponents of governance, like SES would have to be satisfied with the grievance procedure adopted by the Bank. SES is of the opinion that SBI and Government should align these laws with current laws.



SES would recommend that as a part of harmonising the law relating to listed entities, SEBI must take up the matter with authorities and ensure that all listed companies are subjected to same law regardless of their vintage or nature of business. Nature of business cannot be the differentiator for investor protection laws.

### VALUATION AND FAIRNESS

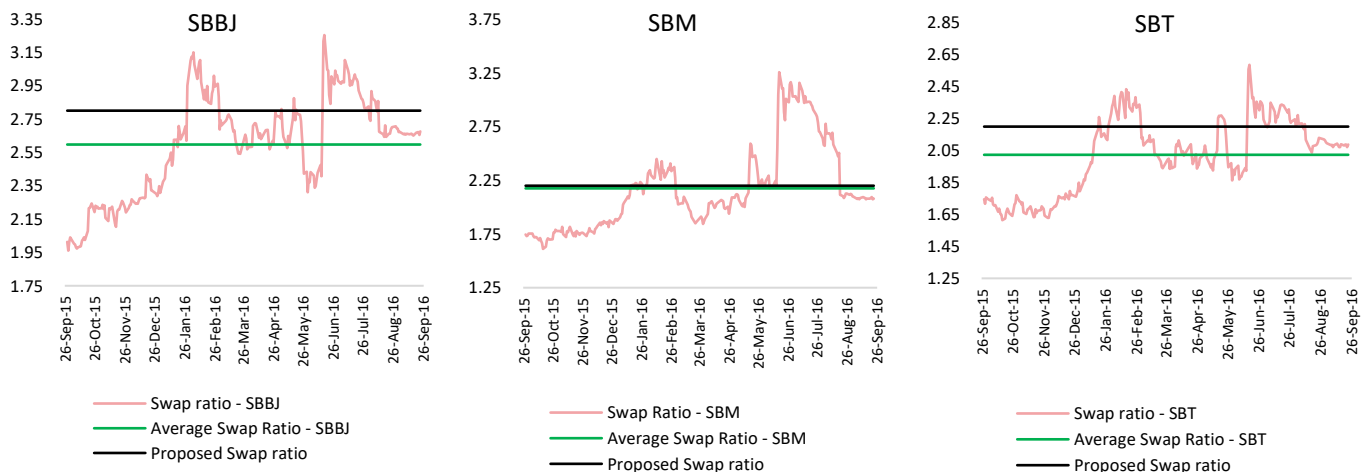
With scheme becoming effective the shares held by SBI in its Associate Banks shall stand cancelled and the other shareholders will receive shares of SBI

Although, the banks have mentioned the names of the Independent valuers and fairness opinion providers, they have not provided their reports on the website or the stock exchange(s). SES is of the view as a matter of transparency, fairness and good governance practice these reports be disclosed to the shareholders. However, in this case as the shareholders’ approval is exempted by SBI Act, 1955, SES is only raising its concern regarding the non-availability of the documents on the website continuously, although the Bank did provide facility of inspection for 21 days. Following information was extracted from valuation reports:

Share Swap Ratio - SBI with SBBJ, SBT and SBM					
	Weights	SBI	SBBJ	SBT	SBM
Market Price Method	45%	197.40	507.00	390.00	394.50
CCM Method	45%	202.80	536.90	433.20	393.10
NAV Method	10%	228.80	906.50	797.70	893.90
Weighted average value per share		203.00	560.40	450.20	443.80
Exchange ratio			<b>28:10 (2.8:1)</b>	<b>22:10 (2.2:1)</b>	<b>22:10 (2.2:1)</b>

### MARKET PRICE AND RATIO

SES has plotted swap ratios based on the daily historic prices of the SBI, SBBJ, SBT & SBM for past one year. The following graphs show movement of swap ratios over a period of one year, the average swap ratio and the recommended swap ratio for SBBJ, SBT and SBM.



From the above graphs it can be inferred that:

- The proposed swap ratio is higher than the average swap ratio in all the three cases
- The proposed swap ratio is higher than the swap ratio for a major duration of last one year
- There is spike in the price of the all the three Banks relative to price of SBI on or around 17<sup>th</sup> June, 2016 which gives spike to swap ratio and the same is higher than the proposed swap ratio in case of all the three banks. The spike was immediately after Cabinet nod (15<sup>th</sup> June 2016) for merger of Associate Banks into SBI and the spikes in prices was speculative. SES is of the view such spikes in the price based on speculation cannot be the basis of swap ratio and



ideally considering the spike as an outlier it should be neglected. In fact, if the impact of spike is ignored in calculation of the average swap ratio, the differential between the average exchange ratio over a year and proposed exchange ratio would increase, in favour of shareholders of all the three subsidiary banks.

- Only in case of SBM swap ratio graph pattern is different from SBBJ and SBT. In case of both SBBJ and SBT the swap ratio graph was well above the average and ratio in early part of 2016. However, in case of SBM pattern is different as there is only a narrow gap between the actual swap ratio, average swap ratio and the swap ratio in early 2016. For most part of 2016 SBM relative price was below SBI price, it is only after cabinet decision that the price moved up.
- In case of SBM average and recommended swap ratio converge more than the other two banks.

Further, the gain loss based on closing price of one day before the merger announcement and a month after the announcement of the merger is as below:

Bank	17-Aug-2016	23-Sep-2016	Exchange Ratio	Value in hand for Shareholders of SBBJ, SBM and SBT in terms of SBI shares		Price difference	
				17-Aug-2016	23-Sep-2016	17-Aug-2016	23-Sep-2016
SBI	246.25	254.40					
SBBJ	650.60	680.60	28:10	689.50	712.32	38.90	31.72
SBT	504.45	530.90	22:10	541.75	559.68	37.30	28.78
SBM	609.15	528.95	22:10	541.75	559.68	-67.40	30.73

As seen from the above table on the date of announcement the merger was in favour of the shareholders of SBBJ and SBT and was negative for SBM shareholders, showing net loss of ₹ 67.40 per share. One can argue that SBM shareholders got a raw deal. However, this statement although technically correct as on date of announcement, cannot be rationally advanced as SBM shares had spiked on / around 14<sup>th</sup> June, 2016 and in three sessions the shares added more than 50%, moving from ₹ 456 per share to ₹ 695. If one would have taken ratio of exchange based on this spiked movement of price, it would have been unfair to shareholders of other banks, viz., SBBJ & SBT as well as SBI shareholder. The common rule is that outliers on either side are to be ignored. However, as on 23<sup>rd</sup> September, 2016 the merger ratio benefits shareholders of all the merging banks.

As seen from the table above, the proposed swap ratios favour the shareholders of SBBJ, SBM and SBT. It can be said that SBI shareholders are at loss. In mergers/ demergers perfect balance is impossible to achieve. For long term gain one has to give up here and there. However, SES understands that markets cannot be judged on the basis of one-time event, and SES is of the opinion that a sweetener is provided to the shareholders of SBBJ, SBM and SBT as they are losing their independent entity. On the other hand, SBI shareholders will have a bigger bank, a Giant Bank with a well-connected network which will be beneficial to them in a long term. More so, holding company discount will disappear. Going by market practice PE ratio is likely to improve as earnings of subsidiaries will be captured directly. This will eventually help SBI and erstwhile Subsidiaries shareholders equally.

Thus, SES is of the view that barring exceptions market price is true barometer of value, and merger ratio has qualified the test based on average prices over a year. It has automatically taken care of natural and unnatural spikes.

SES would earnestly request that the Bank Requests Government, RBI and SEBI to harmonise the law, so that the Bank can implement shareholder friendly measures.



**RESEARCH ANALYST: GAURAV BANSAL | JN GUPTA**

**RELEASE DATE: 1<sup>ST</sup> OCTOBER, 2016**

## **DISCLAIMER**

---

While SES has made every effort and has exercised due skill, care and diligence in compiling this report based on publicly available information, it neither guarantees its accuracy, completeness or usefulness, nor assumes any liability whatsoever for any consequence from its use. This report does not have any approval, express or implied, from any authority, nor is it required to have such approval. The users are strongly advised to exercise due diligence while using this report.

This report in no manner constitutes an offer, solicitation or advice to buy or sell securities, nor solicits votes or proxies on behalf of any party. SES, which is a not-for-profit Initiative or its staff, has no financial interest in the companies covered in this report except what is disclosed on its website.

The report is released in India and SES has ensured that it is in accordance with Indian laws. Person resident outside India shall ensure that laws in their country are not violated while using this report; SES shall not be responsible for any such violation.

This report may not be reproduced in any manner without the written permission of Stakeholders Empowerment Services.

All disputes subject to jurisdiction of High Court of Bombay, Mumbai

All rights reserved.

