

March 01, 2013

WIPRO Limited (WIT ADR - \$9.60 - NYSE)

Stellar returns – So why this?

WIPRO Ltd announced the much-anticipated spin off of their non-IT segment (to be known as Wipro Enterprise limited (WEL)) on October 31, 2012. The post spin off WIPRO (W) would now exclusively be an IT company. While we applaud the action to segment the business, the corporate action raises significant corporate governance concerns.

The WEL corporate action proposal details:

- a) Receive one equity share in WEL for every 5 equity shares in WIPRO that they hold OR
- b) Receive one 7% redeemable preference share in WEL, with face value of INR 50, for every 5 equity shares of WIPRO that they hold. Preference shares shall have a maturity of 12 months and shall be redeemed at INR 235.2 OR
- c) After receiving WEL shares, exchange the equity shares of WEL for equity shares of W held by the majority shareholder in the exchange ratio: 1 equity share of W for every 1.65 equity shares in WEL
- d) WEL will be a private, non-listed company upon spin off

Voting process for the scheme

These proposals have been ratified by WIPRO as effective and approved through a shareholder vote. We believe there are governance concerns both with the content of the proposal, and most importantly with its process. **Firstly**, only a small percentage of the minorities voted for these proposals. This is likely because the company **required physical presence in voting in Bangalore at 4 PM on Friday December 28, 2012**. **Secondly**, the consideration of WEL to be spun out into a non-listed company is **contrary to the underpinnings of free market processes** that WIPRO has enjoyed during its years of growth.

By mandating shareholders to either be present in person or by sending a representative as a physical proxy, comprehensive minority participation was restricted¹. Further, a fair voting process should have been considered only if 50% or more of the minority vote in favor. However, what would be even more in accordance with the nature and in the spirit of the SEBI guidelines regulating such action, is to ensure ratification only if 75% of the minority vote in favor. This 75% minority threshold is consistent with the broad vote regulation for such a proposal. We recognize that the majority shareholder holds 78.3% of the vote and therefore ratifying these proposals would be routine, fair corporate governance calls for the involvement of shareholders holding a fractional percentage of your franchise.

While the voting process complies with the court order CA 1470/2012 dated November 26, 2012, the fact that the scheme is being implemented via a physical presence requirement resulted in limited minority participation (Table 1). We assert that the process should have been better managed to ensure wider participation and discussion.

¹ SEBI (Acquisition of shares & takeovers) Regulations, 2011, allows for a postal ballot/evoting on demergers. SEBI circular CIR/CFD/DIL/5/2013 dated February 4, 2013 mandates this.

Table 1

Voting details

Particulars	By shares	As a %	Shareholders holding these shares
Shares			
Total O/S as on December 31, 2012	2,462,350,878		235,598
Held by majority shareholder	1,927,880,883	78.3%	18
Held by minority shareholders	534,469,995	21.7%	235,580
Voting on the corporate action			
Minority that voted	110,373,217		375
as a percentage of total minority		20.7%	
as a % of shares O/S		4.5%	
Minority that voted in favor	110,347,584		Not disclosed
as a percentage of total minority		20.6%	
as a % of shares O/S		4.5%	
Majority that voted (all voted in favor)	1,721,585,430		Not disclosed
as a percentage of total minority		89.3%	
as a % of shares O/S		69.9%	

Source: Horizon Research, NSE, WIPRO voting results 28/12/12

WEL Post Spin: Shareholders are forced into a Non-public stub

The options before minority shareholders are unfair. Minority shareholders are forced to either hold equity shares in a private, non-publicly traded stub of WEL, or to hold compulsorily redeemable preference shares in the non-public stub. In both cases, the minority is forced to accept the exchange offer at the valuation determined by WIPRO. **We say let the market decide.** This is fair and it is what shareholders in WIPRO have today. It is well accepted that a minority shareholder will not elect to hold either an equity share or a preference share in the non-public stub. Hence, the post spin off promoter shareholding in WEL would almost certainly be near 100% through effective form of coercion.

Our Philosophy

At Horizon we follow the *Gabelli Magna Carta of Shareholder Rights*TM. It states, "We are neither for nor against management. We are for shareholders". Our goal is to invest for the long term in great businesses. WIPRO today represents two great businesses with a great management. We ask that management consider our framework of shareholder fairness and implement our proposal to let WEL trade freely.

***Gabelli Magna Carta of Shareholder Rights*TM**

We are in favor of	We will vote against
Cumulative voting	Greenmail.
Golden parachutes	Poison pills, or antitakeover provisions
One share, one vote	Supermajority voting
Cash incentives	Blank check preferred
Preemptive rights	Superdilutive stock options

Source: www.gabelli.com

Growth of Franchise has been Stellar

The growth in the value of WIPRO under the dynamic management of Mr. Premji has been very competitive. He is one of the most admirable entrepreneurs and exemplary citizens of India. WIPRO has generated over INR 180 billion in cumulative free cash flow for equity shareholders between FY02-FY12. The Total return to a shareholder for holding a WIPRO share between FY02-FY12 meets comparable benchmarks (Table 2).

Table 2 Total Return to a shareholder 01/04/2002 to 31/03/2012

<u>Particulars</u>	<u>Return</u>
WIPRO	11.2%
WIPRO ADR	12.3%
S&P 500	4.1%
Berkshire Hathaway	5.6%
MXEF	14.1%
NIFTY	18.4%

Source: Horizon Research, NSE, Bloomberg

We outline the growth of the franchise as seen through the market capitalization in Table 3. For comparison we observe the divisional segments that are part of the corporate action. WIPRO's non IT segment, WEL, proposed to be taken private through this unfair process has grown revenues and EBITDA at 33% and 26% respectively. This is 27% faster in revenues and 13% faster in EBITDA than WIPRO's IT segment, the segment that will remain public. We re-assert that the faster growing WEL segment should remain freely traded after the division is spun off to the public.

Table 3 Value Creation

<u>Capitalization</u>			CAGR
Balance Sheet as of:	3/31/02	3/31/12	
Fully Diluted Shares	2,299	2,416	
Market Price	168	440	
Equity Market Capitalization	386,725	1,063,313	11%
ADRs outstanding	26	42	
ADR price / unit	182	537	
Capitalization of ADRs	4,715	22,527	
Total Equity Market Capitalization	391,440	1,085,839	11%
Plus: Debt	285	58,958	
Less: Cash and Equivalents	7,158	128,309	
Total Capitalization	384,567	1,016,488	10%
<u>WIPRO IT Segment (W)</u>			
Revenue	30,914	322,749	26%
EBITDA	8,868	68,033	23%
<u>WIPRO Non IT Segment (WEL)</u>			
Revenue	3,067	52,500	33%
EBITDA	442	4,322	26%

Source: Horizon Research, NSE, Bloomberg. FY12 Shareholding as on 31/12/2012

In Conclusion

We recommend that WIPRO:

1. Allow a re-casting of votes via a comprehensive proxy process.
2. Change the proposal to allow the spun off WEL stub to trade freely in the public market

We highlight that the fair and free market has brought WIPRO great rewards, and should be respected to do the same for the WEL Spin Co; let the market decide the value.

Manjit Singh Kalha, the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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