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How should Fortis confront its Revlon moment?[1]

Fortis Healthcare's investors may be forgiven for wondering why everyone in the room is sitting scared. There are four competing bidders sitting across the table, yet all of them are holding back. Nor is the board pushing them hard. For investors the solution lies in pressurizing the board to be bold and redraw the sale process.

The unexpected and unprecedented fourth bid by Fosun International Limited and the revised offer from the Munjal-Burman combine for Fortis Healthcare, is clear proof that there is value in the assets. The board needs to rework how it approaches the various bidders and for it to open up the bidding process. This is not without its risks, but Fortis' board needs to ensure that shareholders realize the full potential of their investments.

Exhibit 1: Fortis has received four disparate bids, all bunched around a tight price range

	Manipal – TPG	IHH Healthcare Bhd	Munjal-Burman	Fosun International Limited
Structure	Merge Fortis Hospitals with Manipal, and acquire 30% stake in SRL	Invest in Fortis to gain control	Invest in Fortis to increase shareholding	Invest in Fortis to gain control
Price per share (Rs.)	155	160	156	156
Binding offer	Yes	No	Yes (upto Rs.7.5 bn)	No
Details	1. Dr. Ranjan Pai to acquire 30.9% of SRL for Rs.11.13 bn. 2. Manipal Health to undertake a right issue of Rs.40 bn, for acquisition of RHT's assets. 3. Equity value of Fortis' hospitals business - Rs.60.6 bn	NA	Currently holds 3% of Fortis' shareholding. An aggregate investment of Rs.15 bn will be infused, which includes a binding offer of Rs.7.5 bn	To invest Rs.23 bn, including an immediate infusion of Rs.1 bn. Maximum shareholding in Fortis will not exceed 25%

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[1] A Revlon Moment refers to a situation when a company's 'takeover' becomes inevitable

For this to happen, they need to put together a vendor due diligence document, that they will share with the four bidders. A vendor due diligence is a document that the seller prepares. It in line with an information memorandum, with deep-dive comments from the lawyers and auditors. This vendor due-diligence report typically flags all relevant issues. The clarity that this document provides may well attract additional bidders.

The Fortis board quickly needs to go back to the bidders are ask them to put in a bid on the basis of this document.

Given that three of the four bids visualize putting in money on the company, the Board should consider the feasibility of negotiating with Manipal Healthcare regarding simplifying their bid structure and getting all four bidders to bid outright.

From the company's filings it is not clear if a break-up fees baked into the Manipal Healthcare offer (- though break-up fees are not typical in Indian deals). If this is so, Fortis needs to ask all bidders to sign-up for a contingency recompense, in case such an amount needs to be paid to Manipal. An easy way to address this is to get the bidders to deposit an amount that covers this (say US$5 million each, into an escrow to be paid to Manipal if they enforce contract). This will serve one other very important purpose, namely answer the question who is serious. If reports are to be believed, for the last many months IHH has vacillated between bidding and staying away. A tightly run auction, will help separate the men from the boys.

The risk that Fortis board might see for themselves is that Manipal, the only bid with a binding offer turns away – a bird in hand in surely more valuable than three non-binding offers. But given that a fourth and totally unexpected bidders has now come forward and another has inched up to pay more, there clearly seems to be value in the franchise. The board needs to be brave to seize it whole-heartedly.

The above are all thorny decisions to take – and the board could well be hesitating because it lacks the necessary wherewithal to decide. As argued in our earlier Institutional EYE, Sholay, Satyam and Fortis Healthcare, an advisory committee to the board, will be in a position to discuss the issues threadbare, and arrive at a decision in everyone's interest.

In this it's not the board alone that needs to show courage. The bidders too need to take a leap from where they are sitting. As of now they are all jostling within a narrow range (Exhibit 1). A well-crafted vendor diligence document will substantially clear the air, enabling the buyers to put their most compelling offer on the table. And just like the four offers show there is value to Fortis' board, the bidders too should realize that this is a valuable asset and another opportunity to acquire such an extensive footprint is not likely to present itself.

Fortis' investors no longer trust the exiting board: they are seeking change. But till then, they need to dialogue with the existing board, and communicate how they expect the board to act under the given circumstances.

With four offers on the table the company has entered what may well be described as its 'Revlon moment.' And while Indian regulations do not say so, Fortis' board in these given circumstances may have no choice but to apply the 'Revlon rule[2]' and maximize the value for its shareholders.

[2] The Revlon rule is the legal principle established in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. that expects a company's board must make reasonable effort to obtain the highest value for a company. Although applicable in the case of hostile offers, in the US it has meant that companies rarely enter into binding agreements.

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