All about Share Swap

Why in news?

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

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What is Share Swap?

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- A Share Swap is when a company pays for an acquisition by issuing its own shares to the shareholders of the target company.
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- The number of shares to be issued in lieu of their existing holdings in 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 to the market usually indicates healthy prospects and high potential, while a discount could indicate a distress sale.
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What is the significance of Share Swap?

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- As shareholders of the target company will also be shareholders of the merged entity, the risks and benefits of the expected synergy from the merger will be shared by both the parties.
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- And 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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- But in case of a share swap, there is no cash outgo involved for the acquirer, saving the acquirer borrowing costs.
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- Cash rich companies can put their cash to use for investments in the business or for other buyouts.
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- On the flip side, 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 i.e., (when the acquisition price is higher than the value of assets and liabilities of the acquired company) is created out of the merger.
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Why is it important for the stakeholder?

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- Stakeholders in companies that is part of such mergers or acquisitions should take a fresh look at the prospects of the stocks after the swap is announced.
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- Generally, these transactions take about a year to complete, needing the approval of creditors, stock exchanges, shareholders, Competition Commission and National Company Law Tribunal. The tax aspect also needs your attention.
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- In a share swap, the shareholders of the acquired company are given shares of the acquirer company as part of the deal, but 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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