Blackstone's Boldest Bet in India

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1. Prologue

In 2008, when HP acquired EDS, Mphasis (an indirect subsidiary of EDS) which primarily focused on the services business also entered the HP world. The initial market reactions suggested that the combination of HP and EDS will create a leading force in global IT services. By 2010, HP also became the largest client for Mphasis, by outsourcing HP's internal IT service requirements to Mphasis. However, HP's inability to efficiently understand EDS's business/ integrate EDS with HP severely impacted post-acquisition value realization. Consequently, HP lost several important customers, thereby indirectly impacting Mphasis' revenues. This impact only grew negatively in the years to come, with Mphasis' revenues steadily declining at 21% annually from 2013. In addition, considering the market/ scale in which Mphasis operated, Mphasis did not fit within the long-term growth strategy of HP. Rumors of HP's desire to exit from Mphasis started as early as 2013. In December 2015, the Blackstone Group received an invitation to bid for HPE's[1] controlling stake in Mphasis. Blackstone was rivalled in the bid by notable industry giants and large private equity houses, including Tech Mahindra (an Indian IT company) and Apollo Global Management (a private equity firm). While Tech Mahindra initially led the bid, making aggressive offers to buy Mphasis, it later pulled out of the race. Blackstone subsequently outbid Apollo Global Management to win HPE's controlling stake of 60.17% in Mphasis.

The primary acquisition by Blackstone (which triggered the Open Offer) was structured in a dual tranche manner, such that Blackstone initially obtains 50.27% of Mphasis' shareholding from HPE for USD 683.5 million. The remaining 9.90% of HPE's stake in Mphasis was to be acquired by Blackstone for USD 134.6 million depending on the outcome of the Open Offer. Since the Open Offer garnered a lukewarm response (for reasons explained in the subsequent sections), Blackstone ultimately emerged from the transaction with a 60.17% stake in Mphasis, and the total value of the transaction was approximately USD 818.2 million.

While the deal made headlines for multiple reasons, one of the main highlights of this deal was the MSA which HPE had to enter into with Mphasis. As a pre-condition for the consummation of the Open Offer, Blackstone mandated that HP agree to make a minimum revenue commitment of USD 990 million (escalating year on year) to Mphasis through a freshly executed MSA, thereby ensuring continued revenue for Mphasis from its biggest client. While the MSA is certainly a positive outcome for Mphasis, will this MSA be sufficient to turn around Mphasis' business? Were the shareholders of Mphasis provided all the necessary details to take an informed decision in approving the MSA? Will Blackstone's vast portfolio play a critical role in scripting a turnaround for Mphasis? In this lab, we will examine these questions and also focus on other key considerations from a commercial, legal, regulatory and tax perspective.

1. HPE was formed on November 1, 2015, after HP (i.e. current HP Inc.) spun off the enterprise, services, software and financial services business to HPE. HP Inc. has retained the personal computer and printing business.

2. Glossary of Terms

Term	Particulars
Acquirer	Marble II Pte Ltd., a wholly owned subsidiary of PAC 1, is a private limited company incorporated in Singapore
BFSI	Banking, Financial Services and Insurance
Blackstone GP	Blackstone Management Associates (Cayman) VI L.P. It is a general partner of PAC 2
Blackstone	The Blackstone Group
BPO	Business Process Outsourcing
Buyers	Acquirer and the PACs
CA 2002	Competition Act, 2002
CCI	Competition Commission of India
Conditions Precedent	The acquisition was subject to the completion of the following conditions precedent: i. Receipt of prior written approval from the: a. Competition Commission of India; b. Federal Cartel Office of Germany; c. Federal Competition Authority and Federal Cartel Prosecutor of Austria; d. Hart-Scott-Rodino Antitrust Improvements Act of 1976; e. Grant of certain exemptions by the United States Securities Exchange Commission ii. Shareholder approval for the MSA between HPE and Mphasis
DLOF	Draft letter of offer submitted to SEBI by the Buyers in connection with the Open Offer, as required under Regulation 16 of the SEBI Takeover Code
DPS	Detailed public statement issued by the Buyers in connection with Open Offer, as required under Regulation 13 of the SEBI Takeover Code
DTAA	Double Taxation Avoidance Agreement
EDS	Electronic Data Systems Corp., a multinational IT equipment and services company headquartered in Texas
EDS Asia Pacific	EDS Asia Pacific Holdings, a company incorporated under the laws of Mauritius, which is a part of the promoter group of Mphasis. Its ultimate holding company is HPE. As on April 12, 2016, EDS Asia Pacific held 83,002,201 equity shares of Mphasis, representing 39.29% of the Emerging Share Capital of Mphasis
EDS Far East	EDS World Corporation (Far East) LLC, a company incorporated under the laws of Delaware, and is a part of the promoter group of Mphasis. Its ultimate holding company is HPE. As on April 12, 2016, EDS Far East held 44,104,064 equity shares of Mphasis, representing 20.88% of the Emerging Share Capital of Mphasis
EDS Netherlands	EDS World Corporation (Netherlands) LLC, a company incorporated under the laws of Delaware, and is a part of the promoter group of Mphasis. HPE is its ultimate holding company. As on April 12, 2016, EDS Netherlands held 1 equity share of Mphasis
Emerging Share Capital	The total voting capital of Mphasis on a fully diluted basis as of the 10th working day from the closure of the Open Offer tendering period (which includes the vested and unvested employee stock options granted to the employees of Mphasis), i.e., 211,262,156 shares

FCA & FCP, Austria	Federal Competition Authority and Federal Cartel Prosecutor of Austria
FCO, Germany	Federal Cartel Office of Germany
FDI	Foreign Direct Investment, as per Schedule 1 of TISPRO
FPI	Foreign Portfolio Investment, as per Schedule 2A of TISPRO
FY	Financial Year
Hart Scott Rodino Act	Hart-Scott-Rodino Antitrust Improvements Act of 1976
HP	Hewlett Packard
HPE	Hewlett Packard Enterprise Company, the ultimate holding company of the Sellers
INR	Indian Rupee
IT	Information Technology
IT Act	Income Tax Act, 1961
ITES	Information Technology Enabled Services
LOF/Letter of Offer	Letter of Offer dated July 13, 2016
MD	Managing Director
Minimum Shares	106,191,313 equity shares amounting to 50.27% of the Emerging Share Capital, being the minimum shares agreed to be acquired by the Acquirer
MSA	Amended and Re-stated Master Services Agreement entered into between HPE and Mphasis
Offer Size	54,928,161 equity shares of Mphasis, representing 26% of the Emerging Share Capital
Open Offer	Open Offer by the Acquirer and the PACs to acquire up to 54,928,161 fully paid-up equity shares of face value of INR 10 each of Mphasis, representing 26% of the Emerging Share Capital
PAC 1	Marble I Pte. Ltd., a wholly owned subsidiary of Blackstone GP
PAC 2	Blackstone Capital Partners (Cayman II) VI L.P., a limited partnership formed in Cayman Islands
PACs	PAC 1 and PAC 2 collectively
Preferred Provider Program	A vendor selection channel HPE, which pre-qualifies certain members to participate in HPE supply contracts
Public Announcement	The first public announcement made by the Buyers in connection with the Open Offer, as required under Regulation 13 of the SEBI Takeover Code
Public Shareholders	Public equity shareholders of Mphasis, other than the Sellers
Purchase Price	INR 430/- (USD 6.4) per equity share
SEBI	Securities and Exchange Board of India
SEBI Circular	SEBI circular dated April 13, 2015
SEBI LODR Regulations	Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015
SEBI Takeover Code	Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
Sellers	The promoters of Mphasis, namely, EDS Far East, EDS Asia Pacific, and EDS Netherlands
SPA	Share purchase agreement dated April 4, 2016, entered into, inter alia, by the Buyers and the Sellers
Target/ Mphasis	Mphasis Limited, a public limited company incorporated in India
TISPRO	Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000

Top up Shares	20,914,953 equity shares of Target amounting to 9.90% of the Emerging Share Capital, to be acquired by the Acquirer depending on the outcome of the Open Offer
US SEC	United States Securities & Exchange Commission
USA	United States of America
USD	United States Dollar[2]
Waverly	Waverly Pte. Ltd., a private limited company incorporated under the laws of Singapore. It is a part of the GIC Ventures group. It is wholly owned by Lathe Investment Pte. Ltd., which is wholly owned by GIC (Ventures) Pte. Ltd. Waverly was named a person acting in concert with the Acquirer in the First Corrigendum to the DPS, published on April 22, 2016. However, this status as a person acting in concert was later removed in the Third Corrigendum to the DPS As per the details in the corrigendum to the DPS, Waverly had the right to subscribe up to 14.07% non-voting ordinary shares and 14.07% redeemable preference shares of PAC 1

2. For purposes of this lab, we have considered 1 USD = 66.8 INR.

3. Details of the Deal

I. The Parties

A. Acquirer and PACs

The Acquirer and the PACs are companies that belong to the Blackstone Group of companies. Blackstone is a private equity fund and the largest alternative investment firm in the world. Blackstone has invested extensively in Indian IT and BPO players in the past; in its last investment in 2015, Blackstone had bought back UK-based Serco's India business process outsourcing operations (known as 'Intelenet') for USD 250 million, 4 years after having sold the entity to Serco for USD 385 million. Blackstone's exposure to the Indian IT/ITeS sector played a critical role in this transaction, since the end-to-end process (starting from the initiation of bid to finalization of the transaction documents) was completed in a very short span of time.

B. Target

The target of this deal is Mphasis, one of India's leading IT companies formed in 2000 as a result of the merger of US-based Mphasis Corporation and Indian IT company BFL Software Limited. While it began with providing IT services in the form of BPO, IT and applications management, following HPE's acquisition of EDS in 2008, Mphasis began expanding its services. It began a new strategy of investment in hyper-specialisation by combining human resources and intellectual property. Mphasis gradually diversified into the banking, capital market, insurance and healthcare sectors,[3] simultaneously expanding the geography of its operations as well.

C. Sellers

The Sellers in this transaction are a group of companies, namely EDS Asia Pacific, EDS Far East, and EDS Netherlands, whose ultimate holding company is HPE. HPE is a multinational IT company based in California, USA. HPE inherited a 60.5% stake in Mphasis following its 2008 acquisition of EDS, which had acquired the Mphasis stake in 2006.

II. Transaction Documents

A. Share Purchase Agreement

The Acquirer and the Sellers entered into the SPA dated April 4, 2016, for the acquisition of 127,106,266 equity shares of Mphasis (which represents 60.17% of the Emerging Share Capital). Under the SPA, the Acquirer had agreed to initially acquire 106,191,313 equity shares (representing 50.27% of the Emerging Share Capital), which triggered a mandatory open offer under Regulations 3 and 4 of the SEBI Takeover Code. Depending on the outcome of the Open Offer, the Acquirer agreed to acquire up to an additional 20,914,953 equity shares (representing 9.90% of the Emerging Share Capital). The Open Offer and the transaction contemplated under the SPA were contingent on the fulfilment of the Conditions Precedent.

B. Amended and Re-stated Master Services Agreement

From the time Mphasis entered the HP group of companies, Mphasis and HPE have traditionally shared a strategic business and commercial relationship, regardless of their financial relationship. The two companies have historically entered into a strategic partnership year on year, whereby HPE committed to providing business to Mphasis. However, the tenure and the value of the commitment was never

3. http://www.moneycontrol.com/news/business/mphasis-gives-its-organizational-structurefacelift_492712.html

fixed. Since HPE is one of the biggest clients for Mphasis (approximately contributing 25% of Mphasis' revenue), in deciding to acquire Mphasis, Blackstone seemed to be looking for an assured revenue commitment from HPE for a considerable period of time before Mphasis developed its customer base otherwise. Consequently, HPE agreed to a multi-year contract for an assured revenue contribution to Mphasis in the form of the renewed MSA. As per the MSA, HPE agreed to provide a minimum revenue commitment of USD 990 million (escalating year on year) to Mphasis for an initial period of 5 years. The MSA will be automatically renewed for 3 consecutive terms of 2 years each after the initial 5 years. Additionally, Mphasis was also given the right to participate in HPE's Preferred Provider Program on commercially agreed terms, which means that Mphasis will have the opportunity to grow its business further with HPE.

III. Deal Snapshot

Acquirer	Marble II Pte. Ltd.
Target	Mphasis Limited
Sellers	The promoters of Mphasis, namely, EDS Far East, EDS Asia Pacific, and EDS Netherlands
Acquisition Price	**Direct Acquisition:** The purchase price of the equity shares that were agreed to be purchased from the Sellers by Blackstone was INR 430 (Rupees Four hundred and thirty only) (USD 6.4) for each equity share. **Open Offer:** Blackstone offered to purchase the equity shares of the Public Shareholders at INR 457.54 (Rupees Four hundred and fifty seven, and fifty four paise only) (USD 6.8) for each equity share. [4]
Modes of Acquisition	**Share Purchase:** The Buyers and the Sellers entered into the SPA for purchase by the Acquirer of 127,106,266 equity shares of Mphasis, representing 60.17% of the Emerging Share Capital. **Open Offer:** Blackstone made a mandatory open offer to acquire 54,928,161 equity shares of Mphasis representing 26% of the Emerging Share Capital.
Offer Size	54,928,161 equity shares of Mphasis, representing 26% of the Emerging Share Capital
Open Offer	Open Offer by the Acquirer and the PACs to acquire up to 54,928,161 fully paid-up equity shares of face value of INR 10 each of Mphasis, representing 26% of the total voting equity share capital on a fully diluted basis

4. The price has been calculated as per Regulation 8 of the SEBI Takeover Code, being the volume-weighted average market price per equity share for a period of 60 trading days immediately preceding the date of the public announcement.

Total actual Acquisition	The details of the acquisition are as follows: i. 60.17% under the SPA [5] ii. 0.001% under the Open Offer
Total contemplated Acquisition	The break-up of the total contemplated acquisition is as follows: i. 50.27% of the Emerging Share Capital, as the first tranche under the SPA ii. 26% of the Emerging Share Capital, under the Open Offer iii. 9.90% of the Emerging Share Capital (depending on the outcome of the Open Offer), as the second tranche under the SPA

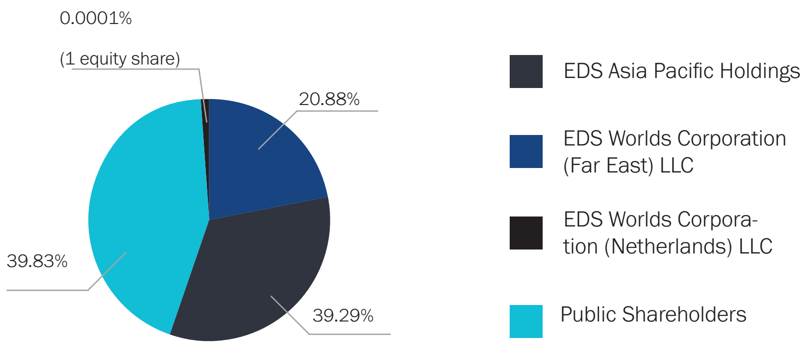
5. The Acquirer acquired 60.17% of the Emerging Share Capital of the Target upon consummation of the transaction. If the shareholding was calculated on a non-emerging basis, the percentage of shareholding acquired by the Acquirer was 60.7%. Prior to completion of share purchase by the Acquirer under the SPA, the non-emerging share capital increased due to the exercise of certain stock options and stock units. Consequently, the Acquirer's shareholding is currently 60.46% as per the shareholding pattern updated on the stock exchanges.

4. Chronology of Events

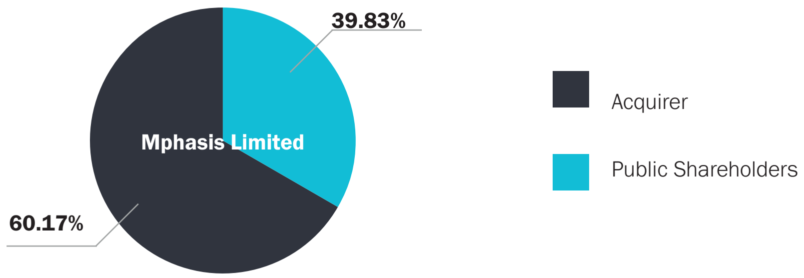
Date	Particulars
January – April, 2016	HPE in talks to sell Mphasis, as a part of its plan to revamp its IT consulting and services group. Blackstone, Apollo Global Management and Tech Mahindra bid for Mphasis.
April 4, 2016	SPA entered into between the Buyers and the Sellers
April 4, 2016	Public Announcement for Open Offer made by the Buyers
April 12, 2016	Publication of Detailed Public Statement by the Buyers in relation to the Open Offer
April 15, 2016	The board of directors of Mphasis, in a board meeting, approved seeking consent of the members of Mphasis by means of a postal ballot under Regulation 23 of the SEBI (Listing Obligations and Disclosure) Regulations, 2015 (related party transactions), for entering into the MSA with HPE
April 22, 2016	Filing of the DLOF with SEBI
April 22, 2016	Publication of the first corrigendum to the DPS ("**First Corrigendum**")
April 22, 2016	Acquirer applied for approval from the CCI for the transactions contemplated under the SPA
April 25, 2016	Acquirer submitted a merger filing with the German competition authorities (FCO, Germany)
May 9, 2016	Acquirer received approval from the US Competition authorities
May 12, 2016	Acquirer received approval from the German competition authorities (FCO, Germany)
May 23, 2016	Scrutinizer's report released, as per which the shareholders of the Target approved entering into the MSA
May 24, 2016	Acquirer received approval from the Austrian competition authorities (FCA and FCP, Austria)
June 3, 2016	Publication of second corrigendum to the DPS
June 13, 2016	Acquirer received approval from the CCI for the acquisition
June 28, 2016	US Securities Exchange Commission granted exemptions and no-action relief
July 11, 2016	Observations by SEBI on the DLOF
July 19, 2016	Date of publication of recommendation by the independent directors of Mphasis
July 20, 2016	Publication of the third corrigendum to the DPS ("**Third Corrigendum**")
July 20, 2016	Date of filing of the Letter of Offer dated July 13, 2016 with SEBI
July 20, 2016	Date on which the Letter of Offer was dispatched to the Public Shareholders (as per the SEBI Takeover Code)
July 26, 2016	Pre-offer advertisement filed with SEBI
July 27, 2016	Date of commencement of tendering period
August 9, 2016	Date of closure of tendering period. The Acquirer acquired only 2178 equity shares from the Public Shareholders, i.e. only 0.001% of Mphasis. [6]
August 24, 2016	Date of payment of consideration for the equity shares validly tendered and accepted in the Open Offer
August 31, 2016	Post-offer advertisement filed
September 1, 2016	Blackstone acquired 60.4704% of the Emerging Share Capital pursuant to the SPA through an off-market transfer.

6. Post Offer Advertisement, available at: http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/C99A762A_DB6C_45EA_983A_9DFCEF-7F0C32_152515.pdf

5. Structure of the Deal



Pre-Acquisition Holding



Post-Acquisition Holding

I. Funding for the Transaction

The share purchase (including the Open Offer) was valued at approximately USD 818.2 million, which was provided as cash consideration. It appears that the deal financing was partly achieved through debt, and partly through internal funds of Blackstone. On the debt funding leg, Blackstone was funded by a syndication underwritten by Deutsche Bank, ING Vysya and Standard Chartered, and which reportedly attracted commitments from Credit Agricole, DBS and Siemens Financial Services.[7] The details of the syndication seem to have been kept confidential. Further, a fact that may be pertinent to note in relation to the equity funding of the transaction is that Waverly had the right to subscribe to 14.07% non-voting ordinary shares and 14.07% redeemable preference shares of the PAC 1 in tranches. The Third Corrigendum stated that the funds received by PAC 1 pursuant to the said subscription by Waverly may be used for the Open Offer as well.

7. On August 30, 2016, PAC 1 pledged its shareholding in the Acquirer in favour of DB International Trust (Singapore) Limited, as security for the syndication. The Acquirer has also entered into a non-disposal undertaking on September 1, 2016, for the equity shares of Mphasis acquired by it. Please see: http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/0502E09A_5348_4B06_93E8_43E4C24AF4B4_111436.pdf

II. Deal Structure

The deal was structured as a share purchase and an open offer. The details of the structure have been provided below:

A. SPA

On April 4, 2016, the Buyers and the Sellers entered into the SPA whereby the Acquirer would acquire the Minimum Shares, being 106,191,313 equity shares amounting to 50.27% of the Emerging Share Capital at the rate of INR 430/- (USD 6.4) per equity share. The SPA also gave the Acquirer the right to purchase the Top Up Shares, being another 20,914,953 equity shares amounting to 9.90% of the Emerging Share Capital, depending on the outcome of the Open Offer. Under the SPA, after taking into account the acquisitions made by the Acquirer under the Open Offer, the Acquirer would acquire such additional equity shares of the Sellers as would result in its holding increasing to 75% of the equity share capital of Mphasis.

Some of the key terms of the SPA were:

a. The acquisition is subject to the completion of the Conditions Precedent.

b. The Acquirer retained the right to acquire the entire shareholding of the Sellers even if such additional acquisition lead to the Acquirer's shareholding exceeding 75% of the equity share capital of Mphasis; in this situation, the Acquirer has acknowledged that it would be bound by statutory obligations to bring down the stake to 75% of the equity share capital, to comply with minimum public shareholding requirements of public companies.

c. The Acquirer does not obtain any right to nominate directors on the board of Mphasis over and above as available to it under the Companies Act, 2013, as amended from time to time.

d. The Sellers will determine the inter-se proportion in which the Sellers will sell the equity shares to the Acquirer.

B. Open Offer

The execution of the SPA, between the Buyers and the Sellers, triggered the requirement to make a mandatory Open Offer under the SEBI Takeover Code. Accordingly, the Buyers made an Open Offer to purchase up to 26% of the Emerging Share Capital (54,928,161 Equity Shares) of Mphasis at an offer price of INR 457.54 (USD 6.8) per equity share. The Open Offer was not conditional on any minimum level of acceptance in terms of Regulation 19(1) of the SEBI Takeover Code; all equity shares which were validly tendered by the Public Shareholders were accepted at the offer price.

However, the mandatory Open Offer made by Blackstone garnered very little interest due to a surge in the price of Mphasis's shares upon announcement of the proposed transaction (thereby making the market price higher the offer price). As a result, Blackstone could only acquire 2178 equity shares from the Public Shareholders, amounting to 0.001% of the Emerging Share Capital.

6. Commercial Considerations

I. What were the key drivers for Blackstone's acquisition of Mphasis?

A. Presence in the IT Industry and Overall Strategic Alignment

Blackstone has displayed a consistent interest to invest in Indian IT/ITES/BPO companies.[8] Blackstone's strategy in identifying targets, similar to that of other buyout funds, seems to be motivated by two major criteria: (a) strong cash flow generation, with good turnaround potential; and (b) deep industry expertise (vertical). Previous acquisitions made by Blackstone in the Indian IT sector (of Intelenet and IBS) also fit within this strategy, considering Intelenet's expertise on offshore banking, travel and hospitality verticals (BPO operations) and IBS' specialization in providing software for the travel and transportation industry. Mphasis' revenue track record in the non-HPE business, coupled with the fact that IT services for sectors such as BFSI offer promising growth possibilities, prompted Blackstone to inject capital into Mphasis which has a deep vertical expertise in banking services. Mphasis also counts the 6 top global banks, 11 of 15 top mortgage lenders and 3 top insurance providers among its clients.[9] With the acquisition of Mphasis, Blackstone has now committed close to USD 1.5 billion in the Indian IT services sector.[10]

8. http://www.livemint.com/Companies/rk8R3a2dgouNcdNAZW-cQUJ/Blackstone-to-acquire-HPs-60-stake-in-MPhasis.html

9. http://articles.economictimes.indiatimes.com/2016-04-05/news/72070424_1_mphasis-shares-blackstone-group-open-offer-price

10. http://economictimes.indiatimes.com/tech/ites/with-1-bn-mphasis-buy-blackstone-makes-its-boldest-bet-in-india/articleshow/51690499.cms

B. Assured revenue from HPE and Direct International Revenue

While HPE is among Mphasis' largest clients, the primary concern for Mphasis over the past 5 years was the declining revenue from HPE related business. Revenue from HPE business, which formed 69% of the overall Mphasis revenue in 2011, has declined in the last 18 out of 20 quarters and now constitutes only 24% of Mphasis' overall revenue.[11] However, since HPE continues to be the largest customer for Mphasis, in order to ensure a significant business commitment from HPE for a considerable period of time (post acquisition), Blackstone insisted that HPE and Mphasis enter into a master services agreement ("**MSA**") pursuant to which: (i) HPE made a minimum revenue commitment of USD 990 million over the next 5 years (escalating year on year); and (ii) Mphasis would be included in HPE's Preferred Provider Program, pre-qualifying it to participate in HPE supply contracts, thereby opening up significant additional revenue opportunities.

Considering the decline of business from HPE, analysts had expected Mphasis' revenue from HPE to be around USD 220 million for FY 2016-2017.[12] This revenue was expected to reduce further, as the enterprise business of HPE is on the fall. Hence, the minimum assured revenue of roughly USD 170 - 200 million per year through the MSA, although lower than the yearly revenue from HPE till date, has provided the much needed visibility in relation to HPE business, and has also afforded Blackstone a comfortable timeline to increase Mphasis' non-HPE revenue.

Separately, while the revenue from HPE had been decreasing consistently, Mphasis' direct international revenue (i.e. revenue from non-HPE business such as revenue from the BFSI vertical etc.) was constantly

11. http://www.motilaloswal.com/site/rreports/635954442193531165.pdf

12. http://app.investmentguruindia.com/mobile/Researcharticles/2016/April/Mphasis%20Company%20Update_060416%20UK.pdf

increasing. Mphasis had reached a stage where roughly 50% of its revenue was contributed by its direct international business. Overall, the growth rate of this segment was approximately 14%, which seemed to be faster than the standard market growth rate.[13]

C. Blackstone's IT Portfolio

A major positive for Blackstone, as a result of Mphasis' acquisition, is the possibility for Mphasis to tap into the portfolio companies of Blackstone globally. Currently, Blackstone has approximately 80 portfolio companies, which spend roughly USD 1 billion annually for procurement of IT services.[14] It is expected that Mphasis will be able to generate new clientele from these portfolio companies and as a result, the direct channel business (i.e. non-HPE business) for Mphasis can also be expected to increase significantly. Blackstone has also successfully implemented this strategy in the past – with Intelenet. Blackstone acquired Intelenet in 2007 and within a span of 4 years, Intelenet's revenues grew 4 times and 7 Blackstone portfolio entities became clients of Intelenet. Further, by 2011, 27% of Intelenet's revenue was contributed by Blackstone's portfolio entities. Considering the above, Mphasis could be in position to leverage Blackstone's connections and substantially augment its revenues.

Amit Dixit, Blackstone's India co-head and MD, mentioned: "*We see large potential going forward, driven by Mphasis' world-class delivery capabilities and its access to Blackstone's portfolio of companies across the globe. The company has an experienced management team who has a clear roadmap for company's growth. With a long-term commitment of company's largest customer, HPE, we are confident that Mphasis will scale new heights.*"[15]

D. Valuation

Another factor that may have motivated Blackstone's decision could be HPE's low valuation of its stake in Mphasis. Mphasis' equity shares trade at relatively lower valuations when compared to its smaller peers such as Mindtree, Hexaware etc. This ensured that Blackstone's acquisition was made at a 31-35% discount when compared to similar-sized companies.[16]

II. What were the main reasons for HPE to sell Mphasis?

A. Structural Incompatibility

In 2008, when HP acquired EDS (thereby indirectly taking majority stake in Mphasis) for USD 13.9 billion, the market perception was very positive. By 2009 – 2010, HP also became the largest client of Mphasis, constituting roughly 60 – 70% of Mphasis' revenue. However, due to various internal/ external factors, HP could never integrate EDS with the business streams of HP efficiently. As a result, HP started losing EDS' key customers, which adversely impacted the revenues of Mphasis on a continuous basis.[17] In addition, considering the market/ scale in which Mphasis operated, Mphasis did not fit within the long-term growth strategy of HP. HP eventually had to write-off USD 8 billion since the EDS business was devalued completely. Thereafter, HP started actively exploring the prospect of selling its stake in Mphasis since as early as 2013.[18]

13. http://www.mphasis.com/downloads/investors/TranscriptEarningsCall/2016/Mphasis%20Analyst%20Conference%20Call%20-%20HPE%20&%20BS%20Definitive%20Agreement.pdf

14. http://economictimes.indiatimes.com/opinion/interviews/with-the-right-ownership-and-strategy-mphasis-can-move-up-from-the-sub-billion-to-the-multi-billion-tech-giant-amit-dixit/articleshow/51691264.cms

15. http://indianexpress.com/article/business/companies/blackstone-to-takeover-mphasis-in-1-1-bn-deal/

16. http://www.livemint.com/Money/FhgzNigCUkYnTEAn3dBnWJ/Will-Blackstone-turn-the-corner-with-Mphasis-buy.html

17. http://articles.economictimes.indiatimes.com/2014-10-30/news/55595428_1_mphasis-revenue-mphasis-ltd-hp-channel

18. http://www.livemint.com/Industry/D04146AAD8tgaKYH64DUTI/HP-may-sell-stake-in-Mphasis.html

The executive vice president of HP, Mike Nefkens, in 2013 said: "*HP bought EDS and never really understood the services business to the extent that they needed to and it's taken them nearly four-five years to really understand the value and understand the drivers and services. We really made a huge error on how we integrated EDS into the HP world and, as a result, it cost us two-three years of momentum.*"

B. Long-term Capital Restructuring

Since Mphasis was never a part of HPE's core operations, this transaction brings in some much-needed leverage for HPE, especially valuable given that HPE's first quarter diluted earnings share fell by almost 50% relative to last year.[19] Having divested a tangential business such as Mphasis, HPE can now invest greater resources in focusing on its core operations.[20] In addition, considering the discounted valuation at which Mphasis has been sold, it seems that the long-term minimum revenue commitment could work out in HPE's favour as the profit margins on HPE revenues could be lower than Mphasis' average profitability.[21]

19. http://www.wsj.com/articles/blackstone-to-buy-mphasis-from-hewlett-packard-enterprise-for-up-to-1-1-billion-1459748924
20. http://articles.economictimes.indiatimes.com/2016-04-05/news/72070424_1_mphasis-shares-blackstone-group-open-offer-price/2
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7. Legal and Regulatory Considerations

I. Why did the transactions contemplated under the SPA trigger the Open Offer?

According to Regulation 3(1) of the SEBI Takeover Code, an acquirer together with persons acting in concert cannot acquire shares or voting rights in a target company which would entitle them to exercise 25% or more voting rights in such company, without making a public announcement of an open offer to purchase at least 26% equity shares from the remaining Public Shareholders. Additionally, as per Regulation 4 of the SEBI Takeover Code, irrespective of any acquisition of shares or voting rights, a person cannot acquire control over a target company without making an open offer as mentioned above.

In the present case, the SPA along with the Letter of Offer contemplate the following: (i) acquisition of a minimum of 50.27% of Mphasis' equity shares from the Sellers, followed by a subsequent acquisition of upto 9.90%, depending on the outcome of the Open Offer; (ii) acquisition of control of Mphasis, and the Acquirer being classified as the promoter of Mphasis. For the above reasons, the transactions contemplated under the SPA triggered the Open Offer.

II. What were the pre-conditions for the completion of the Open Offer?

Regulation 23 (1) of the SEBI Takeover Code prescribes that an open offer once made can be withdrawn only under limited circumstances, including but not limited to: (i) statutory approvals required for the open offer/ for effecting the acquisition triggering the open offer having been finally refused; and (ii) any condition stipulated in the agreement for triggering the open offer not being met for reasons outside the reasonable control of the acquirer. In addition, such withdrawal conditions must be specifically disclosed by the Acquirer in the detailed public statement and the letter of offer.

In the present case, relying on Regulation 23 (1) of the SEBI Takeover Code, the Open Offer was subject to the completion of the following conditions:

a. receipt of prior written approval or the expiration or termination of any waiting periods (and any extensions thereof) from/under: (i) the Competition Commission of India; (ii) the FCO, Germany; (iii) the FCA & FCP, Austria; and (iv) the Hart Scott Rodino Act; and

b. approval from the shareholders of Mphasis for the execution of the MSA.

Despite Regulation 23 (1)'s clear guidance, SEBI has been rather reluctant in permitting open offer withdrawal conditions which do not relate to regulatory approvals (Eg: CCI approval etc.). The most recent case in this regard is the matter of M/s. Jyoti Limited.[22] However, considering that the LOF contains "approval from the shareholders of Mphasis for execution of the MSA" as a withdrawal condition, SEBI's position on Regulation 23 (1) is certainly a positive indication for investors to protect themselves against genuine intervening circumstances (beyond the reasonable control of the investor) that make a target unviable for acquisition.

22. In the matter of Open Offer of M/s. Jyoti Limited decided on August 1, 2016, WTM/SR/CFD/39/08/2016.

III. Why was the first tranche of purchase by the Acquirer structured to ensure a minimum sale of 50.27% by the Sellers?

The Letter of Offer coupled with the SPA sets out that upon completion of the Open Offer, the following actions (inter alia) shall be undertaken in accordance with Regulation 31A (5) of the SEBI LODR Regulations: (i) the Sellers (i.e. the current promoters of Mphasis) shall be reclassified as "public shareholders" of Mphasis; and (ii) the Acquirer shall be classified as the "promoter" of Mphasis. One of the key pre-requisites under Regulation 31A (5) for an existing promoter to be reclassified as a "public shareholder" is to ensure that the existing promoter holds not more than 10% equity shares in the target company.

Hence, in order to fulfil the aforementioned condition, the first tranche of purchase under the SPA was structured in a manner such that irrespective of the outcome of the Open Offer, the Acquirer will have the right to acquire 50.27% of Mphasis' equity shares from the Sellers, thereby reducing the Seller's shareholding in Mphasis to below 10% (i.e. 9.90%).

IV. Did the MSA amount to a related party transaction? Were all the details with respect to the MSA provided to the shareholders before obtaining approval?

Since HPE is the ultimate holding company of Mphasis, the MSA (which was proposed to be entered into between HPE and Mphasis) qualified as a 'related party transaction' under the SEBI LODR Regulations. Further, since the value of the MSA was expected to exceed 10% of the annual consolidated turnover of Mphasis (as per its latest audited financials), the transaction was considered as a "material related party transaction" in accordance with Regulation 23 of the SEBI LODR Regulations. Consequently, as per Regulation 23 (4) of the SEBI LODR Regulations, thus entering of the proposed MSA required the approval of the shareholders of Mphasis through a resolution, with the "related parties" abstaining from voting on the said resolution.

Accordingly, pursuant to a postal ballot notice dated April 15, 2016, Mphasis sought the approval of its shareholders by way of an ordinary resolution for entering into the MSA. While the shareholders approved the MSA with a thumping majority (i.e. 99%, with the Sellers abstaining from voting), a key aspect which may require deeper analysis is the disclosures made by Mphasis about the MSA in the explanatory statement of the postal ballot notice.

Since the MSA was only an amendment to an already existing agreement between HPE and Mphasis, the main focus of the MSA seems to be to identify two aspects – viz. – tenure of guaranteed business and the margins involved. Although the tenure was clearly identified (5 years mandatory, with an automatic renewal of 3 terms for 2 years each), there seemed to be lack of disclosure on the profit margins at which Mphasis agreed to provide services to HPE. The postal ballot notice only notes that the monetary value of services will be as per the rate table (where applicable), implying an already approved rate table under the existing agreement. On this basis, Mphasis may have decided that no further explanation regarding margins under the MSA are required to be disclosed under law. However, shareholders may have certainly been better placed to take an informed decision about the MSA had the explanatory statement identified the margins (eg: margin accretive or margin dilutive or as per the same margins).

On a related note, a transfer pricing assessment may also have been conducted while determining the margins at which HPE will be availing services from Mphasis. This may have ensured that the MSA has been entered into on an arm's length basis.

V. What was the mode of Open Offer tendering provided to the Public Shareholders?

Recently, the SEBI vide its circular dated April 13, 2015 ("**SEBI Circular**") permitted the acquisition of shares through stock exchanges pursuant to an open offer under the SEBI Takeover Code. This was a significant incentive for the Acquirers initiating an open offer, since there was increased likelihood of Public Shareholders tendering their shares in the open offer due to tax advantages (explained in paragraph 2 of the section titled '**Tax Considerations**') However, the SEBI Circular also states the following:

"In case an acquirer or any person acting in concert with the acquirer who proposes to acquire shares under the offer is not eligible to acquire shares through stock exchange due to operation of any other law, such offers would follow the existing tender offer method."

In the present case, the Acquirer is a foreign direct investor, and its investment is guided by Schedule I of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 ("**TISPRO**"). As per Schedule I of TISPRO, non-resident purchasers are not permitted to acquire securities of an Indian listed company directly on the stock exchange, except the promoters of such a company. Hence, the only mode by which the Acquirer could purchase shares tendered by the Public Shareholders was through off-the-market transactions, thereby subjecting the Public Shareholders to a higher tax liability.

VI. Why was the CCI approval required? Did the CCI approve the transaction?

According to Section 6 of the Competition Act, 2002 ("**CA, 2002**"), any acquisition of shares that breaches the numerical thresholds prescribed under Section 5 of the CA, 2002 will require the approval of the CCI. In the current transaction, the value of the assets and turnover of the group to which Mphasis would belong (post-acquisition) breaches the thresholds prescribed under Section 5, necessitating the requirement to obtain CCI approval.

The Acquirer applied for CCI approval on April 22, 2016, and identified the following as the relevant markets:

a. the broad relevant market for the provision of Information Technology and Information Technology Enabled Services in India; or

b. alternatively, the narrow relevant markets for the provision of the following services in India: (i) Information Technology Outsourcing services; (ii) Consulting services; and (iii) Implementation services.

The CCI's assessment was focussed on overlapping business of: (a) the Acquirer and Mphasis; and (b) the Acquirer's portfolio companies and Mphasis. The CCI observed that regardless of how the relevant market is delineated: (a) the combined market share of Mphasis and the portfolio companies of the Acquirer are insignificant; and (b) other players, with a sizeable market share, are present in each of the sub-segment of the IT and ITeS business in India. Based on the above, the CCI approved the proposed transaction and held that the transaction was unlikely to have any appreciable adverse effect on competition in India.

VII. Why was Waverly Pte. Ltd. categorized as a person acting in concert with the Acquirer in the First Corrigendum, but removed as a person acting in concert in the Third Corrigendum?

As mentioned above, upon execution of the SPA on April 04, 2016, a Public Announcement was made on the same day. However, on April 21, 2016, a new shareholders' agreement was entered into, *inter alia* between Blackstone Capital Partners (Singapore) VI Holding Co. Pte. Ltd., Waverly and PAC 1, whereby Waverly was provided the right to subscribe to 14.07% non-voting ordinary shares and 14.07% redeemable preference shares of PAC 1. Hence, on April 22, 2016, the Buyers issued the First Corrigendum to the DPS, stating the above and categorizing Waverly as a person acting in concert with the Acquirer for the purposes of the Open Offer.

However, on July 20, 2016, the Buyers issued a Third Corrigendum, removing Waverly as a person acting in concert with the Acquirer on the basis that: (i) Waverly is investing in PAC 1 as a pure financial investor, with no other interest whatsoever; and (ii) Waverly will not exercise any control (as defined under the SEBI Takeover Code) over PAC 1 or Mphasis. While the entire legal analysis behind this move is not spelt out in the Third Corrigendum, this may have been done because of the main reason that Waverly did not share the same objective as the Acquirer with respect to acquisition of Mphasis' shares.

As per the SEBI Takeover Code, for an entity to be considered as acting in concert with an acquirer, one of the pre-requisites is for such entity to share a common objective/ purpose of acquiring shares of a target company. Precedents also suggest that mere financing/ lending arrangements will not result in the financier/ lender being categorized as a person acting in concert with the acquirer, provided such lender/ financier has a commercially distinct objective vis-à-vis the acquirer.[23] Therefore, Waverly may have been removed as a person acting in concert based on the above rationale, since Waverly's objective may have been different from that of the Acquirer and not linked to acquisition of Mphasis' shares by the Acquirer.

23. Kishore Chabbria v SEBI (SAT Order dated August 1, 2003, Appeal No. 13/ 2002); Vijay Mallya v SEBI (SAT Order dated August 1, 2003, Appeal No. 15/ 2002).

8. Tax Considerations

I. What was the tax implication on the Sellers, pursuant to the sale of shares under the SPA?

As an FPI can only acquire a maximum of 9.99% equity shares of a listed company, the acquisition could not have taken place through the FPI route, since it involved acquisition of more than that 9.99% equity shares of Mphasis. Consequently, the same could be achieved only through the foreign direct investment ("**FDI**") route. However, since FDI investors are generally not permitted to acquire shares on the floor of the stock exchange (except where such investors are promoters of a listed company), the Sellers had to sell their stake to the Acquirer (set up as FDI entity) through an off-the-market transaction. As a result, the Sellers would have been subject to: (i) long term capital gains tax at the rate of 10% excluding surcharge and cess (if the shares were held by the Sellers for a period more than 12 months); or (ii) short term capital gains tax at the rate of 40% excluding surcharge and cess (if the shares were held by the Sellers for a period of 12 months or less).

On a related aspect, since EDS Asia Pacific is a Mauritius based entity, it should be eligjble to obtain benefits under the India-Mauritius DTAA and any gains on the sale of its shares to the Acquirer should be tax exempt.

II. What was the tax implication on the Public Shareholders who tendered their equity shares under the Open Offer?

As mentioned in paragraph VI of the Legal and Regulatory Considerations section above, the Acquirer in this case could not opt for an on-the-exchange tendering process, since the existing legal regime did not permit the same. Hence, all the Public Shareholders were only provided with the option of tendering their equity shares through an off-the-market transaction. This would have significantly impacted the interest expressed by Public Shareholders to participate in the Open Offer, since the long-term capital gains exemption in India is not applicable for off-the-market transactions.[24]

As for the actual tax impact, the rate of taxation of the Public Shareholders would depend on the duration for which the equity shares were held by the Public Shareholders. If the equity shares were held for a period of 12 months or less, gains arising on sale of such equity shares would have been taxable as short term capital gains at the maximum marginal rate. On the other hand, if the equity shares were held for a period longer than 12 months, gains arising on sale of equity shares would have been taxable as long term capital gains at the rate of 10% (excluding surcharge and cess).

24. Any gains arising from the sale of shares of a public listed company on the stock exchange is tax exempt under the IT Act.

9. Epilogue

With the acquisition of Mphasis, Blackstone has added another feather to its cap of IT/ITeS companies in India. Every party seems to have emerged as a winner, with Blackstone acquiring another ITeS company with deep and established vertical expertise, and Mphasis obtaining access to all of Blackstone's portfolio companies and increasing the possibility of Mphasis' non-HPE business flourishing. However, it remains to be seen whether HPE's continued revenue commitment, one of the conditions on which the acquisition was made, coupled with Blackstone's experience in the industry, will be sufficient to turn around the business of Mphasis. The manner in which HPE's business progresses in the next few years will be crucial to determine the post-acquisition value of Mphasis, since revenue from HPE's business currently constitutes about 24% of Mphasis' overall revenue. Although the internal structure at Mphasis has remained the same post Blackstone's acquisition, a complete shift in strategy by Blackstone (whereby the existing management is overhauled/ Mphasis moves for delisting etc.) cannot be ruled out. Mphasis has performed rather poorly over the last 3 – 4 years. Considering this, is Mphasis the right choice for Blackstone? Will Blackstone be able to revamp Mphasis, and turn it into a multi-bagger?

About NDA

Nishith Desai Associates (NDA) is a research based international law firm with offices in Mumbai, Bangalore, Palo Alto (Silicon Valley), Singapore, New Delhi, Munich and New York. We provide strategic legal, regulatory, and tax advice coupled with industry expertise in an integrated manner.

As a firm of specialists, we work with select clients in select verticals on very complex and innovative transactions and disputes.

Our forte includes innovation and strategic advice in futuristic areas of law such as those relating to Bitcoins (block chain), Internet of Things (IOT), Autonomous Vehicles, Artificial Intelligence, Privatization of Outer Space, Drones, Robotics, Virtual Reality, Med-Tech, Ed-Tech and Medical Devices and Nanotechnology.

We specialize in Globalization, International Tax, Fund Formation, Corporate & M&A, Private Equity & Venture Capital, Intellectual Property, International Litigation and Dispute Resolution; Employment and HR, Intellectual Property, International Commercial Law and Private Client. Our industry expertise spans Automobile, Funds, Financial Services, IT and Telecom, Pharma and Healthcare, Media and Entertainment, Real Estate, Infrastructure and Education. Our key clientele comprise marquee Fortune 500 corporations.

According to the recent report by India Brand Equity Foundation (IBEF), India's Civil Aviation Industry is on a high-growth trajectory expected to grow from being the 9th largest aviation market in the world with a size of around US$ 16 billion to being the 3rd biggest by 2020 and the largest by 2030.

The Government of India (GOI) also envisions airport infrastructure investment of US$ 11.4 billion under the Twelfth Five Year Plan (2012-17). It has opened up the airport sector to private participation. The Airports Authority of India (AAI) also aims to bring around 250 airports under operation across the country by 2020.We at NDA accordingly prepare ahead, envisaging the coming 10 to 15 years, in order to provide clients appropriate insights based on our understanding of current as well as future legal and regulatory issues.

Our ability to innovate is endorsed through the numerous accolades gained over the years and we are also commended by industry peers for our inventive excellence that inspires others.

Most recently, NDA was ranked the 'Most Innovative Asia Pacific Law Firm in 2016' by the *Financial Times - RSG Consulting Group* in its prestigious **FT Innovative Lawyers Asia-Pacific 2016** Awards. While this recognition marks NDA's ingress as an innovator among the globe's best law firms, NDA has previously won the award for the 'Most Innovative Indian Law Firm' for two consecutive years in 2014 and 2015.

As a research-centric firm, we strongly believe in constant knowledge expansion enabled through our dynamic Knowledge Management ('KM') and Continuing Education ('CE') programs. Our constant output through Webinars, Nishith.TV and 'Hotlines' also serves as effective platforms for cross pollination of ideas and latest trends.

Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has been developed into a global case study and published by John Wiley & Sons, USA in a feature titled 'Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage' in the September 2009 issue of Global Business and Organizational Excellence (GBOE).

A brief below chronicles our firm's global acclaim for its achievements and prowess through the years.

- **IDEX Legal Awards:** In 2015, NDA won the "M&A Deal of the year", "Best Dispute Management lawyer", "Best Use of Innovation and Technology in a law firm" and "Best Dispute Management Firm". Nishith Desai was also recognized as the 'Managing Partner of the Year' in 2014.

- **Merger Market:** has recognized NDA as the fastest growing M&A law firm in India for the year 2015.

- **Legal 500** has ranked us in tier 1 for Investment Funds, Tax and Technology-Media-Telecom (TMT) practices (2011, 2012, 2013, 2014)

- **International Financial Law Review (a Euromoney publication)** in its **IFLR1000** has placed Nishith Desai Associates in Tier 1 for Private Equity (2014). For three consecutive years, IFLR recognized us as the Indian "Firm of the Year" (2010-2013) for our Technology - Media - Telecom (TMT) practice.

- **Chambers and Partners** has ranked us # 1 for Tax and Technology-Media-Telecom (2015 & 2014); #1 in Employment Law (2015); # 1 in Tax, TMT and Private Equity (2013); and # 1 for Tax, TMT and Real Estate – FDI (2011).

- **India Business Law Journal (IBLJ)** has awarded Nishith Desai Associates for Private Equity, Structured Finance & Securitization, TMT, and Taxation in 2015 & 2014; for Employment Law in 2015

- **Legal Era** recognized Nishith Desai Associates as the Best Tax Law Firm of the Year (2013).

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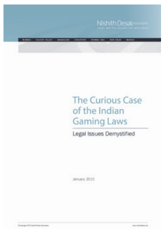

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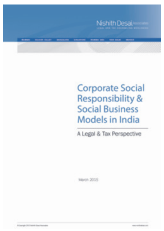

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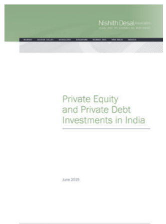

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Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

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We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

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As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

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