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“Mergers and Acquisition in Telecom Industry an Analysis of Financial Performance of Vodafone India and Idea”

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ABSTRACT

Telecommunication sector has seen increased mergers and acquisitions ever since Reliance Jio (country's largest 4G network) owned by Mr MukeshAmbani invested \$25 billion into a Pan India national 4G service, offering a free voice calls and tariffs well below prevailing rates in September 2016 with predatory pricing strategy. By the end February 2017, it had added 100 million customers, gaining over six percent market share.

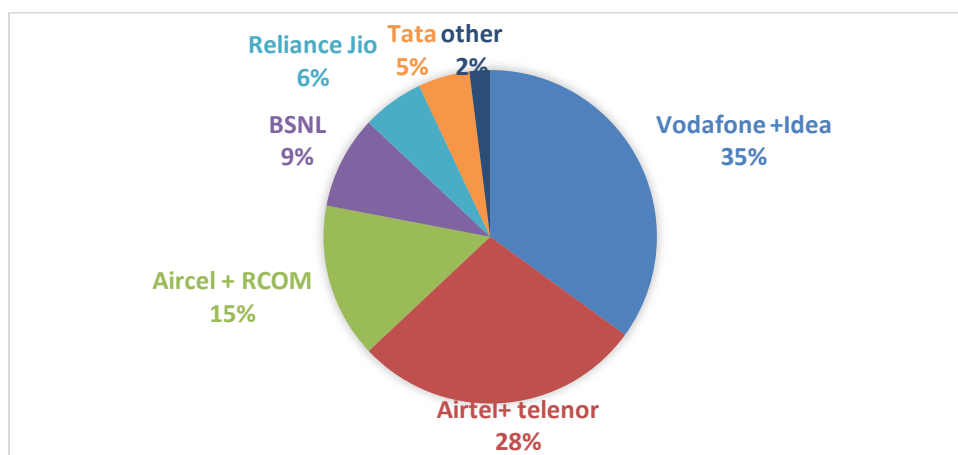
Since then reliance Jio has disrupted the business model of telecomm industry giants like Airtel, Vodafone, Idea and as well as the government-run BSNL. All these telecomm operators have slashed their prices many times to compete with Reliance Jio. There were other small players like Telenor, MTS, Aircel, and MTNL which were planning to exit the telecomm industry for survival or planning for consolidation.

As of march 2017, the three largest wireless carriers by subscribers were all the result of recently completed tie-ups between previous telecomm operators. As a result in terms of subscribers, over 90% of India's wireless market is controlled by five companies namely Bharti Airtel, Vodafone, Idea, Reliance Jio, and BSNL.

keywords: Consolidation, Mergers and acquisitions, predatory pricing strategy.

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Post-consolidation market share :(Based on data as of 31/12/2016)

Graph based on data from TRAI

INTRODUCTION

This case study is all about merger which took place between two telecom giants. I.e. Vodafone India and Idea cellular on 20th March 2017 for \$23 billion, which would result in the biggest company considering the number of subscriber base both the companies have.. The combined entity will have an enterprise value of \$23.2 billion. The new entity will be controlled jointly and equitably by Vodafone and Idea. The merger will result in removal of Airtel from its apex position it enjoyed had since 15 years and aimed at creating a leader in terms of number of customers in India. The merger allows Vodafone India and Idea to get a strong position by cutting costs and effectively competing with reliance Jio.

keywords: enterprise value, mergers, subscriber base

OBJECTIVE

- To Study the financial performance of Vodafone post-merger
- To study the rationale behind the collaboration between Vodafone and Idea

Parties involved :

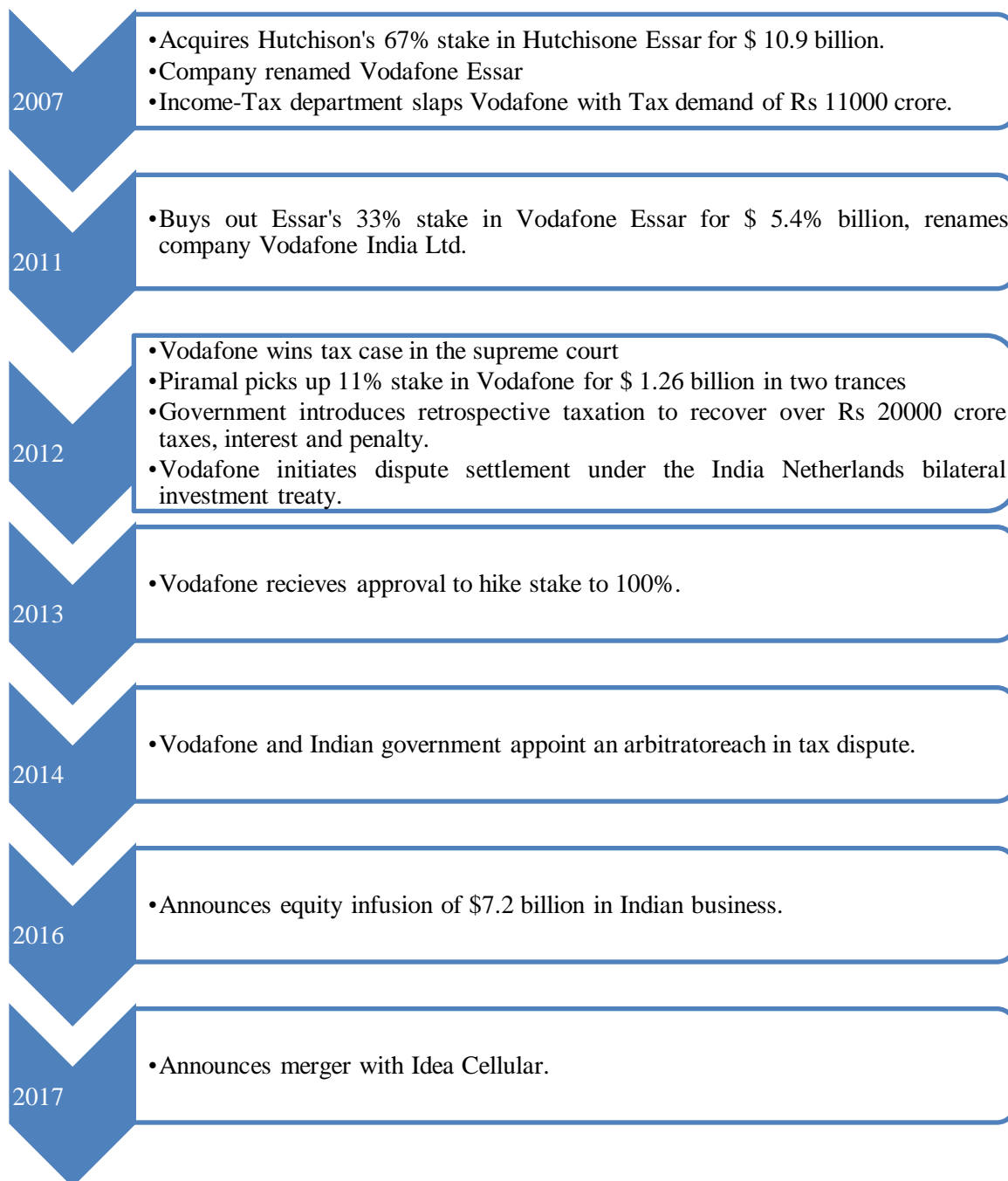
- **Idea cellular ltd. :**

Idea cellular limited is a Public limited company, headquartered in Mumbai, India. Idea cellular is the third largest Indian mobile operator in terms of number of customers it serves offering to its client 2G, 3G and 4G mobile services. Shares of Idea cellular trade in National India Stock Exchange.

At its beginning (1985), AT &T wireless, Aditya Birla Group and Tata Group each held 1/3 of the company. Nowadays Idea is controlled by Aditya Birla Group, the only surviving original shareholder. Kumar Mangalam Birla a renowned Indian businessman is the chairman of Aditya Birla group and exercises significant influence over the operations of Idea cellular.

- **Vodafone :**

Vodafone is one of the world leading telecommunication companies, it was founded in year 1985 and is based in London. Shares of Vodafone is traded on London stock exchange and NASDAQ. It came to India in September 2007, after Vodafone Plc. Acquired a majority stake in Hutchison Essar in May 2007. **Journey of vodafone in india :**



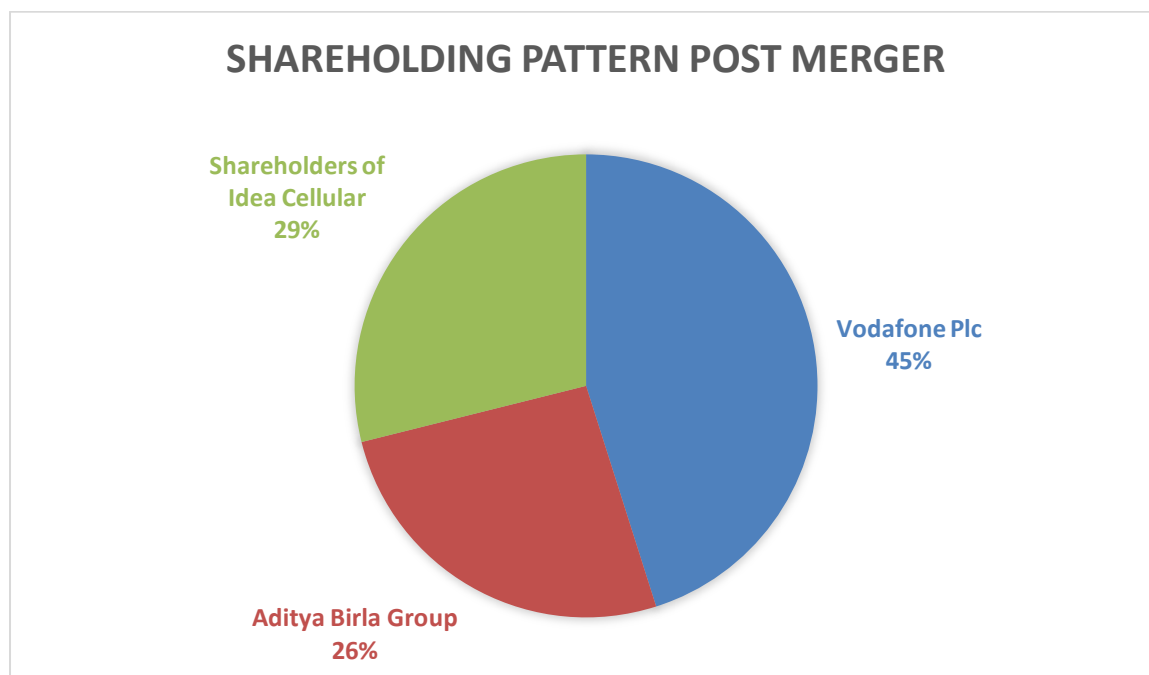
The deal highlights :

The merger between Vodafone and Idea was approved by NCLT Mumbai bench on 30th August 2018 which means the merger became effective from 31st August 2018. As per the scheme of arrangement, Vodafone will combine its subsidiary in India i.e. Vodafone India(excluding its 42% stake in Indus

tower) with Idea which is listed on Indian stock exchange. The combined entity is worth more than \$23 billion.

The deal is said to be the merger of equals. The two companies agreed to merge their operation with a swap ratio of 1:1 i.e. every one share held by shareholder of Idea will be exchanged by one share of the merged company.

The deal has been structured in such a way that, on completion of this deal, Vodafone will end up getting 45.1% stake in combined entity and Aditya Birla Group owned by Kumar Mangalam Birla will own 26.0% stake in merged entity after acquiring 4.9% from Vodafone for Rs 3875 crore, whereas, Idea's other stake holder will own the remaining 28.9% stake. Further Birla group will have a right to acquire additional 9.5% stake from Vodafone over next 4 year from the date of merger to comply with the condition of "merger of equals", However, if equalisation is not achieved due to inability of Aditya Birla Group to acquire these extra 9.5% stake from Vodafone then Vodafone is obliged to sell these excess stake in share market. But till equalization is achieved, voting on excess stake held by Vodafone is restricted and is to be exercised jointly as per the agreement of deal.



The merged entity known as "Vodafone Idea Ltd" will have 12 directors consisting 6 independent directors. Equal representation is being offered to both Aditya Birla group and Vodafone, the chairmanship being offered to Mr Kumar Mangalam Birla.

The merger of Vodafone and idea will make it world's second largest telecom company and India largest telecom company.

Advisors :

- For Vodafone Robey Warshaw and Morgan Stanley acted as lead financial advisors while Bank of America Merrill Lynch, Kotak investment Bank, Rothschild and UBS acted as financial advisors.
- Idea cellular was advised by Goldman Sachs.

Stock market reaction :

After the announcement of merger Vodafone's share price jumped up by 3% and Idea's share prices soared more than 27% in India.

Rationale behind the merger :

Vodafone and Idea will both have annual savings of Rs 14000 crore in terms of operating expenditure and capital expenditure which will be achieved by fourth full year of operation from the date of merger as combined entity. The net present value of total savings is estimated at Rs 70,000 crore.

The merged entity will leverage Idea's leadership in semi-urban and rural telecom markets and Vodafone India's strong presence in metro cities to serve pan-India audience and allow for nationwide leadership within Indian guidelines of mergers and Acquisition.

The merger will help in growing the business of the companies thereby increasing the market value of the shares owned by the shareholders and all other stakeholders.

With this merger a reduction in number of players in market would be witnessed thereby increasing the ability to compete in market more effectively with some relief from bitter price war initiated by Reliance Jio.

Merger conditions :

Department of telecommunication has given approval to the merger on the following conditions.

An upfront payment of Rs 7268 crore has to be made which is split between a bank guarantee of Rs 3342 crore to cover what Idea owes on account of one time spectrum charges and Rs 3926 cash which Vodafone will pay for liberalising non-auctioned spectrum.

Among other conditions one such condition is that Idea needs to replace Vodafone's bank guarantees which is worth Rs 6452 crore held by DOT with its own.

Advantages :

People who are using Idea and Vodafone sim can expect better network coverage in cities and towns.

Consumers can expect more diverse services and access to newer and smarter technology like VoLTE, Digital wallets and internet of things after the merger.

This merger will create India's biggest telecom service provider having a customer base of over 394 billion. Which is more than that of Airtel who is having 263.35 million mobile subscribers. Further, it will have 35% market share, a 41% revenue market share

Vodafone and Idea presently are the second and third largest telecom operators, respectively, in the Indian telecom industry after the merger of these two entities they would emerge as an industry leader replacing Bharti Airtel.

With the financial health of the sector being at its worst phase the merger of both the companies Idea and Vodafone will help them to overcome their debts and large sum of credits will be infused in the system.

It will help the government by contributing truly towards "Digital India" mission by enabling millions of customers connect and build a better tomorrow.

Challenges :

Integration of management of both the organisations will have to cope with cultural differences i.e. staff working with a foreign MNC versus a home grown firm.

Vodafone Idea have at least 6 markets –Maharashtra, Gujarat, Kerala, Haryana, Madhya Pradesh and west Bengal where there combined revenue market would exceed 50% hence they will need to bring down its revenue market share below 50% as per M&A rules within a period of one year from the date of consolidation.

In terms of spectrum limits, the combined entity will exceed the limit of 25% in four circles-namely Gujarat, Haryana, Maharashtra and Kerala this excess spectrum is needed to be sold to comply with M&A guidelines within one year from the date of merger.

Financial performance post-merger :

	Q3FY19 (Sept18-Dec18)	Q 2FY19 (July18-Sept 18)	Change (Rs)	Change %
	Year17-18	Year16-17		
Sales turnover	11751.60	7663.50	4101.30	53.52%
Operating xpenses	10614.7	7202.2	3412.5	47.57%
EBITDA	1136.90	461.40	675.50	146.40%
PAT	-5004.60	-5,016.10	-28.30	-0.56%
Equity share capital	8735.40	8735.10	0.30	00.00%
EPS	-5.73	-5.69	-0.04%	-0.62%
EBITDA margin	9.67%	6.02%		3.64%
Profit after tax margin	-42.88%	-65.45%		22.58%

The merger of Vodafone Idea with Idea cellular was completed on August 31, 2018, The Q2 FY19 results include results for idea cellular up to August 30, 2018 and results for Vodafone-Idea from August 31, 2018 to September 30, 2018.

Source: Company Report, bloombergquint

*Results Consolidated

ANALYSIS

To analyse the financial performance of the sample case during post-merger period it has been observed that company's turnover during quarter3 went up by 53.52%.

EBITDA increased from 461 crore in Q2FY19 to 1136.90 crore in Q3FY19. EBITDA margin increased from 6.02% to 9.67% during the same period.

There has been a decline in profit after tax by -0.56% on account of high finance cost, integration cost, and mobile tower exit charges. Additionally, the major reason of declining profit is due to the intense competition in the market which is because of the competitive tariff being offered by Reliance JioInfocomm limited.

According to the CEO of the merged entity Mr Balesh Sharma the company is working well on track to deliver its synergy targets by FY 2021.

Further notwithstanding the losses incurred by the company, it is said to raise Rs11000 crore from Vodafone group and Aditya Birla group and infuse the total Rs 25000 in the firm to ensure that company has sufficient balance sheet flexibility to successfully execute its strategy.

LIMITATION OF THE STUDY

The study is based purely on secondary data which are taken from financial statements of the case available on internet and hence ambiguity in the data can't be denied.

Since merger took place on 31 August 2018 hence financial statement for the post-merger period starting 1st April 2018 to 31st March 2019 is currently not available therefore quarterly results have been used instead.

CONCLUSION

Reliance Jio is the threat to most of the companies in telecommunication industry and to survive in this cut throat competition mergers and acquisitions is seen taking place in industry. In the present case of Vodafone-idea it can be said that Synergy benefits would gradually be achieved in coming years which will result in higher profits and leverage is expected to reduce hence resulting in value addition to shareholder. As of now there is no gain to public shareholder, it is a loss making company posting a loss of Rs 5003 crore loss in the December quarter.

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