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REASONS AND RULING OF APPEAL COMMITTEE

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**1. INTRODUCTION**

The appellant is appealing against a ruling of the Executive Director ordering appellant to make an offer of 38.6 cents per share to the minority shareholders of the South African Coal Mining Holdings Limited (SACMH), a wholly owned subsidiary of Royal Bafokeng Capital. This ruling was made consequent to the triggering of an affected transaction by the appellant obliging it to make an offer in terms of Rule 6.3 of the Code.

**2. THE ISSUES**

This appeal committee is called upon to decide:

- (a) the appropriate comparable offer to be made to the holders of the relevant securities of SACMH.
- (b) whether the claims included in the purchase consideration paid by appellant in acquiring control of SACMH (the controlled company) should be excluded in the determination of the see-through price (the appropriate comparable offer);

**3. THE FACTS.**

The appellant concluded a purchase and sale of shares and claims agreement with Strider Holdings (Proprietary) Limited (Strider) and Karl Johannes Gribnitz in terms whereof appellant purchased and Strider sold its 49.8% equity<sup>1</sup> in Royal Bafokeng Capital. The 50.2% balance of the share capital in SACHM is owned by Royal Bafokeng Holdings. The total issued share capital of South African Coal Mining Holdings Limited owned by Royal Bafokeng Capital is 264 583 275 shares of which 40 million shares have been committed to third parties for no consideration<sup>2</sup>. This leaves a balance of 224 583 275 shares proportionately owned by Royal Bafokeng Holdings and Strider. The 49.8% shareholding held by Strider in Royal Bafokeng Capital is equal to 111 842 471 shares in SACMH. This shareholding is confirmed by the parties in the Amendment Agreement which reads as follows in

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<sup>1</sup> Clause 2.2 of the Sale of Shares and Claims reads as follows: ***“The Seller wishes to sell the Equity and the Purchaser wishes to purchase same”***.

<sup>2</sup> 20 million shares to Standard Bank and the other 20 million shares to management. This is also confirmed by notes 5 and 27 of the Royal Bafokeng Capital annual financial statements.

clause 2.2: ***“By virtue of the Seller’s ownership in the Company, the Seller indirectly owns, through the Company, 111 762 471<sup>3</sup> ordinary shares in South African Coal Mining Holdings Limited.”***

Royal Bafokeng Capital owns 58.8% of the total issued share capital of South African Coal Mining Holdings Limited (SACMH) making it a pyramid company and SACMH a controlled company in terms of Rule 6.3 of the Code.

#### **4. THE PURCHASE CONSIDERATION**

The agreed purchase price for the 49.8% equity in Royal Bafokeng Capital in terms of the purchase and sale agreement is the sum of R43 158 741. The purchase and sale agreement attributes this amount of R43 158 741 to the shares and claims as follows: R 33 528 741 nil cents<sup>4</sup> for shares and R9 630 000<sup>5</sup> for Strider's claim owed by Royal Bafokeng Capital.

#### **5. THE OFFER MADE TO MINORITY SHAREHOLDERS**

The appellant made an offer of 30 cents per share<sup>6</sup> to the minority shareholders of South African Coal Mining Holdings Limited to acquire all their shares as a consequence of its indirect acquisition of 111 842 471 shares in SACMH. In making an offer of 30 cents per share gave the same value to the securities it indirectly held in SACMH as the shares it purchased from Strider. The Executive Director requested the Board of Directors of SACMH to appoint an independent valuator to determine a see-through price that was paid by the appellant to acquire the 49.8% securities held by Strider in Royal Bafokeng Capital. The determination of this price will constitute a comparable offer to be made to the minority shareholders of SACMH for the change of control.

#### **6. THE SEE-THROUGH PRICE**

The Securities Regulation Panel requires an independent verification of a comparable offer to be made to minority shareholders where control takes place through a pyramid company. The comparable offer that is determined through an independent verification is called a see-through price. A see-through price in this matter is the price that appellant has paid to indirectly acquire the shares of SACMH. If the share price of SACMH is more than the share price in Royal Bafokeng Capital appellant should not pay less than the share price of SACMH.

The London Code on Takeovers and Mergers gives good examples of **“see through”** value in Practice Statement No. 24. We deem it appropriate to reproduce two examples not chronologically.

##### ***“Example 1***

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<sup>3</sup> The correct figure is 111 842 471.

<sup>4</sup> This amount is inclusive of an amount of R13 111 904.60 which was owed to Strider. Strider borrowed this amount from Investec and pledged its shares in Royal Bafokeng Capital as security for the loan. The appellant paid this money to Investec to release the pledged shares.

<sup>5</sup> This amount represents the sum of R17 729 000.00 owed by Royal Bafokeng Capital to Strider which Strider sold to the appellant at R9 630 000.00, a discount in excess of R6 000 000.00.

<sup>6</sup> The appellant arrived at this amount by dividing R33 528 741 by 111 842 471 and excluded an amount of R9 630 000 representing claims.

*Offeror A offers 100p for each ordinary share in offeree company B. Each offeree company B warrant entitles the holder to subscribe for one ordinary share in offeree company B at an exercise price of 10p. The see through value of each offeree company B warrant by reference to the value of the offer for the ordinary shares is therefore 90p.”*

**“Example 3**

*Offeror E offers 200p for each ordinary share in offeree company F. Each offeree company F convertible bond entitles the holder to convert that bond into one ordinary share in offeree company F. The current market price of offeree company F convertible bonds is 220p. The see-through value of each offeree company F convertible bond by reference to the value of the offer for the ordinary shares is therefore 200p.....”<sup>7</sup>*

## **7. THE APPOINTMENT OF MERCHANTEC AS INDEPENDENT VALUER.**

The Executive Director requested the Board of Directors of SACMH to appoint an independent valuer to determine the see-through price. Merchantec Capital (“Merchantec”) was appointed as an independent valuer and assured the Executive Director and the interested parties that it did not have direct or indirect material interest of SACMH or in the mandatory offer as prescribed by Rule 3 of the Code. It further indicated that its professional fees were not contingent on the success of the mandatory offer. None of the parties to this appeal questioned the independence of Merchantec.

In calculating the see-through price Merchantec took into account<sup>8</sup>:

- (a) the fact that they were dealing a single asset pyramid holding company;
- (b) that any leverage at the pyramid holding company level could not affect the value of the single asset; and
- (c) the fact that the see-through price be calculated taking into account all the shareholders equity and debt in the pyramid holding company.

## **8. THE VALUATION FORMULA APPLIED**

The principle applied by Merchantec in determining the acquisition consideration of Strider’s 49.8% interest in Royal Bafokeng Capital is the accounting principle of: assets = equity + liabilities. The 58.5% Royal Bafokeng Capital holding in SACMH is the only asset owned by Royal Bafokeng Holdings and Strider consequently one can accept that all shareholders loans in Royal Bafokeng Capital have been invested in Royal Bafokeng Capital by such shareholders to grow their investment in SACMH. The growth or appreciation of securities in SACMH is for the benefit of all shareholders of SACMH.

It therefore defies logic and common sense to argue that Strider has not derived any benefit from its claims against Royal Bafokeng Capital as these claims consist of loans that were invested in SACMH. These claims cannot be excluded in the calculation of the purchase consideration of the

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<sup>7</sup> Although these examples are made in the context of Rule 15 of the London Code on Appropriate Offers and Proposals they are applicable to a see-through in the present matter.

<sup>8</sup> See page 158 of the record.

equity acquired by Strider in Royal Bafokeng Capital. The submission by the appellant that the sum of R9 630 000 representing claims should be excluded in the purchase consideration of the 49.8% interest in Royal Bafokeng Capital is not sustainable. This submission goes against the spirit of the purchase and sale agreement which clearly states that the subject matter of the sale is equity. Equity is defined in the agreement as shares and claims.

We therefore agree with Merchantec and KPMG that it will impoverish the shareholders of pyramid companies if the loan used to acquire equity or an asset is deducted from the asset acquired when determining its value. Doing so is irrational. The submission further loses sight of the fact that the agreement in question is a purchase and share sale agreement<sup>10</sup> and not an asset sale agreement.

Merchantec arrived at this amount by an analysis of the transaction<sup>11</sup> agreements, the annual financial reports of Royal Bafokeng Capital and SACMH for the year ending 31 December 2009 and by holding consultations with the attorneys who drafted the transaction agreements in question. The appellant rejected the see-through price of 38.6 cents per share as determined by Merchantec. The rejection of the see-through price of 38.6 cents per share of SACMH resulted in a dispute between Merchantec and the appellant and the latter's legal advisors (the parties).

In its calculation Merchantec arrived at a see-through price of 38.6<sup>12</sup> cents per share. The sum of 38.6 cents per share was arrived at by dividing R43 158741 (the purchase consideration) by 111 842 471, being the number of shares indirectly held by Strider in SACMH.

## **9. THE APPOINTMENT OF KPMG AS UMPIRE TO ADJUDICATE ON THE SEE-THROUGH DISPUTE**

The Executive Director discussed the matter with the parties and proposed to them that KPMG

Services (Pty) Ltd (KPMG) be appointed to adjudicate the dispute as umpire and that its finding/ the determination of the see-through price should be final. The parties agreed on the proposal and Mr W Watkins, a director of KPMG, was appointed as umpire to determine the see-through price. The representatives of the parties when this agreement was reached the appellant was represented by Mr R Appelbaum of ENS, SACMH was represented by Mr G Scrutton, the chief executive officer and Merchantec was represented by Mr D Truda. These representatives participated fully in the adjudication process and none of the representatives complained to the appeal committee that the adjudication process was unfair or bias. There was full compliance with the rule of natural justice<sup>13</sup>.

Mr Watkins arrived at two different valuations per share the end of the adjudication process. Mr Watkins' first valuation was 42.3 cents per share and the second valuation was 43.8 cents per share.

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<sup>10</sup> A share sale and an asset sale are two distinct transactions. The former includes liabilities and the latter invariably not.

<sup>11</sup> The sale of shares and claims agreement between Strider Holdings Limited and appellant and the put and call agreement between appellant, Royal Bafokeng Ventures (Pty) Ltd and Royal Bafokeng Holding Resources (Pty) Ltd.

<sup>12</sup> This amount differs with a discounted cash flow valuation methodology which determined a valuation range between 19.48 cents and 23.80 cents per share-see page 199 of the record.

<sup>13</sup> The audi alteram partem.

In the first valuation Mr Watkins factored the Investec loan and in the second valuation<sup>14</sup> he excluded the Investec loan. The accounting principle he applied was similar to that of Merchantec<sup>15</sup>.

It may be convenient to reproduce the portion that deals with the valuation which includes his reason for rejecting the appellant's submission that the claim should be excluded in the determination of a see-through price. Mr Watkins expresses himself as follows:

***“When acquiring the share capital of RBC, JSW gains control over all the assets and liabilities of the company. One of these assets was an investment in SACMH. To illustrate this, assume a new company is formed as follows:***

***Shareholder A puts R100 cash into Pyramid (Pty) Ltd in the following form:***

<b><i>Share Capital</i></b>	<b><i>R1.00</i></b>
<b><i>Shareholder Loan</i></b>	<b><i><u>R99.00</u></i></b>
	<b><i>R100.00</i></b>

***The funds introduced by the shareholder are used immediately to purchase an asset, say 50% of a listed company for R100.***

***The relevant balance sheet on the day of formation would be as follows:***

<b><i>Pyramid (Pty) Ltd</i></b>			
<b><i>100.00</i></b>	<b><i>Share Capital</i></b>	<b><i>1.00</i></b>	
	<b><i>Shareholder Loan</i></b>	<b><i>99.00</i></b>	
<b><i>100.00</i></b>		<b><i>100.00</i></b>	

***On the same day, Shareholder A disposes his shares and claims to buyer B for the same face value, the value of the Listco investment, by calculation (R1.00+R99.00) remains at R100.00. A relevant offer to minorities of Listco would be based on a grossed up 100% value of Listco being R200.00 (100/50%). If one ignores the shareholder loan in this calculation, as proposed by JSW...the value of Listco (50% ) falls from R100.00 to R1.00 with the resultant offer to minorities being based on a grossed up 100% value of Listco being R2.00 (R1.00/50%).....minority shareholders would reject the offer as it significantly undervalues the company by 99%.....(and) it is therefore not a comparable offer.....KPMG has included the value of all liabilities in RBC at the value given to them in terms of the transaction.<sup>16</sup>”***

We agree fully with the statement made above that shareholder loan or claim should be taken into account when determining a comparable offer. Security is defined in Section B of the Securities Regulation Panel as: ***“any shares in the capital of a company and includes stock and debentures***

<sup>14</sup> As a result of the amended sale agreement.

<sup>15</sup> Assets = equity + liabilities.

<sup>16</sup> See pages 3-4 of the KPMG's presentation dated 2 February 2011.

***convertible into shares and any rights and interests in a company<sup>17</sup> or in respect of any such shares, stock or debentures, and includes any “financial instrument”.....”***

We do however have difficulty with KPMG’s calculations which is based on 100% interest owned by Royal Bafokeng Capital in SACMH<sup>18</sup> and not the actual price paid by appellant which is R43 158 741. This cannot be right because the highest price paid or the comparable offer to be made should be based on an amount equal or higher than what the appellant has, in real terms, paid for the 49.8% equity held by Strider in Royal Bafokeng Capital. The amount paid is R43 158 741.00 and represents 111 842 471 shares indirectly purchased by the appellant in SACMH. We do not believe that the option agreement signed with Royal Bafokeng Holdings should be taken into account. The calculation of the see-through price should be on 49.8% and not 100%.

## **10. WHAT IS A COMPARABLE OFFER?**

Rule 6.3 of the Code provides: “***Where a change of control takes place and the offeree company is a pyramid company, the offeror shall make a comparable offer to holders of the relevant securities of the controlled company, unless at the time of the creation of the pyramid company the holders of the relevant securities in the controlled company were offered relevant securities in the pyramid company in proportion to their holdings in the controlled company on the same terms as applicable to the holders of the controlling interest in such controlled company.***<sup>19</sup>”

Our understanding of the underlined wording is that no comparable offer will be made to the holders of securities in SACMH if they were offered relevant securities in Royal Bafokeng Capital at the time of the creation of Royal Bafokeng Capital on the same terms as applicable to Royal Bafokeng Holdings. There is no evidence that the share holders of SACMH were offered securities in the pyramid company when it was created. We therefore have to determine a comparable offer that should be made to the minority shareholders of SACMH. The Code does not define what a comparable offer is.

Rule 8.1 of the Code states that “***in making such determination, the Panel shall have regard to the facts of the case, the General Principles of the Code and equity***<sup>20</sup>. ***The offers for the different classes of equity capital shall be for the same or comparable consideration.***”

## **11. THE RULING**

We therefore conclude that the comparable price to be offered to the minority shareholders of SACMH is 38.6 cents per share representing the same consideration paid by the appellant <sup>21</sup>at the

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<sup>17</sup> Our underlining.

<sup>18</sup> See page 115 of the bundle where KPMG in the words of Mr Watkins says: “***In determining the price.....KPMG has considered the JSW/Strider agreement in isolation to any other agreement and applied the values contained in this agreement to all the shareholders of the company in order to obtainan “equivalent” 100% value of the company. The resultant valuation placed on the SACMH shares has been divided by the total SACMH shares controlled/owned by RBC at the date of the transaction.***” The total number of these shares is 224 583 275.

<sup>19</sup> Our underlining.

<sup>20</sup> My emphasis.

time of the acquisition of its 49.8% equity in Royal Bafokeng Capital. This amount is not less than the highest price paid by the appellant for the said equity within the preceding 3 months as prescribed by Rule 8.4(a) of the Code. All interest earned in the Escrow account should be for the account of the minority shareholders. In other words our ruling does not include interest other than interest earned on the 30 cents per share invested in the Escrow account. The interest will be on the 8.6 cents if the 30 cents per share has been paid to the minority shareholders already.

The appellant is ordered to pay the cost of the Panel.

Signed on this the 4<sup>th</sup> day of April 2011

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N A Matlala  
Chairperson

I agree

A Khumalo  
Appeal Committee Member

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I agree

A De Bruyn  
Appeal Committee Member

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I agree

J Damons  
Appeal Committee Member

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I agree

T Matshazi  
Appeal Committee Member

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<sup>21</sup> That is the total purchase consideration.