

Worldwide Acquisition By Indian Companies : A Case Study of HINDALCO Industries Ltd.

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INTRODUCTION

A takeover generally involves the acquisition of a certain block of equity of a company which enables the acquirer to exercise control over the affairs of the company. Each takeover should aim at improving operational efficiency and quality of management of the acquired firm when the acquiring group shares its resources and expertise.

Indian businesses get the confidence of acquisition from outsourcing phenomenon; especially the IT industry has helped Indian companies in a lot of direct and indirect ways. First and the foremost, it has ensured that Indian managers and executives are now exposed to western business culture and practice. In the recent period of time, the Indian offshore companies have created an image of reliable low cost, yet high quality products & services and now Indian companies are eyeing Global markets instead of domestic markets to move up the growth ladder. Further, the regulatory changes have made the whole process of acquisition much easier than ever before. Some restrictions like the amount of Foreign exchange entering India have been relaxed. The top ten acquisitions made by Indian companies' world wide are as follows:

THE TOP 10 ACQUISITIONS MADE BY INDIAN COMPANIES WORLDWIDE

Table: 1

Acquire	Target Company	Country targeted	Deal value (\$ ml)	Industry
TataSteel	Corus Group plc	UK	12,000	Steel
HINDALCO	Novelis	Canada	5,982	Aluminium
Videocon	Daewoo Electronics Corp	Korea	729	Electronics
Dr. Reddy's Labs	Betapharm	Germany	597	Pharmaceutical
Suzlon Energy	Hansen Group	Belgium	565	Energy
HPCL	Kenya Petroleum Refinery Ltd.	Kenya	500	Oil and Gas
Ranbaxy Labs	Terapia SA	Romania	324	Pharmaceutical
TataSteel	Natsteel	Singapore	293	Steel
Videocon	ThomsonSA	France	290	Electronics
VSNL	Teleglobe	Canada	239	Telecom

ABOUT THE HINDALCO

HINDALCO Industries Limited, a flagship company of the Aditya Birla Group, is structured into two strategic businesses -Aluminium and Copper and is an industry leader in both. HINDALCO was established in 1958. HINDALCO commissioned its aluminium facility at Renukoot in eastern U.P. in 1962 and has today grown to become the country's largest integrated aluminium producer and ranks among the top quartile of low cost producers in the world. A non-ferrous metals powerhouse with a turnover of Rs.11,396 crore (FY06), HINDALCO's integrated operations and operating efficiency have positioned the company as Asia's largest integrated primary producer of Aluminium and among the most cost efficient producers globally. HINDALCO enjoys a leadership position in specialty alumina, primary aluminium and downstream products. HINDALCO's major products include standard and specialty grade alumina and hydrates, aluminium ingots, billets, wire rods, flat rolled products, extrusions, foil and alloy wheels. All HINDALCO units are ISO 9001:2000 and 14001 certified, and several have attained the OHSAS 18001 - the occupational health and safety certification.

The production capacity of HINDALCO is as follows:

Table: 2

Division	Capacity	Location
Aluminachemicals	1,160,000 tpa	700,000 tpa (Renukoot)
		110,000 tpa (Muri)
		350,000 tpa (Belgaum)
Primary aluminium	424,000 tpa	345,000 tpa (Renukoot)
		65,000 tpa (Hirakud)
		14,000 tpa (Alupuram)
Extrusions	27,700 tpa	19,700 tpa (Renukoot)
		8,000 tpa (Alupuram)
Rolled products	200,000 tpa	80,000 tpa (Renukoot)
		45,000 tpa (Belur)
		30,000 tpa (Mouda)

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Wire rods	64,000 tpa	40,000 tpa (Renukoot)
		10,000 tpa (Alupuram)
		14,000 tpa (Mouda)
Aluminium foil	11,000 tpa	5,000 tpa (Silvassa)**
		6,000 tpa (Kalwa)
Aluminium wheels	300,000 wpa	Silvassa
Copper cathodes	500,000 tpa	Dahej
** Additional 17,000 tpa thick gauge foil capacity at Silvassa		

ABOUT THE NOVELIS

Novelis was born in early 2005 as a result of a 'forced' spin-off from its parent company, Alcan Inc. (Alcan), the Canada-based aluminum giant and set up as its subsidiary in January 2005. The origin of the company can be traced back to 1902 when the Northern Aluminum Company, a Canadian subsidiary of the Pittsburgh Reduction Company was set up. The Pittsburgh Reduction Company was renamed as the Aluminum Company of America (ALCOA) in the year 1907. Novelis has its headquarter in Toronto, Canada. Novelis has its executive offices in Atlanta, US. It has operations in 11 countries including the US, Canada and Brazil besides a JV in Germany, which is 50-per cent owned by the company. It produces and sells more than three million tonnes of flat rolled products. For the nine months ending in September 2006, the company reported a net loss of \$170 million on revenues of \$7.4 billion as compared to a net income of \$32 million on revenues of \$6.3 billion during the same period of previous year. For the year 2005, Novelis had reported a profit of \$10 million on revenues of \$8.4 billion. The company has approximately 12,500 employees worldwide. Novelis is the largest manufacturer of aluminium rolled products in the world and controls nearly 20 per cent of the market. Rolled products are used mostly for making food and beverage cans besides automobile components and as construction material. Its list of customers includes beverage giant Coca Cola, beer major Anheuser-Busch and Can maker Rexam besides auto companies like GM and Ford.

WHEN THE TROUBLE COMES AT THE DOOR OF NOVELIS:

In the spin-off process, Novelis ended up inheriting a debt mountain of almost \$2.9 billion on a capital base of less than \$500 million. That was just the beginning of its troubles. The situation is worse now. Though it marginally reduced debt, it made some losses too. On a net worth of \$322 million, Novelis has a debt of \$2.33 billion (most of it high cost). That's a debt-equity ratio of 7.23:1.

Soon, it stumbled into another crisis. Novelis has a simple business model. It buys primary aluminium, processes it into rolled products like stock for soft drink cans, automotive parts, etc., and sells it to customers such as Coke and Ford. But the management took a wrong decision on aluminium prices. In a bid to win more business from soft drink manufacturers, it promised four customers not to increase product prices even if raw material aluminium prices went up beyond a point. A few months after Novelis signed those contracts, aluminium prices shot up 39 per cent (between 30 September 2005 and 2006). To these four customers, Novelis was forced to sell its products at prices that were lower than raw material costs. These four account for 20 per cent of Novelis's \$9-billion revenues. But the management's wrong judgment led to losses of \$350 million (in 2006).

For long, Novelis's former CFO Geoffrey P. Batt, former controller Jo-Ann Longworth and the finance team didn't quantify these losses. After the complicated spin-off from Alcan, this involved extensive operations in over 35 plants in 11 countries and four continents, the finance team also struggled to file quarterly and annual results on time. Many of the reports that were filed on that time were wrong and later re-stated.

FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF NOVELIS:

Events and factors impacting the Novelis business during the three months ending March 31, 2007 and 2006 are presented briefly below:

Three Months Ended March 31,

Table : 3		(\$ in millions)	
Shipments (kt (A))	2007	2006	Percentage
Rolled products	732	741	(1.2)
Ingot products (B)	40	41	(2.4)
Total shipments	772	782	(1.3)
Net Sales	2,630	2,319	13.4
Net Loss	(64)	(74)	(13.5)

* 1 kilotonne (kt) is 1,000 metric tonnes

Rolled products shipments decreased in 2007 in North America and Asia. In North America, shipments declined due to reduced demand from the original equipment manufacturers (OEM)/distributor market and lower automotive demand with U.S. manufacturers. In Asia, shipments declined as Chinese export competition eroded sales in the industrial and light gauge markets.

From the table we can see that net increase of 13.4% in sale is not due to increase in the sale volume, but it is because of increase in a pricing of London Metal Exchange (LME) of an average of 16%.

Costs and expenses for the quarters ended March 31, 2007 and 2006, in U.S. dollars and expressed as percentages of net sales

Table: 4

Particulars	2007 \$ in millions	Percentage of net sales	2006 \$ in millions	Percentage of net sales
Cost of goods sold (exclusive of depreciation and amortization)	2,447	93.0 %	2,135	92.1 %
Selling, general and administrative expenses	99	3.8 %	92	4.0 %
Depreciation and amortization	58	2.2 %	58	2.5 %
Research and development expenses	8	0.3 %	9	0.4 %
Restructuring charges - net	9	0.3 %	1	- %
Impairment charges on long-lived assets	8	0.3 %		
Interest expense and amortization of debt issuance costs - net	50	1.9 %	48	2.0 %
Equity in net income of non-consolidated affiliates	(3)	(0.1)%	(3)	(0.1)%
Other (income) expenses - net	9	0.3 %	(49)	(2.1)%
Total	2,685	102.0 %	2,291	98.8 %

From the table: 4 we can see that cost of goods sales increased from \$2,135(million) to \$2,447(million). Increasing in the cost of goods sold is because of increasing in the prices of LME.

We can also see from the table that the selling general and administrative expenses increased to \$99(million) from \$92(million). The net increase is \$7(million). This increase is because of share based compensation driven by increase in Novelis share price.

The Table also shows that there is an Impairment charge on long-lived assets \$8(million) which was spent in restructuring of Novelis facilities in Bridgnorth UK, but due to certain reasons, production lines of UK were shutdown and it was relocated in European plant.

In the table: 4 there is an increase in the amount of Interest expense and amortization of debt issuance costs - net from \$48(million) to \$50(million), as compared to first quarter 2006. This is because of higher short term borrowings and waiver fees.

REASON FOR THIS ACQUISITION:

HINDALCO has a strong presence in the upstream part of the aluminium business and has been looking at consolidating its foothold in the downstream or value-added part of the business. For the downstream business, HINDALCO wanted technology and market proximity. With Novelis, HINDALCO can now add value to the aluminium that it produces.

HINDALCO is looking upon the aluminum business as a core business that has enormous growth potential in revenues and earnings. Its vision is to be a big producer of premium metals, global in size and reach with a passion for excellence. The acquisition of Novelis is a step in this direction.

ABOUT THE DEAL:

HINDALCO Industries Limited (HINDALCO) and AV Aluminum Inc., an indirect subsidiary of HINDALCO, entered into an Arrangement Agreement (the Arrangement Agreement). On March 30, 2007, AV Aluminum Inc. assigned its interest in the Arrangement Agreement to AV Metals Inc. (Acquisition Sub), a subsidiary of HINDALCO. Under the Arrangement Agreement, Acquisition Sub will acquire all of the issued and outstanding common shares of Novelis for cash at a per share price of \$44.93, without interest and less any required withholding taxes (the Purchase Price), to be implemented by way of a court-approved plan of arrangement (the Arrangement). Pursuant to the Arrangement Agreement, at the effective time of the Arrangement, each common share of Novelis issued and outstanding immediately prior to the effective time (other than common shares held by (i) HINDALCO or Acquisition Sub or any of their affiliates or (ii) any shareholders who properly exercise dissent rights under the Canada Business Corporations Act) will be transferred to Acquisition Sub in exchange for the right to receive the Purchase Price. The acquisition of Novelis is an all-cash transaction which values Novelis at approximately \$6 billion, including approximately \$2.4 billion of debt and the equity components of the deal works out to \$3.6 billion. The transaction is not subject to a financing condition. The consummation of the Arrangement is subject to various customary conditions, including Novelis shareholder approval and the receipt of regulatory approvals specified in the Arrangement Agreement and/or until the expiration of all applicable waiting periods, including antitrust approvals under the Competition Act (Canada), the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, the European Union or the relevant antitrust authorities in the applicable European Union member states, as well as approval under the Investment Canada Act and approval by the Agencia Nacional de Energia Eléctrica (ANEEL) for the transfer of power generation concessions/ authorizations in Brazil. On May 10, 2007, they had the necessary regulatory approval to proceed with the transaction from all known parties and shareholders. The Arrangement Agreement contains certain termination rights and provides that, upon or following the termination of the Arrangement Agreement, under specified circumstances

involving a competing acquisition proposal, Novelis may be required to pay Acquisition Sub a termination fee of \$100 million or, in certain circumstances, to reimburse costs and expenses of HINDALCO and its affiliates, to a maximum of \$15 million. In connection with this process, Novelis has incurred or will incur fees and expenses, including a termination fee with an unsuccessful bidder.

HOW THE FUND WILL BE ARRANGED BY HINDALCO:

Hindalco borrowed almost \$2.85 billion of the balance (\$300 million was being raised as debt from group companies and \$450 million was being mobilized from its cash reserves). The second part of the deal was \$2.4-billion debt on Novelis's balance sheet. Hindalco would have to refinance these borrowings, though they would be repaid with Novelis's cash flows.

CHALLENGES THAT HINDALCO WOULD FACE IN INTEGRATING THE OPERATIONS:

Hindalco's consolidated debt-equity ratio may skid from about 0.5:1 to well over 2:1. The estimated interest costs on \$2.85 billion will lie between Rs 700 crore-800 crore. That is almost one third of the Rs 2,500 crore net profit generated by Hindalco in 2006-07. Rating agency, CRISIL placed its long-term rating of 'AAA/Stable' on Hindalco. It is expected that with this rating Hindalco's long-term ratings will come under pressure.

BENEFITS OF ACQUISITION TO BOTH COMPANIES:

The acquisition would make HINDALCO the global leader in aluminium rolled products and one of the largest aluminium producers in Asia. With post-acquisition combined revenues in excess of \$10 billion, HINDALCO would enter the Fortune-500 listing of world's largest companies by sales revenues.

The acquisition would establish a global integrated aluminium producer with low-cost alumina and aluminium production facilities combined with high-end aluminium rolled product capabilities. With the acquisition, the current market capitalization became over \$7.5 billion. With this, HINDALCO becomes world's largest aluminium rolling company, one of the biggest producer of primary aluminium in Asia and India's leading copper producer.

Novelis shareholders received \$44.93 per share (including 15% premium) in cash which is a handsome amount. HINDALCO has also taken \$2.4 billion of debt which is good for Novelis.

CONCLUSION:

The acquisition is expected to produce the synergy that Birlas were looking for in the flat products segment. The combination of HINDALCO and Novelis will establish an integrated producer with low-cost alumina and aluminum facilities combined with high-end rolling capabilities and a global footprint. The complementary assets and expertise of the team will provide a strong platform for growth and success. Novelis has excellent synergies with HINDALCO and opens new global markets for value-added high-end aluminium rolled products and aluminium can recycling. The Novelis acquisition provides it with capabilities in technologically sophisticated rolled aluminium products. The acquisition gives enormous geographical market and product synergies. Novelis is the global leader in the value-added high-end aluminium rolled products and aluminium can recycling. HINDALCO is consistently increasing its share of value-added products, which today stand at nearly 60 per cent. The Novelis acquisition gives it an instant leg-up with its technologically sophisticated rolled aluminium products capability, apart from a scale and a global footprint.

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Further, majority of the companies have FII stake in the range of 10-20%. These figures suggest that relative share of FIIs in Indian companies is marginal. The govt. should take concomitant policy efforts in terms of improving financial regulation and corporate governance to encourage individuals as well as institutional investments.

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