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Hutchinson Essar - Vodafone – A Case Study

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ABSTRACT

Mergers & Acquisition have become very popular throughout the world in the recent times. This has become popular due to globalization, liberalization, technological developments & intensely competitive business environment. The Indian economic reform since 1991 has opened up a whole lot of challenges both in the domestic and international spheres it is an indispensable strategic tool for expanding product portfolios, entering into new market, acquiring new technologies and building new generation organization with power & resources to compete on global basis. The post-merger performance of the firms could be measured in several ways. One way to measure the performance is to monitor the share prices after the merger deal is struck, that is "event studies" which assumes that stock markets are efficient (Franks & Harris, 1989. Studies relating to profitability after M&A's may not, therefore, be sufficient to evaluate the corporate performance. It is, therefore, useful to examine the relative efficiency of the firms after M&A's.

Keywords : Merger & Acquisitions, product portfolio, efficient market, corporate performance

1) Introduction:

In February 2008 Vodafone announced officially its acquisition of 67% of Hutch-Essar for \$11.08 billion defeating the rival bidder Reliance Communications.

2) HISTORY: Hutchison-Essar (Year and Events):

In 1994 Hutchison Max Telecom Limited (HMTL), a joint venture between Hutchison and Max, wins the license to provide cellular services in Mumbai. C. Sivasankaran sells 51% stake in Delhi's Sterlings Cellular to Essar group. 1995 HMTL launches mobile services in India under the Max Touch brand name. 1996 Swisscom sells 49% stake in Essar Cell phone to Hutchison. 1998 Max's Anajit Singh sells 41% stake in Hutchison Max to Hutchison Hong Kong. 2000 (Jan) Hutchison acquires a 49 per cent stake in Sterling Cellular in the Delhi circle from Swisscom, an Essar Group company. A few weeks later, the Orange brand name replaces Max Touch in Mumbai. 2000 (July) Hutchison and Kotak together acquire a 100 per cent stake in Usha Martin Telecom in Kolkata circle. 2000 (Sep) Hutchison acquires a 49 per cent stake in Fascel, which operates in Gujarat, from Shinawatra. 2001 Hutchison puts in the bid to provide cellular licences in Chennai, Andhra Pradesh, Karnataka and Maharashtra. It wins all except Maharashtra. 2003 Essar Teleholdings sells its operations in Rajasthan, Uttar Pradesh (East) and Haryana to Hutchison Essar. Essar was running these operations through Group Company; Airtel Dig link India Ltd. Hutchison acquires licence to provide cellular services in Punjab. This is bought from Escotel. 2004 Essar picks France Telecom's 9.9% stake in BPL Communications.

3) Reasons for Hutch Sale

There are two main reasons which are responsible for Li Ka-shing to leave India.

They are

- Hutch-Essar: Mutual Distrust
- A right time to quit Indian operations to finance other operations

Li Ka-Shing was the 10th richest man globally in 2007, is known as a businessman who spots an opportunity early, invests in it and exits at a neat premium. It is only after he exits that the rush begins. In the early 1990s, he sold his stake in Star TV to Rupert Murdoch for \$825 million. The Hutch Essar deal has netted him a neat \$8.48 billion. What could he do with that money? Li is a major player in the ports and retail businesses. Getting access to the ports business in India is difficult, thanks to being from China. However, with retail being the new mantra in India, Li could be looking at a third entry. His retail outfits include Watson's and PARKnSHOP. While Watson's operates 7,700 stores in 37 countries, PARKnSHOP is a supermarket chain.

Industry sources say that several incidents revealed the deepening rift between Hutch and Essar. They say that as telecom valuations in India started rising, Essar tried to increase its stake in the joint venture. However, in December 2005, Orascom of Egypt bought a 19.3 per cent stake in Hutchison Whampoa. This indirectly gave it control of 12.93 per cent stake in Hutchison Essar. The stake sale decision was reportedly taken without Essar's knowledge and strained its relations with Hutchison. Following this Essar approached the Department of Telecommunications on this sale saying that Hutchison Whampoa's equity sale to Orascom may have an impact on national security as Orascom has a stake in Pakistan's Mobilink. Subsequently, say sources, Essar sounded out some private equity investors about buying out Hutchison's equity holding in Hutchison Essar.

4) Advantage Hutch

The biggest advantage Hutch offers is a presence in a market of 143 million subscribers that's growing at a mind-boggling rate of 5 per cent on a month-on-month basis, making it the fastest-growing cellular market in the world. What's more, penetration levels are still low at 12 per cent (less than 2 per cent in rural India), and as developed telecom markets slide into saturation, India is clearly the geography where most of the long-term potential is concentrated.

Fourth largest mobile operator in India with 24.41 million subscribers

16.41% of the Indian mobile market

Present in 16 of 23 circles and has a license for six others

ARPU at Rs 374 (\$8.31) against national average of Rs 335.46 (\$7.45)

Hutch Mumbai ARPU at Rs 609.36 (\$13.54), the highest in India, but yet to be integrated. Accounted for 41 per cent of Hutchison Telecommunication International's revenues. Revenues of \$908 million (Rs 4,086 crore) in H1 2006 against \$1.29 billion (Rs 5,800 crore) in 2005

Operating profits of Rs 1,017 crore, EBITDA margins at 32.7 per cent in H1 2007.

5) VALUATION

In 1999, when the first telecom deal happened in India, Bharti paid 300 crore for a 63% stake in JT mobile. That worked out to an acquisition cost of \$117 per subscriber. Predictably, since in June 2006, Hutchison paid \$450 million to buy the Hinduja's 5.11% stake in Hutch Essar, worked out to be a valuation of \$8.8 billion, or \$505 per subscriber. It was much lower than the \$1000 per subscriber that Vodafone paid to buy a 10% stake in Bharti in October 2005. The latest valuation of Hutch Essar doing the rounds (\$21 billion) values each subscriber at \$943. While this is lower than what Vodafone paid for Bharti, it is more than double what Essar paid (\$370 per subscriber) to acquire BPL Communications in August 2005. Globally telecom valuations have been on the high side. In 2000, Vodafone paid \$202 billion for Germany's Mannesmann.

VALUATION OF HUTCH-ESSAR

Value (\$ billion) Hutch Essar 100% enterprise value: 18.8

Hutch Essar debt: 1.33

Equity Value: 17.47 Value of 67% stake: 11.10

Other Debt: 0.63

Net Value: 11.08 ,

Value from Bharti stake sale: 1.62

Net outflow for Vodafone: 9.46

6) FINANCING THE DEAL

VODAFONE'S successful bid for Hutchison's 67 per cent stake in Hutch Essar may have been driven by its compulsions to enter the high-growth Indian market, but what clinched the deal for the UK-based company was the enormous booty of cash at its disposal. Analysts estimate that Vodafone was probably the least leveraged of all the bidders and this helped them bid aggressively. It already has \$5 billion from the sale of its Japanese unit for \$15 billion last year (the remaining \$10 billion is expected to go back to shareholders). It will also get \$1.62 billion cash from its 5.6 per cent stake sale in Bharti. This \$6.62 billion may go towards funding the \$11.1-billion price tag for the 67 per cent stake. In addition, Vodafone has free cash reserves (for the first six months of 2006) in excess of \$3 billion. It has also sold its 25 per cent stake in Swisscom Mobile and exited Belgium. Therefore, the debt component in the deal is likely to be low, according to an analyst. Unconfirmed sources say that Reliance Communications was wary of raising too much debt, which may have acted as a deterrent. Whether the UK-based Telco overpaid is another question. Investment bankers in India, too, have underlined Vodafone's advantage, thanks to its access to cash and its capability to strike the least leveraged deal.

7) Synergies Claimed

Vodafone gets access to the fastest growing mobile phone market in the world that is ex-

pected to touch 500 million subscribers by 2010.

Cellular penetration in rural India is below 2%, but 67% of India's population lives in rural India. Hutchison-Essar is not just the 4 player, but also one of the better-run companies with higher average revenue per subscribers. 3G is set to take off in India, allowing data and video to ride on cellular networks. Vodafone already offers 3G elsewhere in the world. India is key to Vodafone strengthening its presence in Asia, a region seen as the big telecom story.

8) STRATEGY TO GO AHEAD

Rebranding: -

First, over the next couple of years, it will replace the pink Hutch logo with its own red logo. That's quite in line with what the company does globally. It starts off with a hybrid brand and, later, phases out the original brand.

Operations: -

Low-cost handsets with the Vodafone logo. That's quite on the lines of what Reliance has already done in the CDMA space. Vodafone has recently struck a deal with China's ZTE to source handsets. Also one can expect such deals for vendors who are already manufacturing in India. This could lead to lower tariffs, though it remains to be seen how much lower it can go from Re 1 a minute. Launching of services like Vodafone Simply for the low-end user, Vodafone Live! For multimedia and Vodafone Passport for cheaper global roaming calls will also be a part of the future plans. Being on the Vodafone network means that roaming will be a lot cheaper. Vodafone expects shared cell-sites to increase to 66 per cent from the current 33 per cent. Second, all national and international long-distance traffic of the new entity will be carried on the Bharti network. Last, for the next three years, half of Vodafone's in-roamers will use the Bharti Airtel network in India. That's a clear way to keep capex in check. Also, it helps Vodafone expand quickly into uncovered areas. The immediate advantage of such an agreement is that it will be possible for both operators to tap the emerging rural market quickly.

8.3) Essar's Options: -

Technically, Essar has three options: stay on with Vodafone, sell the entire stake, or sell part of its stake. In case Essar wants to exit, Sarin points out that it will be paid the same price that Vodafone offered to Hutch. Or else, it could work with Vodafone to build the company and find a right place and time to exit. However, Vodafone has reportedly reserved the right to walk out of the deal if litigation to thwart the deal is launched. In case Essar decides to leave, Vodafone has to maintain the 74 per cent FDI limit. Hutchison held 52 per cent; Anajit Singh and Asim Ghosh together hold 15 per cent, while Essar holds 33 per cent. In Essar's stake, 22 per cent is held abroad (Mauritius) as a foreign investor, and the balance 11 per cent as a domestic investor. Technically, therefore, Vodafone can pick up another 22 per cent.

9) CONCLUSION OF STUDY

Hutch is going to be a tough battle ahead as the world's largest mobile operator (by revenues) tries to woo the price-conscious Indian consumer. Vodafone is targeting 100 million Indian subscribers in three years (Hutch has 24.41 million at present).

But getting there means adding between 1.5 million and 2 million subscribers every month. While Hutch has been adding around 1 million subscribers a month, market leader Bharti has been adding 1.75 million. Vodafone needs to exceed Bharti's net subscriber additions to be the leader in three years. Second, it needs to tap rural India in a big way. Vodafone has earmarked an investment of \$2 billion over the next couple of years to strengthen its presence here. The agreement with Bharti fits in perfectly to tap the hinterland. Realizing the importance of familiarity with the terrain, Sarin has opted to retain Asim Ghosh as the man to head the venture. Once the board approves it, Ghosh will formally take charge. After all, that's what he has been doing as Hutchison's key lieutenant over the past few years. However, even before it

gets to that, Vodafone has to ensure that the Essar Group, the 33 per cent partner in the venture, does not go to court on its entry. It has an uneasy equation with Essar, which is one-third partner in Hutch-Essar. That could be a source of problem.

The Vodafone brand is relatively unknown in the Indian mar-

ket. Besides the brand will cost money and take time Telecom valuations are at a high and this could mean it is years Vodafone recovers its multi-billion dollar investment Its big competitors are home-grown majors, who can manage the 'environment' better.

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