



# ZEE shakes the TREE – Class Action: Best Option

**BACKGROUND**

ZEE Learn Limited (Transferee Company or 'ZLL') and Tree House Education & Accessories Limited (Transferor Company or 'THEAL') at their respective Board meeting held on 4<sup>th</sup> December, 2015 accorded in principle approval to explore option for consolidation of both the companies and constituted a committee to look into the same. Both these companies made simultaneous announcement to stock exchanges in this respect.

For THEAL's Announcement: [Click here](#); For ZLL's Announcement: [Click Here](#)

Subsequently, ZEE Learn Limited (Transferee Company or 'ZLL') ([Click here](#)) and Tree House Education & Accessories Limited (Transferor Company or 'THEAL') ([Click here](#)) at their respective Board meeting held on 23<sup>rd</sup> December, 2015 unanimously approved merger of both the entities, subject to shareholders' approval.

It may be noted that both the companies made identical disclosures. In nutshell the disclosures read as under:

- Boards of both the companies unanimously approved merger, it was **subject to: approval of shareholders of respective companies, their creditors and regulatory authorities as may be required under law***
- Both the Boards **took into account valuation reports and fairness opinion***
- Both the Boards approved share exchange ratio and announced it to public*

However, subsequently on 30<sup>th</sup> May, 2016, ZLL [announced](#) that the Board has decided to put the aforesaid **merger on hold on account of the financial results of THEAL** for the 4<sup>th</sup> quarter and financial year ended on 31<sup>st</sup> March, 2016 which was announced a day before i.e., on 29<sup>th</sup> May, 2016.

The Company ZLL said that *"these results requires careful evaluation and the potential impact of the same, if any, on the Scheme of Amalgamation of THL with the Company needs to be properly evaluated. The Company would keep investors / stakeholders informed on the development of the same from time to time."*

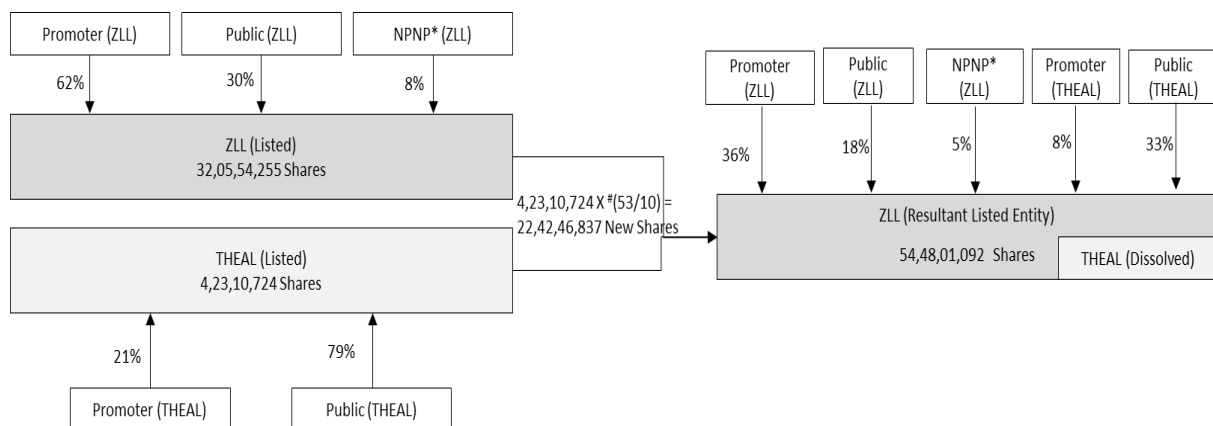
SES is of the view that this decision is not only unfair to shareholders, it is also;

- against the law,
- example of bad corporate governance and
- adversely impacting integrity of securities market

**The decision taken by the Board of Zee Learn Limited raises various questions pertaining to the fate of investors of these companies.**

**PROPOSED SCHEME IN BRIEF**

On 23<sup>rd</sup> December 2015, both the aforesaid Companies announced that their Board have unanimously approved a [scheme of Amalgamation](#) of THEAL (Transferor Company) into ZLL (Transferee Company) with a view to consolidate the business operations, as both entities are into similar line of business.

**Scheme of Amalgamation**

\* NPNP – Non Promoter Non Public shareholding consisting of 2,75,09,770 Depository Receipts. # Share Exchange Ratio



The Scheme stated that to shareholders of THEAL shares, for every 10 equity shares held in THEAL, 53 equity shares of ZLL shall be issued. The [Valuation Report](#) issued by SSPA & Co stated that for computing the share exchange ratio, it has relied upon the following information:

- Annual Report of both Companies for the financial year 2014-15
- Estimated financials statements of THEAL and ZLL for the financial year 2015-16.
- Financial Projection of both the Companies for financial year 2016-17 and 2017-18.

The above Amalgamation would result in THEAL being dissolved by merging into ZLL. The resultant entity will operate under the identity of ZLL, where existing promoters of THEAL will hold **only** around **8.45%** of the total shareholding of the resultant entity. Simultaneously, ZLL promoters holding would also come down drastically from 61% pre amalgamation to around 36% post amalgamation, **a situation not liked by many promoters in India, where ordinary resolutions could be passed or rejected without promoters' consent.**

### **RATIONALE FOR THE MERGER (AS STATED BY THE COMPANIES)**

The Scheme states that amalgamation of both the Companies will provide the following benefits to both the Companies: -

- Opportunity to leverage combined assets, build a stronger sustainable business,
- Enable optimal utilization of existing resources,
- Opportunity to fully leverage capabilities, experience and infrastructure,
- Accessibility to broader markets
- Improved organisational capability and leadership arising from the pooling of human capital that has diverse skills, talent, and vast experience to compete successfully in an increasingly competitive industry.

The Scheme would be in the best interest of the shareholders, creditors and employees of the Transferor Company and would result in enhancement of shareholder value and would help transferee Company vigorously pursue its expansion.

### **EVENTS PRE AND POST ANNOUNCEMENT OF SCHEME**

#### **PRE ANNOUNCEMENT**

##### **SES REPORT ON THEAL:**

SES had released its Report on THEAL on 14<sup>th</sup> September 2015, questioning the accounts specially debtors ([read the full Report](#)). THEAL had submitted its explanation thereto and, thereafter SES had issued an Addendum ([read more](#)) where last para of Addendum read as under:

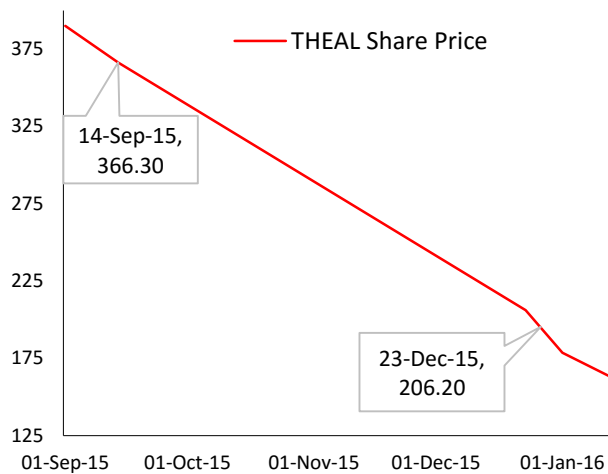
***"In view of the disclosures made by the Company SES is of the opinion that the Company has explained the issue satisfactorily and shareholders may please note the same. SES wishes to clarify that the same is based on written communication from the Company. The Company may get the same certified by their Auditors and make proper disclosure to shareholders through stock exchanges."***

The Company i.e. THEAL did not follow what was recommended by SES i.e., they did not submit to Stock Exchanges Auditor certified disclosures and on the other hand they enclosed SES Report itself.



**Impact on Share Price:**

THEAL had been seeing a fall in its share price for quite some time.

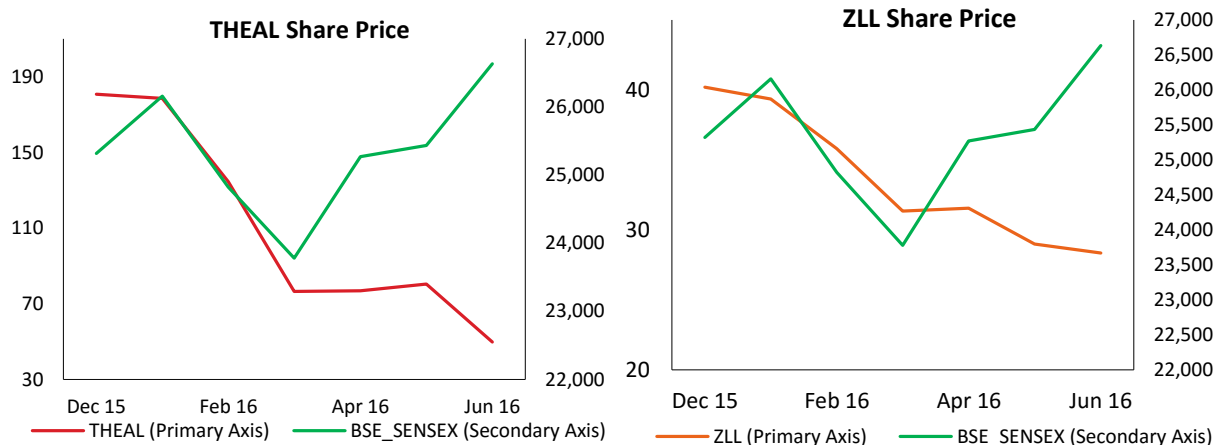


The share price of THEAL has been on a constant decline ever since SES reported irregularities in its financial statements on 14<sup>th</sup> September, 2015. Share price fell from ₹ 366 to ₹ 206 on the date of announcement of Scheme.

SES Report raised several questions pertaining to the continuous increase in the trade receivables in the Company's Balance Sheet despite operating in an industry where fees (revenue) is charged in advance. Moreover, the stock continued its decline even after the announcement of Amalgamation with ZLL on 23<sup>rd</sup> December, 2015.

**POST ANNOUNCEMENT**

If the objective and benefits that were stated by both the companies were to be believed by the market participants, it would generally be expected that a merger would be treated positively by the market, as THEAL and ZLL have a country wide network of pre-schools and are into advisory services in the school education industry. Amalgamation would have been beneficial for both the Companies considering that both the Companies are into similar business and positive for market price/ market cap. **However, the market reacted negatively to the announcement as can be seen in the graph below:**



Although, the share price of ZLL fell by 31% post announcement, its performance has been relatively stable compared to THEAL which plummeted by 76% post announcement.



**SWAP Ratio Economics:**

**Comparison of swap ratio on three dates;** date of announcement, date of postponing / putting on hold and on 10<sup>th</sup> June 2016 based on prices of THEAL and ZLL shares and declared swap ratio works out as under:

	RELEVANT DATES		
	23 <sup>rd</sup> Dec, 2015	30 <sup>th</sup> May 2016	10 <sup>th</sup> June, 2016
ZLL Share Price ₹	41.15	28.60	28.35
THEAL Share Price ₹	206.00	70.75	49.80
Swap Ratio based on Market price for 10 shares of THEAL	50.06	24.74	<b>17.57</b>
Declared Swap Ratio	53.00	53.00	<b>53.00</b>
Exchange Ratio in Favour of THEAL Shareholders	1.06	2.14	3.02
Impact on THEAL Shareholders	+VE	+VE	+VE
Impact on ZLL Shareholders	-VE	-VE	-VE
<b>Indexed Share price (Considering base share price on 23<sup>rd</sup> Dec, 2015 as ₹ 100)</b>			
ZLL	100.00	69.50	68.89
THEAL	100.00	34.34	24.17

Based on stated exchange ratio, as on 10<sup>th</sup> June 2016, THEAL shareholders were getting almost three times the number of ZLL shares compared to what they would have got had the exchange ratio be based on current market price. This ratio on the date the deal was put on hold was 2.14 i.e. THEAL shareholders were getting more than double based on market price. Whereas the exchange ratio was evenly balanced on the date of announcement of merger on 23<sup>rd</sup> December 2015.

Looking at changed circumstances and free fall of THEAL share continuously, it is quite evident that market had lack of faith in THEAL and fall in its share price even after favourable ratio is all the more perplexing. Either investors/ market was doubtful about the deal going through right from beginning or the fall was an engineered one. In such scenario arbitrage drives prices of two merging companies to converge to replicate given exchange ratio adjusted for tax. Price difference of this nature reflects large risk premium, and once again market is proved right as the risk came to surface in the form of postponing/ putting on hold the merger and dismal results of THEAL.

Relatively, price of THEAL fell sharply losing almost 75+% of its value from date of announcement till date, as against around 30% loss in case of ZLL. Even after putting on hold the deal, THEAL has lost about 30% whereas ZLL has remained at almost the same level.

Such price behaviour becomes inexplicable, if fall after putting on hold was justified for THEAL due to its poor result and having been left in the cold, what would explain post announcement fall in December 2015, when all throughout THEAL shareholders were having a favourable share swap ratio? Were shareholders doubtful of merger or combined entity did not give market better prospects of business. Truth behind the fall is hidden inside the minds of investors who contributed to the price fall due to their trading decision and would remain buried unless market regulator SEBI finds a pattern of trading which is violative of SEBI Regulations.

**SES is of the view that a part of the problem lies in THEAL Annual and Q4 Results.**

**THEAL DISMAL 4<sup>TH</sup> QUARTER RESULTS:**

From THEAL's point of view, the Scheme of Amalgamation announced by both the Boards would have been an ideal situation for the shareholders of THEAL as they were getting favourable swap ratio and chances of revival and growth were there. However, on account of dismal financial results pertaining to the 4<sup>th</sup> quarter and financial year ended 31<sup>st</sup> March, 2016 announced on 29<sup>th</sup> May 2016, the very next day, **ZLL announced that the Scheme has been put on hold.** ZLL concluded that the results of THEAL require careful evaluation and can potentially impact the Scheme of Amalgamation.



**POSSIBLE FACTORS PUTTING SCHEME IN JEOPARDY****FINANCIAL PERFORMANCE OF THEAL**

Annual Audited Results				Quarterly results		
Particulars (In ₹)	2016	2015	2014	Mar' 16	Dec' 15	Sept' 15
Revenue	<b>209.33</b>	207.45	157.64	<b>27.27</b>	<b>55.78</b>	57.25
Other Income	<b>10.09</b>	7.15	1.34	<b>1.23</b>	2.71	3.15
Total Income	<b>219.42</b>	214.60	158.98	<b>28.50</b>	58.49	60.40
PBDT	<b>76.51</b>	110.56	82.98	<b>-30.75</b>	22.75	28.78
Net Profit	<b>6.78</b>	60.88	43.92	<b>-40.10</b>	6.12	12.74
EPS (₹)	<b>1.60</b>	15.66	12.04	<b>-7.11</b>	1.44	3.01
OPM (%)	<b>43.69</b>	60.67	57.45	<b>-100.11</b>	49.86	58.17
NPM (%)	<b>3.23</b>	29.35	27.86	<b>-147.05</b>	10.97	22.25

The financial results of THEAL for the quarter / year ended 31<sup>st</sup> March, 2016 ([full financial results](#)) were disappointing on account of the following reasons: -

- 4<sup>th</sup> Quarter revenue reduced to less than 50% of the preceding quarters. This is strange, considering that the Company is into the business of early Childhood Education. It is only possible if there is exodus of children from schools or the **Company shut down half of its schools? Or it is an action of course correction and showing the real revenue? It may be noted that in terms of [Scheme of Amalgamation](#), THEAL was running school as trustee of ZLL. Did ZLL made any effort to clean the books and account correct revenue? If that be the case than ZLL would have been aware of the position much before Q4 results of THEAL came in public domain. Did ZLL deliberately delayed the announcement? If yes, for what objective? It would be interesting to see trading data for last few months. SES is of the opinion that ZLL has a duty to explain the truth behind THEAL numbers especially Q4 as during this period THEAL was being run in 'Trust' for ZLL.**
- The Company's other expenses amounted to ₹ 32.32 crores in the March quarter (₹ 7.55 crores for Dec quarter) majorly on account of **higher provisioning for bad debts.**
- Even after writing off bad debts worth ₹ 22.46 crores in the Q4 2015-16, the trade receivables of the Company still stood at ₹ 57.11 crores at the end of FY 2015-16 (₹ 41.50 crores for FY 2014-15). The receivables are twice as high as the Q4 2015-16 revenue. This indicates that including write-offs and debtors (₹ 57.11 + ₹ 22.46 = ₹ 79.57 Crore) out of entire past 6 months' revenue (₹ 83.05 Crore) only an insignificant amount of ₹ 3.48 Crore was received, unless these debtors are beyond 6 months old. SES maintains that such debtors are unusual in Education business, especially in the segment in which THEAL operates. SES had questioned Debtors of THEAL in its report in 2015. THEAL at that time gave a roundabout explanation and it seems that the problem lies in revenue recognition and Debtors.
- SES is of the opinion that receivables of THEAL are an unsolved puzzle. As per [THEAL disclosure to stock exchanges on 1<sup>st</sup> December](#) their receivables as on that date were ₹ 27 Crore, Turnover for Q4 was ₹ 27.27 Crore and for Q3 was ₹ 55.78 Crore. On pro-rata basis one-month revenue of Q3 would be ₹ 18.60 Crore. Assuming not a single penny received by THEAL 31<sup>st</sup> March 2016 debtors would amount to (27 + 27.27 + 18.60) = ₹ 72.87 crore. Of this amount ₹ 22.46 Crore was written off, therefore if no money was received debtors would be (72.87-22.46) = ₹ 50.41 Cr, the Q4 results place the figure at ₹ 57.11 Cr leaving an unexplained amount of ₹ 6.70 Crore that too with assumption that not a single parent/ child paid fee. SES feels that in books of account of THEAL debtors are some sort of sundry account to balance the books as convenient.
- Net Profits plunged from ₹ 60.88 crores in 2014-15 to mere ₹ 6.78 crores for the FY 2015-16 mainly on account of depleted revenue and higher provisioning for bad debts.



- Big question is, can ZLL claim that it was not aware of debtors' position in THEAL? Being in same line of business, fact that THEAL debtors were almost thrice in percentage terms of yearly revenue compared to ZLL, alone was a red signal for ZLL, which was in all probability ignored by ZLL.

In addition to the above, THEAL's shareholding pattern as on 31<sup>st</sup> March, 2016 suggest that 99.45% of the Promoter Shareholding is pledged or encumbered with Financial Institutions. Above facts if read in consonance, show that the Promoters have no 'Economic Interest' in the Company and may no longer be interested in the performance of THEAL.

## OTHER SMOKE SIGNALS COMING OUT FROM THEAL

### SHEDDING OF STAKE BY THEAL PROMOTERS

Just a day before announcing to public that the Board of THEAL has given in principle go ahead for consolidation with ZLL and appoint a committee, on 3<sup>rd</sup> Dec, 2015 Promoters of THEAL sold a large chunk of their holding. Insider trading disclosures reveal that the Promoters' offloaded as much as 32% of their shares in the Company in the first week of December, 2015. 24,70,000 (5.84%) held by Ms. Geeta Bhatia ([View Disclosure](#)) and 15,30,000 (3.62%) shares held jointly by Rajesh Bhatia & Geeta Bhatia ([View Disclosure](#)) were sold over Stock Exchanges on 3<sup>rd</sup> Dec, 2015. Sale of shares amounted to 9.46% of Company's Capital and 32% of Promoter holding.

Comparing current price of THEAL shares as on 10<sup>th</sup> July, 2016 of ₹ 49.8 with the price of ₹ 200.50 on date of sale, this appeared to be a smart move by the promoters of THEAL as it netted them about ₹ 60 Cr more than what is the value today as seen by the following table.

Particulars	3 <sup>rd</sup> Dec, 2015 (sale of shares)	10 <sup>th</sup> July, 2016 (post FY 16 results)	Shares bought by:	
Equity Shares	40,00,000	40,00,000	Prism Commodore Pvt. Limited	5,24,000
Market price (in ₹.)	200.50	49.80	Arch Finance Limited	10,25,990
Total Value (in ₹.)	80.20 Crore	19.92 Crore	Nishu Finlease Pvt. Ltd.	9,50,010
			Decent Financial Services Pvt Ltd	4,94,000
			Pixel Mercantiles Pvt Ltd	4,95,990
			Plasma Commercials P Ltd	5,10,010
			<b>Total shares</b>	<b>40,00,000</b>

This action raises some pertinent questions and as answers to these questions are not available in public domain, the same needs to be responded by the concerned companies.

- Was ZLL aware of such a large chunk of shares sold by THEAL Promoters just prior to announcement of intention to merge? How it was viewed by ZLL? ZLL cannot claim its ignorance as it was a public disclosure.
- Who were the buyers of these shares? Names of buyer disclosed do not give any indication, whether they are independent investors or are affiliated to either ZLL or THEAL or their promoters. However, trading and delivery of 9% of company's equity or 33% of promoter equity on market in a single day is not a normal trading, it has to have a motive behind, which unfortunately is not in public domain. Without proper investigation, connection if any, of these buyers with either of the companies or their promoters cannot be made and SES does not have resources and capability to investigate.
- Were the buyers acting for ZLL promoters to protect their future potential dilution in the merged entity? Answer to this could be only found by SEBI after investigation or disclosure or denial by Promoters of ZLL. It may be noted that promoters of ZLL were to retain only 36% equity post-merger vs 62% pre-merger.
- If the merger was in the interest of both the Companies for harnessing great future potential, why would a rational person sell off 32% of his stake in the Company?





- Was this part of deal? Or a smart move by THEAL promoter knowing the real financial position? Nothing can be said with certainty.
- Or were the Promoters of THEAL privy to some other information, which was not otherwise available to public at large or even to ZLL. They were certainly aware of the **Real Numbers in their Financial Statements**.
- Later events suggest that ZLL was probably not aware of financial health of the Company or it had not anticipated such a bad position. What was ZLL expectation versus real financial position must be brought to public domain as ZLL cannot say that it was not aware of THEAL promoters' sale of shares and doubtful accounting.

### RESIGNATION OF KEY PERSONNEL

Bad governance or future problem gets manifested in actions of employees, especially key employees, THEAL is no exception as seen by the following:

#### 1. Chairman of THEAL resigns at a crucial juncture

Mr. Sanjaya Kulkarni, apart from being the Chairman of the Board, was also the Chairman of the Audit Committee and that of the Nomination and Remunerations Committee ('NRC'). Mr. Kulkarni resigned from the Board of the Company on 4<sup>th</sup> February, 2016 when the Company was undergoing a Scheme of arrangement.

#### 2. Resignation of Nominee Directors

During the Financial year 2014-15, Mr. Ashu Garg who was appointed as a Nominee Director of Venture partner of Foundation Capital (holding 6.84% shares in THEAL as on 31<sup>st</sup> Mar, 16), resigned from the Board of the THEAL on 27<sup>th</sup> May, 2015.

Further, Mr. Rishi Navani, a Nominee of Matrix India Asset Advisors Private Limited (holding 12% of shares as on 31<sup>st</sup> Dec, 2015) on the Board of THEAL resigned the very day i.e., 3<sup>rd</sup> December, 2015 on which the Board accorded in-principle approval for exploring consolidation options with Zee Learn Limited. On 23<sup>rd</sup> Feb 2016, Matrix India Asset Advisors Private Limited sold its entire stake and exited from the Company.

**These two resignations and exit by investors indicates that investors did not foresee comfortable future of the company. Were they not sure of performance post-merger or they were not sure of the merger itself?**

#### 3. Another Chairman of the Board resigns.

Immediately after the declaration of the financial results for the financial year ended 31<sup>st</sup> March, 2016 and the subsequent announcement by ZLL that the Scheme has been put on hold, Mr. T S Sarangpani who was associated with the Company since 2008 tendered his resignation on 2<sup>nd</sup> June, 2016. Mr. Sarangpani was the Chairman of the Board and this was the second such instance within 5 months where the Chairman of the Board has resigned.

**Was the resignation of Mr. Sarangpani on account of trying to present a true and fair view of the financial statements of THEAL? Or was there something more to it?**

#### 4. Multiple Resignations of KMPs in THEAL.

The Company witnessed resignation of 4 individuals as Company Secretaries of the Company within a span of 2 years, including 3 resignations between the month of March to November, 2014. A position which is considered to be that of a Key Managerial Personnel has experienced abnormal turnover ratio.

S. No.	Name of the Company Secretary	Date of Appointment	Date of Resignation
1	Deepali Hanchate	Since 2013	14 <sup>th</sup> March, 2014
2	Khushboo Kavedia	10 <sup>th</sup> April, 2014	5 <sup>th</sup> August, 2014
3	Pooja Bhimjiyani	5 <sup>th</sup> August, 2014	14 <sup>th</sup> November, 2014
4	Hardik Desai	28 <sup>th</sup> May, 2015	18 <sup>th</sup> March, 2016

The above facts reflect that something was wrong with the governance practices at THEAL.





**NOT EVERYTHING OK WITH ZLL AS WELL****Resignation of Chief Executive Officer of ZLL**

Although, Mr. KVS Seshasai was not a Board member in ZLL, he was designated as the Chief Executive Officer and received remuneration higher than anyone else in the Company. This reflects that he occupied critical role in the management of ZLL. On 25<sup>th</sup> January, 2016, he resigned from the management of the Company.

**Are the above resignations mere coincidence, or there is something more to it?** Did Mr KVS Seshasai paid the price for doing the deal which appears to have gone sour? If yes, then ZLL must have known about accounting issues at THEAL prior to his resignation? Or he was against the deal and was eased out? A fact only he and the Board of ZLL know.

In case of ZLL also, pledge of promoters shares has increased, as can be seen from following:

	30 <sup>th</sup> Sept., 2015	31 <sup>st</sup> Dec., 2015	31 <sup>st</sup> March, 2016
Promoters holding in ZLL	61.60	61.60	61.60
Promoters holding in ZLL Shares in Crore	19.73	19.73	19.73
% of promoter shareholding pledged	49.88	63.58	<b>64.54</b>
Shares pledged (Crore)	9.84	12.54	12.73
Market Price as on date	31.50	39.30	30.60
Value of pledged shares	309 Crores	492 Crores	390 Crores

This indicates that promoters have pledged more shares post September 2015 in Q3 and total value of pledged shares increased to ₹ 492 crores from earlier figure of ₹ 309 crores. Indicating extra amount of pledge and probably extra borrowing. What was the purpose of these extra borrowing? This question needs to be asked especially in view of the fact that around ₹ 80 Crore worth of shares were sold by THEAL promoters during the same period and at 50% margin the amount that could have been borrowed was ₹ 90 Crore approximately. The promoters must explain to investors the purpose of extra pledge, failing which various theories could be pronounced, which may be absolutely wrong.

**QUESTIONS ON THE MERGER**

**Against the background , at this juncture following questions merit attention:**

- Did ZLL hurried into the merger? Or were they led to garden path?
- Can ZLL put the Scheme on hold? If yes, on what grounds? If not, why not?

Before any of the question is answered it is important to have a look at following provisions of [scheme of Amalgamation](#) duly signed by both the companies.

**“7. STANDSTILL PROVISIONS TILL EFFECTIVE DATE**

***Upon approval of the Scheme by the Board of Directors of the Transferor Company and the Transferee Company and up to the Effective Date:***

**7.1** *The Transferor Company shall be deemed to have been carrying on and shall carry on its business and activities and shall be deemed to have held and stood possessed of and shall hold and stand possessed of all its properties, assets, and liabilities pertaining to the Transferor Company for and on account of and in trust of the Transferee Company. The Transferor Company hereby undertakes to hold its said assets with utmost prudence until the Effective date. Further:*

- a)** *The Transferor Company shall carry on its business and other activities with reasonable diligence, business prudence and shall not without prior consent of the Transferee Company alienate, charge, mortgage, encumber or otherwise deal with or dispose of its assets or any part thereof:*



- b) *Transferor Company shall not enter into any contracts, agreement, understandings, negotiation, memorandum of understanding and any other commercial understandings which relates to the business of the transferor Company unless Transferor Company has obtained prior written consent of the Transferee Company.*
  - c) *All the profits or income accruing or arising to the Transferor Company or expenditure or losses arising or incurred (including the effect of taxes, if any, thereon) of the Transferor Company shall, after the Appointed Date for all purposes be treated and be deemed to be and accrued as the profits or income or expenditure or losses or taxes, as the case may be, of the Transferee Company.*
  - d) *Any of the rights, powers, authorities and privileges attached or related or pertaining to and exercised by or available to the Transferor Company shall be deemed to have been exercised by the Transferor Company for and **on behalf of and as agent for the Transferee Company**. Similarly, any of the obligations, duties and commitments attached, related or pertaining to the undertaking that have been undertaken or discharged by the Transferor Company shall be deemed to have been undertaken or discharged for and on behalf of and as agent of the Transferee Company.*
  - e) *All taxes (including income tax, sales tax, services tax, VAT, etc.) paid or payable by the Transferor Company in respect of the operations and/ or the profits of the business before the Appointed Date, shall be on account of the Transferor Company and, insofar it relates to the tax payment (including, without limitation, sales tax, service tax, VAT, etc.) whether by way of deduction at source, advance ta or otherwise howsoever, by the Transferor Company in respect of the profits or activities or operation of its business after the Appointed Date, the same shall be deemed to the corresponding item paid by the Transferee Company and shall, n all proceedings, be dealt with accordingly.*
- 7.2 *Without prejudice to the provisions of this Scheme, with effect from the Appointed Date, all inter-party transactions between Transferor Company and Transferee Company, if any, shall be considered as intra-party transactions for all purposes, from the Appointed Date. Any income tax (including tax deducted a source or dividend distribution tax) or service tax paid in relation to such transaction shall, to the extent permissible by applicable law, be claimed as a refund.*
- 7.3 *The Transferee Company shall be entitled, pending the sanction of the Scheme, to apply to the Central/ State Government and all other agencies, department and authorities concerned as are necessary and as may be required under any law or rules, for such consents, approvals, and sanctions, which the Transferee Company may require pursuant to this Scheme.”*

#### **“17. SCHEME CONDITIONAL UPON APPROVAL / SANCTIONS**

##### **17.1 This Scheme is conditional upon and subject to:**

- a. *Requisite approvals, clearances or permissions that may be required to be obtained under applicable law, or where applicable, the waiting periods or time periods for approval of the Reserve Bank of India, rules and regulations having expired or been terminated.*
- b. *The Scheme being approved by the requisite majorities in number and value of such classes of shareholders and / creditors of the Transferor Company and the Transferee Company as may be directed by the High Court.*
- c. *The Scheme being sanctioned by the High Court.*
- d. *The certified copy of the order(s) of the High Court sanctioning the Scheme being filed with the Registrar of Companies having jurisdiction by the Transferor Company and the Transferee Company.*
- e. *Any other approvals and sanctions from a Government Authority as may be required by law in respect of the Scheme being obtained.”*



**1. Did ZLL hurried into the merger? Or were they led to garden path?**

In opinion of SES, the Answer is clear **NO**.

1. ZLL was aware of sale by Promoters a day before Board meeting
2. SES Report questioning accounts was in public domain
3. ZLL had conducted due diligence, had valuation done
4. ZLL was aware of December 1<sup>st</sup> 2015 announcement of THEAL on debtors position
5. ZLL was aware that level of debtors in THEAL were almost three times as compared to ZLL, although both operated in the same business

There is no doubt that prior to announcement of the Scheme, ZLL would have conducted thorough due diligence with respect to the financial and non-financial matters of THEAL. This is adequately evident from the above Clause 7 of the Scheme of Arrangement. The aforesaid clause suggests that ZLL had conducted thorough due diligence on the operations of the THEAL before announcing Scheme. In other words, as per the Scheme, the “*Risks and Rewards*” of THEAL were transferred to ZLL on the date when the Scheme was approved by the respective Board of Directors, i.e., 23<sup>rd</sup> December, 2015.

**2. Can ZLL put the Scheme on hold? If yes, on what grounds? If not, why not?**

Now, that the financial results are not in line with the expectations of ZLL, ZLL announced that they will re-consider the share Exchange Ratio. The announcement raises the following questions:

1. Does ZLL has any right to re-evaluate on account of higher potential risk when THEAL’s operations, post 23<sup>rd</sup> Announcement and signing of Scheme, were deemed to be a part of ZLL as per Clause 7 of the Scheme?
2. The Scheme was subject to shareholders’ consent and relevant regulatory approvals (and not due diligence or re-evaluation), therefore, can ZLL backtrack on the basis of re-evaluation?
3. If the Scheme goes through with the current share exchange ratio, are the investors of ZLL hard done by?

SES is of the view that ZLL cannot go back on its decision to merge as para 17 of the Scheme does not envisage rethink by ZLL or THEAL. The entire Scheme is conditional upon two factors - Shareholder Approval and Regulatory approval, and it was after all the required exercise both the Companies had inked the Scheme of Amalgamation. There was no other condition precedent to be fulfilled.

The only reason advanced by ZLL for relooking at Scheme is Q4 and FY 2015-16 results. Relevant question is whether the financial results are surprising. The answer is yes for an unconnected investor who does not have access to THEAL Books of accounts, who is not operating similar business and who did not have all the information and opportunity to smell a rat right from beginning. However, if sale of 1/3<sup>rd</sup> equity by promoter a day before merger announcement does not ring bell, nothing would ever ring a bell. It was not the only red signal, but many more were staring at face. Why these were ignored, is a question the investors and the regulators must ask ZLL.

**DECISION TO ‘PUT ON HOLD’ VIEWED FROM EYES OF ZLL, THEAL AND REGULATOR**

**From ZLL shareholders perspective**, decision of ZLL Board to put on hold and revisit the Scheme is perfectly in order as far as logic goes, as it protects their interest and saves them from potential loss due to unfavourable exchnage ratio and merger with a company whose finncials are suspect.

**From THEAL shareholders perspective**, view is entirely opposite of ZLL view. The most surprising aspect is meek surrender of Board of THEAL to ZLL decision and effort to save the merger. Such an action or behaviour is unexpected from a party who has signed a legal document and has not violated any clause. Why such behaviour? The only excuse is that they somehow want to go ahead with the deal and bury the matter and avoid unpleasant situation, having already encashed their stake and pledged 100% of the balance, they have no



economic interest left. What they are avoiding is trouble of investigation if the deal fails. SES feels that it is their mistake. The entire deal needs to be investigated.

**From Regulators point of view:** The entire issue is of integrity of securities market & investor confidence and protection apart from issue of disclosures and compliances.

From 4<sup>th</sup> December 2015 onwards, specially after 23<sup>rd</sup> December 2015 all the trading in the market has been taking place based on merger and ratio approved by both Boards. Investors altered their position based on the same knowing only two possible risks- Scheme rejection by;

- i. shareholders or
- ii. by Regulators

No other risk was envisaged. Certainly not the risk of ZLL rethink. Connected with this are many other factors:

- Role of Auditors, who have been certifying accounts
- Role of Directors and ease of their disowning responsibility
- Exit by investors and their role including nominee directors
- Role of Investment Bankers presenting rosy pictures of business model which proved wrong
- And role of promoters and their tailored disclosures

## REMEDY FOR SHAREHOLDERS AND ZLL

### FOR SHAREHOLDERS

Investors have multiple remedy passive as well as active

- They can take up the issue with SEBI, NSE/BSE & MCA, complaining about this or can take up a more active approach by filing a class action suit with NCLT
- Take up the matter for action against CA firm, Directors and promoters.

In either case, it is the investors of ZLL or THEAL who will be at the receiving end. Such questions force us to examine the state of legal provision pertaining to the Scheme of arrangement in the country.

### FOR ZLL

If at all there is any remedy for ZLL, it lies under the agreements that ZLL would have signed with THEAL. If ZLL finds that THEAL had misled them or hidden facts, then remedy lies in ZLL suing THEAL management and promoters. Or simply putting the scheme before shareholders of ZLL and having it rejected by them.

## LEGAL PROVISIONS IN INDIA

The above unhappy situation forces SES to review the laws applicable. The provisions pertaining to Scheme of arrangement in India are governed by the following broad legislations;

- **Section 391-395 Companies Act, 1956.**

These provisions administer the manner in which a Scheme of compromise and arrangement between Companies are to be undertaken via High Court route (now NCLT). These provisions are applicable to all Companies irrespective of whether the same is a public, private, listed or unlisted Company. The aforesaid provisions are complete code governing Amalgamation, Takeover, Demerger and other forms of Corporate Restructuring. It involves holding meeting of the members or creditors (or any class of them) whose rights and obligations are proposed to be altered. For the approval of the said Scheme, consent of members or Creditors (or any class of them) by way of majority in number and 3/4<sup>th</sup> in value is required to be obtained in a meeting convened and held in the manner the High Court directs.

**The above provisions are silent, whether a Scheme of amalgamation once announced by the Boards of respective Companies can be recalled. A silent legislation is always interpreted against the interest of investors. This has led to the uncertain fate of investors of THEAL and ZLL.**



SES feels that proper timelines should be prescribed under the Companies Act for getting the Scheme approved by the members, once it is approved by the Board of Directors. Delay in obtaining shareholders' approval results in challenging situations for the investors, as witnessed in this case. However, at the same time legislation should also provide flexibility by authorising the Tribunal or High Court (as the case may be) to condone any delay, if any caused due to regulatory approvals. Timely implementation of Schemes would always result in a win-win situation for the Company and its members.

Further, in order to guard the integrity of the Securities Market, there is a need to incorporate a law that binds Companies to perform their obligations. As evident in this case, where the Board of ZLL is contemplating to re-evaluate the Scheme after announcing the same 6 months back. In such case, the confidence of the investor over the Company and Capital Market as a whole take a substantial hit.

SES strongly feels that if a provision binding the person to perform his obligation can be incorporated in SEBI (Substantial acquisition of shares and Takeover) Regulations, 2011, then why the same cannot be done under the Companies Act as well. After all, the principles enshrined under both the provisions are to safeguard the interest of the shareholders.

**The situation opens up various issues with regard to fortune of investors of Listed Companies under a Scheme of Arrangement. At present, no legislation stops the Board of Directors of Company to backtrack, after publicly announcing a Scheme of arrangement. The issue is sensitive in nature as such announcements are highly price sensitive in nature. SES feels that either MCA or SEBI should step in to plug this lacuna prevailing in the Corporate Legal system in India.**

## CONCLUSION

It is evident that the Board of ZLL announced the Scheme of arrangement with THEAL after considering all the relevant facts, probably including the concerns raised by SES regarding the financials of THEAL. ZLL was in all probability already aware regarding the financial position of THEAL as SES Report stating financial irregularities was already in public domain since September, 2015.

Investors of ZLL and THEAL who were holding shares on the date of announcement of the Scheme by the Board i.e., 23<sup>rd</sup> December, 2015 and those who traded in share thereafter, were aware that the Scheme can fail to materialise only on conditions mentioned under Clause 17 of the Scheme.

In short, the Scheme could have been turned down either by members or by any regulator. As per the terms of the Scheme, there is no other possibility. The shareholders never factored the 3<sup>rd</sup> possibility where the Board itself would take a U-turn from what it announced before.

Therefore, SES feels that reconsidering the terms of the Scheme after announcement is not in the interest of shareholders, especially that of THEAL. At the same time, moving ahead with the Scheme with the current valuation shall not be in the interest of the shareholders of ZLL, however, the option of reconsidering or terminating the Scheme is not available.

SES feels that the Board of ZLL was aware of questions on THEAL accounts as the SES report highlighting the same was already out in the public. Further, if ZLL now finds that the accounts of THEAL are not found to be reflecting a true and fair view of the Company's operations, then, ZLL should take legal course against the management, Promoters, Auditors of THEAL. And may be against those who did due diligence.

Further, the shareholders of THEAL should pursue its management to proceed with the Scheme as ZLL cannot unilaterally and for reasons other than those stated in the Scheme, put the Scheme on hold. Agreement of THEAL to agree to reconsider the Scheme as desired by ZLL clearly indicates that THEAL promoters are not at all adversely affected by proposed reconsideration.



**COMMUNICATION WITH ZLL**

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SES had sent a mail appended below to ZLL, for their comments on the Report. SES did not receive any response from ZLL in the time limit given.

Quote:

**From:** J N Gupta [mailto:jng@sesgovernance.com]  
**Sent:** 20 June 2016 12:50  
**To:** investor\_relations@zeelearn.com  
**Cc:** 'Devendra Bhandari' <devendra.bhandari@sesgovernance.com>; 'Ritika Gupta' <ritika.gupta@sesgovernance.com>; 'Piyush Gautam' <piyush.gautam@sesgovernance.com>; 'Gaurav Bansal' <gaurav.bansal@sesgovernance.com>; 'Varun Krishnan' <varun.krishnan@sesgovernance.com>; 'Aditi Chandani' <aditi.chandani@sesgovernance.com>  
**Subject:** ZLL-THEAL Merger

Ms. Hemangi Patil

This has reference to your press release dated 6<sup>th</sup> June 2016 to BSE on the captioned subject

As you may be aware SES is a “not for profit” company working in the field of corporate governance. SES, apart from other activities, carries out research on topical issues which have an impact on governance and shareholders’ rights

We are in the process of issuing a report on the captioned issue. Pl note that

- SES reports are based on authentic public data
- SES does not act on behalf of any issuer, investor or any entity
- SES is a not for profit, independent conflict free company

Although SES does not consult or share its report with any company prior to the issue, SES as a measure of abundant caution not to publish any incorrect statement keeping in mind your 6<sup>th</sup> June 2016 note, is sharing the report.

You are requested to please go through the report and advise

- If there are any factual errors
- Our view is our view, however we respect your view as well, therefore as a policy, if your view is different from our view please let us know. We shall place it appropriately in our report in verbatim unless it is offensive.
- Please note that we will correct only factual mistakes but not our opinion. We will also not take into account any nonpublic non official information

Please send your reply by close of business tomorrow 5.00 PM 21<sup>st</sup> June 2016.

Please note title can be changed by SES

Regards,

J N Gupta

Managing Director



**ANALYSTS: VARUN KRISHNAN | JN GUPTA****SEBI REGISTRATION NUMBER: INH000000016****SOURCES**

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- BSE & NSE Corporate Announcements
- THEAL & ZLL Company Website

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