Nishith Desai Associates
LEGAL AND TAX COUNSELING WORLDWIDE

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Thomas Cook – Sterling Holiday Buyout

December 2014

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Please see the last page of this paper for the most recent research papers by our experts.

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1. Glossary of Terms

Acquirer / TCISIL	Thomas Cook Insurance Services (India) Limited
BSE	Bombay Stock Exchange
Companies Act	Companies Act, 1956
Competition Act	Competition Act, 2002
Contract Act	Indian Contract Act, 1872
Deal	The acquisition of Minimum Shares, and if applicable, the Top-up Shares pursuant to the SPA, the subscription to the Subscription Shares by the Acquirer pursuant to the SSA, the purchase of Equity Shares of Sterling from the Public Shareholders pursuant to the Open Offer, the Open Market Purchases, the Merger and the Demerger
Emerging Share Capital	The share capital of Sterling assuming allotment of Subscription Shares and 1,023,258 Equity Shares upon exercise of employee stock options / purchase schemes and calculated as per the Takeover Code
Equity Shares	The equity shares of Sterling of face value INR 10/-
Fairbridge Capital	Fairbridge Capital (Mauritius) Limited
Fairfax	Fairfax Financial Holdings Limited, Canada
ICDR	Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009
INR	Indian Rupees
ITA	Income Tax Act, 1961
Minimum Shares	11,592,846 Equity Shares amounting to 12.83% of the Emerging Share Capital agreed to be sold under the SPA
Offer Price	The price offered by TCISIL for any shares tendered during the Open Offer
Open Market Purchases	Purchases of Equity Shares made by TCIL on the open market, not contemplated under the SPA
Open Offer	The mandatory open offer under the Takeover Code made by TCISIL, TCIL and PAC 2 via offer letter dated May 23, 2014
PAC	Persons Acting in Concert
PAC 1	Thomas Cook (India) Limited
PAC 2	Travel Corporation (India) Limited
Public Announcement	Public announcement made by TCISIL along with TCIL to the public shareholders of Sterling on February 7, 2014 to acquire up to 23,486,264 fully paid up equity shares amounting to 26% of the Emerging Share Capital
Purchase Price	The agreed sale price of the Purchase Shares sold under the SPA
Purchase Shares	The aggregate of the Minimum Shares and the Top-up Shares
Scheme	The composite scheme of arrangement and amalgamation between Sterling, TCIL, and TCISIL under Section 391 of the Companies Act, proposed to be filed before the Bombay High Court and Madras High Court.
Sellers	Persons and entities other than TCIL, TCISIL, Travel Corporation and Sterling who were party to the SPA including: Mr. Sidharth Shankar, Mrs. Dhanlakshmi S., Mr. Rakesh Jhunjhunwala, Bay Capital Investments Ltd., Bay Capital Investment Managers Pvt. Ltd., and India Discovery Fund Limited
SPA	The share purchase agreement dated February 7, 2014 entered into between the Sellers, TCISIL and TCIL.
SSA	The share subscription agreement entered into between TCIL, TCSIL and Sterling
Sterling	Sterling Holiday Resorts (India) Limited
STT	Securities Transaction Tax
Subscription Shares	20,650,000 Equity Shares, representing 22.86% of the Emerging Share Capital
Takeover Code	Securities Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011
TCIL	Thomas Cook (India) Limited

Top-up Shares	The number of equity shares that is the lower of: (i) 6,414,831 Equity Shares held by the relevant Sellers; or (ii) such number of Equity Shares that together with the Equity Shares held by the Acquirer and PACs (including the Subscription Shares, Equity Shares acquired pursuant to Open Offer and the Minimum Shares), would cause the aggregate shareholding of the Acquirer and PACs in the Company to be equal to 74.9% of the Emerging Share Capital on the date of completion of the SPA.
USD	United States dollar

2. Prologue

"A vacation used to be a luxury, but in today's world it has become a necessity" – Anonymous.

With the boom in the working upper-middle class and the rise in accessibility to travel and leisure, exotic vacationing has become the trademark of this generation. India's wide ranging topography and climate, provides a variety of experiential options to the average traveller. This rise in demand has resulted in a steep growth in the setting up of resorts and hotels across the country. Sterling Holiday Resorts Limited ("**Sterling**") first pioneered the ability to plan and invest towards future vacations in the late eighties and has since seen a bumpy ride, following market changes, in providing people with the trip they need. In early 2014[1],Thomas Cook (India) Ltd ("**TCIL**"), announced the acquisition of Sterling to take its portfolio beyond travel planning and insurance in to the domain of vacation ownership.

The part-cash, part-equity acquisition ("**Deal**") was structured in a complex manner. Naturally, the acquisition made headlines, owing to the brands involved, the possibility of a change in the dynamics in the holiday sector in India and the particular structure of the transaction.

The Deal brings together TCIL, a travel and travel finance business, and Sterling, India's pioneer in vacation ownership and leading hotel and resort company. Through this deal, TCIL also purchases over 20 hotels, resorts and other properties owned by Sterling across India, Sri Lanka and Mauritius. This acquisition comes close on the heels of TCIL's acquisition of IKYA Human Capital Solutions in 2013. The Deal and its structure is also a step towards defining TCIL as the Indian investment vehicle of Prem Watsa's Fairfax, TCIL's Canadian promoter.

While, the public announcement made on February 7, 2014 gave the impression of a strait-jacket corporate merger between two bigwigs in their respective domains, in reality, it was a much more complex transaction. The transaction contemplated a merger of Sterling with TCIL but the merger was preceded by a series of inter-linked corporate actions intended to extract best results out of the proposed merger. It was a step by step integration of the business operations of Sterling into the Thomas Cook group. With a cash-out for Sterling's promoter and large shareholders by way of a secondary purchase of shares, primary infusion of capital into Sterling, mandatory open offer and then a composite scheme of demerger and merger, every trick in the book seems to have been used for getting the Deal done.

The Deal draws attention on many counts but what will be of most interest would be to take a deeper look into the complex structure of the Deal and see where it leads us.

In this lab we make an attempt to examine the transaction structure and the implications thereof. As always, we analyse the Deal from commercial, legal, regulatory and tax perspective.

1. http://www.thomascook.in/tcportal/downloads/PressReleaseTCILannouncesmergerwithSterlingHolidayFebruary_2014.pdf

3. Details of the Deal

I. The Parties

A. TCIL

TCIL is a public listed company incorporated in India. TCIL commenced its India operations in Mumbai in 1881 as a branch of Thomas Cook and Sons, dealing in travel and travel finance related business. The company was incorporated as a company in 1978, under its current name, and was later listed in 1983. In 2012, Thomas Cook Group plc, UK (the erstwhile parent) sold its majority shareholding in Thomas Cook (India) Limited (“**TCIL**”) to Fairbridge Capital (Mauritius) Limited (“**Fairbridge Capital**”) a 100% subsidiary of Fairfax Financial Holdings Limited, Canada (“**Fairfax**”).[2]

TCIL is the leading service provider of travel and travel related financial services in India offering services that include Foreign Exchange, corporate travel, MICE, leisure travel, insurance, and visa and passport services.[3]

TCIL’s footprint currently extends to over 235 locations (including 15 airport counters) in 99 cities across India, Mauritius, and Sri Lanka. It is supported by a strong partner network of 114 Gold Circle Partners and 165 Preferred Sales Agents in over 136 cities across India.

B. TCISIL

TCISIL is a public unlisted wholly owned subsidiary of TCIL, incorporated in 1989. TCISIL largely handles TCIL’s insurance business and is also a corporate agent of Bajaj Allianz General Insurance Company Limited.

C. Travel Corporation

Travel Corporation (India) Limited is also a public unlisted wholly owned subsidiary of TCIL, incorporated in 1961. Its businesses are inbound tourism and corporate travel management.

D. Sterling

Sterling is a public listed company initially promoted by Mr. R. Subramanian. It was established in Chennai in 1986 as a private limited company. Over the years, Sterling pioneered the Vacation Ownership sector in India. It became a public company in 1989 and is currently listed on the Bombay Stock Exchange and the Madras Stock Exchange. It is a leading Timeshare/Vacation Ownership and leisure hospitality company in India. Currently, Sterling has a total inventory of 1512 rooms spread across 21 resorts in 18 scenic holiday destinations in India. The company also has 15 additional sites that are currently undeveloped.[4] Tough market conditions and stiff competition forced the company in to debt and losses in and around 2008. This brought the entry of Bay Capital, an institutional investor, who since acquiring a majority stake in 2009 has promoted Sterling. Though this round of funding clubbed with the return of CEO Ramesh Ramanathan saw a turn-around for the company, it is still today running losses and carries over INR 250 Million (USD 4.17 Million) in debt.[5]

At the time of announcement of the Deal, Sterling had various individual and institutional investors such as Bay Capital, Mr. Rakesh Jhunjhunwala, Mrs. Dhanlakshmi S. and Mr. Radhakrishna Damani who held substantial stake in it.

II. Chronology of Events

February 7, 2014	▪ TCIL and TCISIL executed the SSA with Sterling for the allotment and subscription of Equity Shares amounting to 22.86% of the Emerging Share Capital. ▪ TCIL, TCISIL, and the Sellers execute the SPA for the purchase of up to 19.94% of the Emerging Share Capital. ▪ The board of directors of TCIL, TCISIL, and Sterling approved the Scheme

2. http://www.thomascook.in/pages/indus/tcportal/aboutus.html
3. *Ibid*
4. http://www.sterlingholidays.com/about/overview
5. http://www.thehindu.com/todays-paper/tp-business/sterling-holidays-debt-recast-plan/article3174806.ece

	▪ Public Announcement of the Open Offer (under the Takeover Code);
February 10, 2014	The Parties issued a detailed public statement.
February 10 - 21, 2014	TCISIL acquired a cumulative of 10.41% of the Emerging Share Capital through multiple purchases on the open market.
February 14, 2014	▪ Travel Corporation acquired 1.66% of the Emerging Share Capital of Sterling through purchases on the open market. ▪ The Parties provided CCI with notice of the Merger / Demerger as a proposed combination agreement, for its approval.
February 24, 2014	Offer Letter (under the Takeover Code) filed with SEBI.
March 5, 2014	CCI granted approval for the Deal.
March 14, 2014	Sterling allotted Equity Shares constituting 22.86% of the Emerging Share Capital to TCISIL pursuant to the SSA.
April 29, 2014	TCISIL acquired 6.80% of the Emerging Share Capital from some of the Sellers pursuant to the SPA via a block trade on BSE.
May 21, 2014	CCI imposed a penalty of INR 100 Million on TCIL and TCISIL for the open market purchases carried out between the 10^{th} and 12^{th} of February, 2014.
May 30, 2014	TCISIL along with TCIL and Travel Corporation (as Persons Acting in Concert) made a mandatory Open Offer under the Takeover Code to acquire 26% of the Emerging Share Capital.
June 12, 2014	Open Offer concluded. TCISIL acquired only 0.01% of the Emerging Share Capital.[6]
July 31, 2014	TCIL, TCISIL and Sterling filed the Scheme before the Bombay High Court and Madras High Court for approval.
September 03, 2014	TCISIL acquired 13.14% of the Emerging Share Capital pursuant to the SPA through an off-market transfer.

III. Deal Snapshot

Target	Sterling Holiday Resorts (India) Limited
Acquirer	Thomas Cook Insurance Services (India) Limited
PAC 1	Thomas Cook (India) Limited
PAC 2	Travel Corporation (India) Limited
Modes of acquisition proposed	*i.* *Share Subscription* TCIL, TCISIL and Sterling entered into the SSA, wherein it was agreed between the parties that TCISIL shall subscribe to the 22.86% of the Emerging Share Capital of Sterling. *ii.* *Share Purchase* TCIL, TCISIL and the Sellers entered into the SPA, under which it was agreed that TCISIL shall purchase a minimum of 11,592,846 shares (12.83%) ("**Minimum Shares**"), and subsequently up to a total of 18,007,677 shares (ie. 19.94% of Emerging Share Capital), held by the Sellers. *iii.* *Market Purchase* TCISIL acquired a cumulative of 9,401,191 Equity Shares, representing 10.41% of the Emerging Share Capital by way of multiple purchases on the open market. PAC 2 acquired 1,500,000 Equity Shares, representing 1.66% of the Emerging Share Capital.

6.. Post offer advertisement issued by manager to the offer, on behalf of TCIL, TCISIL and Travel Corporation, under Regulation 18(12) of the Takeover Code.

	iv. *Open Offer* TCISIL along with TCIL and PAC 2, as persons made a mandatory Open Offer to acquire 26% of the Emerging Share Capital.
Total contemplated acquisition	68.80% of the Emerging Share Capital of Sterling (assuming full acceptance in the Open Offer). The break-up of the total contemplated acquisition is as follows: i. 22.86% under the SSA; ii. 19.94% under the SPA; and iii. 26% - under the Open Offer.
Total actual acquisition	TCISIL, TCIL, and PAC 2 acquired and subscribed to a total of 48,885,743 shares representing 54.88% of the Emerging Share Capital of Sterling. The details of the acquisition are as follows: i. *Share Subscription* TCISIL subscribed to Subscription Shares i.e. 20,650,000 Equity Shares, representing 22.86% of the Emerging Share Capital of Sterling. ii. *Share Purchase* TCIL and TCISIL purchased, from the Sellers, a total of 18,007,677 Equity Shares, representing 19.94% of the Emerging Share Capital of Sterling in two tranches of 6,144,343 and 11,863,334 Equity Shares respectively. iii. *Open Offer* TCISIL Acquired 10,209 Equity Shares, representing 0.01% of the Emerging Share Capital of Sterling. iv. *Open Market Purchase* TCISIL acquired a cumulative of 9,401,191 Equity Shares, representing 10.41% of the Emerging Share Capital of Sterling by way of multiple market purchases. PAC-2 acquired 1,500,000 Equity Shares, representing 1.66% of the Emerging Share Capital.
Scheme of arrangement and amalgamation	The Scheme was approved by the board of TCIL, TCISIL and Sterling under which the timeshare and resort business of Sterling will be demerged and will be transferred to TCISIL, and Sterling along with its remaining business will be merged with TCIL. Thereafter, TCISIL will be renamed as Sterling Holiday Resorts (India) Limited.
Consideration	The total consideration for the Deal is valued at INR 8.70 Billion (USD 145 Million) which was paid partly in cash and partly by way of a share swap under the Scheme. The following are the details of the cash consideration part of the Deal: *i.* *Share Subscription* INR 1,868,618,500 (Rupees One Billion, Eight Hundred and Sixty Eight Million, Six Hundred and Eighteen Hundred Thousand, Five Hundred) (USD 31.14 Million). *ii.* *Share Purchase* INR 1,764,752,346 (Rupees One Billion, Seven Hundred and Sixty Four Million, Seven Hundred and Fifty Two Hundred Thousand, Three Hundred Forty Six) (USD 29.41 Million). *iii.* *Open Offer* INR 1,000,482 (Rupees One Million, Four Hundred and Eighty Two) (USD 16,675). *iv.* *Open Market Purchases* ▪ INR 915,834,143 (Rupees Nine Hundred Fifteen Million, Eight Hundred Thirty Four Thousand, One Hundred and Forty Three)[6] (USD 15.36 Million); and ▪ INR 147,000,000 (Rupees One Hundred Forty Seven Million) (USD 2.45 Milllion)

Following was the equity consideration given under the Scheme:

i. *Demerger*

The entire business division and undertaking of Sterling engaged in time share and resort business shall be transferred by way of demerger from Sterling to TCISIL, in lieu whereof 116 equity shares of TCIL will be issued to the shareholders of Sterling for every 100 equity shares held by such shareholders of Sterling ("**Demerger**").

ii. *Merger*

Sterling with its remaining business shall be amalgamated into TCIL in lieu whereof 4 equity shares of TCIL will be issued to the shareholders of Sterling for every 100 equity shares held by such shareholders in Sterling ("**Merger**").

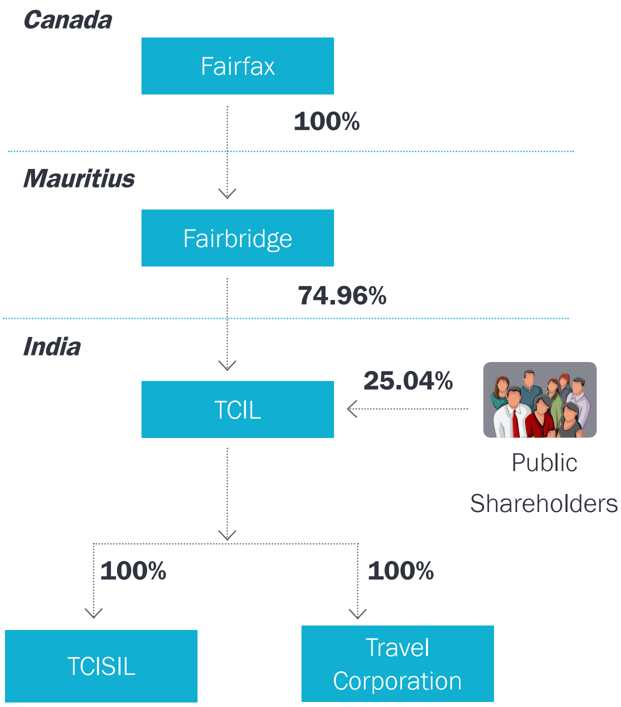
IV. Structure of the Deal

A. Funding the transaction

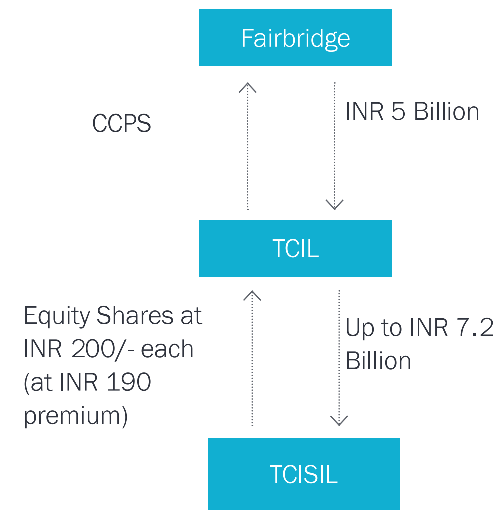
The total Deal was valued at approximately INR 8.70 Billion[7] (USD 145 Million), involving a cash consideration of up to INR 5.93 Billion (i.e. aggregate of INR 1.88 Billion under SSA, INR 1.76 Billion under SPA and INR 2.3 Billion for Open Offer) (USD 98.83 Million) and a share swap for the remaining amount under the Scheme. TCIL was funded by its immediate promoter, Fairbridge Capital, through the subscription to Compulsorily Convertible Preference Shares ("**CCPS**") worth INR 5 Billion (USD 83.33 Million). The remaining amount required was funded through internal accruals.[8]

Further, funds of up to INR 7.2 Billion (USD 120 Million) were pushed down to TCISIL by subscription to 3,60,00,000 equity shares, each of face value INR 10/- of TCISIL by TCIL at INR 200/- per share (ie. at a premium of INR 190/-).[9]

STRUCTURE



FUNDING



7. http://www.thehindu.com/business/Industry/cci-imposes-fine-on-thomas-cook-sterling-holidays/article6158129.ece
8. http://icra.in/Files/Reports/Rationale/Thomas%20Cook_1_11042014.pdf
9. http://www.thomascook.in/tcportal/downloads/ThomasCookIndiaLimitedAnnualReport2013includingnotice.pdf

B. Deal Structure

The Deal was structured in a multi-layered manner involving the following steps:

i. SPA

On February 7, 2014, TCIL, TCISIL entered into the SPA with the Sellers to purchase a minimum of 11,592,846 Equity Shares (“**Minimum Shares**”), amounting to 12.83% of the Emerging Share Capital, at the rate of INR 98/- per share (“**Purchase Price**”). The SPA also gave the Acquirer the right to purchase another 6,414,831 Equity Shares, amounting to 6.80% of the Emerging Share Capital (“**Top-up Shares**”) at the Purchase Price. Under the SPA, the Acquirer had the option to purchase the Top-up Shares or such lesser amount of shares, as required to bring the shareholding of the Acquirer to 74.9% of the Emerging Share Capital on the date of completion post the completion of Open Offer and acquisition under the SSA and SPA.

Thus under the SPA, TCIL and TCISIL had the right to purchase up to 19.94% of the Emerging Share Capital.

TCISIL purchased 6,414,831 equity shares, amounting to 6.80% of the Emerging Share Capital on April 29, 2014 through a block deal on BSE.[10] It further purchased 11,863,334 Equity Shares, amounting to 13.14% of the Emerging Share Capital on September 03, 2014 through an off-market purchase.[11]

Some of the key terms of the SPA were:

i. Inter alia the following pre-conditions must have been met for completion under the SPA:
   a. Attaining required regulatory approvals; and
   b. The requisite shareholder majority and requisite creditor majority of Sterling having approved the Scheme.
ii. Creation of an escrow mechanism for the Purchase Shares and the consideration for the Purchase Shares;
iii. If the Offer Price was increased, the Purchase price would also be increased to the same extent;
iv. The Sellers have undertaken a non-solicitation obligation for a period of two years from the date of completion in relation to officers, directors, and employees of Sterling, and clients, customers, and distributors of Sterling; and
v. The rights of the Sellers to nominate three persons to be appointed as ‘independent directors’ by the Board shall fall away and cease to have effect upon completion of the SPA.

ii. SSA

On February 7, 2014, TCIL, TCISIL and Sterling entered into the SSA wherein it was agreed that TCISIL shall subscribe to 20,650,000 Equity Shares which would amount to 22.86% of the Emerging Share Capital. On March 14, 2014, Sterling allotted the 20,650,000 Equity Shares under the SSA.

Some of the key pre-conditions to the allotment under the SSA were:

i. the warranties of Sterling being true and correct;
ii. Sterling not having breached its covenants under the SSA;
iii. receipt of ‘in-principle’ approval from the stock exchanges where the equity shares of Sterling are listed with respect to listing and trading of the subscription;
iv. approval of the CCI;
v. approval of the shareholders of Sterling for the issue and allotment of the shares;
vi. receipt of a certificate from the statutory auditors of Sterling pursuant to the provisions of Chapter VII of the ICDR Regulations; and
vii. receipt of consent from certain current lenders of Sterling.

iii. Open Offer

TCIL’s purchase and subscription to Equity Shares of Sterling triggered the requirement to make a mandatory open offer under the Takeover Code.[12] Accordingly, TCISIL along with TCIL and PAC-2 made an open offer to purchase up to 26% of the Emerging Share Capital (23,486,264 Equity Shares) at the rate of INR 98 per share (“**Open Offer**”).

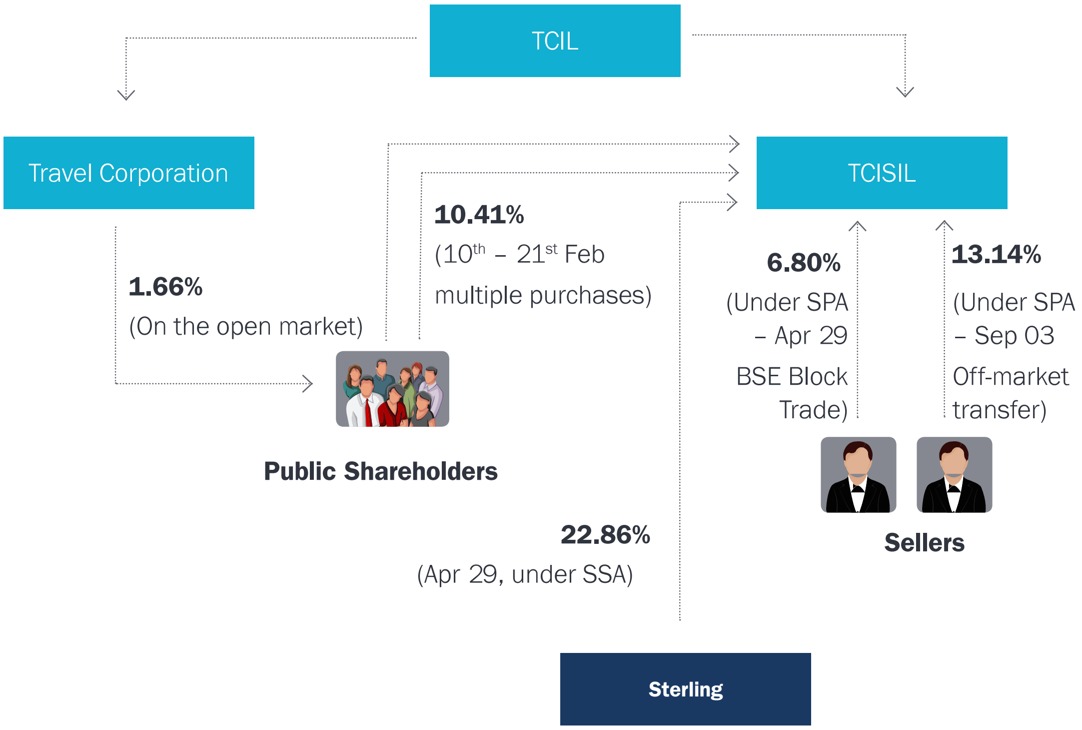
However, TCISIL was able to acquire only 10,209 Equity Shares amounting to 0.01% of the Emerging Share Capital.

10. Letter of offer dated May 27, 2014.
11. http://www.bseindia.com/stock-share-price/stockreach_sast.aspx?scripcode=523363&expandable=2
12. For more information regarding this, refer section on Legal and Regulatory Considerations below.

iv. Market Purchases

TCISIL and TCIL did not acquire any shares of Sterling prior to the date of Public Announcement. However, TCISIL acquired Equity Shares of Sterling multiple times through purchases on the open market (**"Open Market Purchases"**) between February 10, 2014 and February 21, 2014, aggregating to 9,401,191 Equity Shares or 10.41% of Emerging Share Capital.

Further, PAC 2 acquired 1,500,000 Equity Shares of Sterling or 1.66% of the Emerging Share Capital, through an off-market purchase on February 14, 2014.



v. Scheme

On February 7, 2014, the board of directors of all the three companies, i.e. Sterling, TCIL and TCISIL approved the Scheme pursuant to which it was agreed that:

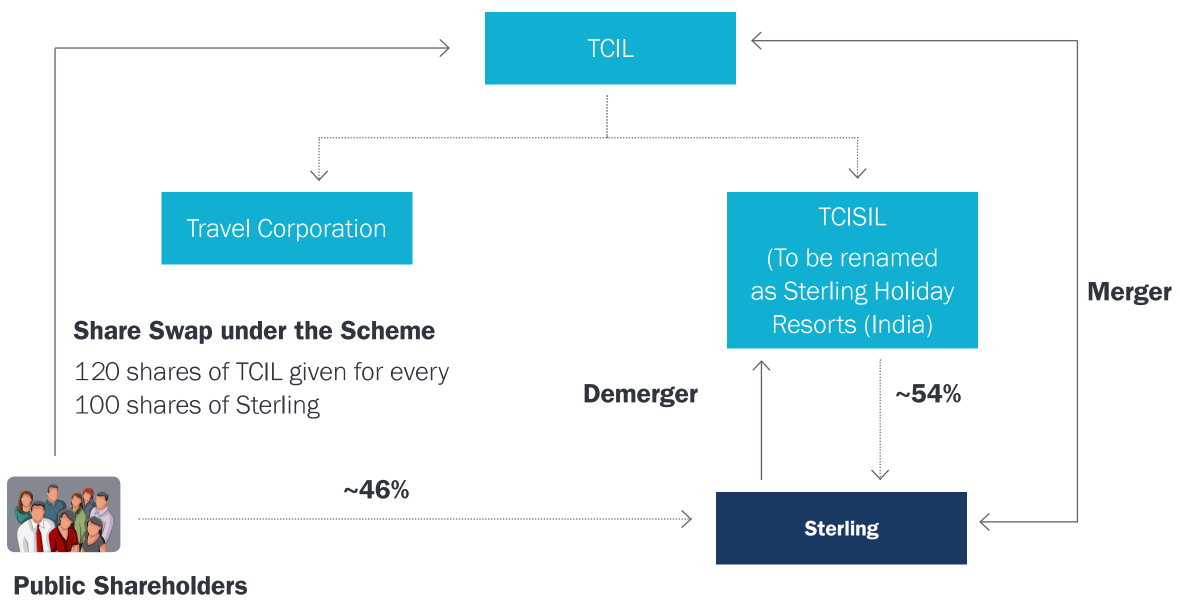
i. the entire business division and undertaking of Sterling engaged in time share and resort business shall be transferred, by way of a demerger, from Sterling to TCISIL; and

ii. Sterling with its residual business shall be merged into TCIL.

The shareholders of Sterling would be issued 116 equity shares of TCIL for every 100 shares of Sterling as consideration for the demerger; and 4 equity shares of TCIL for every 100 equity shares of Sterling held by them as consideration for the merger.

Thus the total swap ratio arrived at was that a 120 shares of TCIL would be issued for every 100 Equity Shares of Sterling. As of this date, the Scheme has been filed by TCIL and TCISIL before the Bombay High Court; and by Sterling before Madras High Court. The Bombay High Court has passed an order approving the Scheme; however, the petition before the Madras High Court is still pending.

Provided upon request only



4. Commercial Considerations

I. What drove TCIL to this acquisition?

In 2012, Fairfax acquired around 77% of the shareholding in TCIL. TCIL has seen aggressive expansion and investment since then. In February 2013, the company acquired a controlling stake in IKYA Human Capital Solutions Limited (“**IKYA**”). IKYA is involved in human resources services, facilities management, skill development and food and hospitality services.[13] In February 2014, the company announced the merger of TCIL and Sterling.

Fairfax in its annual report for the year 2013-14 mentioned that TCIL will be an investment vehicle for investment by Fairfax in India and will not be up for sale. Mr. Prem Watsa, Chairman of Fairfax in an interview said that their investment into the TCIL is a strategic investment, he said that, *“We invested in Thomas Cook with a view that its future cash flow can be used to purchase further investments in India in the future. Thomas Cook will look for companies run by great management teams that are good clean businesses, run for the long term.”*[14]

According to the World Economic Forum’s Travel and Tourism Competitiveness Report 2013, India ranks 11th in the Asia-Pacific region and 65th globally out of 140 economies ranked on Travel and Tourism Competitiveness Index. India has been witnessing steady growth in its travel and tourism sector over the past few years. Total tourist visits have increased at a rate of 16.3 % per annum from 577 Million tourists in 2008[15] to 1057 Million tourists in 2012.[16]

‘The Spectrum of Leisure Real Estate Products in India’ a report published by the Group RCI-Cushman and Wakefield Hospitality Report[17] in 2009 said that Vacation Ownership (or timeshare) was a nascent concept in India then and it had a potential to grow at approximately 16% per annum from 2006 to 2015, which will be facilitated by the supply growth of approximately 12% per annum over the same period.

An article published in 2012, noted that the Vacation Ownership / Timeshare sector witnessed a growth of 18% during 2008-2012 period.[18]

The healthy growth projections quoted in the above mentioned reports seems to have consistently met by the companies operating in the Vacation Ownership sector. Further, the Vacation Ownership players have been enthused by the new government’s focus on building the tourism industry in India, and with economic sentiment on the upswing, the industry is expecting a boost in the growth of vacation ownership sales.[19]

II. Why did TCIL choose to invest in Sterling?

Fairbridge’s and consequently TCIL’s choice to acquire Sterling appears to have been based on the following reasons:

A. Key Management Personnel

One of the most compelling reasons for TCIL to acquire Sterling was Mr. Ramesh Ramanathan, the CEO of Sterling. Mr. Ramanathan, a veteran in the Vacation Ownership space, first joined the company in 1991 and helped in developing its business for the next six years. After this period, he spent 13 years at Mahindra Holidays (a prime competitor to Sterling). Up on his return to the Company in 2009 the Company saw a drastic turn-around from it otherwise bleak looking business future. The 2013 Fairfax annual report recently stated that, *“It is fair to say that Ramesh created the time share resort industry in India. Sterling went through some difficult times in the interim and Ramesh rejoined the company in 2011. He has already turned the company around and we expect significant growth in the future.”*[20]

13. http://articles.economictimes.indiatimes.com/2013-02-06/news/36949804_1_fairbridge-capital-madhavan-menon-thomas-cook-plc
14. http://businesstoday.intoday.in/story/thomas-cook-india-transformation-new-owner/1/203043.html
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20. 2013 Fairfax Annual Report, Available at http://www.fairfax.ca/files/Final%202013%20Annual%20Report%20from%20Printers_v001_x9wa46.pdf

B. Vertical integration

Both the companies operate in the same sector with each of them having a large travel oriented customer base. Further, industry experts believe that this could also be a move towards vertical integration. TCIL as a travel services company can start offering the hospitality options to its customers as currently provided by Sterling on standalone basis, thus helping them to plan their holidays better.

C. Sterling's debt free model and potential asset growth

Sterling has been generating positive cash flows, and it is expected that Sterling's revenue for the year ending March 2014 will be of approximately USD 26 Million, with a breakeven free cash flow. Thus, to that extent, it can be expected that Thomas Cook will not be required to further fund Sterling's operation and management cost.

In addition to the developed property in form of existing resorts, Sterling also owns 150 acre of the undeveloped land with huge development potential and TCIL's acquisition price (approximately USD140 Million) is excluding the value of the unutilized land.

Further a report recently published lays down the sector specific advantages for investing in Vacation Ownership. Report says that, *"For one, its a debt-free model, as customers pay for 25 years of holidays upfront. The funds raised from the sale of vacation ownership membership plans are used for the expansion of the resort and the holiday destination network, expanding inventory to bring in more members. Second, vacation ownership companies see better year-round resort occupancies, as members tend to holiday more to utilise their membership fully."*[21]

III. Why was such a complex structure chosen?

The acquisition involved a four stage process (more specifically detailed in the " Structure of the Deal" portion of this Lab) covering a share subscription, share purchase, open offer, and merger and demerger, having the ultimate effect of merging Sterling into the Thomas Cook group. Below are the possible reasons for undertaking each step of the Deal instead of a simple merger and demerger.

A. Share Purchase and Allotment

The share purchase under the SPA, and share subscription under the SSA may have been undertaken keeping in mind the following considerations:

i. providing a lucrative exit for the Sellers at INR 98/- per Equity Share;

ii. Curbing the dilution of TCIL's promoter's shareholding upon merger (since TCIL would already hold that many more shares in Sterling pre-merger); and

iii. To gain control over the Merger / Demerger process and ease the grant of Court approval for the same. An intra-group restructuring would be subject to much less scrutiny than the merger of two entirely separate public listed companies.

Lastly, the apparently defining consideration to the acquisition of shares prior to the Merger / Demerger is TCIL's intention to not distribute its share capital to large institutional investors (who held over 40% of Sterling[22]) in order to continue to use TCIL as an investment vehicle in India.

B. Merger / Dermerger

In addition to the preferential allotment and acquisition of shares TCIL opted to proceed with the Merger / Demerger, despite already holding a promoter stake of 54.88% of the Emerging Share Capital. The reasons for this could be the want to privatize the timeshare entity allowing TCIL to deal with it and its assets more flexibly.

Further the choice to proceed with the Scheme and effect both a merger and demerger allows the group the following benefits:

i. Retains the name, and consequently the goodwill of both entities;

ii. Allows for management, and growth of Sterling undertaking as a separate unit; and

iii. Transfers the asset heavy undertaking into TCISIL, allowing TCIL to remain asset light, and well poised as an investment vehicle.

21. http://archive.financialexpress.com/news/time-for-timeshare/1275877/0
22. Shareholding of Sterling as of December, 2013

There also appears to be an active choice on the part of TCIL to keep Sterling as a separate unit, retaining its name and management under the leadership of Mr. Ramanathan. Though even after the merger of TCIL and Sterling, Sterling's business could have been operated as a separate department / undertaking within TCIL, this split structure allows Sterling and TCIL to retain their respective names, and goodwill connected to the same.

Lastly, as detailed in the Section on the Tax Considerations of the Deal (*infra*), the merger and demerger was also a tax efficient means of carrying out the transfer of the numerous heavy assets of the Sterling to TCISIL.

IV. What are the benefits for Sterling and its institutional investors?

The business of Sterling tremendously benefits from the Deal, having become a debt free company with a clean slate, and having retained much of its own identity and management. With the backing of TCIL and the Fairfax group behind it, which should be able to provide it with sufficient funding for future projects and growth, Sterling is now well placed to take on the growing hotel and timeshare markets. [23]

The institutional investors were provided with an exit at a price that was 5% higher than the average market price at the time of signing the SPA.

The greatest winners in the scheme of the Deal appear to be the investors/shareholders of Sterling who retained their shares beyond the Open Offer. Soon after the Open Offer closed the market price of Sterling shares shot-up, and even touched 200% of the Offer Price in the months that followed. A number of these shareholders and investors, have opted to liquidate their holding at this higher price than wait to be allotted TCIL shares under the Consolidated Scheme. BSE has in fact recorded 5 block trades from September to December including trades by Bay Capital.

23. http://www.indiahospitalityreview.com/news/debt-free-sterling-holidays-plans-expand/12819

5. Legal and Regulatory Considerations

I. Did the Deal require any regulatory approvals?

A. FIPB Approval

Under the FDI Policy, 100% foreign direct investment ("**FDI**") is allowed in case of resorts, hotels under the automatic route i.e. without prior approval either of the Government or the Reserve Bank of India, and there are no other restrictions on FDI in the hotel and tourism.[24]Thus, even though TCIL is a foreign owned company, and offshore funding was brought in for the Deal, FIPB approval was not be required for the Deal.

However, as part of the Deal, TCISIL will also acquire large amounts of undeveloped immovable property. Active steps towards developing this immovable property *towards hotels or resorts* will have to be taken by TCIL soon, so as to not appear to be dealing in real estate, which is heavily restricted and regulated under the FDI Policy.

B. Competition Commission Approval

Under the Competition Act any person or enterprise proposing to enter into a combination transaction must provide notice of the same to the CCI, who will then approve the transaction if it is found to not have an adverse effect on competition in the country.[25]

The Parties provided the CCI with notice on February 14, 2014 of the Merger/Demerger proposed and disclosed (though claimed exempt) the SPA, SA, proposed Open Offer, and the purchase of shares of Sterling on the open market (amounting to 9.93%) carried between Feb 10, 2014 and Feb 12, 2014.

The CCI granted its approval to the Merger/ Demerger on March 5, 2014.[26]It found that the Deal would not have an adverse impact on competition in the relevant market which was found to be hotel and travel related services. This was based on the fact that the business of hotel services across India is relatively fragmented and there are various channels for availing the hotel services, along with the presence of a large number of big players in the market.

C. SEBI Approval

Pursuant to Clause 24(f) of the Listing Agreement all listed companies must file any scheme of merger/ amalgamation proposed to be filed before any Court or Tribunal under Sections 391-394 of the Companies Act with a the Stock Exchange for its approval.

The draft Scheme was filed on with NSE on March 29, 2014. SEBI however returned the scheme to the Parties because as on March 29, 2014 the details of shareholding were not yet crystalized in light of the pending Open Offer, and completion of the SPA, which was likely to change the shareholding.

On July 26, 2014 a revised Consolidated Scheme was finally approved by the market regulator.

II. What was the price discovery mechanism under each leg of the Deal and was it in compliance with law?

A. Preferential Issue of Shares

Because Sterling is a Listed Company, the norms under the ICDR had to be followed in determining the price of the allotment of fresh equity shares ("**Allotment Price**"). Regulation 76 of the ICDR lays down that in the case where the equity share of a company have been listed on a recognized stock exchange for more than 26 weeks, the Allotment price shall be not less than the higher of these two:

i. The average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date; or

ii. The average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

24. Paragraph 6.2.11 of the Foreign Direct Investment Policy of India, 2014

25. Section 6(2) Competition Act, 2002

26. Combination Registration No. C-2014/02/153, available at http://www.cci.gov.in/May2011/OrderOfCommission/CombinationOrders/C-2014-02-153.pdf

In the Allotment Price of INR 90.49 was reached in compliance with paragraph (i) above.

B. Open Offer under the Takeover Code

For any open offer under the Takeover code, the price offered for any shares to be tendered (**"Offer Price"**) must be reached based on a valuation process. As per Regulation 8 of the Takeover Code, the Offer Price had to be no lower than the highest of the following:

i. The highest negotiated price per share under the SSA or SPA

ii. The volume weighted average price paid by the Acquirer and PACs during the 52 weeks immediately preceding the Public Announcement

iii. The highest price paid for any acquisition by the Acquirer/PAC in the 26 weeks preceding the date of the Public announcement.

iv. The volume weighted average market price of the Equity Shares of Sterling for a period of 60 trading days immediately preceding the date of the Public Announcement as traded on BSE.

Since the Purchase Price of INR 98/- was the highest of the above, this was the Offer Price under the Open Offer.

C. Share Swap under the Consolidated Scheme

In conformity with SEBI circular dated February 4, 2013 the scheme and valuation of the share swap must have been approved by the Company's Audit Committee taking in to consideration a Valuation Report from an independent chartered accountant.

III. Is the non-solicitation clause in the SPA enforceable in India?

A non-solicitation clause prevents a person from indulging in a business with company's employees or customers against the interest of the company. Although non-compete clauses may be considered unenforceable if such clauses are in restraint of trade as per Section 27 of Contract Act, usually non-solicitation clauses are enforceable in India on a case to case basis.

IV. Why did the Competition Commission fine them INR 10 Million?

Although approval for the Deal was granted, the CCI found that the Open Market Purchases, which were a part of the Deal, were consummated prior to providing notice to the CCI. This was found to be in contravention of the Competition Act and thus a penalty of INR 1,00,00,000/- was imposed on the Parties.

The CCI's order was based on the finding that the Open Market Purchases between the 10th and 12th of February were inherently related to the Scheme and other acquisitions and could not be viewed isolated from the entire acquisition. It was further clarified that the test for determining a composite combination is either inter-dependence or inter-connection of transactions. In this case the Open Market Purchases were found to be inter-connected to the other transactions. Because Section 6(2) requires an acquirer to give the CCI notice of the proposed transactions, and the Open Market Purchases had been consummated before notice was provided to the CCI, these transactions were found to be in violation of the provision.

V. Why did the Acquirers make an Open Offer on May 23, 2014, and could it have been avoided?

As per Regulation 3(1) of the Takeover Code, an acquirer together with persons acting in concert cannot acquire shares or voting rights in a target company which would entitle them to exercise 25% or more of voting rights in such target company without making a public announcement of an open offer. Further, Regulation 4 of the Takeover Code states that irrespective of any acquisition of shares or voting rights, if the acquirer directly or indirectly acquires control over a target company, then it must make a public announcement of an open offer for the acquisition of shares from the public shareholders.

As per the Takeover Code, such open offer must be at least for 26% of the total share capital of the target company calculated as of the tenth date from the closure of the tendering period and after factoring all potential increases contemplated during the offer period.

The SPA and SSA wherein the Acquirers contemplated an acquisition of approximately 42.8% of the Emerging Share Capital of Sterling triggered the open offer obligation under Regulations 3(1) and 4 of the Takeover Code.

The Open Offer could have been avoided if the acquisition was structured entirely through a scheme of merger or demerger sanctioned by the Court, as such acquisitions are exempt under Regulation 10(1) (d) of the Takeover Code.

VI. How was TCIL able to consummate the preferential share allotment and parts of the share purchase during the Open Offer?

Under Regulation 22 of the Takeover Code if an acquirer deposits in an escrow account a cash amount equal to 100% of the consideration payable under the open offer, assuming full acceptance of the offer, the acquirer may after the expiry of 21 days from the date of the detailed public statement, complete or consummate the acquisition of shares contemplated.

The Deal being well funded, allowed the acquirers to deposit in the escrow account (under Regulation 17) a cash amount equal to 100% of the consideration possibly payable under the Open Offer assuming full acceptance of the offer. Because of this, the Acquirers were able to exercise rights with respect to the shares allotted/acquired under the SPA and SSA with effect from March 31, 2014.

VII. What other approvals did the parties require?

A. Preferential Issue of Shares

Because Sterling is a listed company, as mandated under Regulation 72 of the ICDR, the shareholders of Sterling had to pass a special resolution, approving the preferential allotment.

B. Scheme

In order to proceed with the Scheme Sterling, TCIL, and TCISIL would all have required the consent of 75% of their the total shareholders and every class of shareholders, as well as the consent of 75% of all creditors and every class of creditors.

Further, the Scheme will require the sanction of the relevant Company Court(s) in order to come into effect.

All three Companies have procured the consents of their respective shareholders and creditors. The Consolidated Scheme has also already received the sanction of the Bombay High Court, but a petition for the sanction of from the Madras High Court is still pending.

Further, under SEBI Circulars dated February 4, 2013 and May 21, 2013, the consent of two thirds of the public shareholders:

i. if under the scheme of arrangement / amalgamation additional shares are allotted to promoter/promoter group; or

ii. the scheme of arrangement involves the listed company and any other entity involving the promoter/promoter group; or

iii. the parent listed company has acquired the equity shares of the subsidiary, by paying consideration in cash or kind in the past to any the shareholders (promoter/promoter group) of the subsidiary and thereafter the same subsidiary is merged with the parent listed company under the scheme.

Because out the subscription to Equity Shares and share purchases (under the SPA and otherwise), as on the date of filing the merger, TCISIL held approximately 54% of Sterling. Thus both the merger and the demerger involved an arrangement with Sterling's promoter group, and thus required half of the public shareholders consent. [27]

27. SEBI Circular CIR/DIL/8/2013 dated May 21, 2013

6. Tax Considerations

I. What are the Tax Implications of the Deal?

A. Stage 1: Share Purchase under the SPA

Any capital gains from the sale of shares would be subject to tax under the Income Tax Act, 1961 ("**ITA**") unless the shares sold can be classified as a long-term capital asset (ie. it was held for more than 1 years preceding its sale), and the transaction through which it is sold is chargeable to securities transaction tax ("**STT**") which is levied by the stock exchange at the time of transfer.

Under the SPA a portion of the shares amounting to approximately 13.14% of Emerging Share Capital were sold off the market. Thus any gains arising from the sale of these shares would be taxed at 10% (exclusive of surcharge and education cess).

All other shares purchased under the SPA are likely to be exempt from taxation, provided they were held by the sellers for 3 years preceding the sale.

B. Stage 2: Share Subscription

Since the issuance of shares is by way of a preferential allotment there will be no incidence of tax on the Parties

C. Stage 3: Open Offer and Open Market Purchases

The public shareholders of Sterling, who tendered their shares in the Open Offer, would be subjected to capital gains tax on the sale of the Equity Shares held by them in Sterling, respectively. If the public shareholder held shares for a period of 12 months or less, it would be taxable as short term capital gains, while if shares were held for a period longer than 12 months, it shall be taxable as long term capital gains.

The public shareholders who sold their shares in open market will be exempt from tax on long term capital gains tax and will be subject to tax on short term capital gains.

D. Stage 4: Merger and Demerger

While any income from the sale of an asset or undertaking is usually subject to taxation, the ITA under Section 47 exempts any transfer from the amalgamating company/ demerged company to the amalgamated/resulting company by way of a scheme of amalgamation or demerger. In order to avail of this exemption scheme must meet the requirements of an amalgamation / demerger, as under the ITA.

Merger: In order to qualify as an amalgamation under the ITA the following conditions have to be met:

- All the property and liabilities of amalgamating company must become the property and liabilities of the amalgamated company by virtue of the amalgamation.
- The shareholders holding not less than 75% in value of shares in the amalgamating company (apart from the shares already held by the amalgamating company) must be shareholder in the amalgamated company.

Additionally, in order to be for the transfer to be tax neutral for the shareholders of the amalgamating entity, the only consideration that can be received by him is the allotment of shares in the amalgamated entity.

Demerger: In order to qualify as a demerger under the ITA inter alia the following conditions have to be met:

- All the property and liabilities of demerged company must become the property and liabilities of the resulting company by virtue of the amalgamation.
- The shareholders holding not less than 75% in value of shares in the demerged company (apart from the shares already held by the resulting company) must be shareholders in the resulting company.
- The resulting company must issue, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis.

Both the Merger and the Demerger under the Scheme were structured to meet the conditions required under the ITA to avail of the exemption. With respect to the Demerger, under the scheme both TCIL and TCISIL have been specifically listed as the "*resulting company*" (which is allowed under the ITA) so that they may jointly meet the requirement that 75% of all the other shareholders of Sterling (apart from TCIL) before the demerger will be shareholders in the resulting company. Thus both the Merger and Demerger were tax neutral schemes, exempting Sterling and the existing shareholders of Sterling from any taxation.

7. Epilogue

The Deal is representative of both the bold strides seen, and to be seen from the Fairfax Group in investing in India, and a renewed vigor in the timeshare sector. The Fairfax group having now shown their defined structure appears to be hungry for what the Indian market promises and has to offer, and we can anticipate more investment moves and acquisitions from it.

The Deal was a win-win for all parties involved. The Fairfax group adds another feather to its cap, and exponentially increases its footprint in the travel and tourism sector in India; while Sterling gets a debt-free clean slate. With the financial backing of the Fairfax group, Sterling can also target more aggressive growth and faster development of its properties across the country.

Having even provided for a relatively lucrative exit option to public and institutional shareholders, it is fair to say that the Deal results in more holidaying for everyone!

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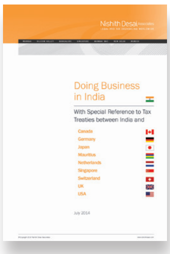

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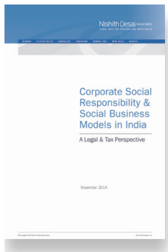

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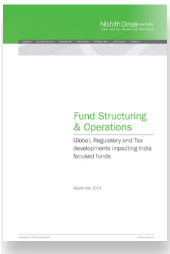

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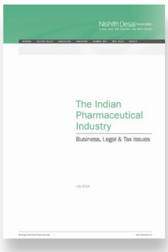

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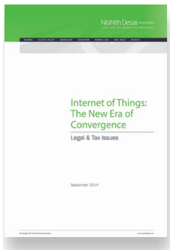

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