THE $10.9BN PURCHASE OF HUTCHISON ESSAR GIVES MOBILE PHONE GROUP VODAFONE A VITAL PRESENCE IN ASIA. **GRAHAM BUCK** REPORTS.

Vodafone goes for growth

In recent years, what are now dubbed the emerging 'BRIC' economies (those of Brazil, Russia, India and China) have all demonstrated a dazzling pace of economic growth. Consumerism is on the rise in each of the four countries, and reflects in a growing demand for consumer items taken for granted in the West.

India boasts not only a booming economy, but also the world's fastest-growing mobile telecoms market, adding at least six million new subscribers a month. Out of a population of 1.1bn, there were a total of 162.5 million mobile users as of February 2007. Fixed-line phone subscribers account for less than 20% of total phone users in India but bring the total number of Indians with phone access to more than 200 million.

For the UK's Vodafone, which recognises that the potential for growth in markets such as Europe is now limited, the potential of India is enormous. In February, the group bid for a majority stake in Hutchison Essar, India's fourth-largest mobile operator with more than 25 million subscribers and a 16% share of the Indian market.

Late last year, Vodafone learned that Hong Kong-based Hutchison Telecom International, which owned 52% of Hutchison Essar, was considering selling its stake. To ensure that the acquisition would be well received, Vodafone held a series of meetings with India's finance, commerce and technology ministers in the opening weeks of 2007 before making its bid. The country's rules prevent foreign groups owning more than 74% of an Indian telecoms operator.

Vodafone also had to calculate an offer price for an asset in an emerging market. It did this largely by calculating anticipated growth rates for the Indian mobile phone sector over the next few years. At the same time, Vodafone had to reassure investors that any offer price would be realistic. The City still hasn't forgotten the group's $183bn purchase of Germany's Mannesmann in 2000. The deal qualified as the biggest hostile takeover in corporate history and critics claimed the price was too high.

Under its Indian-born Chief Executive Arun Sarin, who took over from Sir Chris Gent four years ago, Vodafone has been determined not to overpay for acquisitions. Sarin stressed that Vodafone would be "financially disciplined" in its approach to Hutchison Essar.

According to Vodafone Group Treasurer Gerry Bacon, Vodafone has for some years had an internal policy of valuing its investments and in May last year summarised it for the equity markets.

Having appointed Ernst & Young to carry out due diligence on Hutchison Essar and concluded its talks with government officials, Vodafone initially bid $11.08bn in February and pledged to invest $2bn in the venture over two years.

The deal gave Vodafone a 67% stake in the operator, to keep it under the government's foreign investment cap of 74%. The bid left Vodafone with the task of smoothing relations with India's Essar Group, holder of the remaining 33% stake in Hutchison Essar (two-thirds of it through a Mauritius-based subsidiary). Vodafone not only beat rival bidders Hinduja Group and Reliance, but also Essar itself, which was keen to increase its stake in the venture and claimed its offer was close to matching Vodafone's.

Diplomacy appears to have worked. Essar declined Vodafone's offer to buy out its stake on the same terms offered to Hutchison Telecom International and will keep its 33% holding. The two groups then sat down to knock out a shareholder's agreement, which gives Essar the option to sell up to $5bn of its shares in the venture to Vodafone between May 2010 and May 2011 at an independently appraised value.

In addition, it was agreed that Essar Vice Chairman Ravi Ruia would be Chairman of the venture, which will be known as Vodafone Essar, while Vodafone's Arun Sarin would hold the post of Vice Chairman.

THE CITY'S RESPONSE to the deal was generally positive, although there were qualms over the price paid. *The Financial Times* suggested that Vodafone might have a problem in explaining the deal to investors "used to more transparent ownership structures".

But the Indian government, apparently keen to reassure foreign investors, was satisfied. The deal finally closed early in May, with $180m shaved off the final sale price to reduce the figure to $10.9bn. In giving its approval, the government resisted critics at home, including influential business figures Ratan Tata and Susil Mittal, who both spoke out against foreign companies entering India's 3G space.

Nonetheless, in the wake of the deal India's commerce ministry is working on revised foreign direct investment guidelines, which are likely to relax investment rules for the country's telecoms sector but may also involve closing loopholes that have been exploited by foreign investors who want to circumvent ownership limits.

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