India Update: January – February, 2012

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Gujarat International Finance Tec-City may shape future of urban India

Rs. 78,000-cr hi-tech city to try new concepts

Gujarat International Finance Tec-City (GIFT) may emerge as a test-bed for future city technologies in India. Work on the proposed Rs. 78,000-crore[1] city has now started, and the first occupant may move in later this year. By the time the first phase is completed in three-and-a-half years, this special economic zone (SEZ) would have tried out, on a small scale, some contemporary urban design ideas.

GIFT would have a command and control centre to monitor the IT infrastructure and respond quickly during emergencies (a fire anywhere, for example, will trigger an automatic response). The city will use the energy-efficient district cooling system instead of air-conditioning. It will also use an automated waste collection system that sucks away garbage from buildings at high speed. No Indian city has these technologies yet.

These concepts may be widely used in smart cities of the future as they are considered sustainable. District cooling, for example, can be used easily with renewable energy. Automated waste collection can be combined with biomass energy generation systems, so GIFT will burn waste to generate energy. Greenfield cities such as GIFT have an opportunity to test new technologies before they are adopted in existing Indian cities.

What is gift

- An international financial centre under development near Gandhinagar in Gujarat
- Area - 3.58 sq km city
- Rs. 78,000-crore investment planned on buildings and infrastructure
- A smart city that would use state-of-the-art technologies in IT, energy, waste management and other areas

Top-Notch Global Financial Centre

GIFT was conceived in 2007 and the idea was developed initially by a set of consultants such as McKinsey and urban development specialist Fairwood Consultants. It is being planned as a top-notch global financial centre to rival London, New York and Hong Kong. On a more immediate time scale, it is being built to attract companies from Mumbai, Gurgaon and Bangalore. After the initial flurry of announcements, the project entered a stage of lull due to the global economic meltdown in 2008. With the city being granted permission in November 2011 to operate as a multi-services SEZ, the Gujarat government is keen to take it forward quickly.

The stock exchanges of London, Tokyo and Singapore have evinced interest in setting up offices in GIFT, as have many Indian banks. Singapore Co-operation Enterprises, a government agency, has just signed an agreement with GIFT to develop a banking enclave. Similar financial centres in Hong Kong, Dubai, China, Malaysia, the UK (London) and the US (New York) contribute 5-60% of GDP of their respective countries. GIFT is expected to create 1 million jobs in 10 years.

Finmin seeks to redefine 'control' in FDI policy

Ministry wants to stop use of quasi-equity tools by foreign investors to control Indian companies

The finance ministry has asked the department of industrial policy and promotion to clearly define "control" in the foreign direct investment policy, toughening its stance against the use of quasi-equity instruments by foreign investors to exercise control over Indian businesses. Holding of more than 50% equity in a company by a foreigner establishes foreign ownership, but control is defined as the ability to appoint majority of directors, giving room to investors to skirt norms via quasi-equity instruments. This is not in line with the stringent definition prescribed under the new Companies Bill and also does not take into account other indirect ways of obtaining control such as lien over voting rights and equity purchase agreements. The finance ministry has been pitching for changes in the new policy, unveiled in 2009, to tighten the loopholes and the inadvertent opening of prohibited sectors to foreign investment through indirect investments. An Indian owned and controlled company enjoys certain advantages over a foreign owned and controlled company under the FDI policy. Such companies can make downstream investments in sensitive sectors and those with caps without seeking approval from the Foreign Investment Promotion Board. But a company with 50%

[1] *1 crore = 10,000,000*

foreign ownership and controlled by foreigners is considered a foreign company. Some companies disclose foreign investment below 50% but issue quasi-equity instruments with voting rights to foreign investors, giving them control of the Indian entity. But this goes unchecked under the FDI policy as the definition of 'control' does not cover it.

The Companies Bill 2009 provides for a more comprehensive definition of 'control' by including the ability to influence management or policy decisions. The definition also takes into account that the ability to influence decision could be by virtue of direct powers such as shareholding or management rights, or indirect ones such as shareholders' agreements or voting agreements or in any other manner.

This issue first came to light after the $11.1 billion acquisition of Hutchison Essar by Vodafone. While the British cellular major in its application for clearance from the FIPB said that it had bought 52% stake in Hutchison, its notice to overseas stock exchanges said it had purchased 67% stake. This happened because the company had bought controlling interest of 15% indirectly held by some investors.

The new elements in the definition will help bring more clarity in establishing control. Additional parameters, such as real voting percentages enjoyed by the parties, could be crucial in determining the control situation.

Foreign investment still on

Many Indian businessmen and commentators contend that political uncertainty and 'policy paralysis' have taken the sheen off India's attraction as an investment destination. They say that foreign capital no longer thinks as highly of opportunities in India. Several Indian businessmen are also said to want out: they would rather invest in markets where investors have to deal with less uncertainty in the economic climate.

If foreign capital has indeed become shy of India, it is not reflected in the figures for foreign inflows in the current year as well as in recent years. Consider the figures in the accompanying graphic for FY 2011-12 for the three most important sources of flows: net foreign direct investment (FDI), portfolio flows including foreign institutional investors (FII), and external commercial borrowing (ECB).

Both FDI and ECBs are considerably higher in April-September 2011-12 than last year. It is only portfolio flows that have taken a severe beating this year. For the year as a whole, CMIE projects a decline in net capital inflows to $49 billion from $60 billion last year. The decline will be mostly on account of the fall in portfolio flows.

As is well known, portfolio flows are extremely fickle. They depend not just on the host country's economic prospects but on international economic conditions. Whenever the global economic climate worsens, there is a tendency for international investors to pull out of risky assets, including emerging markets, and head for US government securities — what is called the 'flight to safety'. It would be unwise to draw inferences about portfolio flows based on year-to-year flows. It is better to look at portfolio flows and indeed all flows by looking at the average over a cycle.

In the period 2004-08, which was the 'India Shining' period, portfolio flows averaged $10.6 billion. The average in the post-crisis period, 2009-11, is higher, $16 billion. FDI flows are a bigger revelation. Foreign sentiment is best measured by gross FDI flows (that is, without netting out FDI outflows from the country). The average gross FDI in the post-crisis period is more than double the figure for 2004-08. We can make two inferences. First, in the current year, foreign flows of capital are being adversely impacted more by global uncertainties than by any uncertainties in the Indian environment itself. Secondly, India's attractiveness has increased in the post-crisis period and at a time when conditions both in India in the advanced countries have been adverse.

We can expect portfolio flows to return strongly whenever the current bout of uncertainty in the global economy is resolved. There is ground for even greater optimism in respect of FDI. The increase we have seen in the past three years reflects some fundamental shifts in FDI that favour emerging markets such as India.

Unctad's World Investment Report 2011, documents trends in FDI. Three facts stand out. First, global FDI flows in 2010 were 15% below their pre-crisis average whereas FDI flows into India ($23 billion) in 2010-11 were higher than the pre-crisis average of $15 billion.

Secondly, FDI flows in the post-war period have been mostly within the developed countries themselves. In recent years, this has changed. An increasing proportion of FDI flows now finds its way into developing countries. In 2010, FDI flows into developing countries crossed 50% of total FDI for the first time.

Transnational corporations are investing more in developing countries both to increase their efficiency of production and to access the local market. Increased inflows into India in recent years are a manifestation of this larger trend.

Thirdly, most of the FDI used to happen through mergers and acquisitions (M&A), not through greenfield ventures. In developing countries, much of the FDI through the M&A route was on account of privatisation of state-owned companies. Privatisation has never been done on a large scale in India. Besides, there are numerous obstacles to acquiring even companies in the private sector. Barriers to M&As in India became barriers to FDI. This is one important reason why the level of FDI in India was so low in the 1990s.

In recent years, foreign direct investors appear to have realised that they cannot gain significant entry into developing countries through the M&A route. FDI through the greenfield route now surpasses that through the M&A route. This would imply that 'policy paralysis' or the absence of 'reform' in respect of privatisation or acquisition of Indian companies is no longer a deterrent to FDI in India.

RBI eases foreign borrowing norms for smaller players

In a move to liberalise foreign borrowing norms for smaller firms, the Reserve Bank of India (RBI) has reduced the minimum maturity period for external commercial borrowing (ECB) up to $20 million to three years as against the earlier five years.

Earlier, there was no distinction in terms of minimum tenor for overseas loans, irrespective of the loan amount and all the overseas loans under the automatic route were required to have a minimum tenor of five years.

Now, ECB up to $20 million should have a minimum average maturity of three years and ECB over $20 million and up to $750 million should have a minimum average maturity period of five years.

In September 2011, RBI had increased the ceiling on foreign loans that could be availed by firms under the approval route from $500 to $750 million. Any amount borrowed over $750 million via the ECB route requires approval by the regulator. The 10-year minimum average maturity norm for loans taken under the approval route remains unchanged.

The central bank has also allowed eligible borrowers to issue foreign currency convertible bonds up to $750 million, the upper limit under the automatic route. However, specified service sectors, viz. hotel, hospital and software, can raise FCCBs up to $200 million or equivalent for permissible end-uses during a financial year, subject to the condition that the proceeds should not be used for acquisition of land.

Foreign investors set to lose special rights

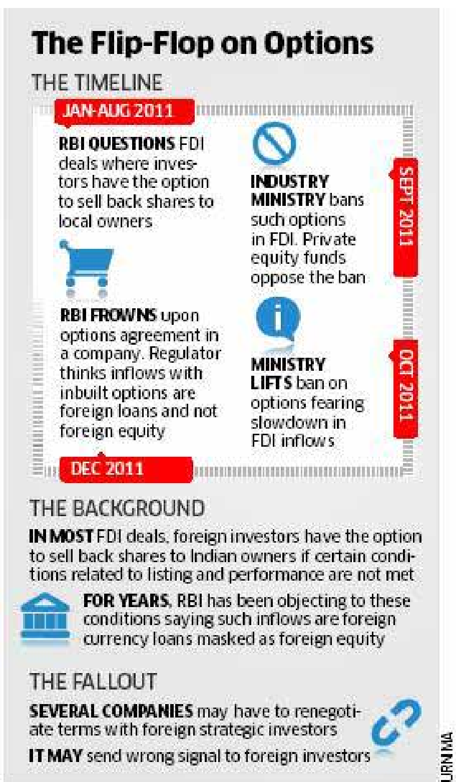
RBI refuses to allow FDI with options despite commerce ministry approving the practice

The dilemma among policymakers over allowing special rights to foreign investors acquiring strategic stakes in local companies has once again turned up like the proverbial bad penny. Even after the government clarified that such rights, in the form of inbuilt options in foreign direct investment (FDI), are permissible, the Reserve Bank of India is unwilling to approve the practice.

In most FDI deals, foreign investors have a right to exercise such options to sell back shares either to the local company or its promoters if certain conditions related to listing and performance are not fulfilled. For years, the RBI has been objecting to these conditions on the ground that such inflows are foreign currency loans masquerading as foreign equity (or, FDI). Since the RBI has the final say on all cross-border inflows, last September the commerce ministry banned options in FDI deals. The move sparked a spate of representations from private equity investors, industry lobbies and several professional advisors who mediate such deals. Amid fears that a ban could impact FDI inflows, the ministry did a volte face. A month later, it issued a notification lifting the ban — a decision that all concerned felt would put an end to the dispute.

But in December, the RBI put a question mark on the shareholder agreement between the promoters of a domestic company and their FDI partner which was sold a put option. The RBI came to know of the option agreement after the company approached it to complete certain documentation.

With the RBI sticking to its earlier view, several companies may have to rework terms with foreign strategic investors. Since options can significantly influence the pricing and size of a deal, it may also send a wrong signal to investors.



100% FDI in single-brand retail notified

The government has formally notified its decision to allow 100% foreign direct investment in single-brand retail, but its decision to stick to a key local sourcing clause has ensured the reaction the reform has elicited is more cautious than celebratory.

Commerce and Industry Minister Anand Sharma had held out hope last year of a likely exemption in the local sourcing clause. But the final rules, framed and notified by the Department of Industrial Policy and Promotion (DIPP) state that single-brand retailers setting up ventures with more than 51% stake will have to source 'at least 30% of the value of products sold from Indian small industries/ village and cottage industries, artisans and craftsmen'.

Small industries are defined as those with investments of $1 million in plant and machinery, a limit experts say is too low to achieve quality levels desired by big brands. Others said the sourcing clause would dilute their brand appeal and even compromise intellectual property rights because they would be forced to work with multiple small vendors.

The 51% limit on foreign direct investment had discouraged many global brands from investing in India. FDI inflows into single-brand retail during the past three-and-a-half years stood at a paltry Rs. 196 crore.

Foreign power companies put on hold India plans

Fuel, tariff and land acquisition problems have forced these companies to rethink India strategy

Global power companies such as Chinese giant CLP India are putting on hold investment plans in India, where fuel, tariff and land acquisition problems have jammed the sector, and are considering opportunities in less risky places like the Middle East and Vietnam. Bankers and international consultants say top foreign companies that were actively negotiating deals to enter India a year ago have developed cold feet —

a move that will reduce the flow of technology and capital to the power sector where domestic banks are already reluctant to lend. At least half a dozen companies from countries such as USA and Japan are said to be reviewing their plans.

Foreign presence in Indian power sector has been limited but was projected to grow as the market is vast and short-supplied and investors had anticipated a friendly policy regime. But even existing foreign companies such as CLP are worried while AES India, a unit of the global major AES, has already announced exit from most of its India operations.

Government to put a cap on energy usage by companies

Programme will create world's largest energy saving certificate-trading platform

Big corporations in India, including Tata Steel, Jindal Power and NTPC, will have to keep a tab on power usage at their plants as the government is setting a cap on the energy consumption of large corporations.

According to officials, the Bureau of Energy Efficiency (BEE) has drawn a list of about 477 plants belonging to different corporations and has set targets on their energy consumption. The move is aimed at improving the energy efficiency of the Indian industry. Companies overshooting their cap will be penalised while those achieving the target will be rewarded with tradable permits.

The programme is expected to create the world's largest energy saving certificate-trading platform. Once implemented, companies that achieve their target would be given permits. Corporations that fail to achieve their target have to compensate for their failure by buying permits. If they fail to do either of this, they may have to pay penalties.

The energy consumption reported by plants will be based on audit by any of the BEE accredited agencies. The programme includes plants across eight sectors, including steel, fertilizer, oil refineries, paper mills, thermal power plants and others. Some of the plants included in the initial list belongs to Tata Steel Ltd, Tata Power, Jindal Steel and Power, Jindal Power, Reliance Energy Ltd, Reliance Industries Ltd, Hindalco Industries Ltd, Birla Corporation Ltd among others. PSUs like NTPC, Rashtriya Chemicals and Fertilisers Ltd. are part of the list.

The Bureau of Energy Efficiency will be the implementing and regulatory agency.

Globally, there are small energy saving certificate-trading platform in Netherlands and Germany. But, this would be the largest such trading platform in the globe.

The companies would be given a time-period of three years to achieve their targets. The first tradable certificate is likely to be issued in 2013. The energy permits would be traded monthly.

The initiative is a part of the government's National Mission on Enhanced Energy Efficiency (NMEEE), which is one out of the eight missions planned under the National Action Plan on Climate Change. Considering the vast potential of energy savings and benefits of energy efficiency, the Energy Conservation Act 2001, was amended in 2010. One of the key amendments was that the government might issue energy savings certificate to the designated consumer whose energy consumption is less than the prescribed norms and standards

RBI sets pay guidelines for executives in private banks

The Reserve Bank of India has laid down guidelines for compensation of executives at private and foreign banks aimed at preventing greed from destabilising the institution, with provisions to clawback pay if transactions fail years after origination.

The guidelines based on the recommendations of the International Financial Stability Board do not prescribe any quantitative limit on absolute pay, but deal with the structure of pay which in the past favoured excessive risk-taking. It has banned

guaranteed bonus, and risk management staff will have more of fixed component than the rest.
These norms include capping the variable component of the compensation at 70% of the fixed pay in a year.

Banks are permitted to exclude the Employees Stock Option Plan from variable pay. The variable pay would have to be deferred over a period of three years. Compensation payable under deferral arrangements should vest no faster than on a pro-rata basis. In the event of negative contributions, bank boards would also have the option to claw-back this deferred compensation. The RBI has also asked bank boards to ensure that any deterioration in the financial performance should lead to a contraction in the total amount of variable remuneration paid.

Banks will now be permitted to offer joining bonus only in case of new hires and will be limited to first year. They will not be allowed to grant severance pay other than accrued benefits like gratuity and pension, except in cases where it is mandatory by any statute. Meanwhile, foreign banks operating in India will be required to submit a declaration to RBI annually from their head offices to the effect that their compensation structure in India, including that of CEO's, is in conformity with the FSB principles and standards.

Profits from offshore supply of IT equipment not taxable: Delhi High Court

A recent verdict by the Delhi high court might set a precedent on the taxation of equipment that comprise hardware and software. In a case between Swedish telecom equipment maker Ericsson and the department of income tax, the court held that profits from offshore supply of equipment comprising hardware and software are not taxable in this country.

The court said if the title to the equipment passes on to Indian clients outside the country, it cannot be taxed in India, even though it is the country where the business negotiation and the signing of the contract or acceptance test were done.

The court judgment also said revenues from the software embedded in hardware were not taxable as royalty income. There is no 'transfer of rights' in respect to the 'copyright' of the software.

The Delhi high court is hearing similar cases with regard to Nokia and Motorola. The orders are expected soon.

Earlier, in the cases relating to Sonata Software and Samsung, among others, the Karnataka HC had held that payments for import of software were in the nature of royalty, thus upholding the view of the income-tax authorities. Not different was the view of the Authority for Advance Rulings in a recent case relating to Millennium Software.

In another case of Lucent Technologies, the Karnataka HC, too, had held that payment for import of software integrated with hardware amounts to 'royalty' under Section 9(1)(vi) of the Income Tax Act, 1961. According to the Income Tax Act, once a payment is in the nature of royalty (under the provisions of Section 9), it is deemed to arise in India. This, consequently, requires the payer to deduct tax at source as per the provisions of Section 195 of the Act.

The aggrieved parties in the Karnataka HC case had said payments for import of software (especially shrink wrapped) were in the nature of payment for import of goods and, as such, these are not in nature of royalty. Payments are being made for a 'copyrighted article' and not a 'copyright', according to the parties. The copying of the software onto the hard-disk for installation purpose is integral to the sale of software, and does not give rise to any copyright to the user as per the OECD commentary, they added.

Employer liable for default in contribution to PF: Supreme Court

The Supreme Court has ruled that the proceedings for the recovery of damages can be initiated against the employer for their default in making payment of contribution to the provident fund even though they come under the 'exempted establishments' under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

'Exempted establishment' means an establishment in respect of which an exemption has been granted under Section 17 of the Act from the operation of all or any of the provisions of any scheme or the insurance scheme, as the case may be, whether such exemption has been granted to the establishment as such or to any person or class of persons employed therein.

Victory for Vodafone in USD 2 bn Hutchison tax case

Tax needn't be paid as deal was between 2 foreign firms: SC

The Supreme Court has spared Britain's Vodafone Group Plc from paying $2.2 billion in taxes on its 2007 purchase of the Indian unit of Hutchison Whampoa as the deal took place between two overseas firms.

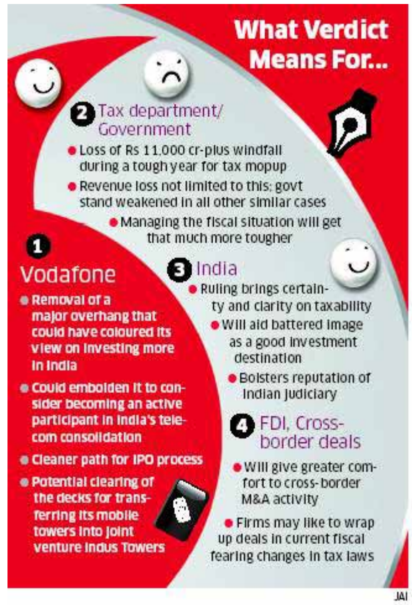
The ruling will come as a setback to India's tax authorities, who had been counting on the extra revenues to plug a growing fiscal deficit. The tax department has been relentless in its pursuit of the world's largest telecom operator by revenues, which started with a demand to pay tax in September 2007, seven months after it bought a 67% economic interest in Hutchison's India operations for more than USD 11 billion.

The transaction on which the Supreme Court delivered its historic verdict was between Hutchison Telecom International Ltd (based in the Cayman Islands) and VIH of the Netherlands. The company that changed hands was Cayman Islands-incorporated CGP, which owned Hutchison's operations in India though a series of companies incorporated in Mauritius.

The court said the transaction was genuine. "We hold that the offshore transaction herein is bonafide structured FDI into India, which fell outside India's territorial tax jurisdiction, hence not taxable. (The) offshore transaction evidences participative investment and not a sham."

The order may make it easier companies to set up structures for tax planning and other purposes.

The judgment may end years of uncertainty for companies such as AT&T, Cadbury, Vedanta, Sanofi, SABMiller and GE, which have been involved in similar cross-border deals.



Canali buys 51% in Genesis JV

Avoids 100% FDI as it would require luxury brand to source 30% from Indian SMEs

Italian luxury brand Canali has picked up 51% stake to form a joint venture with its Indian franchise, Genesis Luxury Fashion. Though Canali had the option to set up a wholly-owned subsidiary, following the government's decision last month to allow 100% foreign direct investment in single-brand retail, it has opted to stick to the previous ceiling. A higher shareholding would have required it to mandatorily source 30% of its products from Indian small and medium enterprises.

Global brands are increasingly eyeing India where the luxury market is growing at 20% a year and is expected to expand to $14.7 billion by 2015, from $5.8 billion, according to a recent report by CII and AT Kearney. India has three million affluent households, defined as those with more than $100,000 of investable surplus. The number of high net worth individuals, who have assets of $1 million or more, will more than double to 403,000 by 2015

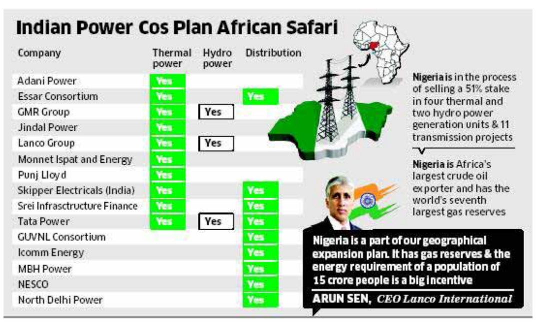
15 Indian companies eye Nigeria power projects

Faced with expansion delays here, Indian firms bet on African country to fuel growth

Around 15 Indian companies, including Tata Power, GMR Group and Adani Power, are among candidates shortlisted by the Nigerian government to participate in the privatisation of power projects of state-owned National Electric Power Authority (NEPA). Struggling on home ground with multiple issues which have delayed capacity addition, Indian power companies are exploring participation in power generation and distribution projects in Nigeria to fuel their growth despite the civil unrest in the country.

Nigeria is in the process of selling a 51% stake in four thermal and two hydro power generation units and 11 transmission projects since NEPA's poor operational and financial performance has deterred capacity addition in the country.

Indian companies are considering Nigeria as a "natural hedge against local slowdown", but the entry into the country would not be easy, given its political and social condition. Some of these Indian companies are already jittery about going ahead in the bidding process as Nigeria struggles with widespread religious violence, labour unrest, crumbling infrastructure and high incidence of corruption.



Indian Power Cos Plan African Safari

Company	Thermal power	Hydro power	Distribution
Adani Power	Yes		
Essar Consortium	Yes		Yes
GMR Group	Yes	Yes	
Jindal Power	Yes		
Lanco Group	Yes	Yes	
Monnet Ispat and Energy	Yes		
Punj Lloyd	Yes		
Skipper Electricals (India)	Yes		Yes
Srei Infrasctructure Finance	Yes		Yes
Tata Power	Yes	Yes	Yes
GUVNL Consortium			Yes
Icomm Energy			Yes
MBH Power			Yes
NESCO			Yes
North Delhi Power			Yes

Japan's NTT buys 74% in Netmagic

Deal underscores growing allure of Indian tech companies

Japan's NTT Communications has bought a majority stake in data centre services provider Netmagic for about Rs. 900 crore in a deal that underscores the growing allure of Indian technology companies for overseas investors. NTT Communications, a part of the Nippon Telegraph and Telephone group, will pay ¥10 billion for a 74% stake in the Mumbai-based company. Netmagic was deep in the doldrums during the dotcom bust about a decade ago, but it bounced back and now counts the Indian arms of online auction site eBay and global banks Barclays and UBS as its customers. Netmagic's suite of cloud-based data centre support services was one of the main attractions.

In the past year, nearly half-a-dozen technology multinationals have bought stakes in local technology start-ups, demonstrating the rising interest in made-in-India technology and the market opportunity that the country presents.

Mounting stress on banking sector

Finance ministry wants spectrum to be used as collateral for loans

The finance ministry has asked for a change in norms to allow spectrum to be used as collateral by lenders of telecom companies, saying this will ease the stress on the country's banking sector.

The finance ministry has asked the telecom department to make policy changes to ensure that airwaves can be seized by banks in the event of a default or cancellation of mobile permits.

Over the past 12 months, banks have almost stopped lending to telecom companies but if the norms are changed, it will make it easier for telcos to raise loans. At present, all spectrum is owned by the government and is given on a 20-year lease to the operators, on the condition that it will be returned to the government. The ministry has also said that lenders must be part of any consultation related to cancellation of mobile permits held by telecom companies.

The ministry's concern possibly stems from the fact that some of the new telecom companies are in danger of losing their permits, depending on the outcomes of court cases, for failure to roll out services in time and other violations. Moreover, stiff competition and low tariffs have resulted in some of them struggling to remain relevant in a crowded market.

The total debt of the telecom industry is estimated at Rs. 275,000 crore. A PwC report says the total exposure of public sector banks is Rs. 100,000 crore with State Bank of India's share being Rs. 25,000 crore.

Indian telecom companies had traditionally been large borrowers as they built and expanded networks, and aggressively bid for 3G and broadband licences. But the 2G scam, coupled with poor uptake of 3G services, mounting losses and slow growth has also resulted in domestic banks cutting off funding for telcos.

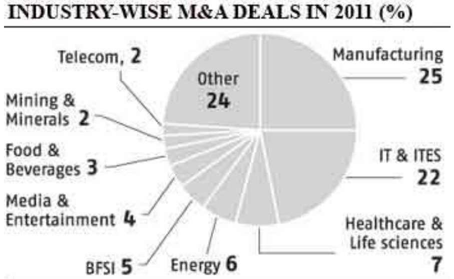
Inbound deals rise 30% in 2011

Inbound merger and acquisition (M&A) deal volumes surged 30 per cent in 2011, while the volume of outbound ones dropped 35 per cent, according to a research report. Foreign companies acquired majority stakes in 131 Indian companies in 2011.

There were 65 inbound deals, with an announced value of USD 9.99 billion. In comparison, 2010 had witnessed a total of 101 inbound deals, of which there were 50 transactions with announced values, amounting to almost USD 8.4 billion.

A study by Venture Intelligence, a research service focused on private equity and M&A transaction activity in India, stated the largest inbound M&A deal by value announced in 2011 was Vodafone's buyout of Essar Group's stake in mobile phone services firm Vodafone Essar for USD 5.46 billion in March. The second-largest inbound deal was the acquisition of business process outsourcing firm Intelenet by UK's Serco Group for an estimated USD 630 million. This was followed by International Paper's acquisition of a 75 per cent stake in publicly-listed Andhra Pradesh Paper Mills for USD 388 million.

INDUSTRY-WISE M&A DEALS IN 2011 (%)



Source: Venture Intelligence M&A Deal Database

US-based companies were the leading acquirers of Indian companies in 2011, followed by English and Japanese firms, Venture Intelligence data showed.

The volume of outbound deals (Indian companies acquiring foreign companies/assets) dropped by about 35 per cent to 127 deals in 2011, compared with 194 in the previous year. Among these, there were 62 deals with an announced value of USD 9.9 billion, against 104 such deals worth $23.7 billion in 2010. The largest outbound deal was Mundra Port & SEZ's acquisition of the Abbot Point Coal Terminal in Queensland, Australia for USD 2 billion. In another major outbound acquisition, GVK Power & Infrastructure acquired various Australia-based coal mines from the Hancock Group for USD 1.26 billion.

The domestic segment saw 333 deals in 2011, compared to 337 in 2010. Of these, 108 deals had an announced value of USD 6.1 billion, compared with 142 deals worth USD 34 billion in 2010.

Overall, in 2011, Indian companies were involved in a total of 591 M&A deals, including both cross-border and domestic transactions. Of these, 235 deals had an announced transaction value of USD 26 billion. The volume of transactions was lower compared to 2010, which saw a total of 632 M&A deals (including 296 deals with an announced value of USD 66.4 billion). Median deal values, for both outbound and inbound deals, rose sharply in 2011, while that in the domestic segment remained flat.

Led by the Aditya Birla Group's acquisition of a controlling 67 per cent stake in Columbian Chemicals for USD 875 million, manufacturing companies emerged as the most active dealmakers (cross-border and domestic deals) in 2011. Other top deals in this industry included the Hero Group's buyout of Honda from their two-wheeler joint venture (for USD 854 million), Essar Group acquisition of Zimbabwe Iron and Steel Corporation USD 750 million), International Paper's acquisition of Andhra Paper Mills (USD 388 million) and MAN Truck and Bus' buyout of its Indian joint venture partner in MAN Force Trucks (USD 202 million).

Led by iGate Global Solution's acquisition of Patni Computer Systems for USD 1,200 million, the information technology information technology-enabled systems segment had emerged as the second most active industry for deal making in 2010. Publicly-listed Fortis Healthcare's acquisition of two of its promoter owned entities — international hospital chain Fortis International (for USD 665 million) and diagnostics chain Super Religare Laboratories (for USD 211 million) — dominated the healthcare and life sciences segment that emerged as the third-most active industry in 2011.

Banks checking CIBIL rating of promoters for corporate loans

Strong credit rating is no longer sufficient for banks to advance loans to corporates. Worried over the rise in bad loans, lenders are combing individual financial reports of promoters and board officials to look for clues or patterns that could ring an alarm bell.

India's leading credit information agency Cibil says banks are actively seeking such reports to make informed decisions.

Cibil reports are often sought by banks in cases of small and medium enterprises, or limited liability partnerships. Such analysis helps to know if the promoter or board directors concerned are in some sort of stress, which may not get reflected in the balance sheet of the company.

Starbucks, Tatas sign JV to set up cafes

First cafe by August and 50 by year-end initial investment will be Rs 400 cr.

The world's biggest coffee chain is finally in India. A year after Seattle-headquartered Starbucks Coffee Company entered into an agreement with Tata Coffee Ltd to source and roast coffee arabica beans in India, it has formed a joint venture (JV) with Tata Global Beverages (TGB), the parent of Tata Coffee, to roll out its cafes nationwide.

As part of the agreement, the two companies will form an equal JV, Tata Starbucks Ltd. The venture will have a separate management team and a board of six members, with equal representation from both partners. A new chief executive and a chief financial officer will also be shortlisted. Though the name of Noel Tata is being speculated upon to head the alliance, Tata and Starbucks' senior management did not reveal the identities.

Starbucks will be the first foreign retailer to enter India after the government loosened rules about how single-brand companies can invest here. But despite the relaxed norms, Starbucks has decided not to go solo. In a first of its kind branding initiative, Starbucks outlets in India would be branded as "Starbucks Coffee: A Tata Alliance".

Tata Starbucks is looking at opening 50 stores by the end of the year, starting with New Delhi and Mumbai over the next seven-eight months. It will also expand into other cities and Tier-II towns. The initial investment will be Rs 400 crore.

The formats, too, will vary, as the venture expands operations, tapping into shopping malls, hotels, offices, airport lounges, railway stations, colleges and other public spaces.

Leveraging the existing Tata eco system of Taj hotels and retail outlets will be an obvious option, though the first store is likely to be a standalone one. TGB products like Himalayan bottled natural mineral water will also get a global rub-off, as these will be retailed across the country and even, internationally by Starbucks.

Tatas to get brand royalty from JV

Starbucks will have to strictly follow the Tata Group's brand code and licence fee as their joint venture kicks off. Separate legal contracts have been signed by which the JV will have to adhere to the brand fee rules the Tata Group follows and pay royalty.

In the mid-1990s Tata Sons, the closely held holding company for the group, had announced a royalty - or a "contribution" or a "fee" - to be charged from all Tata group companies for the use of the Tata name, either directly in the company's name or indirectly. The fee ranged from 0.25 per cent of the turnover (not exceeding five per cent of net profit) from blue-chip group companies to 0.10 per cent, depending on the brand leverage. Joint ventures where the foreign partner was offering its brand name gratis were exempted.

Tatas are possibly the only Indian corporate house to have institutionalised a brand code of conduct and have a separate cell within Tata Sons called Brand Equity and Brand Promotion Fund to monitor all brand-related issues.

When it comes to branding initiatives, the JV will have some unique features, too. In a first of its kind move, Starbucks outlets in India will be branded as "Starbucks Coffee, a Tata Alliance". This very usage will make Tata Starbucks Ltd dish out the royalty.

Both the stakeholders of the JV company will pay an equal "equity" or licence fee to Starbucks and Tata Global Beverages, respectively, for using their brands and services. This could even be as high as one per cent of sales. Tata Global Beverages, in turn, will sign a separate agreement with Tata Sons to share 0.25 per cent of the sales value for using the Tata moniker.

Amazon takes the Junglee way to India

Makes quiet entry via comparison shopping site

The world's largest online retailer is tiptoeing into India, using cover from a comparison shopping site Junglee.com it acquired 13 years ago. Amazon, whose moves have been closely watched for any sign of an imminent entry into the Indian retail market, will not sell or buy anything in the country for now. Instead, it will direct customers to both online and offline vendors listed on Junglee.

Conspicuously missing from the list of vendors on the Junglee site is Flipkart.com, India's biggest online retailer founded by two former Amazon executives. Flipkart expects to post sales of Rs. 500 crore by March 2012. Amazon ended 2011 with revenues of USD 48 billion.

Amazon's recent moves to set up a fulfillment centre (in Mumbai) and now the Junglee launch certainly look like precursors to a retail launch whenever the government allows FDI in multi-brand retail. Junglee will display over 1.2 crore products and 14,000 brands for Indian consumers. The company has also launched Amazon seller services in India where vendors can hook up to Amazon's portal to acquire customers

Supreme Court cancels 122 telecom licences

Favours auction route pre-Jan 2008 licences untouched incumbent players to gain FDI hit seen

The Supreme Court has ordered the cancellation of all the 122 unified access service licences issued in January 2008 by former telecom minister A Raja. It also directed the Telecom Regulatory Authority of India (Trai) to make fresh recommendations for the telecom spectrum auction route in future, within four months.

The eight companies holding the licences together invested Rs 35,000-40,000 crore, of which two-thirds was put in by two telcos, Uninor and Sistema. However, with their pan-India market share of about 7.9 per cent (71 million subscribers), their customers are not expected to face any trouble in shifting to competing players, thanks to the option of mobile number portability. Even here, the bulk of the subscribers (over 51 million) are with the two new players. The total number of subscribers in the market stands at 894 million.

The companies whose licences have been scrapped, apart from Uninor (a joint venture between Norway's Telenor and Unitech Group), and Sistema Shyam (it offers services under the MTS brand name through a JV between Russia's Sistema and Shyam Telecom) include S Tel, Videocon, Idea Cellular, Tata Teleservices, Loop Telecom, Etisalat DB (a JV between the UAE's Etisalat and Swan Telecom).

Detailing the future process, the Supreme Court said, "Within two months, Trai shall make fresh recommendations for grant of licence and allocation of spectrum in 2G band in 22 service areas by auction, as was done for allocation of spectrum in 3G band. The Central government shall consider the recommendations of Trai and take an appropriate decision within the next one month and fresh licences be granted by auction."

The court also ordered Tata Teleservices, Unitech Wireless Group and Etisalat DB Telecom to pay Rs 5 crore as fine as they "benefitted by a wholly arbitrary and unconstitutional action taken by the

DoT for the grant of UAS (unified access service) licences and allocation of spectrum in 2G band and who off-loaded their stakes for many thousand crore in the name of fresh infusion of equity or transfer of equity".

Loop Telecom Ltd, S Tel Ltd, Allianz Infratech Ltd and Sistema Shyam Teleservices Ltd shall pay Rs 50 lakh each. The orders were passed by a bench of Justice G S Singhvi and Justice A K Ganguly in public interest petitions moved by the Centre for PIL and Janata Party leader Subramanian Swamy. A special court was set up during the hearing of these petitions last year.

The cancellation of licences will release 470 MHz of 2G spectrum across the country — more than half of what has already been given to the operators. For incumbent players, the decision is a bonanza. For one, it substantially reduces the number of competitors and makes raising tariffs easier. Two, if the auction of 2G spectrum is muted, the price would be what they would have had to fork out as market value of their spectrum when their licences would come up for renewal in 2012.

Power ministry kicks off action plan to reform distribution

In a bid to give a much needed boost to distribution reforms, the power ministry has launched an ambitious action plan.

It will revise Case I and Case II standard bid documents (SBDs), introduce a rating methodology of utilities to enable them get loans, provide a reform-linked interest subsidy to utilities and promote distribution franchises to reduce aggregate transmission and commercial (AT&C) losses.

These steps are crucial, as the cumulative losses of distribution companies increased sharply to Rs 106,347 crore as on March 31, 2010 from Rs 79,339 crore in the corresponding period of the previous year. Besides, the gap without subsidy between the average revenue realised per unit and the average cost of supply had risen to Rs 0.86 in 2009-10 compared to Rs 0.79 in 2008-09.

The ministry has already prepared a consultation paper for revising Case I and Case II SBDs to capture factors arising out of fluctuations in fuel prices, especially during imports and a pass-through provision to consumers. The ministry would hold consultations with the stakeholders and plans to put a draft SBD on its website by April.

The revised case I and case II SBDs would be applicable for future power projects.

The government has proposed capacity addition of 100,000 MW during the 12th Plan period. The new bid documents would not cover those projects where the producers have entered into a power purchase agreement with distribution utilities.

For a rating methodology, the ministry has launched a process to facilitate banks and financial institutions evaluate the performance of utilities and enable them to take informed decisions while providing loans. The banks and institutions would rate utilities on the basis of reforms, including timely tariff revisions, a reduction in AT&C losses, an increase in realisation, etc.

The ministry is finalising the SBD for the appointment of a distribution franchise on the lines of Bhiwandi in Maharashtra to bring down AT&C losses.

Under Case-I bidding, a developer has to decide the location, fuel and technology for the proposed power plant, get all the requisite clearances and acquire land for the same. Here, the onus lies more on the developer than the government. In Case-II bidding, the developer has to bid on the basis of a specific location and fuel. The government facilitates the acquisition of land and clearances, and signing of power purchase agreements.

Equipment sourcing rule likely for IT, telecom

In an initiative that could prompt foreign telecom equipment majors such as Huawei, ZTE and Ericsson to set up base in India, the government is working on a Cabinet note to make it mandatory for all information technology (IT) and telecom public sector units to source 30 per cent of their purchases from domestic equipment makers.

Work on the note has started following a proposal by the Department of Telecommunications (DoT), recommendations of the Telecom Regulatory Authority of India (Trai) and the IT department.

The DoT proposal had, in fact mooted that from the eighth year of any such rule, the sourcing from domestic equipment makers should go up to 80 per cent. However, in that case, the manufacturer would have to match the price of the first lowest bidder. This proposal might not be included in the final cabinet note.

The note is to also ensure that companies setting up base in India do not lose in the long run. So, the research & development rights for their equipment will remain with these companies. Also, for internet protocol (IP) commercial activities by these companies, the commercial value derived from global sales of the product or the IP will accrue to them.

The note will also have value addition norms to ensure foreign companies do not merely import equipment and make only small changes at the Indian facility, officials said. The value addition for Indian products will be 40 per cent for the first year and go up to 60 per cent by the fifth year.

For products assembled or manufactured in India but where intellectual property rights belong to a company registered outside India, or these were developed abroad, the value addition will be 25 per cent for the first year and go up to 45 per cent by the fifth year.

DoT will amend the Unified Access Service Licence conditions to include the provision of market access, value addition and auditing in terms of domestic products.

The note will define a domestic manufacturer as a company registered in India and with a manufacturing facility in the country that could be involved in contract manufacturing. But traders are excluded.

The note from DoT said a service provider procuring over 10 per cent of the requirement of telecom equipment from Indian products should get a discount of 10 per cent of its licence fee for the year. But if the service provider fails to meet the criteria, it would have to deposit an amount equal to 10 per cent of the shortfall in the value of the equipment in the telecom research fund or telecom equipment manufacturing fund.

New York Life to exit Indian insurance JV

In talks with European & Japanese companies; partner Max India to get 1/3rd of proceeds

New York Life Insurance Company plans to sell its near-26% stake in Max New York Life Insurance in a transaction that could see it sharing about one-third of its sale proceeds with Analjit Singh-led Max India, its local partner in the joint venture.

New York Life, the US-based insurer, is in talks with a few European and Japanese companies as it seeks to exit India as part of its strategy to withdraw from Asia and focus on its home market of North America. As part of the strategy, New York Life has divested its stake in operations in Thailand, Hong Kong, South Korea and China since last year.

The US insurer has agreed to pay around one-third of the sale proceeds to its local partner for its contribution in building the business and creating its valuation as well as for giving consent for the deal, even though Max India is not selling any shares itself.

New York Life's stake in the Indian insurance JV is estimated to be worth around Rs. 3,500 crore and Max India could end up earning Rs. 1,000-1,100 crore on the basis of this valuation.

Telco mergers made easier, sharing of spectrum tougher

Sharing rejected for 3G operators, restricted for 2G

The government has approved mergers between telecom companies with a combined market share of 35 per cent and rejected spectrum-sharing among 3G operators while restricting it for 2G operators.

Operators can now share 2G spectrum only in the same service area and those sharing it should hold spectrum. It means operators having spectrum in a few circles cannot enter into roaming agreements in circles where they do not. The sharing will initially be allowed for five years and could be renewed for another five on terms to be prescribed.

Currently, mergers are allowed only if the combined market share of the entities does not exceed 30 per cent. That has been raised to 35 per cent. The modalities for mergers in case of a combined market share of 35-60 per cent will be finalised after Trai recommendations. Under the new rules, the combined entity can hold 25 per cent of the total spectrum in a circle.

In another move that may force a few incumbent operators to give back some spectrum, the department of telecom (DoT) has prescribed a limit of 2x8 MHz to be assigned to a GSM service provider and 2x5 MHz for CDMA players while renewing licences for another 10 years. Taking into consideration the higher density in the two key metros of Delhi and Mumbai, the limit will be 2x10 MHz and 2x6.25 MHz for GSM and CDMA players, respectively.

An operator can acquire additional spectrum beyond these prescribed limits through a market mechanism. Operators keen to extend the licence will have to pay a fee of Rs 2 crore for metro and 'A' circles, Rs 1 crore for 'B' circles and Rs 50 lakh for 'C' circles. Earlier, the operators were assigned spectrum based on subscriber-linked criteria. DoT has accepted the recommendation for refarming of spectrum but spectrum trading and leasing have not been allowed.

No regulatory vetting of M&As involving up to 25% control

Relaxing the rule on mergers and acquisitions to be vetted by it, the Competition Commission of India (CCI) has exempted acquisitions resulting in a cumulative control of up to 25 per cent of shareholding or voting rights from such scrutiny. The current practice sets the limit at 15 per cent.

The change is in sync with market watchdog Sebi's new takeover code, which raised the open offer trigger from 15 to 25 per cent of the shares acquired.

Besides, intra-group mergers or amalgamations involving enterprises wholly owned by group companies will escape CCI vetting.

However, companies that need to undergo CCI scrutiny will now have to spend several times more as the fee for normal M&A (merger and acquisition) scrutiny has been raised from Rs 50,000 to Rs 10 lakh and from Rs 10 lakh to Rs 40 lakh in cases where intense scrutiny is required.

RULE CHANGES

- Simpler application form for clarity and uniformity
- Board-authorised company secretary permitted to sign M&A scrutiny applications along with managing director or director
- Parties to provide details of value of assets and turnover, and copies of M&A agreement, board resolution, etc
- A brief summary of the combination must be filed when filing notice

Since July 2011, the Competition Commission has cleared 28 merger and acquisition applications. In none of those did it find any possibility of an adverse impact on competition.

FIPB accepts pharma FDI riders

Technology & research investment conditions rejected sector gets long-awaited clarity

The Foreign Investment Promotion Board (FIPB) has accepted some of the stiff riders proposed by the health ministry for multinational pharmaceutical companies trying to acquire Indian firms. However, it has rejected the ministry's proposal to insist such companies must bring new technology and invest the necessary funds in research and development so that new molecules were developed keeping Indian conditions in mind. It has also rejected a proposed mechanism to monitor compliance of these conditions.

The three pharma proposals where the health ministry's proposed riders have been accepted and the requests cleared include the 100 per cent acquisition of Bangalore-based Pharmaceutical Ingredients and Formulations India Pvt Ltd by US company Levomed Inc and a proposal of US-based Akorn Inc to buy 100 per cent stake in Akorn India Pvt Ltd. The third proposal was of Edict Pharmaceuticals, in which the existing shareholders proposed to sell 100 per cent stake to Par Pharmaceuticals of the US.

With this, half a dozen-odd pending FDI (foreign direct investment) proposals are also expected to be cleared.

CONDITIONS ACCEPTED

- Foreign company must seek approval before curtailing or discontinuing production of any active ingredient or formulation part of the national list of essential medicines
- Manufacturing facility must continue to be used for supply of medicines to the domestic tariff area as during the financial year preceding the year of acquisition
- Acquirer must increase production of generic medicines and make them available for domestic use before export
- Acquired company should go for value addition and new products, and meet commitment to create jobs

NOT ACCEPTED

- Acquirer must bring new technology and invest in research so that molecules were developed keeping Indian conditions in mind
- A compliance-monitoring mechanism must be set up

One of the riders accepted says the company must seek approval before curtailing or discontinuing production of any active pharmaceutical ingredient or formulation included in the national list of essential medicines. Another is the manufacturing facility must continue to be used for supply of medicines to the domestic tariff area as done during the financial year preceding the year of acquisition. Also, the acquirer must increase the production of generic medicines in the acquired facility and make them available for domestic use before export.

The ministry has added the acquired company should go for value addition and new products. It should also meet the commitment to create jobs (as promised by Akorn).

The ministry has suggested the FIPB set up a mechanism in the department of pharmaceuticals or the department of industrial policy and promotion (DIPP) to ensure undertakings or commitments made by companies were complied with and the compliance monitored regularly.

The FIPB, however, said a monitoring mechanism should be examined by the DIPP and incorporated in amendments to the FDI policy, if required. It observed the insistence on funds for research and bringing new technology was not a practice in any sector. The board added that till such time as the policy was not amended, the health ministry must directly convey the conditions it had imposed and oversee their compliance in the absence of an FIPB mechanism.

Brownfield investments in the pharma sector came under the FIPB approval route as an interim measure last year after the Cabinet decided to monitor foreign takeovers of Indian pharma companies from a public health perspective.

FIPB scrutiny was recommended until the Competition Commission of India (CCI) got legislative support to scrutinise pharma M&As (mergers and acquisitions) irrespective of the deal size.

Manufacturing policy runs into labour trouble again

Labour ministry has refused to relax labour laws inside the national manufacturing zones

The ministry of labour and employment may have given a green signal to the broad contours of the National Manufacturing Policy (NMP), but the policy has yet again run into trouble. The ministry has refused to relax labour laws inside the national manufacturing zones (NMZs).

The Department of Industrial Policy and Promotion (Dipp), the nodal agency for NMP, had written to the labour ministry, requesting it to reconsider labour laws related to employability and retrenchment of workforce inside the NMZs. The letter specifically sought to transfer the responsibility of the industrial establishments to insurance companies, in case of closure and layoffs.

In its reply, the labour ministry has conveyed the law cannot be changed as it could possibly jeopardise the social security of workers. The labour ministry believes that such a change could be time consuming as it would require amendment to the Industrial Dispute Act, 1947.

Labour laws relating to closure and retrenchment are governed by the Industrial Disputes Act, 1947, according to which industrial establishments are required to provide compensation and alternative employment to workers if they are laid off or the establishment shuts down. Indian labour laws have often been criticised for being too harsh on the employer.

Delisting 'nightmare' haunts MNCs

With June 3, 2013 deadline to push stakes below 75% nearing, most may have to use their accumulated profit of 10 years to delist from SEs

Delisting shares from Indian bourses could cost multinational companies dear, as some of them may have to shell out more than 10 years of their accumulated net profits to delist their Indian entities.

The global parents of some of the Indian entities may find the fund set aside for delisting inadequate as their share prices soar on hopes of delisting, making it unviable for some firms to delist, said industry experts. As per regulations, the global parents will have to reduce promoter stake to below 75% if they fail to delist their Indian units before June 3, 2013.

Most of these delisting candidates have surged once again, trading at exorbitant valuations. This may make delisting expensive even for MNCs with deep pockets.

A failure to delist can result in the stock price of the company coming down in the same manner as it could have caused it to rise in case of a successful delisting. Several foreign companies are being prompted to delist due to increasing compliance requirements and rising investor activism, which are interfering with their day-to-day operations.

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Chadha & Co. is a law firm based in New Delhi, India, with a strong Corporate and Commercial practice. The Firm has a specialized inbound practice in advising domestic and foreign corporations doing business in India on all Indian laws and regulations that are relevant to their business.

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