



India

Optimism takes root



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Current Environment

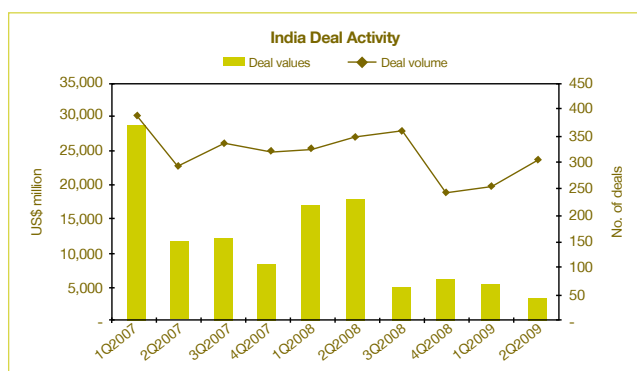
The Indian economy grew by an estimated 6.7% during the fiscal year ending March 2009. While this is significantly lower than the 9% growth achieved in 2007 and 2008, the growth was broadly in line with projections made by the Reserve Bank of India. The slowdown in economic growth was primarily attributable to the lower growth in the agricultural and industrial sectors, which grew by 1.6% and 3.9% respectively, compared with the 2.4% and 8.1% growth achieved in the fiscal year 2008. Manufacturing was the key disappointment and grew a mere 2.4% during fiscal year 2009 compared with 8.2% in fiscal year 2008. Services showed a growth of approximately 8.5%, with the global downturn significantly impacting growth in the hotel, transport and communications segments, with cumulative growth of 9% in these segments versus the 12.4% growth achieved in fiscal year 2008. Growth in financing, insurance and other services also fell from 11.7% in fiscal year 2008 to 7.8% in fiscal year 2009.

The Wholesale Price Index showed a steady decline and turned negative for the first time in 30 years in June 2009. This was primarily attributed to the fall in the price of oil and commodities. However, the Consumer Price Index ("CPI"), which is more representative of household consumption, continues to be in the range of 9% to 10% as prices of food products remain firm. The CPI is expected to start declining gradually in the next six months, though it is unlikely to fall below 5% to 6% levels.

The Indian stock markets were in a state of steady decline for most of 2008, but have been on recovery mode since the beginning of 2009 and reacted in a very positive manner to the results of the general elections where the Congress-led United Progressive Alliance government came to power. The Sensex fell to a low of 8,500 in November 2008 and touched 15,000 in June 2009. With the stock markets improving, the foreign institutional investors who had turned net sellers in 2008 appear to have regained confidence and have been in a buying

mode, albeit in moderate quantities. The election results and the anticipation of continued reforms have raised confidence of the domestic investors too, and a number of companies have used the opportunity to raise funds by way of the Qualified Institutional Placement route. On hopes of persistent capital inflows from foreign investors, the Indian rupee has strengthened vis-à-vis the US dollar by 3% in the first half of 2009. On an overall basis, it appears that investors believe that the Indian economy is much more resilient; growth in Foreign Direct Investment has risen from US\$24.5 billion to US\$27.3 billion in 2008 to 2009 which appears to support this opinion.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 30 June 2009. Data for 2Q2009 has been adjusted to exclude the deal between Bharti Airtel Limited and MTN Group Ltd which was not completed at time of writing.

The global downturn has had a significant impact on M&A activity in India with a fall in both outbound and private equity deal activity being the most obvious impact. Both M&A deal volumes and values fell in the first half of the year in comparison to corresponding periods in 2007 and 2008. The total number of M&A deals in this period stood at 565 deals, down from 677 deals in the first half of 2008. Deal values fell 65% during the same period, from US\$32.5 billion to US\$11.5 billion.

While lack of financing was one of the key reasons for the fall in deal activity, the conservative approach to growth adopted by Indian companies also made a significant contribution. In general, companies appear to have made a perceptible shift in their thought process about the pace at which they want to grow and how they would achieve that growth. For the most part, they adopted a wait-and-watch approach, focusing only on deals which had a compelling investment and pricing rationale. The focus was on conserving resources, both cash and management bandwidth, and consolidating existing operations; this has already resulted in divestiture of non-core businesses and more divestitures are likely in the near future.



Outbound investments accounted for a mere approximately US\$0.4 billion of M&A activity in the first half of 2009, spread over 47 deals, representing a fall of over 97% in terms of value compared with the first half of 2008. Indian companies focused primarily on distressed asset transactions during the period, and the prevailing economic conditions in the West provided such opportunities, owing to lower demand and volumes, eroding customer confidence, overcapacity and volatile cost base. Two deals stand out in this regard:

- Motherson's acquisition of Visiocrp, a company in administration in the UK, for US\$31.6 million. The new entity to emerge will be one of the world's largest manufacturers of automotive rearview mirrors.
- Apollo Tyres' acquisition of Vredestein Banden of the Netherlands, a company that was also in administration.

Other significant outbound deals announced during the period include:

- Lupin Ltd's acquisition of a 51% stake in Multicare Pharmaceuticals Philippines Inc.
- Aegis BPO Services Ltd, announced the acquisition of US-based ICT Group Inc., a provider of information technology services for a consideration of approximately US\$127 million.

GMR Energy Ltd acquired over 50% of Homeland Energy Group Ltd, a coal mining company. It also acquired Barasentosa Lestari PT, an Indonesian coal mining company for US\$80 million.

Inbound deal volume and value fell by 35% and 80% respectively. However, much higher inbound deal activity is expected in the second half of 2009. One of the sectors which continue to interest overseas investors in spite of the overall economic slowdown is the Indian telecommunications sector. In 2008, Norway's Telenor bought a 60% stake in Unitech Wireless while Japan's NTT DoCoMo invested US\$2.7 billion in Tata Teleservices for a 26% stake. In 2009, Bahrain Telecom invested US\$225 million in Chennai's S Tel, a new player yet to start operations, and talks are currently underway for an approximate US\$25 billion transaction between MTN and Bharti Airtel Limited, which will involve both companies taking stakes in one another.

Other significant inbound deals during the period include:

- BIC acquired a 40% stake in Cello Pens for US\$160 million.
- Sodexo SA acquired Radhakrishna Hospitality Services Pty Ltd, a catering and food support services provider for US\$100 million.

Domestic transactions contributed 55% of the deal activity in the first half of 2009. Most of these transactions resulted from domestic consolidation and re-alignment of businesses by the key business groups in the country. This included Godrej Consumer Products Ltd's acquisition of Godrej Consumer Business Private Limited, a wholly-owned unit of Godrej & Boyce Manufacturing Co Ltd in exchange for 30.29 million ordinary shares of Godrej Consumer Products Ltd, valued at approximately US\$106 million.

Other key domestic deals during this period include:

- Quippo Telecom Infrastructure Ltd's acquisition of a 49% stake in Wireless TT Info Services Ltd, a telecommunication services provider and part of the Tata Group, for a consideration of approximately US\$1.3 billion.
- Sesa Goa Ltd's acquisition of VS Dempo & Co Pvt Ltd, an iron ore mining company, for approximately US\$370 million.
- Indian Hotel Company Limited's acquisition of an undisclosed minority stake in Elel Hotels & Investments Ltd, from Claridges Hotels Private Ltd for a consideration of approximately US\$143 million.

Private equity transactions also declined during the first half of 2009, with only 96 deals worth approximately US\$1.9 billion reported during the period. Private equity investors continue to be cautious of investing, given the continuing high value expectations, further fuelled by the stock market rally after the announcement of the results of the general elections. Certain private equity firms are carrying significant mark-to-market losses on their books, and have focused on ensuring there is no further value depletion in their existing portfolio. Some of the notable private equity deals during the first half of 2009 include:

- FIM Ltd and LNM India Internet Ventures Ltd's 37.5% acquisition in Sophia Power Co Ltd, an electric utility company for a consideration of US\$325 million.
- Vernon & Park Capital LLP and Dunbay Co Ltd announced the acquisition of a 5% stake in Delhi Stock Exchange.
- KS Oils, a producer of edible oils, raised US\$90 million from an investor group comprising New Silk Route Partners, Citigroup Venture Capital International Growth Partnership Mauritius Limited and Baring Private Equity Asia III Mauritius.



Outlook

The new Finance Minister has indicated that the Indian government is aiming to achieve GDP growth of 9% for the financial year 2009/2010. To counter the negative fallout of the global slowdown on the Indian economy, the government has responded by providing three focused fiscal stimulus packages in the form of tax relief to boost demand, and has also increased expenditure on public projects to create employment and public assets. Some of the key measures taken in this direction include:

- Reduction of customs duty on consumer durables such as LCD televisions, mobile phones and commercial vehicles.
- Increased allocation under the National Rural Employment Guarantee Scheme by 144% to approximately US\$8.2 billion in 2009 to 2010.
- Implementation of social security schemes for workers in unorganised sectors such as weavers, fishermen, leather and handicraft workers, plantation labour, construction labour, etc.
- Launch of a new project for modernisation of the Employment Exchange through a public private partnership.
- Debt relief to farmers by extending the Debt Waiver and Debt Relief Scheme from 30 June 2009 to 31 December 2009. The target for agriculture credit flow has been set at US\$65 billion for the year 2009 to 2010.
- Allocation towards Urban Infrastructure under Jawaharlal Nehru National Urban Renewal Mission stepped up by 87% to US\$3 billion in 2009 to 2010. Allocation towards Infrastructure development of highways and railways increased by 25% and 45% respectively.

Additionally, the Reserve Bank of India has taken a number of liquidity enhancing measures to facilitate and ease financing options for Indian corporates. These include:

- FII regulations have been amended to enable Sovereign Wealth Funds to register as FIIs.
- Indian companies in the energy and natural resources sectors such as oil, gas, coal and mineral ores have been permitted to invest in excess of 400% of their net worth with prior approval of the RBI.
- Registered Trusts and Societies engaged in the manufacturing or educational sector and those that have set up hospital(s) in India are now permitted to make investment in the same sector(s) in a JV or WoS outside India, with the prior approval of the RBI subject to satisfaction of certain eligibility criteria.
- ECB (External Commercial Borrowings) guidelines have been revised to allow ECB up to US\$500 million per borrower per financial year for rupee expenditure and/or foreign currency expenditure for permissible activities under the Automatic Route for infrastructure and industrial sector.

A combination of the stimulus package and enhancement of liquidity in the system is expected to set the pace for better investment activity in the second half of 2009. There is a lot of optimism that the education, healthcare, agricultural, FMCG and infrastructure sectors will see a lot of activity, since most of these sectors are driven by domestic demand. With the increase in financing options, including private equity and debt financing, outbound acquisition activity is also expected to pick up. ■