Rapid Response Report

Subject: A CONFIDENTIAL REPORT ON SUBRATA ROY, SAHARA GROUP

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METHODOLOGY AND SCOPE

The following is a rapid turnaround report on Indian businessman Subrato Roy and the Sahara Group.

It has been compiled using confidential sources in India including well placed people in regulatory and government bodies and commercial contacts. An analysis of open sources in English and Hindu has also been completed.

This report was requested to examine the following questions, some of which can only be satisfactorily completed with a proper due diligence investigation. However, confidential sources have been able to provide an indication or narrative of key issues. The areas requested are:

- The Group’s sources of funding;
- Level of assets as opposed to ‘churn’;
- Reputation in India;
- Financial stability if the Group loses an on-going litigation matter.

Key findings have been reported orally to the client.
1. **KEY FINDINGS**

Investigations conducted within the available time frame have revealed the following key issues with regards to Subrata Roy and the Sahara Group:

- Roy claims to have made his money primarily as a parabanker to poor farmers. However, a significant source of his wealth comes from elsewhere, and was discussed with the client in person.

- The subject’s business affairs are opaque. By the standards of western companies there are a number of issues which would cause concern. Within the Indian business context his position is more nuanced. He is frequently photographed at social events with political and commercial figures – such as the Hindujas and Vijay Mallya - as well as Bollywood stars. But he is not considered to be a member of the ‘corporate club’ by the leading high profile families.

- Roy is under investigation by financial regulators but, perhaps more tellingly, sources with close contacts to India’s financial intelligence agencies said his business activities are “under close surveillance”. This was also discussed in further detail with the client.

- Most of the companies in the Group are not publicly listed and are involved in areas where poor governance issues are prevalent, including real estate and sport. Decision making within the Group falls to close family members, and there is no evidence that corporate governance has improved over the past five years.

- Two of the Sahara Group companies are currently embroiled in a Supreme Court case that could see them forced to pay back almost US$5.5 billion to investors in a complicated bond product. The case is currently under review, having only been recently launched. Whether Sahara wins or not, it is likely to have regulatory repercussions. Sources consulted for this report said that losing the case will hinder Sahara’s ability to raise funds in the future. This said, at present he does not appear to have difficulty raising funds. At the beginning of this year he threw a financial lifeline to Vijay Mallya, whose Kingfisher Airlines was in serious financial trouble. Roy bought a 42.5 per cent stake in the Force India Formula 1 team, giving Mallya a much needed £100 million.

- In 2008, Sahara India Financial Corp (SIFCL) was banned from taking any public deposits by the Reserve Bank of India (RBI), due to a violation of guidelines for non-banking financial companies. The company was subsequently ordered to cease its present business activities by 2015.

- Roy has traditionally been close to Mulayam Singh Yadav, a very influential politician in Uttar Pradesh. Yadav has served as chief minister three times, but is no longer in office. This has removed some of Roy’s political cover, and some sources maintain this has increased the regulatory attention being paid to his business practices.
Sources with knowledge of his working practices describe Roy as mercurial, unreliable and many of his “cultish” views are thought of as carefully cultivated to provide obfuscation and cover for his unconventional business practices.

2. REPUTATION

Subrata Roy is the head – self styled “chief managing worker” – of the Sahara Group, an Indian conglomerate that has interests in property, finance, media, entertainment, retail, manufacturing, information technology, hospitality and sport.

The Sahara Group has more than 900,000 employees, and according to open source reports, an asset base of US$25 billion (this is based on a financial statement posted on the company’s website).

The Sahara Group is headquartered in Lucknow, Uttar Pradesh in a complex known as Sahara City. Financial and other details around most of the Group’s businesses are difficult to obtain and only the relatively small media arm, Sahara One, and a home loan company, Sahara Housingfina, are listed entities. However, a fuller investigation could provide comment from well placed sources with knowledge of the group.

The lack of transparency over business affairs has been one factor leading to Roy’s reputation. It is notable that he is involved in sectors which have traditionally poor corporate governance reputations. Confidential sources say that a private company in the real estate industry in particular would pose concerns because it is contingent upon close political relationships allowing the company access to land.

2.1 Banned From Taking Public Deposits

In 2008, one of Roy’s companies, Sahara India Financial Corp (SIFCL) was banned by the Reserve Bank of India (RBI) from taking any public deposits due to violation of guidelines set by the RBI for non-banking financial companies.

The group began its “parabanking” business in 1978, and claims that its operations have helped millions of impoverished Indians who are unable to access mainstream banking services. Sahara agents visited homes taking tiny deposits from customers. But the RBI ruled that Sahara must cease activities in their present form by 2015.

An advertisement reportedly posted by the parabanking institution in late November 2011 purported that all deposits would be paid back before the end of December 2011. This prompted the RBI to examine the advertisement’s credibility – it did not feature a company logo and was signed only with a designation, rather than a person’s name. The company was not penalised for the announcement, nor did it, however repay its obligations – valued at Rs5,000 crore – by the announced date.

SIFCL has likewise not endeared itself to other financial groups. Senior bankers in Mumbai have said that the SIFCL should not be permitted to operate because it could default on liabilities and cause a problem to the Indian economy which would be comparable in scope to the collapse of Bear Stearns in the US.
2.2 Alleged Tax Evasion

The Sahara Group has also run afoul of the income tax authorities. There are reports in open sources that some entities in the Group have evaded tax payments and conducted some questionable fund transfers between companies. In December 2007 the Income Tax (IT) department ordered a Special Audit for the Financial Year 2004-05.

Part of its report included the finding that expenses of other Sahara group companies had been billed to SIFCL for which the latter claimed tax benefit from the IT department.

2.3 Cricket Sponsorship

Roy’s ownership of the Sahara Pune Warriors cricket team has also caused controversy. Along with some other high profile club owners, Roy defended the disgraced India Premier League (IPL) commissioner Lalit Modi, when he was accused of financial irregularities. The controversy prompted tax investigations into Pune Warriors, and nine other cricket clubs. One of the issues which has raised questions in the Indian press is the financial viability of Roy’s – and other business moguls’ – involvement in cricket.

In late May 2012, it was reported that income tax investigators had carried out a search of the Pune Warriors offices following the suspension of one of their players – Mohnish Mishra – following allegations of match fixing. Sahara has denied that an investigation took place but the sport continues to be plagued by match fixing allegations and attention could be drawn closer to the team’s finances in coming months.

On a separate matter, one source who knows Roy well reported that he is focused on sport as a means of raising his profile. He has an underlying belief that a higher profile will lead to greater business success.

2.4 Financial Health

The Sahara Group’s financial opacity is regularly remarked upon in the media and by human sources. Its website claims that it receives funding largely from “secured loans from Banks, Advances against various projects, Life Insurance Policy Holders Fund and Mutual Funds” and defines the majority of its assets as falling under the “Land, Inventory, Work in Progress”.

As a privately owned group, it is not required to disclose a significant amount of information regarding its assets as a matter of course. However, its controversial disclosure tactics have caused problems for the group in the past.

Most recently, a probe initiated by the Securities and Exchange Board of India (SEBI) against two group companies – Sahara India Real Estate Corporation (SIREC) and Sahara India Housing Corporation (SIHC) – directly resulted in the failed IPO of another group real estate company – Sahara Prime City.

2.4.1 Supreme Court Case

In 2008, SIREC and SIHC (companies with paid up capital of less than $20,000), began raising funds through optionally fully convertible debentures – complicated bonds that were sold to 23 million investors, largely in rural India, raising at least $3.7 billion – larger than India’s biggest ever IPO.
In November 2010, the SEBI ordered both companies to stop raising funds in this manner and return the money they had already raised (with 15 per cent interest), arguing that this was a public offer undertaken without the SEBI’s approval. Sahara vigorously contested the claim, stating that it was a private placement and thus did not require SEBI approval. They secured a stay order on the SEBI’s demands from a tribunal but the matter was eventually elevated to the Supreme Court.

Amongst a series of allegations of intimidation levelled against the finance ministry, both companies and Roy are barred from raising funds. The apex court eventually stayed the order for repayment but an intervention application was filed with the Supreme Court in June 2012, alleging non repayment of the funds and asking for the appointment of a committee to ensure prompt and full repayment of investors’ funds. SIREC and SIHC have been charged with repaying billions of dollars, all of which remain in their bank accounts. Despite the chairman’s bluster – he has publicly stated he can repay the debt “tomorrow” – the person who filed the order has argued that Sahara is being treated as “too big to fail” and is driving for change.

The complainant, Arun Kumar Agrawal, is a lawyer, who has been involved in exposing some of the biggest scandals in Indian commercial history. One press article reported that he was responsible for blowing the whistle on the 2G telecoms scandal, while he was also involved in litigating against the Karnataka mining scam and the Cairn-Vedanta deal. His success rate in identifying commercial impropriety is significant and he can be expected to fight against Sahara until he sees a change either in the company or the regulatory environment.

2.4.2 Questionable Real Estate Practices

The issue of the OFCDs is not the only questionable behaviour in which Sahara’s real estate arm is involved.

Open sources have reported on cases where individuals have paid several thousands of dollars in deposits for apartments bought off plan, and are still waiting for construction to begin years after they have been purchased. Sahara have been accused by critics of leveraging their popularity as sponsors of the national cricket team and failing to disclose material information. In one case, an individual paid a deposit on an apartment, only to wait two years before being told that an alternate construction site was being sought because of apparent “interference” from authorities.

Sahara has not yet been subjected to any official investigations relating to these practices. However, there are a growing number of disgruntled potential homeowners who are already drawing media attention to the issue, which could prove troublesome if regulators do start paying closer attention to the group. This is in line with the intervention application currently sitting in front of the Supreme Court.

2.5 Personal Reputation

Subrata Roy enjoys a flamboyant, yet often illusive, reputation. He is sometimes referred to in the Indian media as the sub-continent’s Howard Hughes. A public image has been built up of a billionaire who owns houses which are replicas of Buckingham Palace and the White
House. His sons were married a few years ago in extravagant ceremonies that lasted two weeks, with a guest list that read like a who’s who of Indian society.

One of the criticisms levelled at Subrata Roy is that he runs his business empire as if it were a quasi religious cult. He has a philosophy of “collective materialism”, upon which he is known to deliver very lengthy motivational sessions to his employees. Confidential sources report that this is mainly window dressing. The region where Roy’s businesses are based has a strong communist tradition and Roy has cleverly utilised socialist sentiments to manipulate workers when he is “about as un-communist as you can get” as one source summed up. Senior figures within the organisation are not permitted to speak publicly about the group or its leader. He calls himself the chief guardian and “father” to the largest family in the world.

Roy’s wife, Swapna, and his brother, Joy Broto Roy are also “deputy managing workers”; whilst Roy’s sons Sushanto and Seemanto, run the property and media businesses, respectively. OP Srivastava – considered a loyalist having been with Roy when the business first started, is another “deputy managing worker” and regarded as the operational number two.

2.6 Political Connections

Subrata Roy likes to portray a rags-to-riches story. He founded Sahara in 1978, employing just three people, building up a huge business empire. But critics say that his rise had far more to do with political connections. In particular, he was closely associated with Mulayam Singh Yadav, a very influential politician in Uttar Pradesh who has served as chief minister of the state three times, as well as being a defence minister in national government. Yadav founded his own Samajwadi (Socialist) Party (SP). During his tenure as chief minister, Yadav was accused of widespread corruption and money laundering. Corruption charges against him are still pending at the Supreme Court.

More recently Roy has grown closer to Congress MP Rajiv Shukla. But some commentators have noted that in effect Roy has lost much of his political cover and is vulnerable to critics such as the present Uttar Pradesh chief minister Kumari Mayawati. The latter ordered parts of the construction project in Lucknow to be pulled down, saying the buildings had been illegally constructed on army land. There is some indication that the changes in political allegiance has resulted in Roy’s present difficulties with the RBI.