

M&A Lab

Warburg – Future Capital Deal Dissected

January 2013

Contents

01	PROLOGUE
01	EXECUTIVE SUMMARY
03	DEAL SNAPSHOT
06	PARTIES INVOLVED IN THE DEAL
08	DEAL STRUCTURE
09	COMMERCIAL CONSIDERATIONS
10	FINANCIAL ARRANGEMENTS
11	LEGAL, REGULATORY AND TAX IMPLICATIONS
19	EPILOGUE

I. Prologue

With the global economic turmoil and the added uncertainty that has ushered in the Indian regulatory scenario since the beginning of the year 2012, it was only obvious for the total number of M&A transactions in the first half of 2012 slipping down as compared to 2010 and 2011. Having said that, it is rather surprising to note that the vast potential of the Indian market is still attracting a large number of foreign investors willing to offer attractive exit prices to the Indian promoters.

This M&A Lab deals with one of the most-talked about exits of 2012, which was initiated in June 2012 when Mr. Kishore Biyani (promoter of Future Capital Holdings Limited (“FCH”)), after his long haul negotiations with several private equity firms finally squared down to US based private equity firm Warburg Pincus to sell Future Group’s stake in FCH, a non-core financial business of the Future Group (the “Deal”). The Deal was launched on June 4, 2012 with the execution of definitive agreements between Cloverdell Investment Limited (“Cloverdell”), an entity belonging to Warburg Pincus, FCH and the promoters of FCH whereby Cloverdell agreed to acquire upto 55.36%¹ of the issued and paid up equity share capital of FCH from the Sellers. With the closing of the Deal Cloverdell acquired 68.40% of the Diluted Voting Share Capital of FCH for a total consideration of approximately USD 136.5 million.

This M&A Lab attempts to probe deeper into the Deal, a multi-million dollar transaction which provides Warburg the opportunity to test its fortune in the financial services sector in India and Future Group the opportunity to de-leverage its balance sheet and take its retail plans ahead, thereby proving to be in the best interests of both the parties.

As always, we seek to analyze the legal, regulatory, tax, financing and few other commercial dimensions of the Deal.

II. Executive summary

On June 4, 2012, Cloverdell along with persons acting in concert ((“PAC” or the “WP XI Fund”), Cloverdell and WP XI Fund collectively referred to as (“Warburg Pincus”)), executed a share purchase agreement (“SPA”) with Pantaloon Retail (India) Limited (“PRIL”), Future Value Retail Limited (“FVRL”) and Mr. Kishore Biyani (all three are part of the promoter group of FCH) to purchase the stake of PRIL and FVRL (PRIL and FVRL are collectively referred as “Sellers”) in FCH in two tranches. Under the First Tranche (as defined below), Cloverdell agreed to purchase 37.88% of the total issued and paid up equity share capital (on a fully diluted basis) of FCH. The quantum of purchase under the Second Tranche (as defined below) was kept contingent on the number of shares validly tendered and accepted from the shareholders in the Open Offer (as defined below). Under the terms of the SPA, the First Tranche and the Second Tranche was anticipated to represent a maximum of 50.83% (i.e. 37.88% under the First Tranche and maximum of 12.95% under the Second Tranche) of the total issued and paid up equity share capital of FCH. However, since the shares validly tendered under the Open Offer were 24.43%, the total shares finally acquired under the First Tranche and Second Tranche finally squared down to 39.45%.

Simultaneous to the execution of the SPA, Cloverdell also executed a share subscription agreement (“SSA”) with FCH, pursuant to which it agreed to infuse approximately INR 1 billion (“Subscription Amount”) for the subscription of 30,086,420 equity shares (“Subscription Shares”) and 30,086,420 compulsorily convertible preference shares (“Subscription CCPS”) of FCH by way of a preferential allotment. The subscription of Subscription Shares resulted in an increase in Cloverdell’s stake in FCH by 4.52%.

¹ All percentages mentioned in this Lab are calculated on the Diluted Voting Share Capital. Please refer to page 7 for the calculation.

The intention of Cloverdell to increase its stake in FCH triggered Regulation 3(1) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (**“Takeover Code 2011”**), thereby mandating an open offer to the public shareholders of FCH for acquisition of minimum of 26% of the total issued and paid-up equity share capital of FCH.

According to the provisions of Regulation 15(1) of Takeover Code 2011, on the even date of execution of SPA and SSA, Cloverdell made a public announcement² (**“PA”**) of the open offer for acquisition of shares constituting 26% of the issued and paid up equity share capital of FCH. Subsequently, Cloverdell also issued the Detailed Public Statement³ (**“DPS”**) on June 11, 2011 and within 5 (five) working days of issuing such DPS, the Draft Letter of Offer⁴ (**“DLO”**) was filed with the Securities and Exchange Board of India (**“SEBI”**). After receiving comments from SEBI on the DLO, FCH filed the revised letter of offer⁵ (**“Letter of Offer”**) with SEBI on September 21, 2012. The Open Offer finally opened on October 5, 2012 till October 18, 2012.

As per the Letter of Offer, the Deal was valued somewhere between USD 110 million to USD 137 million (approximately).

2 Public Announcement, available at, http://www.sebi.gov.in/cms/sebi_data/commondocs/futurecapitalpa_p.pdf

3 Detailed Public Statement, available at, http://www.sebi.gov.in/cms/sebi_data/commondocs/futurecapital-detailedPS_p.pdf, under Regulation 13(4), Takeover Code 2011.

4 Draft Letter of Offer, available at, www.sebi.gov.in/cms/sebi_data/commondocs/futuredraftlof_p.pdf, under Regulation 16(1), Takeover Code 2011.

5 Letter of Offer, available at, <http://www.sebi.gov.in/sebiweb/home/list/3/20/15/0/Letter-of-Offer>

III. Deal snapshot

Acquirer	Cloverdell, a private company limited by shares, incorporated under the laws of Mauritius. ⁶
Sellers	PRIL and FVRL
Mode of Acquisition	<p>SPA dated June 4, 2012 and Amendment Agreement to the SPA dated August 3, 2012, entered between Cloverdell, the Sellers, Mr. Kishore Biyani and FCH for purchase of Sale Shares by Cloverdell.</p> <p>SSA dated June 4, 2012, entered between Cloverdell and FCH for issuance and allotment of Subscription CCPS to Coverdell by FCH.</p> <p>Open Offer under Takeover Code 2011 for acquiring 26% of shares held by public shareholders of FCH.</p>
Total Diluted Voting Share Capital of Target	<p>The total diluted voting share capital⁷ of the Target as of the tenth working day⁸ from the closure of the tendering period⁹ was calculated to be 68,416,404 equity shares of face value of INR 10 (Rupees Ten only) comprising of the following:</p> <ol style="list-style-type: none"> 1. 64,798,484 fully paid equity shares. 2. 531,500 Employee Stock Option (“ESOPs”), consisting of ESOPs which were (i) vested, and (ii) unvested as on the date of the Letter of Offer, but were required to vest till November 30, 2012, and for which shares could be issued during the period of the Open Offer. 3. Subscription Shares, under the SSA, acquired by Cloverdell, by infusing 50% of the total additional investment of approximately INR 1 billion.¹⁰

⁶ *Supra* note 5.

⁷ Diluted voting share capital means the fully paid-up voting equity share capital of Target after factoring the shares allotted by conversion of CCPS, ESOPs in future.

⁸ As per Regulation 7(1) of Takeover Code 2011 total shares of the target company as of tenth working day from the closure of the tendering period shall take into account all potential increases in the number of outstanding shares during the offer period contemplated as of the date of the public announcement.

⁹ The Takeover Code 2011 introduced the concept of ‘tendering period’ during the offer period. Regulation 2(1)(za) of Takeover Code 2011 provides that “tendering period” means the period within which shareholders may tender their shares in acceptance of an open offer to acquire shares made under these regulations. Further, Regulation 18(8) of the Takeover Code 2011 provides that the tendering period shall start not later than twelve working days from date of receipt of comments from SEBI on the draft letter of offer and shall remain open for ten working days.

¹⁰ *Supra* note 5.

Acquisition	<p>Acquisition pursuant to the SPA – Cloverdell had agreed to purchase shares from the Sellers in two tranches. The acquisition of shares under the First Tranche was completed on September 28, 2012, whereas the purchase under the Second Tranche was made contingent to the completion of Open Offer (as discussed below):</p> <ol style="list-style-type: none"> 1. First Tranche: Purchase of 25,919,394 shares of the Target, representing 37.88% of the Diluted Voting Share Capital, and 2. Second Tranche: It was decided that if the shares validly tendered and accepted from the shareholders in the Open Offer are less than the offer size, Cloverdell was to acquire such number of shares of the Target from PRIL so as to be equal to the difference between offer size and the actual number of shares validly tendered and accepted under the Open Offer, subject to a maximum of 8,860,605 shares of the Target, representing 12.95% shares of the Target. In the Open Offer 24.43% shares were tendered by the public shareholders, hence Cloverdell acquired 1.57% shares of FCH from PRIL.¹¹ <p>Equity shares under the First Tranche and the Second Tranche are collectively referred to as the Sale Shares.</p> <p>Open Offer: Open offer was made pursuant to the provisions of the Takeover Code 2011 for 26% of shares held by the public shareholders, post-acquisition of equity shares in First Tranche under the SPA. The tendering period was initially scheduled to open on July 25, 2012 and close on August 11, 2012, however due to delay in getting certain regulatory approvals,¹² the tendering period opened on October 5, 2012 and closed on October 18, 2012.¹³</p> <p>Acquisition pursuant to the SSA: Cloverdell subscribed to Subscription Shares and Subscription CCPS, issued by FCH on a preferential basis, having a face value of INR 10 each and a price of INR 162 each, amounting to an aggregate consideration of approximately INR 1 billion ("Subscription Amount").</p> <p>The Subscription CCPS are convertible at any time after January 1, 2013, at the option of the Acquirer, but prior to the expiry of 18 months from the date of allotment of Subscription CCPS.</p> <p>The subscription of Subscription Shares, resulted in an increase in the Acquirer's stake by 4.52%.</p> <p>For an understanding of the steps involved in the Acquisition, please also refer to the diagrammatic representation on Page 8.</p>
Underlying Transaction Triggering Open Offer	Cloverdell's increase in stake due to purchase of equity shares in First Tranche + expressed intention to purchase equity shares in Second Tranche + increase in stake due to subscription of Subscription Shares.
Mode of Payment	Foreign Funds – Cash
Acquisition Price for acquisition in SSA, SPA	INR 162 per share ¹⁵

¹¹ Post offer advertisement under Regulation 18(12) in terms of Takeover Code 2011 dated November 9, 2012.

¹² <http://www.business-standard.com/india/news/warburg%5Cs-open-offer-for-future-capital-delayed/481890/>

¹³ *Supra* note 5.

¹⁴ Regulation 2(b) of the Takeover Code 2011 defines "acquisition" as meaning, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company

¹⁵ *Supra* note 5.

A. Subsidiaries of FCH relevant for the Deal

Myra Mall Management Company Limited (“Myra Mall”)	A real estate company that derives its operational income from lease rentals and amenities services.
Future Capital Home Finance Private Limited (“FCHFPL”)	An NBFC and a subsidiary of FCH, with effect from December 23, 2010, as per the notes to accounts provided in the annual report of FCH ¹⁶ for the financial year 2010-2011. ¹⁷
Future Capital Securities Limited (“FCSL”)	A member at NSE, BSE, MCX Stock Exchange Ltd and is a Depository Participant of CDSL.
Future Capital Commodities Limited (“FCCL”)	A 100% subsidiary of FCCL, hence, an indirect subsidiary of FCH and is engaged in the business of commodities broking/ trading business.
Future Finance Limited (“FFL”)	An NBFC and a wholly owned subsidiary of FCH. On May 25, 2012, the FCH board had resolved to not pursue the business under FFL. Subsequently, on September 17, 2012, FCH entered into a share purchase agreement with APAC Consultants Private Limited (“APAC”) for the sale of its entire shareholding in Future Finance Limited to APAC and its associates. ¹⁸

B. Chronology of Key Events

1.	Public Announcement (PA) date	June 4, 2012
2.	Detailed Public Announcement (DPS) date	June 11, 2012
3.	Draft Letter of Offer submitted to SEBI	June 15, 2012
4.	Last date for making a competing offer	July 2, 2012
5.	Myra Mall ceases to be subsidiary of FCH Finance Limited (“FFL”)	July 9, 2012
6.	Initial scheduled date of opening of tendering period (rescheduled under the Letter of Offer)	July 25, 2012
7.	Intimation of cancellation of Open Offer to BSE	July 30, 2012
8.	BSE Announcement: promoter group of FCH takeover loan exposure of FCH to Deccan Chronicle. Amendment to the SPA pursuant to which certain additional indemnities were provided to the Target Company.	August 3, 2012
9.	Scheduled date of completion of tendering period (rescheduled under the Letter of Offer)	August 11, 2012
10.	SEBI issued its comments on DLO	September 17, 2012
11.	FCH entered into a share purchase agreement with APAC to sell its stake in FFL	September 17, 2012
12.	Identified Date	September 20, 2012
13.	Corrigendum to DPS (“Corrigendum”) issued	September 24, 2012
14.	Dispatch of Letter of Offer to shareholders	September 27, 2012
15.	Date by which the underlying transaction triggering Open Offer completed	September 28, 2012
16.	Publication of addendum to public announcement (“Addendum”)	October 1, 2012
17.	Date of commencement of the tendering period	October 5, 2012
18.	Date of closure of the tendering period	October 18, 2012
19.	Date by which acceptance / rejection was intimated and the corresponding payment for the acquired shares and / or the share certificate for rejected shares was dispatched.	November 5, 2012

Source: The DPS, DLO and the Letter of Offer

¹⁶ <http://www.moneycontrol.com/annual-report/futurecapitalholdings/notes-to-account/FCH>

¹⁷ FCHFPL application to the National Housing Bank for registration as Housing Finance Company was under process. FCHFPL on June 20, 2012 provided intimation to the NHB for the indirect change of control or change of shareholding, http://www.moneycontrol.com/livefeed_pdf/Oct2012/Future_Capital_Holdings_Ltd_041012.pdf

¹⁸ Supra note 5.

IV. Parties involved in the deal

Cloverdell Investments Ltd. (“Acquirer”)

Cloverdell Investments Ltd. is a private company limited by shares and incorporated under the laws of Mauritius. Cloverdell is owned by Warburg Pincus XI Fund which comprises of 5 (five) entities, each holding shares in the Acquirer, namely (i) Warburg Pincus Private Equity XI, LP, (ii) Warburg Pincus Private Equity XI-B, L.P., (iii) Warburg Pincus XI Partners, L.P., (iv) WP XI Partners, L.P., and (v) Warburg Pincus Private Equity XI-C, L.P. (the person acting in concert **“PAC”**). WP XI Fund is operated by Warburg Pincus LLC (**“WP LLC”**) which is registered with the U.S. Securities and Exchange Commission (the **“SEC”**) as an investment adviser under the Investment Advisers Act of 1940.¹⁹ WP LLC is a part of Warburg Pincus Group (**“Warburg Pincus”**).

Future Capital Holdings Limited (“Target”)

FCH is a systemically important non-banking finance company (**“NBFC”**). It was incorporated on October 18, 2005 under the Companies Act, 1956. It is a wholly-owned subsidiary of PRIL, focusing largely on providing loans to medium, small and micro enterprises, gold loans, consumer durable loans, two wheeler loans, and senior secured wholesale loans.²⁰ As on March 31, 2012, FCH had a loan book of approximately INR 46.35 billion and a network of 207 branches across India.²¹ Shares of FCH are listed on Bombay Stock Exchange Limited (**“BSE”**) and National Stock Exchange of India Limited (**“NSE”**).

The retail financial services of FCH were initiated in June 2007 with an agreement with PRIL, the said agreement allowed FCH to expand its reach to a wide customer base and offer a one-stop solution for financial products and services at the point of consumption across several retail outlets of PRIL. FCH, vide the aforesaid agreement was bestowed with an exclusive right to provide financial products and services at retail outlets which are owned, controlled or managed by PRIL.²² In addition to the aforementioned, FCH also offers broking services to retail and high net-worth individuals through its subsidiary, Future Capital Securities Limited.²³

Pantaloon Retail (India) Limited and Future Value Retail Limited

PRIL and FVRL both form part of the Future Group.

PRIL is a public company listed on the BSE and the NSE.²⁴ PRIL is also the flagship company of the Future Group which operates through multiple retail formats connecting to a diverse Indian buyers, sellers and businesses by its presence in 93 cities and 60 rural locations in India.²⁵

FVRL is a public limited company, incorporated in June 2007 under the name Pantaloon Future Ventures Limited. It is a wholly owned subsidiary of PRIL and operates certain particular format of retail stores, in over 93 cities in India.²⁶

¹⁹ *Supra* note 5.

²⁰ <http://www.warburgpincus.com/portfolio/ViewCompany,id,575.aspx>

²¹ <http://www.warburgpincus.com/portfolio/ViewCompany,id,575.aspx>, <http://www.venturefinance.in/news/warburg-pincus-acquires-equity-stake-in-future-capital-holdings.html>

²² http://www.pantaloonretail.in/pdf/ar_2006_2007.pdf, <http://www.moneylife.in/article/8/7784.html>

²³ <http://www.futurecapital.in/investments/broking-services>

²⁴ *Supra* note 3.

²⁵ <http://www.pantaloonretail.in/about-us/overview-retail.html>

²⁶ <http://www.fvrl.in/about-us/overview-retail.html>

Pre and post open offer shareholding

(Conclusion of underlying transaction triggering open offer taken into consideration)

	Shareholding & voting rights prior to the SPA, SSA /acquisition and open offer		Shares/voting rights agreed to be acquired under SPA and SSA which triggered off Takeover Code 2011		Shares/ voting rights acquired in Open Offer		Shareholding /voting rights after the acquisition under the SPA, SSA, conversion of ESOPs and Open Offer	
	(A)		(B)		(C)		(A) + (B) + (C) = (D)	
	No	%*	No	%*	No	%*	No	%*
FVRL	25,000,000	36.54	(25,000,000)	(36.54)				
PRIL	9,779,999	14.29	(919,394)	(1.34)				
Acquirer	Nil	Nil	29,005,814 + 1,074,323	42.40 + 1.57**	16,713,943	24.43	46,794,080	68.40
Public	30,018,485	43.88			(16,713,943)	(24.43)	21,622,324^	31.60
Total	64,798,484	94.71	3,086,420 (number of Subscription Shares)	4.52	0	0	68,416,404	100.00

* % shareholding calculated as percentage of Diluted Voting Share Capital of FCH

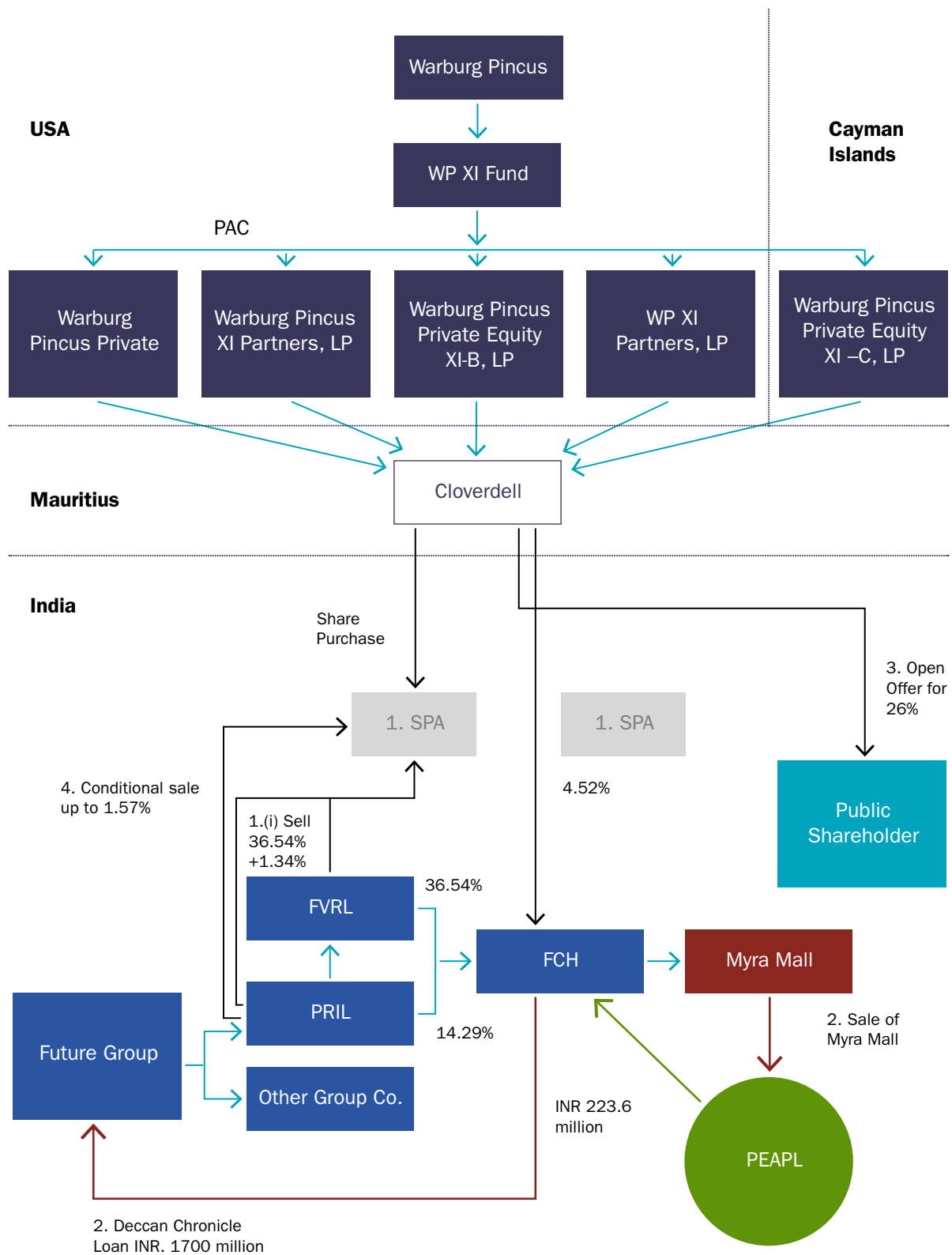
** % shareholding acquired by Acquirer under Second Tranche

^ Remnant PRIL shareholding (after sale of Shares to the Acquirer in accordance with the SPA) is included in public shareholding.

Also includes 531,500 stock options under employee stock option plan which have already vested or could vest by November 30, 2012

Figures in brackets signify figures in negative

V. Deal Structure



VI. Commercial considerations

1. Why did Future Group sell its stake in FCH?

As of May 2012, the total debt of Future Group including FCH was approximately INR 78.46 billion on a consolidated basis²⁷ hence, with the intention of de-leveraging the debt on its balance sheet, Future Group decided to sell FCH. It appears that Mr. Kishore Biyani decided to sell FCH among all other businesses of Future Group because of the following reasons: (i) FCH alone had a huge loan book of approximately INR 46.35 billion, so it was best to remove FCH from the consolidated balance sheet of Future Group,²⁸ (ii) FCH formed part of the non-core retail business of the Future Group and out of the many non-core businesses of Future Group, FCH stood out as a prime investment and accordingly was considered favorable for an exit.²⁹

We understand that de-leveraging of the debt was aimed at strengthening the balance sheet of PRIL, so as to allow PRIL to form a strategic alliance with the foreign retailers and help give effect to the retail expansion plans of PRIL.³⁰

2. What is the benefit for Warburg Pincus in acquiring FCH?

It seems that it was best for Warburg Pincus to acquire a systemically important NBFC like FCH instead of setting up its own NBFC in India. Needless to mention that acquisition of an existing NBFC has its own set of advantages over setting up a new NBFC in India including but not limited to (i) no requirement of obtaining a fresh certificate of registration from the Reserve Bank of India (“**RBI**”) in relation to the existing NBFC, (ii) reduction in time by approximately 6 (six) to 12 (twelve) months in terms of the time involved in setting up a new NBFC.

An NBFC is defined under section 45I(c) of the RBI Act, 1934 (“**RBI Act**”). Per section 45IA of the RBI Act every NBFC is required to be registered with the RBI, unless specifically exempted. Obtaining a certificate of registration from the RBI for an NBFC is a time consuming process, which usually takes around 6-12 months or in some cases, even longer. Due to the elaborate time period involved in setting up of the NBFC, one of the alternatives that is usually adopted is to purchase an existing NBFC.

However, in addition to the aforementioned, Warburg Pincus might have had other reasons behind the acquisition of FCH, some of them being:

- i. **Strong Statistical Credentials:** The fact that the loan book of FCH comprised of 49% of its exposure towards retail credit with 207 branches³¹ across India in both Tier I and Tier II cities, evidences that FCH had a fairly strong presence in the consumer loan market in India alongside their presence in the wholesale credit market.³²

27 May 10 2012, Future Capital may sell stake by month-end, <http://www.livemint.com/2012/05/10222719/Future-Capital-may-sell-stake.html>

28 Investor Presentation Q1 FY13, Corporate Presentation – 30 June 2012, available at http://www.futurecapital.in/pdfs/Investor_Presentation_Q1_FY13_30July2012_V1.1.pdf

29 <http://www.dealcurry.com/20120511-Warburg-Pincus-To-Acquire-Majority-Stake-In-Future-Capital.htm>

30 http://articles.economictimes.indiatimes.com/2011-11-18/news/30415187_1_pantaloons-multiple-retail-formats-big-bazaar

31 *Supra* note 28.

32 *Supra* note 28.

- ii. **Strong Management Credentials:** According to the DLO and the Letter of Offer, the approach and investment philosophy of Warburg Pincus behind the acquisition of FCH was to enable the growth of FCH with the aid of FCH's strong management team, and therefore it was decided by Warburg Pincus that Mr. Vaidyanathan, Vice Chairman and Managing Director of FCH shall continue as the head of FCH post the acquisition also.³³ Mr. Vaidyanathan responded positively to the offer made by Warburg Pincus and agreed not to sell a certain portion of his shares in FCH for a period of 12 (twelve) months and the remaining for a period of 60 (sixty) months post acquisition.³⁴

3. What is the benefit that FCH would derive under the control of Warburg Pincus?

As per Mr. Vaidyanathan, the entry of Warburg Pincus into FCH is a positive sign for FCH. While considering Warburg Pincus past credentials, he says:

“Its track record speaks for itself. It has supported companies like Kotak Mahindra Bank, HDFC, Bharti Airtel and their tremendous success speaks of its own achievements.”³⁵

“Warburg Pincus believes in backing people and it assures companies management that capital will not be a constraint which is evident from the fact that they are bringing in so much money when everyone is bearish about the country.”³⁶

Considering Mr. Vaidyanathan's views stated above, it appears that FCH might be abundantly benefited with the proposed capital infusion by Warburg Pincus into FCH.

VII. Financial arrangements

For SPA and SSA

We understand from the Letter of Offer that the consideration for the Deal was to be paid in cash and the total amount was contingent on the quantum of acquisition under the Open Offer.³⁷

For Open Offer

The maximum consideration payable under the Open Offer, assuming full acceptance, was approximately INR 2.88 billion (**“Maximum Consideration”**). The source of funds to meet the obligations of the Acquirer and the PAC under the Open Offer is foreign funds, raised from various international investors.

Arrangement for 25% of Maximum Consideration

In accordance with Regulation 17(1) of the Takeover Code 2011, the Acquirer opened a **“Cash Escrow Account”** in the name and style as **“Escrow Account-Cloverdell Investment Ltd-Open Offer”** with Kotak Mahindra Bank Limited, Mumbai (**“Escrow Bank”**) and made a cash deposit of approximately INR 720 million in it, which represented 25% of the Maximum Consideration, in accordance with Regulation 17(3)(a) of the Takeover Code 2011.³⁸

³³ *Supra* note 3.

³⁴ *Supra* note 3.

³⁵ <http://www.firstpost.com/business/future-ceo-vaideyanathan-talks-of-future-with-warburg-334153.html>

³⁶ *Ibid.*

³⁷ *Supra* note 5.

³⁸ *Supra* note 5.

Alien was marked on the said Cash Escrow Account in favour of Kotak Mahindra Capital Company Limited (“**Manager to the Offer**”) by the Escrow Bank. The Manager to the Offer was solely authorised by the Acquirer to operate and realize the value of Cash Escrow Account in terms of the Takeover Code 2011.

Arrangement for balance Maximum Consideration

Further, it is understood from the Letter of Offer that the Acquirer had set aside an amount of USD 43 million (equivalent to approximately INR 2.38 billion)³⁹ in an “**Offshore Escrow Account**” with HSBC Bank (Mauritius) Limited, which, together with the amounts set aside in the Cash Escrow Account, represented more than 100% of the cash required to fund the entire Open Offer.

It was mentioned in the Letter of Offer that the funds in the Offshore Escrow Account were to be utilized solely towards fulfilling the obligations of the Acquirer under the Open Offer and shall be released only upon instructions received from the Manager to the Offer.⁴⁰

Arrangement for upward price revision in the Open Offer: We understand from the Letter of Offer that an arrangement was made for any upward revision in the Offer Price or the offer size. It was decided in terms of regulation 17(2) of the Takeover Code 2011 that the Acquirer and the PAC shall increase the cash in the Cash Escrow Account such that it represents 25% of the revised consideration calculated at such revised Offer Price or offer size prior to effecting such revision.

VIII. Legal, regulatory and tax implications

1. What was the problem in FCH continuing to hold its wholly owned subsidiary Myra Mall Management Co. Ltd.?

Myra Mall was incorporated in the year 2006 under the provisions of the Companies Act, 1956 and is engaged in the business of acquiring, improving, building, selling, leasing, managing and commercially exploiting real estate and properties of diverse nature. Myra Mall was a wholly owned subsidiary of FCH.

However, Myra Mall ceased to be a subsidiary of FCH with effect from July 9, 2012 when FCH sold the entire equity shares held in Myra Mall to Providence Educational Academy Private Limited (“**PEAPL**”), in its capacity as a Trustee of AAA Holding Trust, a private trust. As a matter of abundant disclosure, it was clarified by FCH that the AAA Holding Trust belongs to Mr. Jaydev Mody and family and is not an affiliate of either the Future Group or the Acquirer. The share sale was consummated on an 'as is where is' basis for an enterprise value of INR 223.6 million.⁴¹

Under the extant exchange control regime of India, foreign investment in completed or rental yielding properties is not allowed. However, foreign investors can invest in construction-development projects provided they comply with certain prescribed requirements.

³⁹ 1 USD = 55.5155 (source: www.rbi.org.in) dated June 4, 2012.

⁴⁰ *Supra* note 5.

⁴¹ NSE Corporate Announcement by FCH dated July 10, 2012.

It is noteworthy that Myra Mall holds a completed property and FDI in such a company is not allowed as per the Consolidated FDI Policy dated April 10, 2012 effective from April 10, 2012 (“**extant FDI Policy**”). Further by virtue of the Press note 2 of 2009 issued by the Department of Industrial Policy and Promotion, foreign investment through the investing Indian company would not be considered for calculation of the indirect foreign investment in case of Indian companies which are ‘**owned and controlled**’ by resident Indian citizens. In the instant case, if the Deal would have gone through without first selling out Myra Mall from FCH, it would have led to an indirect foreign investment into Myra Mall, which is impermissible under the extant FDI Policy.

Accordingly, as a matter of abundant caution, FCH decided to sell its entire stake in Myra Mall to PEAPL, vide board resolution dated May 25, 2012, which was much before the execution of the SSA and SHA in relation to the Deal.⁴²

2. What was the reason for promoters of Future Group to take over the loan exposure of FCH to Deccan Chronicle?

Reportedly, FCH had given certain loans amounting to approximately INR 170 crores to the Deccan Chronicle Group⁴³ which is engaged in the business of print media (“**Deccan**”) (within Deccan Chronicle Group INR 1.2 billion were given to Deccan Chronicle and INR 500 million were given to Aviatech Private Limited).⁴⁴

In return for the loan, the promoters of Deccan Chronicle Group namely, Mr. T Venkatram Reddy, Mr. T Vinayak Ravi Reddy and Mr. P.K Iyer had on July 26, 2012, created a pledge on 11,28,51,000 shares amounting to its 54% stake, in favour of FCH, leaving them with only 19.83% unencumbered equity in Deccan.⁴⁵

The Deal got into a complicated situation when it was contemplated that in case FCH is required to invoke the pledge and acquire the shares of Deccan upon failure of Deccan to repay the loan, then FCH would effectively become the owner of 54% shares of Deccan, which is a print media company. As per the extant FDI Policy, foreign investment in a print media company is only permitted upto the extent of 26% subject to the prior government approval. In case the Deal between FCH and the Acquirer is consummated during the continuance of the impugned loan and it turns out later that Deccan fails to repay the loan, it may lead to indirect foreign shareholding in Deccan exceeding the prescribed statutory threshold of 26%, which is clearly not permissible within the four corners of applicable law.

It was further observed that the same shares of Deccan Chronicle were pledged with different entities by the promoters.⁴⁶

To solve this concomitant problem, the promoter group of FCH agreed to take over the entire loan exposure of FCH to Deccan Chronicle, at book value, with this FCH ceased to have any exposure to the Deccan Chronicle Group.⁴⁷ We understand from the announcement of FCH on the Bombay Stock Exchange dated, August 3, 2012 that the promoter group of FCH took this decision to safeguard the interest of the stakeholders of FCH.⁴⁸ This debt transfer to Mr. Kishore Biyani not only ceased any exposure of FCH to Deccan Chronicle but also facilitated the deal between FCH and the Acquirer.

42 Paragraph 30 of the DLO. Also see <http://www.indianexpress.com/news/future-capital-exits-its-subsiary-myra-mall-management/972637/>

43 BSE Announcement, Sale of Loans given to Deccan Chronicle Group, August 3, 2012, available at, <http://www.bseindia.com/stockinfo/annndet.aspx?newsid=e48cob74-d8d7-4542-9691-bbbdo6504652¶m1=1>

44 <http://business-standard.com/india/news/future-capital-pays-for-deccan-chronicle039s-mess/181244/on>

45 http://articles.timesofindia.indiatimes.com/2012-07-28/india-business/32906522_1_dchl-fchl-vice-chairman-deccan-chronicle-promoters-pledge

46 <http://www.business-standard.com/india/news/biyani-takes-over-rs-170-cr-loan-to-push-warburg-deal/482286/>

47 Vijaya Rathore, MC Govardhana Rangan, , Deccan Chargers sale: Whoever buys the IPL team faces a complicated financial & legal process, September 8, 2012, The Economic Times, available at, <http://economictimes.indiatimes.com/news/news-by-industry/et-cetera/deccan-chargers-sale-whoever-buys-the-ipl-team-faces-a-complicated-financial-legal-process/articleshow/16306883.cms>

48 BSE Announcement, Sale of Loans given to Deccan Chronicle Group, August 3, 2012, available at, <http://www.bseindia.com/stockinfo/annndet.aspx?newsid=e48cob74-d8d7-4542-9691-bbbdo6504652¶m1=1>

3. Why did Warburg opt for equity shares in lieu of CCPS for 50% of the Subscription Amount?

We understand from the Letter of Offer that pursuant to the SSA, the Acquirer proposed to subscribe to Subscription CCPS for 50% of the Subscription Amount. The Subscription CCPS shall carry a dividend rate of 0.01% and shall be compulsorily convertible into 1 (one) equity share of FCH at any time prior to the expiry of 18 (eighteen) months from the date of allotment of CCPS, provided that no such conversion shall be effected at any time prior to January 1, 2013. It was however proposed that the Acquirer may elect to invest part of the Subscription Amount not exceeding approximately INR 500 million towards subscription to equity shares of FCH instead of CCPS. The Subscription Amount invested either in the form of Subscription CCPS / Subscription Shares shall entitle the Acquirer to not more than an aggregate of 8.70% of the enhanced equity share capital of FCH on a fully diluted basis.

Pursuant to (i) purchase of equity shares (39.45%) under the provisions of the SPA and (ii) subscription of Subscription Shares (4.52%) under the provisions of the SSA, the Acquirer was entitled to a total of 43.97% of the total equity share capital of FCH. Upon conversion of the Subscription CCPS after January 1, 2013, the Acquirer shall be entitled to an additional equity share capital over and above the 43.96%.

Under the provisions of the Takeover Code 2011 disclosure obligation is triggered at the time of acquisition of convertible instruments and the open offer obligation is triggered on conversion of the convertible instruments into equity shares.

Considering a situation where the Acquirer would not have agreed to the subscription of Subscription Shares and would have subscribed only to Subscription CCPS for the entire Subscription Amount, upon conversion of such Subscription CCPS, the Acquirer would have been eligible to acquire additional 8.70% of equity shares of FCH. In this case, the Acquirer would have been hit by the provisions of Regulation 3(2) of the Takeover Code 2011 and would have been required to make another public announcement. Regulation 3(2) of the Takeover Code 2011 essentially requires an acquirer who holds more than 25% but less than 75% shares or voting rights in a target company to make a public announcement before acquiring additional shares or voting rights which will entitle them to more than 5% of the voting rights in the target company.

To avoid a second open offer, it is probable that the Acquirer opted for acquisition of 50% of equity shares upfront in lieu of the CCPS.

4. What was the reason behind FCH making preferential allotment of Subscription CCPS?

As per the extant FDI Policy foreign direct investment in an NBFC is permitted up to 100% under the automatic route subject to certain minimum capitalization requirements for fund based NBFCs which are as follows:

- USD 0.5 million which is to be brought upfront for FDI up to 51%;
- USD 5 million to be brought upfront for FDI above 51% and up to 75%; and
- USD 50 million out of which USD 7.5 million to be brought upfront and the balance in 24 months for FDI beyond 75% and upto 100%.

FCH which itself is a systemically important NBFC has another subsidiary FCHFPL which is also an NBFC. As per the Notice of Postal Ballot⁴⁹ the Preferential issue was made to provide flexibility in terms of use of capital to FCH while helping it meet the minimum capitalization requirements for FCH itself and its subsidiary FCHFPL.

5. What was the reason for using CCPS and not CCD, considering CCD has more advantages compared to CCPS?

Compulsorily convertible debentures (“**CCD**”) are preferred as an investment instrument over CCPS on account of the following reasons:

CCD	CCPS
No requirement for company to have profits to pay interest to CCD holders.	Requirement for company to have profits for declaration of dividends to CCPS holders.
Interest payment on CCD is a tax deductible expense for the company.	Dividends can be declared only after paying corporate taxes and transfer to general reserves.
No cap prescribed on the maximum coupon that can be given on CCDs subscribed by foreign investors. However, it is market practice to restrict the coupon rate that can be paid on CCDs to the same extent as dividends that can be paid on CCPS to non-resident shareholders.	The rate of dividend on CCPS subscribed by foreign investors cannot be more than 300 basis point over and above the prevailing SBI prime lending rate.
Company is obligated to withhold tax on interest paid. Interest income is taxable at the hands of the recipient.	Company is required to pay dividend distribution tax on the distribution. Dividends received are not taxed at the hands of the recipient.
Conversion of CCDs into equity share not treated as transfer under Income Tax Act, 1961, ⁵⁰ hence, no capital gain tax is payable.	Conversion of CCPS into equity can be considered will be a taxable event and long term or short term capital gains may be applicable
CCDs are considered as loan stock till they are converted into shares, hence CCDs have a liquidation preference over equity shares of a company.	CCPS will be subordinated to CCDs in terms of liquidation preference.

Despite the benefits of CCDs over CCPS, it appears that the possible reason for FCH to opt for CCPS instead of CCD could be to avoid increasing the debt on its books.

6. Was the Offer Price of INR 162 justified under the Takeover Code 2011?

The Open Offer is intended to provide an exit opportunity to the public shareholders of FCH, in light of the proposed acquisition of shares of FCH by the Acquirer. The price at which the Acquirer would acquire the shares tendered in the Open Offer (“**Offer Price**”) is determined as per the provisions of the Takeover Code 2011. The PA clarified that the Offer Price for the Open Offer would be INR 162 per share, which was the negotiated price per share at which the Sale Shares were acquired under the SPA and SSA by the Acquirers.

Acquirers had detailed the calculation of the Offer Price as INR 162 per share in the PA. It needs to be seen if such price was justified under the Takeover Code 2011.

The equity shares of FCH are listed on BSE and NSE and are frequently traded on the floor of the stock exchanges. Consequently, the Offer Price was calculated under Regulation 8(2) of the Takeover Code 2011, which prescribes the following three different modes of calculation:

49 Notice of Postal Ballot, available at, http://www.bseindia.com/xmldata/corpfiling/AttachHis/Future_Capital_Holdings_Ltd_070612.pdf

50 Section 47(x) of the Income-tax Act, 1961.

51 Regulation 8 (1) of the Takeover Code 2011: The open offer to acquire shares under Regulation 3, 4, 5 and 6 shall be made at a price not lower than the price determined in accordance with sub-regulation (2) or (3), as the case may be.

The Offer Price shall be the highest of⁵¹ :

1. The highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer;
2. The volume weighted average price paid or payable for acquisition, whether by the acquirer or by any person acting in concert with him, during the 52 weeks immediately preceding the date of public announcement;
3. The highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him during the 26 weeks immediately preceding the date of public announcement;
4. The volume weighted average market price of such shares for a period of 60 trading days immediately preceding the date of public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;
5. Where the shares are not frequently traded, the price determined by the acquirer and the manager of the open offer taking into account valuation parameters including book value, comparable trading multiples and such other parameters as are customary for valuation of shares of such companies; and
6. The per share value computed under sub-regulation (5), if applicable.

Since the shares of FCH are frequently traded on the stock exchanges, point (5) and (6) above shall not be applicable.

Based on the trading volume pattern of the immediately preceding 60 days, it was observed that the shares of FCH are more frequently traded on the NSE than the BSE.⁵²

The above mentioned modes of calculation (1) to (3) give the following results for Offer Price:

Particulars	INR
The negotiated price under the Definitive Agreements dated June 4, 2012.	Requirement for company to have profits for declaration of dividends to CCPS holders.
The volume weighted average price paid or payable for acquisition, whether by the acquirer or by any person acting in concert with him, during the 52 weeks immediately preceding the date of public announcement.	Not applicable ⁵³
The highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him during the 26 weeks immediately preceding the date of public announcement	Not applicable ⁵⁴
The volume weighted average market price of such shares for a period of 60 trading days immediately preceding the date of public announcement as traded on the NSE (as the maximum volume of trading in the shares of the Future Holdings is recorded on NSE during such period).	134.41

⁵² *Supra* note 5.

⁵³ As of the date of the PA, the Acquirers and the PAC did not hold any shares in FCH. Further, the Acquirers and the PAC or any of their directors have not acquired any shares of FCH in the 12 (twelve) months prior to the date of the PA

⁵⁴ *Ibid.*

7. Why did the Open Offer get delayed?

The Open Offer by the Acquirer was subject to the receipt of the following regulatory approvals and clearances by FCH and the Acquirer:

Approvals required by the Acquirer for the Deal and further acquisition of shares under the Open Offer:

- a. We understand that the Acquirer had applied to the Financial Services Commission, Mauritius (“**FSC Mauritius**”) for seeking approval to purchase the Sale Shares from the Sellers and the shares under the Open Offer. Accordingly, the Deal was subject to receipt of requisite approval/no-objection certificate of the FSC, Mauritius.
- b. Approval from the RBI under the applicable foreign exchange rules and regulations and compliance with any conditions prescribed thereunder.
- c. Approval from the Foreign Investment Promotion Board (“**FIPB**”) and compliance with any conditions prescribed thereunder. We understand that FCH had approached FIPB for seeking its approval for the Deal on account of the fact that the Deal envisaged induction of foreign equity in FCH (being an operating NBFC) with downstream investments in companies engaged in/proposed to be engaged, inter alia, in the business of housing finance, stock broking (including derivatives and currency derivatives broking), depository participant service, commodity broking and investment advisory activities.⁵⁵

Approvals required by FCH

- a. In – principle approvals from the BSE and NSE for issuance and allotment of Subscription CCPS and Subscription Shares.
- b. Approval of the shareholders of FCH in relation to preferential allotment of the Subscription CCPS in favour of the Acquirer pursuant to Section 81(1A) of the Companies Act, 1956 of India and other applicable laws pursuant to a postal ballot process notice for which has been dispatched on June 4, 2012
- c. As per the extant provisions of the extant FDI Policy, prior approval from RBI is not required for transfer of shares from resident to non-resident, where the investee company is in the financial sector provided that, (i) NoC is obtained from the respective financial service regulator of the investee company as well as the transferor and the transferee entities and such NoCs are filed alongwith the Form FC-TRS with the authorized dealer; and (ii) the FDI Policy and regulations framed under the Foreign Exchange Management Act, 1999 (“**FEMA**”) in terms of sectoral caps, conditionality’s (such as minimum capitalization, pricing, etc.) reporting requirements, documentation etc. are complied with.

Acting in accordance with the aforementioned provision of the extant FDI Policy, FCH had applied for a no-objection certificate from the RBI.

- d. The completion of a period of 30 (thirty) days from the date of issuance of each of the public notices in relation to the proposed change in shareholding and control of FCH and indirect change of control of Future Finance Limited pursuant to the Deal and acquisition of shares under the Open Offer.
- e. FCHFPL having provided a notice to the National Housing Board for the indirect change of control or change of shareholding and compliance with any conditions imposed thereunder.

⁵⁵ <http://www.thehindubusinessline.com/industry-and-economy/government-and-policy/article3700157.ece>

- f. On account of the indirect change in control and shareholding arising pursuant to the Deal and acquisition of shares under the Open Offer, the following approvals had been obtained by:
 - i. Future Capital Securities Limited from SEBI, BSE, NSE, MCX Stock Exchange Limited and Central Depository Services (India) Limited.
 - ii. Future Capital Commodities Limited from the Forward Markets Commission, Multi Commodity Exchange of India, National Commodities and Derivatives Exchange Limited and National Spot Exchange Limited.
- g. Approval from all creditors of FCH (if applicable), in accordance with the terms of the loan agreements executed with such creditors.

8. Did the Acquirer offer any non-compete fee to the Sellers of FCH? Whether the payment of such non-compete fee is permissible under law?

Under the provisions of the SPA, a non-compete and non-solicit obligation has been imposed on the Sellers, Mr. Kishore Biyani and their respective affiliates in the territory of India for a period of 24 (twenty four) months from the date of transfer of the equity shares in the First Tranche and imposes a restriction on undertaking financing activities relating to purchases made at their stores without first offering such opportunity to FCH for a period of 36 (thirty-six) months from the date of transfer of equity shares under the First Tranche. It is however observed that no separate consideration has been paid by the Acquirers to the Sellers in relation to such non-compete obligation of the Sellers under the SPA.

As a matter of recapitulation, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 provided for a separate non-compete fee to be paid by an acquirer to the selling promoters upto a maximum of 25% of the price offered to the public shareholders under the mandatory open offer in addition to the consideration otherwise paid. However, keeping in line with the spirit of equal treatment of all shareholders, the Takeover Code 2011 provides for the omission of the separate non-compete fees to the promoters/sellers. The Takeover Code 2011 provides that any direct or indirect non-compete fees or control premium or any other consideration paid to the controlling shareholders would be added to the offer price. This change is targeted to benefit the public shareholders of a company who will get the same price as offered to the promoters/sellers.

Accordingly, no separate fee was paid as consideration for imposing the non-compete restriction.

9. Did the Deal require the prior approval of the Competition Commission of India (“CCI”)?

Under the provisions of the Competition Act, 2002 (“**Competition Act**”) read along with the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 dated May 11, 2011, the Deal would have qualified as a ‘combination’ under Section 5 of the Competition Act, if:

- a. The share purchase agreements in relation to the Deal were executed after June 1, 2011;
- b. The combined asset value and the turnover of FCH and the Acquirer or (ii) the combined asset value and the turnover of the “group” to which FCH and Acquirer shall belong pursuant to the Deal exceeds the financial thresholds prescribed under Section 5 of the Competition Act; and
- c. The turnover of FCH is more than INR 7.5 billion (approx. USD 167 million) and its assets value is more than INR 2.5 billion (approx. USD 56 million).⁵⁶

⁵⁶ Notification S.O 482 E, March 4, 2011, under the said notification the enterprise, whose control, shares, voting rights or assets are being acquired has assets of the value of not more than Rs. 2.5 billion or turnover of not more than Rs. 7.5 billion has been exempted from the provisions of section 5 of the Competition Act for a period of five years.

If the above conditions were satisfied under the Deal, as per Section 6(2) of the Competition Act, it would have been mandatory for the Acquirer to notify the Competition Commission of India (“**CCI**”) and seek its approval, prior to effectuating the Deal.

However, we understand from the DPS that no prior approval from CCI was required for the Deal and hence no notice was filed by the Acquirer.⁵⁷

10. What are the tax implications of the Deal?

Gains earned on the transfer of shares and other listed securities held for a period of 12 (twelve) months or less are termed as short-term capital gains and those held for more than 12 (twelve) months are termed as long-term capital gains. Assuming that the Sale Shares were held by the Sellers for a period of 12 (twelve) months or more, there should not be any capital gains tax payable upon sale of Sale Shares if applicable securities transaction tax is paid on such transaction and the transfer takes place on the floor of the stock exchange. However, since the Sale Shares were transferred off the floor of stock exchange,⁵⁸ the Sellers would be taxed at the rate of 10% (excluding currently applicable surcharge and education cess) for long-term gains, and at the rate of 30% in case of short-term gains, depending on the individual tax position of the Sellers.

The public shareholders, who participated in the Open Offer and tendered their shares thereof, would necessarily have made the transfer off the floor of the stock exchange. Long term capital gains arising from transfer of such shares shall be subject to tax at the rate of 10% (excluding currently applicable surcharge and education cess). Short term capital gains arising thereof shall be subject to tax at the rate of 30% (excluding currently applicable surcharge and education cess).

⁵⁷ *Supra* note 3.

⁵⁸ <http://www.bseindia.com/corporates/Sast.aspx?scripcd=532938>

IX. Epilogue

Future Capital Holdings Limited name has been changed to Capital First Limited⁵⁹ owing to certain conditions under the SPA⁶⁰ which allowed Target to use the brand, trademark or co-brand containing the word “Future” and “Future Group” in the name and business of the Target Company and all its subsidiaries for a period of only 9 (nine) months from the date of sale and purchase of the First Tranche equity shares. The reconstituted board of Capital First Limited has Mr. V. Vaidyanathan as the Chairman after the resignation of Mr. Kishore Biyani as Chairman and Director of FCH. Further, Mr. Vishal Mahadevia has been appointed as an additional director of FCH after Mr. G N Bajpai and Mr. Shailesh Haribhakti stepped down as directors of FCH with effect from September 28, 2012.⁶¹

The Deal after the initial jolt owing to delays in getting regulatory approvals sailed through successfully and the developments through the Deal substantiate that this was possible because of joint efforts of both the Target and the Acquirer.

It is yet to be seen how Warburg Pincus brings the much anticipated positive impact in the working and growth for FCH but it certainly has depicted foreign investors trust in India as an emerging market.

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 nishchal.joshi@nishithdesai.com, harshita.srivastava@nishithdesai.com and mukul.aggarwal@nishithdesai.com.

⁵⁹ <http://in.reuters.com/finance/stocks/FCHLNS/key-developments/article/2644891>

⁶⁰ *Supra* note 5.

⁶¹ <http://www.hdfcsec.com/Market/BSE-NSE-Announcements.aspx?CoCode=28364>