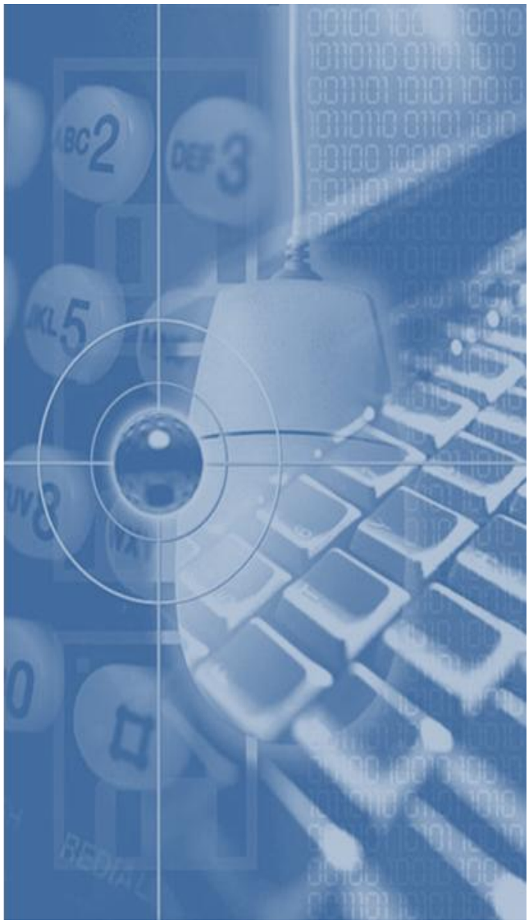

M&A LAB

BHARTI - MTN DEAL (Part – I) Dissected

Dissected by – *Team M&A*

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Nishith Desai Associates ("**NDA**") is a research oriented international law firm with offices in Mumbai, Bangalore, Singapore and USA. The firm specializes in providing strategic legal and business solutions coupled with industry expertise. Core practice areas of the firm include mergers and acquisitions, structuring and advising on outbound & inbound investments, private equity investments and fund formation, international tax, globalisation, intellectual property and dispute resolution. From an industry perspective, the firm has practice groups which have developed significant expertise relating to various industries including but not limited to banking and financial services, insurance, IT, BPO and telecom, pharma and life sciences, media and entertainment, real estate, infrastructure and education sectors.

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PROLOGUE

Bharti Airtel Limited's ("**Bharti Airtel**") announcement of intent to forge a strategic merger with MTN Group Limited ("**MTN**"), the South African cellular mobile operator with a pan African and Middle East subscriber base, comes as a shot in the arm to the already in vogue blitzkrieg of Indian outbound acquisitions. Bharti Airtel and MTN have agreed to discuss the potential strategic merger ("**Transaction**") exclusively with each other until July 31, 2009.

Terming the Bharti Airtel-MTN combine as an "*emerging market telecom powerhouse*", Sunil Bharti Mittal, Chairman and MD of Bharti Airtel in the media statement ("**Media Statement**") issued on May 25, 2009, said, "*Both companies would stand to gain significant benefits from sharing each other's best practices in addition to savings emanating from enhanced scale. We see real power in the combination and we will work hard to unleash it for all our shareholders. This opportunity also represents a first of its kind in developing an Indian-African initiative that would serve as a shining example of South-South cooperation*."

The '*Runaway Bride*' MTN, which in the past dumped several leading cellular operators making "*strategic merger*" offers including Bharti Airtel and Reliance Communications, has now agreed to explore the possibility of a "*strategic merger*" with Bharti Airtel until July 31, 2009. The Transaction, if consummated, will catapult the Bharti-MTN combine as the fourth largest telecom operator in terms of subscriber base outshining AT&T, France Telecom and Verizon with more than 200 million subscribers, and revenues in excess of USD 20 billion.

In this M&A Lab, we attempt to anatomize the Transaction and in the process analyze the legal and regulatory implications that the deal is likely to encounter until its consummation, based on the set of facts which are currently in public domain. In keeping with our tradition to analyze international legal and regulatory regimes, we have, in this lab also attempted to ascertain and analyze the potential issues under the South African laws that the deal may encounter in South Africa to provide more fullness to the dissection.

BACKGROUND

Parties Involved

MTN

Initially known as M-Tel, MTN was incorporated in the year 1994. It is a leading service provider of communication services, offering cellular network access and business solutions. The MTN Group carries on these services through its several subsidiaries in most African and Middle East countries with an approximate market share of 30%-40% in each of the countries.

Bharti Airtel Limted

India's first private telecom services provider with a footprint in all the 23 telecom circles. Widely regarded as India's largest service provider in terms of annual revenues, Bharti Airtel provides mobile & fixed wireless services using GSM technology across all the telecom circles alongwith broadband & telephone services in 94 cities. All these services are provided under the Airtel brand. Bharti Airtel, as we understand, also has licenses to operate telecom operations in Sri Lanka and Seychelles.

*Bharti Telecom Limited ("**Bharti Telecom**")*

It is the holding company of Bharti Airtel which has 45.3% shareholding[1] in Bharti Airtel. Bharti Telecom is likely to play an instrumental role in the structuring of the Transaction, and for this purpose its shareholding pattern is described in this lab.

SingTel

Founded in 1879 in Singapore, SingTel is Asia's leading communication group with operations and investments in more than 20 countries across the world. With significant operations in Singapore and Australia (through wholly-owned subsidiary SingTel Optus), the Group provides a comprehensive portfolio of services that include voice and data services over fixed, wireless and Internet platforms. It has a direct stake in Bharti Airtel.

Chronology of key events

The chronology of the key events till the proposed scheme of arrangement is summarized as follows[2]:

Date	*Events*
May 5, 2008	Bharti Airtel announces that it has entered into exploratory discussions with the MTN Group
May 6, 2008	Bharti Airtel denies media reports that it has put an offer on the table for acquiring MTN
May 16, 2008	Both parties reach an in-principle agreement, and a term sheet was initiated between the two parties
May 21, 2008	The agreed term sheet is presented to the MTN Board
May 24, 2008	Bharti Airtel withdraws from the talks, following the MTN board presenting a completely different structure to Bharti Airtel. Bharti Airtel sees this new proposal as a convoluted way of getting indirect control of the proposed combined entity, which would have made Bharti Airtel a subsidiary of MTN.
May 26, 2008	Reliance Communications ("**RCom**") enters into exclusive merger discussions with MTN
June 13, 2008	RCom alleges that Reliance Industries Limited ("**RIL**") sent a communication to MTN, making a claim of the right of first refusal. MTN dismisses RIL's claims
July 19, 2008	RCom and MTN formally end talks
May 21, 2009	Bharti Airtel makes a media statement that it has entered into talks for a 'strategic merger' with MTN

COMMERCIAL CONSIDERATIONS

The Indian telecom growth story, we believe seems to have remained unaffected by the global liquidity crisis, with unabated interest in the sector from global operators. The Indian telecom market is regarded as the fastest growing in the world, with the number of total outstanding cellular subscribers growing at an exponential pace. The fact that a large segment of the market remains untapped has lead to a heightened interest from investors in relation to the telecom sector. The proposed Bharti Airtel-MTN deal, we believe, would be the crown jewel among a host of other high profile acquisitions in the telecom sector.

[1] Source: As per Ministry Of Corporate Affairs website as on June 3, 2009

[2] Source: www.medianama.com

The following statistical data shows the pace of the growth that has been witnessed by the Telecom sector.

Particulars	USD in million
FDI inflows during 2008-09 *(from April 2008 to March 2009)*	27,309
FDI inflows Telecommunications *(radio paging, cellular mobile, basic telephone services)*	2,588

Year	Acquirer	Target	% Stake Acquired	Deal Value (USD million)
2009	Batalco	SingTel	49	225
2008	NTT DoCoMo	Tata teleservices	26	2,700
2008	Telenor	Unitech Wireless	60	1,070
2008	Etisalat	Swan telecom	45	900
2008	Telecom Malayasia	Idea Cellular	14.9	1,707
2008	Providence Equity	Aditya Birla telecom	20	640
2007	Vodafone	Hutchinson Essar	67	13,665
2006	TA Associates Inc	Idea Cellular	4	125
2006	Providence Equity	Idea Cellular	20	623
2006	Hutchinson Telecom	Hutchinson Essar	5	450
2006	Aditya Birla Group	Idea Cellular	48	983
2006	Telecom Malayasia	Spice	49	179
2006	Temasek Holdings	Tata Teleservices	10	300

Source: Department of Industrial Policy and Promotion

Why MTN?

With the liberalization of the telecom policy and entry of several new players in the telecom sphere providing varied telecom services such as dual CDMA and GSM services, Bharti Airtel is facing competition from other telecom service providers. This competition is further expected to increase due to introduction of 3G services and mobile number portability. Thus, expansion becomes essential for Bharti Airtel to maintain its supremacy in telecom sector that it has maintained all this while.

Considering the stagnant growth rate in telecom sector in developed economies, Bharti Airtel had in the past made unsuccessful bids to enter emerging foreign telecom markets. Bharti Airtel had participated in auctions for bidding for telecom licenses in countries like Kenya and acquisition of stake in the national telecom operator of Gabon. In fact, exactly a year prior Bharti Airtel had entered into an exclusive agreement with MTN to acquire a stake in MTN and explore the possible synergies that can be developed between the two companies, but the negotiations fell away for reasons discussed later herein.

There are certain significant gains that Bharti Airtel is expected to derive from acquiring stake in MTN. The acquisition would provide Bharti Airtel access to the African continent and Middle East countries, which have huge potential for growth. It may be noteworthy, that in terms of the subscriber base, both Bharti Airtel and MTN have same size, however the average revenues per user ("**ARPU**") in African countries and Middle East countries is considerably higher that the ARPU in India. The ARPU of MTN's operations in various countries range within USD 7-36 per month, with an average blended ARPU of USD 14 in the year 2008, while Bharti Airtel's average ARPU is USD 6.4 per month.

A Comparative Analysis[3]

Heads	*Reference*	*Bharti Airtel (USD Million)*	*MTN (USD Million)*
Revenue	FY09/CY08	7,781	12,062
Revenue CAGR	2-year,%	41.30	40.09
EBITDA	FY09/CY08	3,193	5,078
EBITDA Margin	FY09/CY08, %	41.00	42.10
Net Profit	FY09/CY08	1,783	1,802
Mobile subscriber base4	Million	93.90	98.20
ARPU5	$/month	6.80	13.20
Enterprise value		33,894	27,887
Market Cap		32,426	26,166
Net Debt	FY09/CY08	1,468	1,721
Net debt-equity ratio	FY09/CY08	0.2	0.2
Net debt-EBITDA	FY09/CY08	0.5	0.5
EV/EBITDA	FY11E/CY10E	6.9	4.2
EV/subscriber	FY11E/CY10E	144.90	207.80

What is in it for MTN?

As per MTN CEO Phuthuma Nhleko, the rationale for the potential transaction is highly compelling as MTN seeks to address its strategic imperative of becoming one of the pre-eminent emerging market telecommunications companies with leading positions in three of the fastest growing wireless markets globally (India, Africa and the Middle East) with no overlapping footprint.

We believe that the proposed Transaction would give access to MTN into hitherto untapped Asian sub-continental markets without having the need to create any ancillary infrastructure. The fact that the combine would be one of the largest telecom service providers in the world would, we believe help MTN to leverage its position in the global market giving it more commercial visibility.

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[3] Source: Respective Companies, COAI, Angel Research. Note: We have taken a rupee-dollar conversion rate of 47.50 and a South African rand-dollar conversion rate of 8.50

[4] Source: Mobile Subscriber base taken as on 31 March 2009 for both companies

[5]Source: APRUs, calculated on the average of 31 March 2009 and 31 March 2008 subscriber figures for Bharti Airtel, and on the average of 31 December 2008 and 31 December 2007 subscriber figures for MTN

What happens to Singtel?

When the Bharti Airtel management announced the renewal of talks, the general sentiment was that SingTel (which has a 15% stake in Bharti Airtel) would burn its fingers badly. However, the reality, presumably, may be different as SingTel would not only remain a significant player in the Bharti-Airtel merger sweepstakes, it would see an expansion of its footprint to Africa and West Asia where it has no presence so far. It is safe to assume that SingTel riding on this deal is poised to penetrate new markets.

The media Statement while not providing any definitive stand on SingTel's involvement in the deal, makes it clear that Singtel would remain a significant shareholder and strategic partner in Bharti Airtel post the merger.

THE DEAL AS ENVISAGED

I. *Bharti Airtel-MTN proposed deal in the year 2008*

Last year in May 2008, Bharti Airtel had proposed to acquire a majority share in MTN of approximately 40%. For the same, an in-principle agreement was reached on May 16, 2008 between the two companies and a term sheet was executed. It was reported that on May 21, 2009, MTN, in its board meeting, considered the term sheet and instead proposed an alternate structure where MTN was to acquire majority of shares held by Bharti family and SingTel in Bharti Airtel.

Why did the deal fail then?

The above structure was not acceptable to Bharti Airtel. In its statement to media, Bharti Airtel stated that the structure proposed by MTN would have compromised the interest of minority shareholders of Bharti Airtel and also would not capture the synergies of a combined entity as contemplated by Bharti Airtel. Bharti Airtel also mentioned that Bharti's vision of transforming itself from a home-grown Indian company to a true Indian multinational telecom giant, symbolising the pride of India, would have been severely compromised and this was completely unacceptable to Bharti Airtel.

Apart from the issue of control of the combined entity, the following factors may have had a bearing on the breakaway of the negotiation talks between the two companies:

- Independent directors of MTN were concerned with the Indian Foreign Direct Investment ("**FDI**") restrictions, which mandate prior approval from the Government of India.
- They also expressed their displeasure on the amount of debt that proposed combined entity would be burdened with.
- Mr. Cyril Ramaphosa, Chairman of MTN, did not give his approval to the merger which resulted in the board rejecting the proposal. As there was a speculation that Mr. Ramaphosa might succeed President Thabo Mbeki whose tenure ended in September 2008, he was agreeable to the change in ownership of MTN, but for political reasons wanted the company to exist.
- MTN's financial advisors approached another Indian telecom company, RCom, which had also expressed its interest in having discussions for possible synergies with MTN.

- Apart from Bharti Airtel and RCom, there were several other companies eager on bidding for MTN. A bidding war would have possibly pushed the valuations of the company close to ZAR 180-200 per share creating a more lucrative option, as the proposed deal between Bharti Airtel and MTN was discussed with a reference price of around ZAR 160 per share.

What has changed?

After the talks between MTN and Bharti Airtel had fallen through, there have been few significant changes which we believe have tilted the balance in favour of Bharti Airtel. In 2008, the talks were not viewed as being on an even plane for MTN had more subscribers as compared to Bharti Airtel. However now with both companies having a 100 million strong subscriber base each, the negotiations may switch to other considerations like per-subscriber cost of acquisition, tilting the scales in favour of Bharti Airtel.

The financial impact of the global financial tsunami has probably been instrumental for MTN and Bharti Airtel to reconsider the idea of merger on mutually acceptable terms. Going by media reports, thanks to the scorching growth in emerging markets, the proposed merger would catapult the combine to the top five global industry players, while last year, the combined group would have ranked among the top ten.

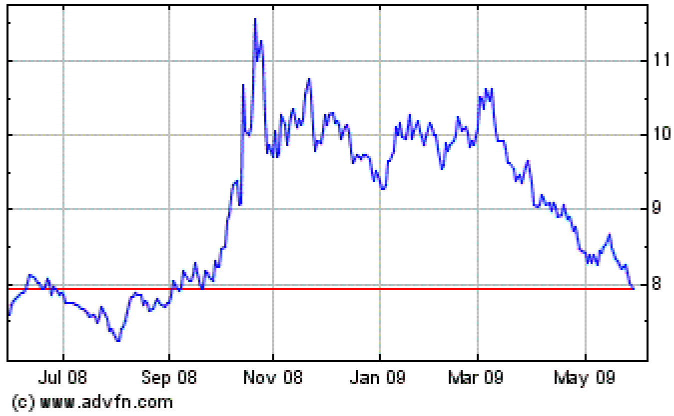
Bharti Airtel-MTN combine as compared to other telcos[6]

Service Provider	*Subscribers (million)*	*Revenue (USD billion)*	*Market Cap (USD billion)*
China Mobile	482.89	59.39	189.6
Vodafone group	289	70.20	96.50
Telefonica	261	82.20	98.50
Bhart+MTN	**200**	**20.70**	**61.50**
AT&T	141.80	123.90	139.7
France telecom	123	78.70	61.1
Verizon	86.60	100.10	81.80
NTT	76.70	104.10	65.30
America Movil	58	30.20	61.60
NTT DoCoMo	54.60	44.40	65.20

What sweetens the deal in favour of Bharti Airtel is the fact that the South African ZAR fell far more against the dollar last year than the Indian rupee, about 80 percent compared with the Rupee's 22 percent drop in 2008. At a time, when MTN has improved its performance riding on escalating subscription revenue, it appears that the proposed deal would act like godsend for Bharti Airtel as the lower value of the ZAR would have a reducing effect on the valuation of the deal. The graph reproduced below shows the rapid decline in the value of the ZAR as compared to the USD since July 2008[7].

[6] Source: Bloomberg, company data

[7] Source: www.reuters.com



However what might be a cause of concern for Bharti Airtel is the fact that the ZAR has rallied more than 2 percent, touching an 8-month high of 8.066 to the USD, partly on optimism over the proposed deal, which in the future may lead to a renegotiation of the existing valuation.

II. *The Deal Now*

Expounding on the manner in which the telecom behemoth slated to generate revenues in excess of USD 20 billion every year will be created, the Media Statement mentions that the merger would be achieved through a scheme of arrangement ("**the Scheme**"), which would essentially be based on the following principal elements:

- MTN would acquire approximately a 25% post-Transaction ***economic interest*** in Bharti Airtel for an effective consideration of approximately USD 2.9 billion in cash and newly issued shares of MTN equal to approximately 25% of the currently issued share capital of MTN.
- Bharti Airtel would acquire approximately 36% of the currently issued share capital of MTN from MTN shareholders for a consideration comprising ZAR 86.00 in cash and 0.5 newly issued Bharti Airtel shares in the form of Global Depository Receipts ("**GDRs**") for every MTN share acquired which, in combination with MTN shares issued in part settlement of MTN's acquisition of approximately a 25% post-Transaction economic interest in Bharti Airtel, would take Bharti Airtel's stake to 49% of the enlarged capital of MTN. Each GDR would be equivalent to one share in Bharti Airtel and would be listed on the Johannesburg Stock Exchange ("**JSE**").
- Bharti Airtel would have substantial participatory and governance rights in MTN enabling it to fully consolidate the accounts of MTN
- MTN's economic interest in Bharti Airtel would be equity accounted and would have appropriate representation on the Bharti Airtel Board

The proposed deal involving two legs can be schematically represented as follows:

Transaction Leg 1:

- MTN gets 25% economic interest in Bharti Airtel

- Bharti Airtel gets USD 2.9 billion + acquires 25% stake in MTN (effectively around 20% on enlarged capital base post issuance of shares to Bharti Airtel)

Transaction Leg II:

- Bharti Airtel acquires 36% of the existing shares from the MTN shareholders (effectively around 29% on enlarged capital base post issuance of shares to Bharti Airtel)
- MTN shareholders get ZAR 86 + 0.5 GDR per MTN share

Summarily, Bharti Airtel will effectively acquire 49% interest in MTN for USD 24.1 billion, of which USD 20 billion will be offset by share/GDR swap resulting in a net cash outflow of USD 4.1 billion from Bharti Airtel to MTN. Since Bharti Airtel will have substantial participatory and governance rights in MTN enabling it to fully consolidate the accounts of MTN, MTN is likely to become a subsidiary of Bharti Airtel.

Level of detail in the media statement does seem to suggest that Bharti Airtel has done its homework well this time, and with a seemingly well thought out structure already on the charts to consummate the Transaction, the sentiment seems positive that the deal is likely to go through this time, regulators willing.

The "strategic merger" depicted by Bharti Airtel as the first step to and a harbinger of, the much larger full merger of Bharti MTN is likely to walk the tight rope of foreign direct investment ("**FDI**") regulations, which, though eased by the introduction of Press Note 2 of 2009, still requires foreign shareholding in Bharti Airtel to be below 74% Further, foreign investment in Bharti Airtel, is likely to be crafted in a manner that also leaves enough headroom for further foreign investment in Bharti Airtel.

If the Transaction goes through, Bharti Airtel will acquire 49% shareholding in MTN (through a combination of share transfer and fresh issuance), MTN shareholders will acquire 11% GDRs with Bharti Airtel's underlying shares and 25% 'economic interest' in Bharti Airtel. Media reports anticipate post merger shareholding of Bharti Airtel and MTN to be as follows[8]:

Bharti Airtel	***Figures in millions***
Total Shares Outstanding	1898
MTN acquire 25% stake through GDRs/Shares of Bharti Airtel	744
Share issuance in the form of Bharti Airtel GDR to MTN shareholders	336
Total Shares outstanding	2979
% Stake of MTN in Bharti Airtel	24.7%
% Stake of MTN shareholders in Bharti Airtel	11.3%
% Dilution of Bharti Airtel's stake	57.07%

MTN	***Figures in millions***
Total Share Outstanding	1869
Bharti Airtel acquires 36% of MTN at price of ZAR 86 (29% on enlarged capital base)	673
Additional shares issued for 25% to MTN (20% on enlarged capital base)	467
Total Shares outstanding	2337
% Stake of Bharti Airtel in MTN	49%
% Dilution of MTN stake	25.0%

[8] Source: Bloomberg, Company Data

LEGAL, REGULATORY AND TAX CONSIDERATIONS

I. SOUTH AFRICAN LAW IMPLICATIONS

South African Securities Regulation Code on Takeovers and Mergers ("Code")

We understand that under the provisions of the South African Securities Regulation Code on Takeovers and Mergers ("**SA Takeover Code**"), any acquirer ("**Acquirer**") acquiring more than 35% of securities of a South African Company ("**Target**") is further obligated to make an open offer to acquire all the remaining securities of the Target from the existing shareholders of the Target.

Since Bharti Airtel will be acquiring 49% stake in MTN, Bharti Airtel may be obligated to make an open offer for acquisition of all the remaining shares of MTN. As per the media reports, a Scheme of Arrangement ("**Scheme**") is proposed to be used for the consummation of the Transaction. The provisions relating to a Scheme are provided under the Section 311-313 of the South African Companies Act, 1973 ("**SA Companies Act**"). Under the provisions of the SA Companies Act, we understand that a Scheme, drawn between the Target and its shareholders, is required to be approved by a majority of three-fourths of its shareholders in value. After seeking the necessary approvals from the shareholders, courts may sanction the Scheme. Once the Scheme has been approved by the Court, it becomes unconditional and will be applicable to the dissenting minority shareholders too.

We understand that making an offer to public may be mandatory under the SA Takeover Code unless:

(a) Bharti Airtel procures a dispensation from Securities Regulation Panel; or

(b) enters into an agreement with existing shareholders agreeing to waive the requirement to make the mandatory open offer; or

(c) the Scheme is sanctioned by 75% shareholders. Since the acquisition is proposed to be by way of a court approved Scheme (which anyways requires approval of 75% shareholders), the role play of minority shareholders will be fairly limited as the Scheme, once approved, will also be binding on the minority shareholders. Accordingly, reaching the 75% threshold will therefore be crucial for Bharti Airtel to consummate the Transaction.

Independent Communications Authority of South Africa

Apart from the need to make a mandatory open offer as discussed above, approval of the Independent Communications Authority of South Africa ("**ICASA**") may be required. ICASA recently granted approval for MTN's competitor Vodacom for its controlling interest to pass to Vodafone in the UK, and may therefore be uncomfortable granting a similar approval in case of MTN as the ICASA may be uncomfortable in the control of both the largest telecom players of South Africa being passed on to foreign hands.

Other Issues

There are several other Corporate and Securities Laws applicable to both Bharti Airtel and MTN, including, the Securities Services Act, 2004 entailing provisions pertaining to insider trading and market manipulation, the Competition Act, 1998, regulating mergers and combination of entities. As securities of MTN are listed on JSE, the companies would be required to meet with the Listing Requirements of the Johannesburg Stock Exchange Limited.

II. THE INDIAN LAW IMPLICATIONS

FDI Regime

Press Note 5 of 2005 ("**Press Note 5**"), Press Note 3 of 2007 ("**Press Note 3**") and Press Note 2 of 2009 ("**Press Note 2 of 2009**") provide for the regulatory framework for FDI in telecom sector and are instrumental to ascertain the trend and degree of regulation that the Government of India intended and intends to administer on FDI attendant downstream investments in the telecom sector. A brief overview of each of these Press Notes is mentioned herein below to equip the reader with a better understanding of the deregulation and liberalization of the Indian FDI regime.

Press Note 5

Initially FDI in telecom sector was capped at 49%. Government of India, with a commitment to liberalize the FDI regime, decided to enhance the FDI ceiling from 49% to 74% in certain telecom services which included such as Basic, Cellular, Unified Access Services, National/ International Long Distance, V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS) and other value added services subject to certain conditions, which amongst other included, prior approval of FIPB for enhancing FDI from 49% upto 74%.

As regards computation of FDI, Press Note 5 provided that 74% FDI limit shall apply to FDI infused into the telecom services company both directly (that is, by investing directly into the company engaged in the business of telecom) or indirectly (that is, by investing into the holding company, of which the company engaged in the business of telecom is a subsidiary). Press Note 5 clarified that in the instances of indirect holding in the operating company, the extent of FDI would be calculated on a *proportionate basis*.

Press Note 3

The Press Note 3 was an extension of the earlier Press Note 5, and clarified that the extant Indian shareholding in telecom companies cannot be less than 26%. However, it is important to note that both Press Note 5 and Press Note 3 provide for certain security conditions that have to be considered while approving FDI proposals in the Telecom sector. The fact that MTN operations primarily cover African countries with a history of security problems and unstable political systems may make the proposed deal subject to a more stringent scrutiny by FIPB. Calculation of indirect foreign investment was still supposed to be on proportionate basis.

Decoding Press Note 2

Press Note 2 of 2009 clarifies the manner and mechanism for calculating indirect foreign investments in Indian companies. In terms of Press Note 2 of 2009, if an Indian investing company, which is "*owned*" or "*controlled*" by "*non-resident entities*", then the entire investment by the investing company into the subject downstream Indian investee company would be considered as indirect foreign investment.

"*owned*" by resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, if more than 50% of the equity interest in it is beneficially owned by resident Indian citizens and Indian companies, which are owned and controlled ultimately by resident Indian citizens

"*controlled*" by resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, if the resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, have the power to appoint a majority of its directors

"*Non-resident entity*" means a 'person resident outside India' as defined under FEMA 1999.

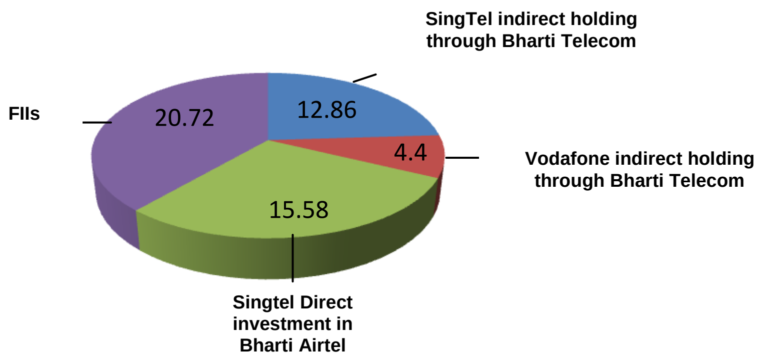
Accordingly, Press Note 2 of 2009 makes it very clear that in the case of "*indirect foreign holding*" of an Indian company in a restricted sector ("**Target**") which is held through another Indian company ("**Investing Company**"), the indirect foreign holding will counted as foreign holding in the Target only if:

(i) the foreign ownership in the Investing Company is more than 50% of the equity capital of the Investing Company, or

(ii) the right to appoint the majority of directors to the board of the Investing Company rests with foreign parties.

While Entry 8 of Press Note 2 of 2009 mentions that any foreign investment already made in accordance with the guidelines in existence prior to issue of this Press Note would not require any modification to conform to these guidelines, any fresh investments are required to be in compliance with Press Note 2 of 2009. Take the example of Bharti Airtel. Foreign investment in Bharti Airtel until the introduction of Press Note 2 of 2009 was as follows:

Under Press Note 5 of 2005[9]:



To put it simply, foreign investment in Bharti Airtel until the issue of Press Note 2 of 2009 was calculated to include Singtel and Vodafone's shareholding in Bharti Telecom translating to 12.86% and 4.4% effective interest in Bharti Airtel, respectively. However, in line with the manner of calculation of foreign investment in

[9] Source: Business Standard, May 27, 2009. We understand that this is only an indicative indirect foreign shareholding for SingTel and Vodafone in Bharti Airtel and there may be other foreign shareholders as well.

downstream companies as stipulated in Press Note 2 of 2009 (as described above), total foreign investment in Bharti Airtel shall not take into consideration any foreign investments at the holding company level, unless the holding company is owned or controlled by non residents.

So, in the above instance, if Press Note 2 of 2009 is followed thereby excluding indirect foreign shareholding of foreign investors in Bharti Telecom including SingTel and Vodafone, there should be enough headroom to accommodate further foreign investment in Bharti Airtel.

Typically, the license (“**License**”) to set up and operate the Unified Access Services, which Bharti Airtel must have procured for the purposes of carrying out its telecom operations, stipulates that 74% threshold for foreign investment shall be calculated in the same manner as stipulated in Press Note 5 of 2005, which takes into account foreign investment at the holding company level as well.

Entry 6.0 of Press Note 2 of 2009 stipulates that the methodology for computation of total foreign investment under Press Note 2 of 2009 shall not apply for determining the total foreign investment in sectors governed specifically under any statutes or rules thereunder. Since the License is issued under the provisions of Indian Telegraph Act, 1885, the regulators may take a view that Bharti Airtel may be ineligible to take the advantage of Press Note 2 of 2009 unless the provisions of the License are amended in consonance with Press Note 2 of 2009.

Applicability of the Takeover Code

One of the most important questions being debated over is whether or not will MTN have to make the mandatory open offer for acquisition of 25% economic interest in Bharti Airtel. Under regulation 10 of the SEBI (Substantial Acquisition and Takeovers) Regulations, 1997 (“**Takeover Code**”), any person acquiring 15% shares or voting rights in a listed company is obligated to make an open offer for the acquisition of 20% additional shares.

However, as per Regulation 3(1)(j) of the Takeover Code, any acquisition of shares or voting rights made pursuant to a scheme of arrangement (“**Scheme**”) is exempt from the application of Regulations 10, 11 and 12 which deal with open offer requirements. In the proposed transaction if the acquisition of economic interest of Bharti Airtel by MTN is made pursuant to the Scheme, benefit of exemption could be taken.

However MTN would have to make the periodical disclosures mandated under the Takeover Code to the stock exchanges (wherein shares of Bharti are listed) as and when it acquires 5% or more shares of Bharti Airtel along with mandatory yearly disclosures.

Regulatory Approvals

i. Cabinet Committee on Economic Affairs ("**CCEA'**)

As per Press Note 7 of 1999 issued by the Department of Industrial Policy and Promotion ("**DIPP**"), any investment proposal in excess of Rs. 6,000 million (approx USD 128 million) requires the prior approval from the CCEA. In the proposed transaction, it is estimated that total investment (cash + shares/GDRs) by MTN would be (approx) USD 24.1 billion, thereby necessitating a prior approval from the CCEA.

ii. Foreign Investment Promotion Board ("**FIPB**") / Department of Telecom ("**DOT**")

In the proposed Transaction, it is likely that there would be an element of swapping of shares/GDR wherein Bharti Airtel would issue fresh shares in favour of MTN as consideration for the issue of shares by MTN in favour of Bharti Airtel. Therefore, prior approval of FIPB would be a pre-requisite as per the applicable exchange control guidelines since a share swap is not permissible under the automatic route. Further, any FDI in the Telecom sector beyond 49% requires the prior approval of FIPB and FIPB in turn could refer the matter to DOT.

iii. RBI

The FIPB may refer the matter to RBI since the Transaction will involve swap of shares which will happen for a consideration other than cash. The RBI approval is likely to come stapled with FIPB approval.

Corporate Law

The tenor of the Media Statement suggests that MTN would be treated as a subsidiary of Bharti Airtel for the purposes of consolidation of accounts. In the event of such a treatment, it would be difficult for MTN to have voting rights in Bharti Airtel as Section 42 of the Companies Act, 1956 ("**Act**") precludes a subsidiary from exercising its voting rights on shares of its holding company. Further, consent of other shareholders who may have negotiated certain investor protection rights at the time of their investment may also be required.

Tax Laws

Since the Transaction does not envisage transfer of shares of an Indian company, there should not be any capital gains tax in India. However, if the structure finally agreed upon in the Transaction envisages transfer of Indian company's shares, capital gains tax may be applicable as per the Indian Income Tax Act, 1961, unless the said capital gains are exempt under the provisions of the appropriate tax treaty, if any.

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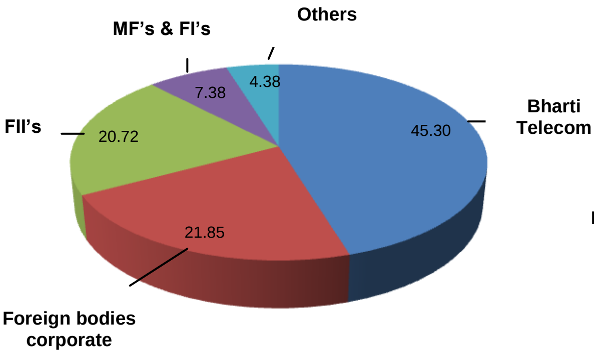
PROPOSED STRUCTURE

The following are possible structures that in our view are likely to be explored by Bharti Airtel and MTN to consummate the Transaction and to achieve the commercial objectives. The structures are based on the facts made public by the Media Statement and the intent to allocate a mere economic interest to MTN in Bharti Airtel. Depending on the actual facts and circumstances, the parties to the Transaction may explore other viable structures. Further, MTN and Bharti Airtel may ultimately decide to invest through intermediate jurisdictions for tax efficiency and flexibility in restructuring purposes.

Before we attempt to analyze the possible structures that may be considered for the Transaction, it will be important to familiarize the reader with the shareholding patterns of both Bharti Airtel and its parent, Bharti Telecom.

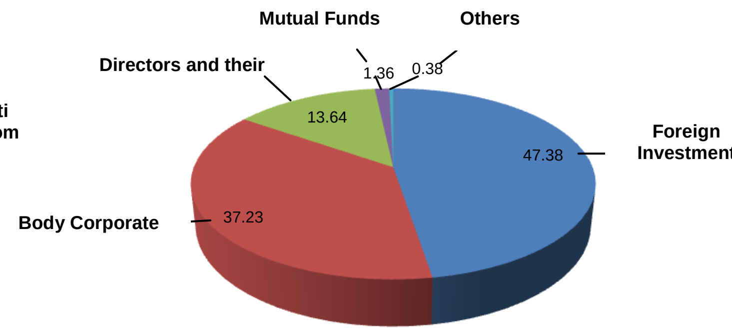
Present shareholding in Bharti Airtel:[10]

Foreign Investment: **43.14%**
Domestic Investment: **56.86%**



Present Shareholding in Bharti Telecom[11]:

Foreign Investment: **47.38%**
Domestic Investment: **52.62%**



We understand that the concept of "***economic interest***" may be instrumental, as all the ensuing structures that we have contemplated for consummation of the potential Transaction have been designed keeping in mind that MTN shall only acquire 25% "economic interest".

What does "economic interest" mean?

Economic interest refers to the right over the pecuniary receivables of / from a company. Typically, when a shareholder is said to have 'economic interest', it is more often than not understood to mean the right to receive dividends or other pecuniary benefits from the company *sans* voting rights.

There can be several ways of structuring economic interest and each of the structures that we have discussed herein below expound how MTN will receive economic interest in Bharti Airtel.

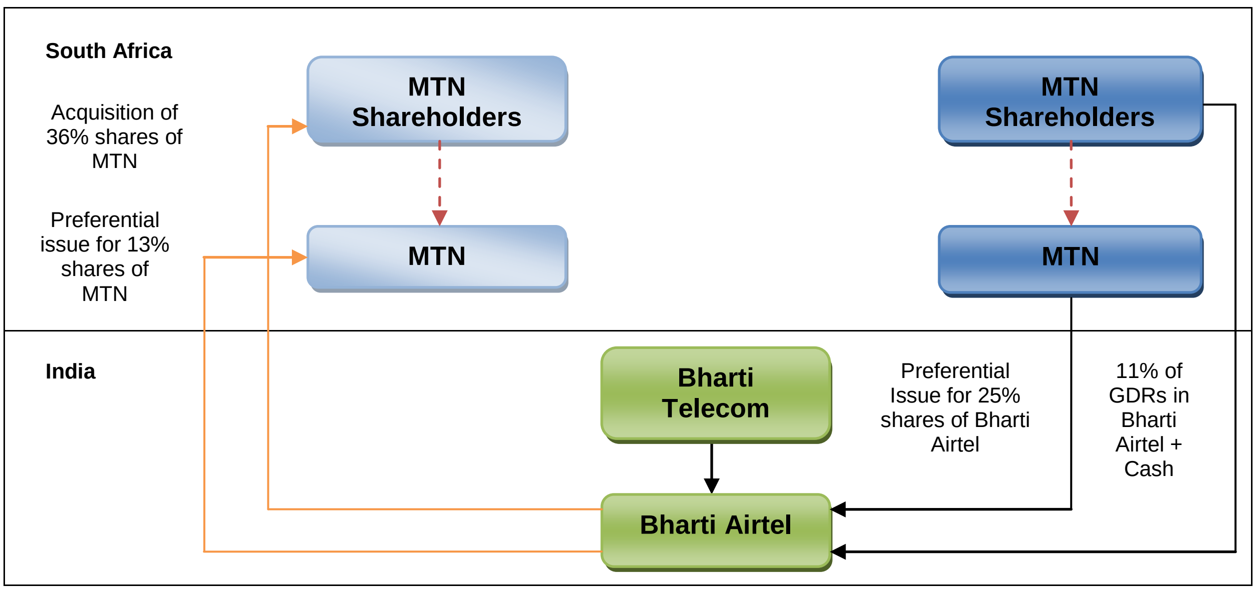
[10] Source: As per the shareholding pattern available on the Bombay Stock Exchange as on June 3, 2009

[11] Source: As per Ministry Of Corporate Affairs website as on June 3, 2009

One of the most typical ways of structuring economic interest has been by way of issuance of shares with differential voting rights (“**DVRs**”). DVRs are fairly common in private companies, and even public (unlisted) companies have sometimes used them for the purposes of giving differential dividends to shareholders. Incidences of DVRs in listed companies have been fairly minimal, primarily owing to SEBIs discomfort in monitoring different classes of shares, but the Ministry of Corporate Affairs (“**MCA**”) has given a clear go ahead for public companies, both listed and unlisted, to issue DVRs, subject to compliance with the provisions of the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 (“**DVR Rules**”). It is however to be noted that the new Companies Bill, 2008 (“**Bill**”) seeks to do away with DVRs. Having said that, even for an unlisted company, which is engaged in a restricted sector or which holds substantial interest in a restricted sector through its subsidiary, issuance of DVRs is likely to be closely scrutinized by the FIPB.

Apart from the laws mentioned herein above, the structures charted out below also *inter alia* invoke the provision of (i) Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 (“**DVR Rules**”); (ii) Guidelines for Preferential Issues as given under Chapter XIII of the SEBI Disclosure and Investor Protection Guidelines (“**Preferential Issue Guidelines**”); and the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 (“**GDR Scheme**”).

Structure I



Structural Analysis

- Bharti Airtel acquires (approx) 36% of MTN from the MTN shareholders in consideration for ZAR 86.00 in cash and 11% newly issued Bharti Airtel shares in the form of GDRs.
- Bharti Airtel makes a preferential allotment of freshly issued shares in favour of MTN (as different from its shareholders) which would constitute (approx) 25% of the issued share capital of Bharti Airtel.
- MTN makes a preferential allotment of (approx) 13% in the form of freshly issued shares to Bharti Airtel

- *Economic Interest:* Since section 42 of the Companies Act prevents a subsidiary from having voting rights in the holding company, MTN will hold a mere 'economic interest' *sans* the voting rights in Bharti Airtel.

Final Shareholding

- Bharti Airtel holds 49% equity shares in MTN.
- MTN shareholders hold 11% equity shares of Bharti Airtel (now in GDR form).
- MTN holds equity shares with 25% economic interest in Bharti Airtel.

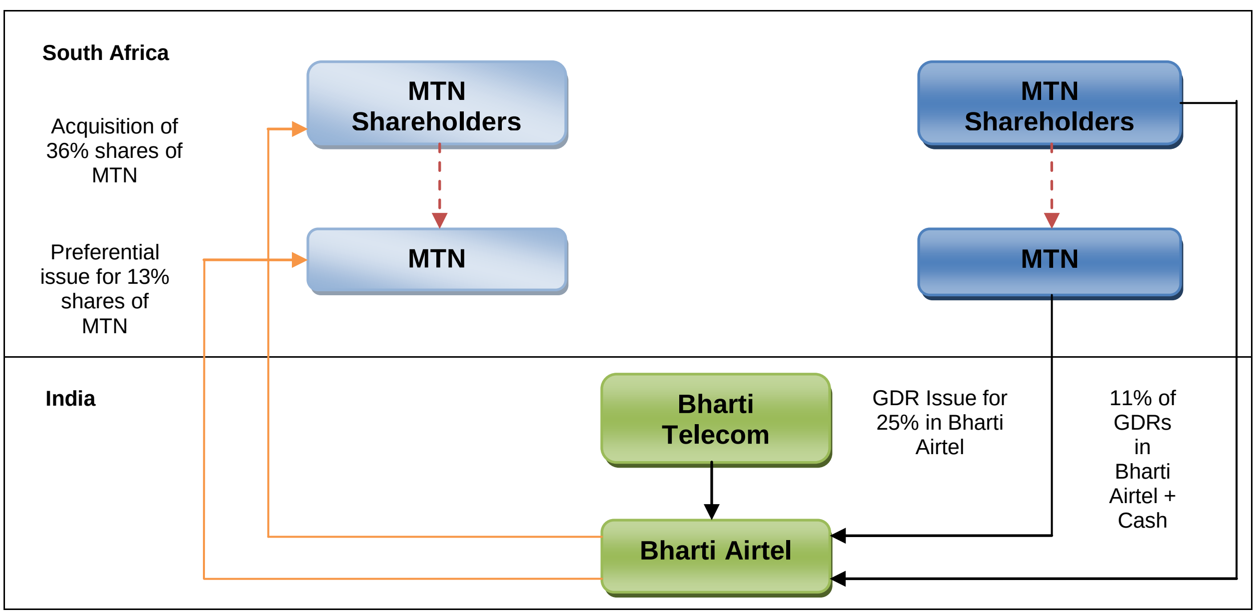
Advantages

- It is a simple and transparent structure.
- The entire investment is being routed through a single entity avoiding complex multilayered investments.
- The GDRs issued could be freely tradable on the JSE.

Challenges

- There would be less headroom available for Bharti Airtel to bring in fresh foreign investments in light of the prevailing sectoral limits in the Telecom sector.
- Bharti Airtel being a listed company would have to comply with the Preferential Issue Guidelines and attendant pricing and lock-in requirements. However, if the proposed scheme of arrangement also covers a scheme of merger, then it would be exempt from the application of Preferential Issue Guidelines.

Structure II



<u>Structural Analysis</u>

- This structure remains the same as Structure I, with the only difference being that Bharti Airtel issues GDRs in favour of MTN with underlying 25% equity shares of Bharti Airtel instead of Bharti Airtel making a preferential share issuance in favour of MTN.
- *Economic Interest:* The GDRs issued would entitle MTN to merely an 'economic interest' in Bharti Airtel *sans* any voting rights.

<u>Final Shareholding</u>

- Bharti Airtel holds 49% equity shares in MTN.
- MTN shareholders hold 11% equity shares of Bharti Airtel (now in GDR form)
- MTN holds 25% equity shares in Bharti Airtel (now in GDR form)

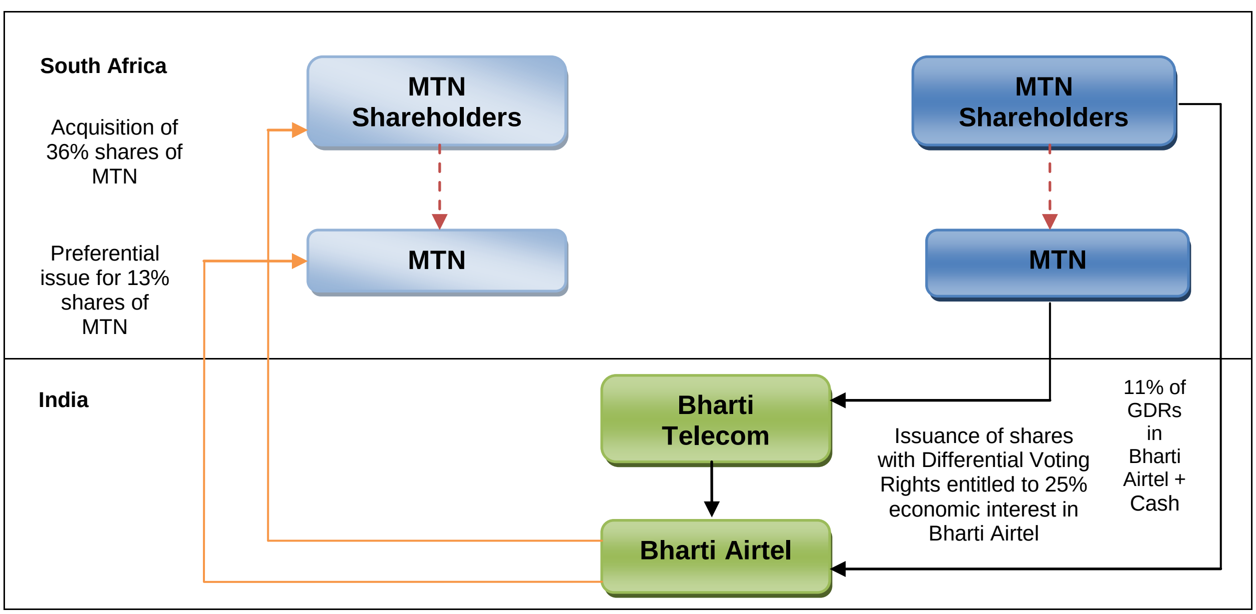
<u>Advantages</u>

- The GDRs issued would be freely tradable on the JSE.
- GDR Scheme would permit pricing of the GDRs at a relatively relaxed two weekly average as against the pricing under Preferential Issue Guidelines as described above.
- There will be no lock in on the GDRs issued as in the case of issuance of shares under Preferential Issue Guidelines.

<u>Challenges</u>

- Bharti Airtel would have less headroom to bring in further investments without breaching the 74% FDI cap.
- Pricing will be as per the 2 weeks average as against free pricing in Structure III and IV.

<u>Structure III</u>



Structural Analysis

- This structure remains same as Structure I, with the only difference being that instead of Bharti Airtel making a preferential issue of 25% shares to MTN, Bharti Telecom issues equity shares with DVRs in favour of MTN entitling MTN to indirectly hold 25% economic interest in Bharti Airtel.
- This can be done by issuing DVRs to MTN, at a high premium which keeps the FDI in Bharti Telecom below 50%.
- *Economic Interest:* Since the intent is to provide mere 'economic interest' in Bharti Airtel, the DVRs issued by Bharti Telecom may have nil/minimal voting rights attached.

Final Shareholding

- Bharti Airtel holds 49% equity shares in MTN.
- MTN shareholders hold 11% equity shares of Bharti Airtel (now in GDR form)
- MTN holds certain number of DVRs in Bharti Telecom entitling it to enjoy 25% economic interest in Bharti Airtel.

Advantages

- It will allow Bharti Airtel more headroom to bring in fresh capital infusions as the investment by MTN would happen at the level of Bharti Telecom.
- Even at the level of Bharti Telecom there would be minimal enhancement in FDI for the proposed issuance involves the issue of DVRs at a high premium and with minimal voting rights.
- The Preferential Issue Guidelines would not be applicable obviating the need to comply with the pricing guidelines and the lock-in requirements as Bharti Telecom is not a listed company.

Challenges

- The issue of DVRs in Bharti Telecom is likely to be closely scrutinized by FIPB at the approval stage on account of Press Note 2 of 2009.
- The Institutional shareholders of Bharti Telecom are unlikely to be comfortable with the idea of MTN shares being entitled to an exponentially high rate of dividend.
- Bharti Telecom would have to comply with the DVR Rules.
- As mentioned earlier, the Bill might be enacted before the consummation of the Transaction preventing any issue of DVRs by Bharti Telecom.

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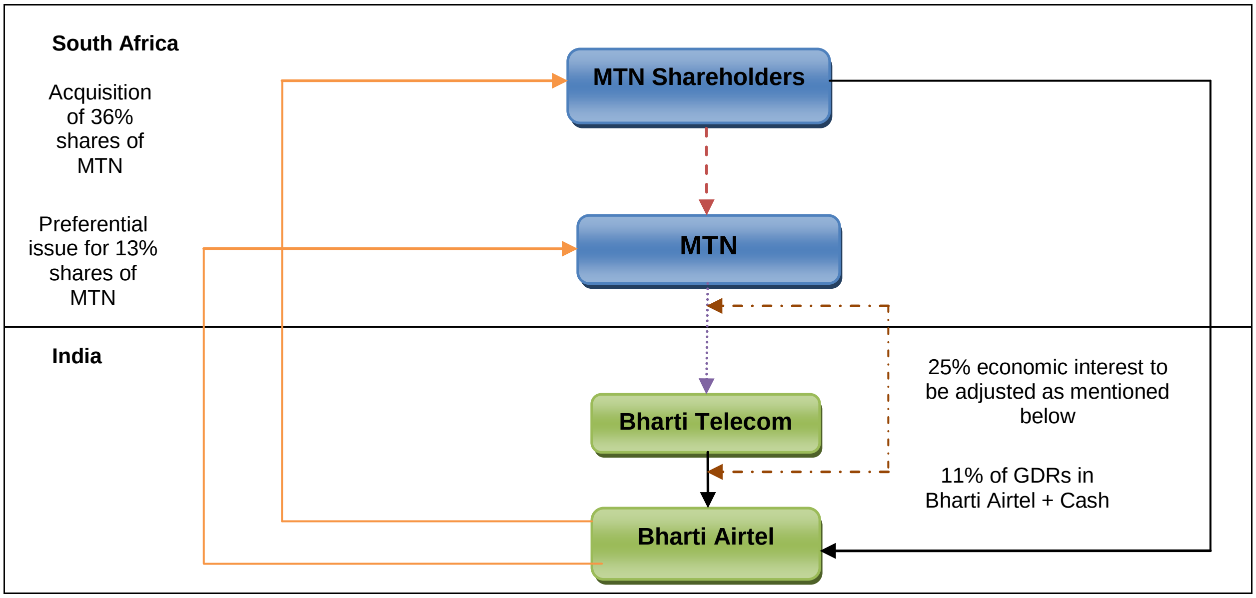
Structure IV



Structural Analysis

- This structure remains same as Structure I, with the only difference being that instead of Bharti Airtel making a preferential issue of 25% shares to MTN, MTN acquires a stake in Bharti Telecom that entitles it to enjoy 25% economic interest in Bharti Airtel, keeping the aggregate FDI in Bharti Telecom below 50%.
- This can be done by way of a share issuance by Bharti Telecom or share transfer by existing foreign investors in Bharti Telecom in favour of MTN. We believe that in the event that some of the existing foreign investors are willing to go in for a stake dilution/transfer at Bharti Telecom level such a proposed structure may be explored. Bharti Telecom would then infuse the cash received from MTN into Bharti Airtel, which will increase Bharti Telecom's stake in Bharti Airtel.
- *Economic Interest:* Since the intent is to keep the aggregate FDI below 50% in Bharti Telecom, MTN would only be entitled to an 'economic interest' without attendant voting rights.

Final Shareholding

- Bharti Airtel holds 49% equity shares in MTN.
- MTN shareholders hold 11% equity shares of Bharti Airtel (now in GDR form)
- MTN holds such stake in Bharti Telecom that entitles it to enjoy 25% economic interest in Bharti Airtel.

Advantages

- The benefits associated with the structure would primarily be the same as Structure III.
- The impact of the investment would be spread over both Bharti Telecom and Bharti Airtel providing more flexibility.

Challenges

- The existing foreign shareholders at Bharti Telecom level would have to be convinced for a dilution/transfer in favour of MTN.
- Fresh issuance at Bharti Telecom level which entitles MTN to exercise 25% economic interest might not be perceived favorably by the existing shareholders of Bharti Telecom.

PROPOSED COMPETITION LAW ISSUES

Recently, the substantive provisions of the Competition Act, 2002 ("**Competition Act**") relating to (i) prohibition of anti competitive agreements and (ii) abuse of dominance have been notified. Further, it is expected that the substantive provisions of the Competition Act with respect to regulations of combinations (mergers, amalgamations and acquisitions of shares and / or control) will also be notified soon with the formation of the New Government.

Once the substantive provisions, with respect to regulation of combinations, of the Competition Act have been notified, parties to the proposed combination must determine whether the proposed transaction triggers the applicable threshold limits viz with respect to the size of the parties or the turnover as prescribed under Section 5 (c) of the Competition Act. Given the magnitude of the assets and/or turnover of the parties involved, it should trigger the threshold limits, thereby, mandating the parties to notify to the Competition Commission of India ("**CCI**") providing the details of the proposed acquisition.

Once such notification has been made to CCI, CCI shall do its due investigation on the basis of the criterion laid down under the Competition Act (*inter alia* level of combination of the market, market share, the extent of barriers to entry to the market, the extent to which substitutes are available or are likely to be available in the market *et al*) to determine whether the acquisition causes or is likely to cause an adverse appreciable effect on competition within the relevant market in India and the CCI shall give its ruling within a maximum period of 210 days, failing which, the combination shall be deemed to be approved by CCI.

If the Transaction is not consummated before notification of sections 5 and 6 of Competition Act pertaining to combinations, it would be interesting to see how CCI handles this Transaction since this Transaction would set a precedent for future cross border M&As in India.

EPILOGUE

With the incumbent UPA government reelected and promising to usher in economic reforms, confidence returning to Indian financial markets and private equity players being more enthusiastic sellers than buyers, M&A activity seems to be making a comeback faster than expected. And such prodigious deals only reiterate that India is indeed shining keeping recession at bay.

As Business India beautifully puts it, "*Whether the African lady and the Indian suitor believe in 'till death do us part' or not, only time will tell. All this, however, depends on the bride first saying 'I do'.*"

Post consummation of the Transaction, we will send Bharti-MTN - Part II to dissect the Transaction as it happened.

Team M&A would like to thank **Pratik Mohapatra (Intern)**, **Abir Roy (Associate, Competition Law Practice)** for their contribution in this dissection.

As you would be aware, we have been providing regular information on latest legal developments. M&A Lab is our initiative to provide you knowledge based analysis and more insight on latest M&A deals. You can direct your views / comments / suggestions on our initiative to siddharth@nishithdesai.com, nishchal@nishithdesai.com, ruchir@nishithdesai.com and shikhar@nishithdesai.com.