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## Impact of Merger and Acquisition in Mobile Industry: A Case Study on “Vodafone and Hutch”

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**Abstract:**

*Mergers and Acquisitions in Global Scenario is the way for the companies to undergo the process of amalgamation, takeover, reconstruction and re-organization. Mergers and Acquisitions are the leading corporate strategies followed by organizations looking for improved value creation post- liberalization era, the demand for intense growth and development in business has paved and profitability. Merger is defined as a combination of two companies in to a single company where one survives and the other loses their corporate existence. The survivor acquires all the assets and liabilities of the merged companies. Acquisition is the process of acquiring a company to build on strengths or weaknesses of the acquiring company. A merger is similar to an acquisition but refers more strictly to combining all of the interests of both companies into a stronger single company. The research paper makes an attempt to examine the opportunities of Vodafone mobile industry, and also emphasizes on comparative study of financial performance pre and post merger. In achieving these objectives the research information is extracted through literature review.*

*The acquisition of Hutchison Essar of India by UK based Vodafone was carried out which has marked the penetration of Vodafone into the Indian telecom market and provided the opportunity to Vodafone to tap the huge potential of expansion in India. The simplicity and comprehensive nature of the Hutch to Vodafone transition campaign was a perfect example of the successful entry of a new brand into a market.*

**Keywords:** Mergers, acquisitions, performance, impact and transition.

### 1. Introduction

#### 1.1. Background

Indian telecommunication industry has seen many swings in the recent past. It has remained stagnant under the government monopoly for many decades. Indian telecommunication industry has become a classical example of combination of government policies, innovation and new technology. There have been many events of mergers and acquisitions in Indian telecommunication industry in the last decade. Foreign investors and major players of telecom sector see India as one of the fastest growing telecom industry of the world. Over the last decade, many reforms have been introduced by the government, which have changed the scenario of telecom industry of India. In telecom sector, mergers and acquisition has been increasing to a great extent. Mergers and acquisitions in telecommunication industry can be driven by the development of new technology. The deregulation of telecom industry tempts the firms to offer bundle of new products and services to customers. Ongoing convergence of cable and telecom industries also tempts telecom firms to innovate products and services (Sanjoy Banka, 2006). In this way, the acquisition of products and services has become a profitable progress for telecom firms. In the world, telecommunication industry is the most developing and profitable industries of the world. Telecom sector has been considered as the most indispensable industries of the world in service sector. Different forms of communication media such as mobile phones, land line phones and internet broadband services are dealt in the telecommunication industry (Sanjoy Banka, 2006). In the recent past, swing of mergers and acquisition has been observed in the telecom sector of the world. Because of its immense importance, the proposed research is going to explore mergers and acquisitions in the telecom sector of India.

### 1.2. Objectives of the Study

- To examine the opportunities of Vodafone mobile industry after the merger.
- A comparative study of financial performance before and after the merger

## 2. Literature Review

### 2.1. Mergers and Acquisitions

1. Sherman and Hart (2006) stress that “mergers and acquisitions are a vital part of any healthy economy and importantly the primary way that companies are able to provide returns to owners and investors”. Furthermore, they point out, that “successful mergers and acquisitions are neither an art nor a science but a process. In fact, regression analysis demonstrates that the number one determinant of deal multiples is the growth rate of the business. The higher the growth rate, the higher the multiple of cash flow the business is worth”. This is certainly true, but it does not offer an explanation to what mergers and acquisitions are.
2. Bernd Wirtz (2003) offers such an explanation in very simple and short terms, stated in 1990 by Behrens/Merkel: “Mergers and Acquisitions (M&A) are fusions and overtakes of organisations, divisions or affiliates, respectively” (German original: “Mergers and Acquisitions (M&A) Sind Fusionen und Übernahmen von Unternehmen bzw. deren Teilbereichen oder Tochtergesellschaften”).
3. Ben MC Clur Mergers and Acquisitions and corporate restructuring are a big part of the corporate finance world. Every day, Wall Street investment bankers arrange M&A transactions, which bring separate companies together to form larger ones. When they're not creating big companies from smaller ones, corporate finance deals do the reverse and break up companies through spinoffs, carve-outs or tracking stocks.

### 2.2. About the Merger

### 2.3. About Vodafone

Vodafone is the world's leading international mobile communications group with operations in 25 countries across five continents and over 200 million proportionate customers by the end of January 2007, as well as 36 partner networks.

### 2.4. About Hutch Essar

Hutch Essar is a leading Indian telecommunications mobile operator with 23.3 million customers at 31 December 2006, representing a 16.4% national market share. Hutch Essar operates in 16 circles and has licences in an additional six circles. In the year to 31 December 2005, Hutch Essar reported revenue of US\$1,282 million, EBITDA of US\$415 million, and operating profit of US\$313 million. In the six months to 30 June 2006, Hutch Essar reported revenue of US\$908 million, EBITDA of US\$297 million, and operating profit of US\$226 million.

Up until January 2006, Hutch Essar had licences in 13 circles, of which nine have 900 MHz spectrum. In January 2006, Hutch Essar acquired BPL, thereby adding three circles, each operating with 900 MHz spectrum. In October 2006, Hutch Essar acquired Spacetel, adding six further licences, with operations planned to be launched during 2007.

The results of Hutch Essar are prepared in accordance with Hong Kong Financial Reporting Standards which may differ in material respects from the accounting principles applied by Vodafone.

Wherever you go, the network follows! Hutch's famous punch line which was adapted appropriately in its much loved advertisement turned out to be quite a pun as the ‘*Merger & Acquisition*’ bug followed and finally caught up with Hutch! Following an entire battle of give and take, Vodafone acquired Hutch for a whopping 10 billion USD! Most of us would be wondering, that why at all a company should acquire a rival? What are the gains and risks involved in the entire transaction and how are mergers different from acquisitions?

February 12, 2007- Vodafone announces today that it has agreed to acquire a controlling interest in Hutchison Essar Limited (“Hutch Essar”), a leading operator in the fast growing Indian mobile market, via its subsidiary Vodafone International Holdings B.V. Vodafone also announces that it has signed a memorandum of understanding (“MOU”) with Bharti Airtel Limited (“Bharti”) on infrastructure sharing and that it has granted an option to a Bharti group company to buy its 5.6% direct interest in Bharti.

## 3. The Key Highlights Are

### 3.1. Acquisition of a Controlling Interest in Hutch Essar

- Vodafone announces it has agreed to acquire companies that control a 67% interest in Hutch Essar from Hutchison Telecom International Limited (“HTIL”) for a cash consideration of US\$11.1 billion (£5.7 billion)
- Vodafone will assume net debt of approximately US\$2.0 billion (£1.0 billion)
- The transaction implies an enterprise value of US\$18.8 billion (£9.6 billion) for Hutch Essar
- The acquisition meets Vodafone's stated financial investment criteria Infrastructure sharing MOU with Bharti
- Whilst Hutch Essar and Bharti will continue to compete independently, Vodafone and Bharti have entered into a MOU relating to a comprehensive range of infrastructure sharing options in India between Hutch Essar and Bharti

- Infrastructure sharing is expected to reduce the total cost of delivering telecommunication services, especially in rural areas, enabling both parties to expand network coverage more quickly and to offer more affordable services to a broader base of the Indian population
- Local partners
- The Essar Group (“Essar”) currently holds a 33% interest in Hutch Essar and Vodafone will make an offer to buy this stake at the equivalent price per share it has agreed with HTIL
- Vodafone’s arrangements with the other existing minority partners will result in a shareholder structure post acquisition that meets the requirements of India’s foreign ownership rules
- 10% economic interest in Bharti
- Vodafone has granted a Bharti group company an option, subject to completion of the Hutch Essar acquisition, to buy its 5.6% listed direct interest in Bharti for US\$1.6 billion (£0.8 billion) which compares with the acquisition price of US\$0.8 billion (£0.5 billion)
- If the option is not exercised, Vodafone would be able to sell this 5.6% interest
- Vodafone will retain its 4.4% indirect interest in Bharti, underpinning its ongoing relationship

Commenting on the transaction, Arun Sarin, Chief Executive of Vodafone, said: “We are delighted to be deepening our involvement in the Indian mobile market with the full range of Vodafone’s products, services and brand. This announcement is clear evidence of how we are executing our strategy of developing our presence in emerging markets. We have concluded this transaction within our stated financial investment criteria and we are confident that this will prove to be an excellent investment for our shareholders. Hutch Essar is an impressive, well run company that will fit well into the Vodafone Group.”

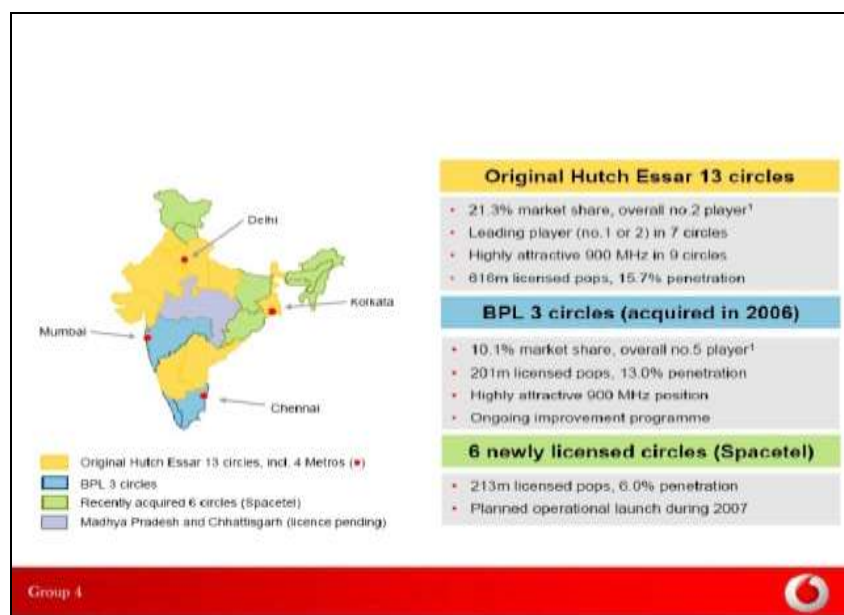


Figure 1: Competitive Positioning

Sir John Bond, Chairman of Vodafone, said: “India is destined to become one of the largest and most important mobile markets in the world and this acquisition will enable our shareholders to benefit from our increased investment in this market. We also look forward to playing our part in delivering the significant economic and social benefits which mobile telephony can bring to the people of India.”

### 3.2. Principal Benefits

#### 3.2.1. The Principal Benefits to Vodafone of the Transaction Are:

- Accelerates Vodafone’s move to a controlling position in a leading operator in the attractive and fast growing Indian mobile market
- India is the world’s 2nd most populated country with over 1.1 billion inhabitants
- India is the fastest growing major mobile market in the world, with around 6.5 million monthly net adds in the last quarter
- India benefits from strong economic fundamentals with expected real GDP growth in high single digits
- Hutch Essar delivers a strong existing platform in India
- Nationwide presence with recent expansion to 22 out of 23 license areas (“circles”)
- 23.3 million customers as at 31 December 2006, equivalent to a 16.4% nationwide market share
- Year-on-year revenue growth of 51% and an ebitda margin of 33% in the six months to 30 June 2006
- Experienced and highly respected management team

- Driving additional value in hutch essar
- Accelerated network investment driving penetration and market share growth
- Infrastructure sharing MOU with bharti plans to reduce substantially network opex and capex
- Potential for hutch essar to bring vodafone’s innovative products and services to the Indian market, including Vodafone’s focus on total communication solutions for customers
- Vodafone and Hutch Essar both expected to benefit from increased purchasing power and the sharing of best practices
- Increases Vodafone’s presence in higher growth emerging markets
- proportion of Group statutory EBITDA from the EMAPA region expected to increase from below 20% in the financial year ending 31 March 2007 (FY2007) to over a third by FY2012
- Operational plan for Hutch Essar
- Vodafone will execute an operational plan to build on the strengths of Hutch Essar in order to capture the Indian telecom growth opportunity.

**4. Key Strategic Objectives**

- In the context of penetration that is expected to exceed 40% by FY2012, Vodafone is targeting a 20-25% market share within the same timeframe. The operational plan focuses on the following objectives:
  - Expanding distribution and network coverage
  - Lowering the total cost of network ownership
  - Growing market share
  - Driving a customer focused approach
  - Site sharing
  - The MOU outlines a process for achieving a more extensive level of site sharing and covers both new and existing sites. Around one third of Hutch Essar’s current sites are already shared with other Indian mobile operators and Vodafone is planning that around two thirds of total sites will be shared in the longer term.
  - The MOU recognizes the potential for achieving further efficiencies by sharing infrastructure with other mobile operators in India.
  - The MOU envisages the potential, subject to regulatory approval and commercial development, to extend the agreement to sharing of active infrastructure such as radio access network and access transmission.

**5. Financial Assumptions**

As part of the operational plan, Vodafone expects to increase capital investment, particularly in the first two to three years, with capex as a percentage of revenues reducing to the low teens by FY2012. The operational plan results in an FY2007-12 EBITDA CAGR percentage around the mid-30s. Cash tax rates of 11-14% for FY2008-12 are expected due to various tax incentives and will trend towards approximately 30-34% in the long term.

As a result of this operational plan, the transaction meets Vodafone’s stated financial investment criteria, with a ROIC exceeding the local risk adjusted cost of capital in the fifth year and an IRR of around 14%.

**5.1. Hutch Essar Footprint**

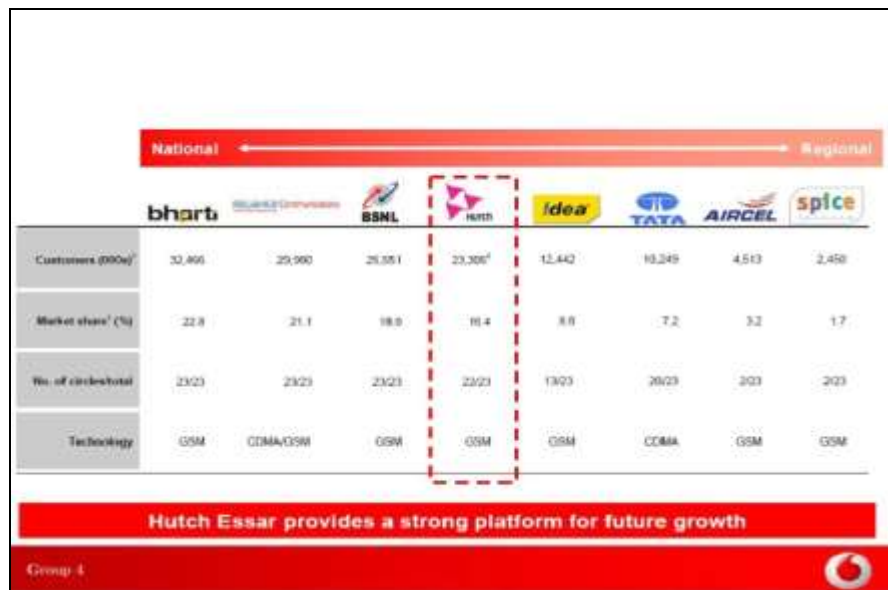


Figure 2

### 5.2. Financial Impact on Vodafone

- The transaction enhances Vodafone's growth profile on a pro forma statutory basis, with Vodafone's revenue and EBITDA CAGR increasing by around one and a half percentage points over the three year period to 31 March 2010.
- The transaction is expected to be broadly neutral to adjusted earnings per share in the first year post acquisition and accretive thereafter excluding the impact of intangible asset amortization for the transaction. Including this impact, the transaction is expected to be approximately seven percent dilutive to adjusted earnings per share in the first year post acquisition and neutral by the fifth year.
- The Board remains committed to its longer term targeted dividend payout of 60% of adjusted earnings per share. Furthermore, the Board expects the dividend per share to be at least maintained in the short term. The acquisition of HTIL's controlling interest in Hutch Essar will be financed through debt and existing cash reserves and Vodafone expects pro forma net debt of around £22.8-23.3 billion<sup>3</sup> at 31 March 2007 as a result of this transaction.
- Further transaction details
- The transaction is expected to close in the second quarter of calendar year 2007 and is conditional on Indian regulatory approval.
- HTIL's existing partners, who between them hold a 15% interest in Hutch Essar, have agreed to retain their holdings and become partners with Vodafone. Vodafone's interest will be 52% following completion and Vodafone will exercise full operational control over the business. If Essar decides to accept Vodafone's offer, these local minority partners between them will increase their combined interest in Hutch Essar to 26%.
- In the event that the Bharti group company exercises its option over Vodafone's 5.6% direct interest in Bharti, consideration will be received up to 18 months after completion of the Hutch Essar acquisition.
- Vodafone will continue to hold its 26% interest in Bharti Infotel Private Limited ("BIPL"), which is equivalent to an indirect 4.4% economic interest in Bharti. Vodafone will now account for its entire interest as an investment.
- UBS Investment Bank acted as financial adviser to Vodafone.
- One of only 4 major mobile operators in India

### 5.3. Essar Was Biggest Hurdle in Deal for Vodafone

- Relations between Hutchison and Ruias of Essar group have never been cordial.
- Hutch and Essar have gone to the courts and the government several times in the last few years over.
- Initially wanted complete control over company.
- Essar wants equal partnership.
- The Ruias who have decided not to sell their stake have been looking at legal options to challenge the HTIL claim opposed acquisition by Vodafone.

## 6. Conclusion

1. Vodafone creating value in India.
2. Controlling position in a leading operator with nationwide Presence.
3. Strong existing platform for growth.
4. Additional value under Vodafone ownership
5. Increased Vodafone's presence in high growth markets
6. Increased presence of big Global Players in India.

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