"I do not maintain one-to-one contact with Mr. Parekh-I do not even remember meeting him other than may be at a social gathering. The bank has no means of knowing who buys or sells shares as the equity of the bank is in demat form. Through investigations we understand that the holdings of the companies which the media states belong to Mr. Parekh are less than 2% today. There is no special advantage offered by GTB to Mr. Parekh or his companies."

- Ramesh Gelli, chairman and managing director, Global Trust Bank, commenting on his alleged nexus with stock broker Ketan Parekh in an interview to Businessworld, April 23, 2001.

Introduction

On January 24, 2001, employees of the Hyderabad based Global Trust Bank (GTB) received an email from Ramesh Gelli (Gelli), Chairman and Managing Director (CMD), GTB. It read, "I am taking the opportunity of sharing some important and exciting news with you. We have now considered growing large through a process of merger. I am happy to inform you that we have now worked out a scheme of amalgamation with UTI Bank and Global Trust Bank. The merged bank will be called UTI-Global Bank with a registered office at Secunderabad. With this contemplated merger, UTI-Global would become the largest bank in private sector and would derive lot of synergy and complement each other strengths... UTI Global Bank is expected to effectively combine the strengths and complementary features of the two banks. It will be strongly capitalized with a net worth likely to exceed Rs. 10 billion by the end of March 2001... I am very confident that ..we all can look to the future with greater amount of confidence and grow to be a dominant player in the financial sector."

The boards of UTI Bank and GTB were to meet on January 27, 2001, to consider the scheme of amalgamation. SBI Capital Markets Limited (SBI Caps) would facilitate the merger, do the valuation, and also act as advisor to both the banks.

On January 27, 2001, the board of directors of GTB approved the amalgamation of GTB with UTI Bank. Soon after, the boards of UTI Bank and GTB approved the share-swap ratio. Said SBI Caps, "The boards agree to recommend to shareholders a swap ratio of nine shares of UTI Bank to four shares of Global Trust Bank" i.e., 2.25:1. Analysts felt that the swap ratio was in line with their expectations. Said one, "I had expected this as most of the financials of the bank pointed to the ratio being in favor of the GTB shareholder."

However, the proposed merger soon ran into problems. Before the merger was officially announced, the counters of UTI Bank and GTB at the Bombay Stock Exchange (BSE) witnessed huge volumes and a sizeable rise in prices. The sudden spurt in volumes raised eyebrows and sources watching the developments felt that this was an apparent case of informed buying and required a probe by the market regulator, Securities and Exchange Board of India (SEBI).

With the merger dogged by controversy, the promoters had to go for a second valuation of the share swap ratio by Delloite, Haskins and Sells. UTI Bank threatened to pull out of the proposed merger, over sharp differences on the issue of going for a fresh valuation. UTI Bank was of the view that the earlier valuation did not take into account the quality of GTB's assets and, more particularly, its capital market exposure.

However, GTB was unwilling to accede to UTI Bank's demand on the grounds that the share swap ratio, which was based on valuation by SBI Caps, had already been accepted by the boards and shareholders of both the banks. UTI Bank was however, firm in its demand. But, the GTB side was non-committal to the issue saying that the two sides should await the SEBI report on the alleged price rigging in the GTB scrip prior to the merger, before taking a decision.

In March 2001, Delliote, Haskins and Sells suggested a swap ratio 2:1, slightly lower than the 2.25:1 swap ratio proposed earlier by SBI Caps. On 23 March, UTI Bank submitted the second valuation report to the RBI.

Before taking a decision, the RBI waited for the SEBI report on the alleged price manipulation in the GTB scrip ahead of the merger. The allegation of price rigging in the GTB stock seemed to be true. A preliminary investigation by SEBI concluded that stock broker Ketan Parekh (Parekh), his associates, and two corporate groups were involved in ramping up the stock ahead of the merger. In Parekh/associates, GTB had one of the largest capital markets related loan exposures.

In early April, in a dramatic move, UTI decided to call off the merger. In a similar move, GTB announced their withdrawal from the merger following allegations that the share price of GTB was manipulated prior to the merger announcement. In a press release GTB said, "The bank would be uncomfortable to enter into a merger process with a finger pointed out for price prop and living with this memory will be onerous". In April 2001, a leading business daily wrote,2 "The merger was to create the biggest private sector bank in the country. The new entity would, it was hoped, be able to take on HDFC Bank and ICICI Bank. But UTI Global-which would have been the culmination of the UTI Bank and Global Trust Bank merger-remains a non-starter. But it was certainly an eventful non-event."

Background Note

On January 24, 2001, when the merger was announced, the GTB stock hit the two upper circuit limits of 8% each on the BSE, and was locked at Rs 93.95. The trading volume pattern of GTB and UTI Bank stocks also showed a marked rise on the BSE. Did someone trading on the BSE know more than the others in the market? The price movement of the GTB, UTI Bank stocks had shown an interesting pattern since the beginning of 2001, with considerable increase in volumes at their counters.

GTB and UTI Bank were attracting meager volumes till the first week of January. Trading volumes picked up, with average daily volumes on the GTB counter at BSE increasing from 20,000 shares to 1,57,000 shares on January 24. At NSE the trading volumes jumped fourfold, from 15,000 shares to close to 67,000 shares. The price of the stock also increased from Rs 81 to Rs 94. It was the same story in the case of UTI Bank shares. Trading volumes on the UTI counter at BSE rose from 34,000 shares to 2,58,000 shares on January 24 while at NSE the volumes shot up five times from an average of 45,000 to 2,70,00. The stock price marginally increased from Rs 45.75 to Rs 49.85. GTB was alleged to have rigged its own shares before the merger for negotiating a better swap ratio of 2.25 shares of UTI Bank for each GTB share. The matter was investigated by SEBI.

Questioning the Swap Ratio

Since the GTB scrip was suspected to have been manipulated prior to the deal, several questions had assumed importance. Some of the issues raised were: Was the merger scheme of GTB and UTI Bank-at 2.25 shares of UTI Bank for every one share of GTB worked out after conducting a 'fair valuation' of these banks? Was it really a 'fair swap ratio' for the merger? What weightage was given to the market prices of UTI Bank and GTB scrip's for the purpose of arriving at the 2.25:1 swap ratio?

A study of certain key components of the Valuation Report prepared by SBI Caps revealed that SBI Caps used four methods to determine the value of the banks-maintainable profits method, book value method, price earnings multiple method and market price method. The swap ratio varied from 1.86:1 to 2.31:1 based on these four different methods, and the average swap ratio was 2.14:1. These ratios were also examined in conjunction with certain qualitative factors of GTB and UTI Bank so as to arrive at a swap ratio that was "fair to the shareholders of both banks".

Under the maintainable profits method, the average maintainable rate of return on net worth was ascertained. This was worked out by dividing the average profit for the last three years by the average net worth. The weighted average rate of return was computed by providing weightages to each of the three years' profit and net worth, wherein a higher weightage was given to the more recent accounting years.

The cost of equity was computed on the basis of the capital asset pricing model (CAPM). In terms of this, the cost of equity for GTB was placed at 17.56%, while that of UTI Bank was placed at 15.16%. These values were divided by the number of equity shares of the respective banks for arriving at the yield value per share. The maintainable profit method placed the yield value per share of GTB at Rs 72.10 and of UTI Bank at Rs 33.24, and the ratio arrived at was 2.17:1.

An SBI Caps official said, "The availability of adequate capital was not just essential to provide a cushion against the losses but also to ensure that future growth in assets was not restricted to the background of the regulatory norms on capital adequacy ratio. The book value method captures the real strength of a bank's capital."

Under this method, the book value was calculated by dividing the net worth4 of each bank by the number of equity shares. Based on the annualized financial results for the period ended December 2000, the book value of GTB stood at Rs 52.16 and of UTI Bank at Rs 22.58, thereby placing the ratio at 2.31:1. The price earnings multiple method was used to derive the P/E ratios. Using this method weighted average over the previous three years was considered, with higher weightage given to the recent earnings. The value of GTB based on the sector P/E stood at Rs 51.40, while that of UTI Bank stood at Rs 23.10, taking the ratio to 2.22:1.

The market price of the merging entities was taken into consideration in the last method of valuation-the market price method. For this, the average market prices of GTB and UTI Bank scrip's were considered with January 19, 2001 as the cut-off date. Under this method, the average market price of GTB stood at Rs 75.48 and of UTI Bank at Rs 40.62, indicating a ratio of 1.86:1- the lowest ratio among the four methods. An SBI Caps official said, "After completing the exercise using the four methods and taking into account the qualitative factors, SBI Caps has recommended a fair swap ratio of between 2 and 2.5 shares of UTI Bank for every share of GTB. Subsequent to the negotiations between the promoters of these two banks, the swap ratio of 2.25:1 was finalized".

The Second Valuation

In March 2001, P S Subramanyam, chairman, Unit Trust of India (UTI), (the chief promoter of UTI Bank) said UTI was willing to appoint another valuer to examine the share swap ratio of the proposed merger if the Reserve Bank of India wanted a fresh valuation. He said, "SBI Caps has looked into all relevant issues and the swap ratio was arrived at following four parameters. Even then if the regulator wants us to seek an independent opinion on this, we are willing to do so". The RBI was believed to have asked UTI Bank to go in for a fresh valuation. The RBI decided to consider every possible aspect before clearing the proposal including the issues of alleged market rigging and insider trading. It sought fresh valuation keeping in mind the sudden spurt in the prices and volumes of GTB shares prior to the merger announcement.

In March, UTI Bank went for revaluation of the share swap ratio. UTI Bank appointed the Mumbai-based consultancy firm, Deloitte Haskins & Sells, to suggest a share exchange ratio. GTB said it was likely to reconsider merger with UTI Bank if the new valuation report of Deloitte, Haskins & Sells suggested a share swap ratio lower than 2.25:1 decided earlier. UTI Bank had earlier threatened to pull out of the proposed merger over sharp differences on the issue of going in for a fresh valuation, to review the share swap ratio decided for the merger. However, GTB was unwilling to accede to UTI Bank's demand on the grounds that the share swap ratio, which was based on valuation by SBI Caps, had already been accepted by the boards and shareholders of both the banks.

UTI Bank gave a free hand to Deloitte, Haskins & Sells to decide on the methodology for arriving at the ratio. A UTI Bank official said, "It checked every account, looked into every asset and adopted a multi-dimensional approach to give a fair valuation report. The emphasis was on qualitative aspects and not only on the numbers alone." Since the new valuer was asked to keep the October-November 2000, GTB scrip movement out of the calculations, the market price valuation came down slightly. In late March 2001, Deloitte, Haskins and Sells submitted a copy of its valuation report to UTI Bank, which in turn submitted the same to the RBI. Deloitte, Haskins and Sells suggested a swap ratio of 2:15, which was slightly lower than 2.25:1 proposed earlier by SBI Caps. Before taking any decision, RBI waited for the SEBI report on the alleged price manipulation in the GTB scrip.

The report was due before March 31, 2001. A delay in the merger appeared inevitable. Said a top UTI source, "The RBI has conveyed to us that no decision on approving the merger would be possible before six to eight months". The UTI source further added, "The RBI has said that it will take a decision on the merger based on SEBI's funding on price manipulation. The SEBI report may lead to parties involved in insider trading ahead of the merger being penalized". GTB did not make any noises about the second valuation and wanted for the RBI to take a decision. The bank was weighing its options on the merger based on SEBI's report and RBI's response to the second valuation. But at the same time GTB resisted moves to significantly alter the share swap ratio suggested by SBI Caps. The share swap ratio was likely to remain unchanged at 2.25:1 even though Deloitte, Haskins and Sells had recommended a marginal reduction in the ratio in favor of UTI Bank. According to a source, "We have decided to keep the ratio unchanged despite the new valuation report which says that there is marginal erosion in the adjusted book value."

The SEBI Probe

Amidst all these developments, SEBI was probing the role of Parekh in the unusual price spurt in GTB stock prior to its merger announcement with UTI Bank. SEBI found that Parekh was one of the most active traders in the stock and had substantial purchases in the scrip during October to December 2000. Parekh also sold actively. SEBI sought client details from five entities, which were directly linked, to Parekh and scrutinized client details of some other brokerage houses to identify whether there was any concerted attempt to push up the share price. SEBI found that there was a prima facie case of manipulation owing to the nature of the spurt in the scrip price. In March 2001, in a report to the RBI, SEBI said there was evidence of price manipulation by GTB, and termed the price movement as "unusual" Commented a senior SEBI official, "There is also an element of insider trading pre-merger announcement when GTB share price touched Rs 114".

Parekh, it was alleged was granted a credit limit of over Rs. 400 crore. Parekh denied this and put his exposure with GTB at less than Rs. 100 crore. Meanwhile, in Hyderabad, Gelli was tight lipped over Parekh's hand in propping up the shares in a bid to wrangle a better swap ratio ahead of the merger announcement.

However, sources said that GTB's total exposure to Parekh and his associate companies could be as much as Rs. 250-300 crore at one time, which was clearly above the prudential limit of 20% of net worth set by the RBI. In several meetings with Businessworld, Gelli admitted that GTB had given loans to over 200 brokers (including Parekh) in 2000. Gelli said that GTB had lent at least Rs. 118 crore to Parekh. SEBI conducted an investigation to find out if Gelli used his influence with the brokers to rig the bank's scrip price to get a favourable swap ratio for the proposed merger.

Parekh and his companies purchased huge chunks of GTB stock in the period November-December 2000, prior to the merger. In March 2001, Gelli for the first time admitted that Parekh held close to 4% stake in GTB with another 2% held in benami transactions. GTB however denied the insider trading allegations. It said that none of the promoters purchased or sold GTB shares in the past one year. SEBI planned to complete its investigations and hand over the reports to the RBI as soon as possible; but it did not set any deadlines for completing the work. Meanwhile, the RBI refused to comments on the entire merger issue. An RBI official said, "We are awaiting the SEBI report."

The Merger is called off

In mid March 2001, it became clear that the proposed merger of UTI Bank with GTB might not come through, as the SEBI preliminary investigation report found manipulation and rigging in the share price of GTB prior to the merger announcement. L. K. Singhvi, senior executive director, SEBI, said, "The investigation, prima facie, indicates that there was manipulation in GTB shares during October-December 2000. Since the merger proposal was pending with the Reserve Bank of India, we have sent our report to the RBI." "he final report will be submitted shortly", he added.

Another SEBI official hinted that the investigation revealed that the manipulation in the GTB scrip "was motivated and done with the help of the bank's senior management team". SEBI's findings had not only questioned the merger proposal but also opened a Pandora's box that may put the management in a major jam. Sources added that the final investigation was also looking at the shareholding pattern of GTB and the major beneficiaries from the swap ratio.

In April first week, the GTB board decided against the proposed merger because of the ongoing controversy. A board meeting was convened and GTB decided to opt out of the merger on the grounds that it would be uncomfortable working with UTI Bank in the light of allegations of price manipulation.

Commenting on this development, BusinessWorld6 wrote, "That was a clever move as it prompted the RBI to call off its investigations in the matter. It might also take the wind out of some of the inquiries being conducted by the Sebi against GTB and Gelli on charges of insider trading and rigging of GTB's scrip price." However, Sebi said that it would continue to probe the charges against Gelli, GTB and Parekh. The entire episode was summed up by a leading business daily7, "The UTI could not have been unaware of the sharp spurt in GTB stock. Perhaps, the prospect of becoming the largest player prompted it to go for the merger. But once the possibility of price manipulation came to the fore, the merger was sure to be called off--either by the banks themselves or by the RBI. GTB had tried to make the best of what was becoming a messy situation. There were indications from the Finance Ministry that the merger was low on the priority list. But it did clear Gelli as chairman for three more years. Perhaps, there was a subtle understanding that the bank would back off on its own".

PS: In mid April 2001, as a damage control exercise, Gelli stepped down as the CMD of GTB.

Questions for Discussion

1. Through the merger, UTI-GTB was expected to derive a lot of synergy and complement each other's strengths. Comment.

2. Compare and contrast the methodology adopted by SBI Caps and Deloitte, Haskins and Sells to arrive at a swap ratio for the UTIB-GTB merger.

3. It was alleged that there was a nexus between Gelli and Parekh to rig the GTB scrip prices to get a favorable swap ratio for the proposed merger. Do you believe there was such a nexus? Justify your stand.

4. Mergers and acquisitions are not new to the banking industry. It all started with the HDFC-Times Bank merger followed by ICICI Bank-Bank of Madura. Some other banks planning a merger are the IndusInd Bank, Centurion Bank and the Bank of Punjab. Keeping in view the failure of the UTIB-GTB merger, outline the steps to be taken by these banks for a successful merger.

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[1] Source : http://www.icmrindia.org