# South and Southeast Asia
# India

*India Inc back on track*

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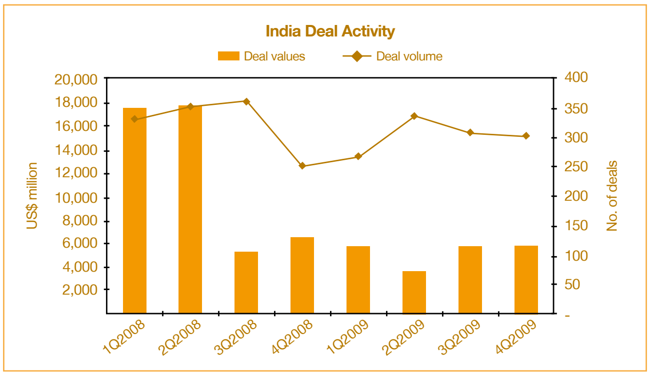
## Current Environment

The Indian economy grew by an estimated 7% in the first half of fiscal 2009/10 (the fiscal year ends on 31 March). While this is slightly lower than the 7.8% growth registered for the same period in the prior year, the growth rate of 7% is higher than the predicted growth rate in the aftermath of the global financial crisis. The macroeconomic data from the first and second quarters of the current fiscal year confirmed signs of a turnaround for the economy. The key contributors to the economic growth were good performance by the industrial and services sector. Growth in the industrial sector was driven primarily by the manufacturing sector, which grew by 6.3% in first half of the current fiscal year compared to 5.3% growth during the same period in the prior year. The mining and quarrying sector showed 8.7% growth in the first half of the fiscal year, vis-à-vis 4.2% growth in the same period in the prior year. The services sector continued to be the main driver of GDP growth, with real estate, financing and business services recording 7.9% growth, while the trade, hotels, transport and communication sectors showed an 8.3% growth in the first half of the fiscal year. The agricultural sector continued to show a weak performance with a 1.7% growth rate.

Inflation which has risen from a negative 1% in August 2009 to 4.8% in November 2009, is expected to be a key concern in 2010. With a revival in the global economy and the expected rise in international crude oil prices, inflation is expected to increase by the end of the current fiscal year. The Indian stock markets have been volatile over the last year and a half, after enjoying an average annual gain in excess of 40% for the last three years. The markets lost over 60% of their value by March 2009, however, they have rebounded by 50%, exhibiting improving investor confidence, narrowing spreads and reduced volatility. Initial Public Offers (IPOs) are also back in favour after a wash out for most of 2008 and the first quarter of 2009.

India's economic turnaround has not gone unnoticed by global investors. As soon as the global markets started rallying earlier this year, strong foreign institutional investor (FII) inflows returned to the Indian markets. The FIIs, who had turned net sellers in 2008, appear to have regained their confidence on account of healthier macroeconomic indicators and improving stock markets. During a year when the value of the stock market increased by over 70%, FIIs made a net investment of over US$16.8 billion in the Indian stock market by the end of 2009. This is the highest ever inflow in the country in a single year and comes a year after the FIIs pulled out over US$10 billion. The surge in FIIs investments helped the Indian rupee strengthen vis-à-vis the dollar by approximately 5% in 2009. While the Foreign Direct Investment (FDI) inflows in India dipped marginally in the first nine months of the current fiscal, by approximately 11% to US$15.3 billion, the total FDI inflow into India surpassed US$100 billion for the first time since 2001.

## Deal Activity




Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 31 December 2009.

Amidst economic uncertainties and the global financial crisis, 2009 has been a year of introspection for Indian deal makers. 2009 witnessed a significant fall in deal activity, primarily in terms of value, despite a slight revival in the second half of the year. While the total number of transactions fell marginally from 1,284 deals in 2008 to 1,201 deals in 2009, aggregate deal value declined by over 50% from US$46.2 billion in 2008 to US$20.4 billion in 2009. Oil and gas, real estate, telecom, pharmaceutical, healthcare and biotech sectors were the leaders as far as deal values were concerned, accounting for over 50% of the total M&A deal value during 2009.

The fall in deal activity is attributed to a decline in both inbound and outbound transactions. The year has also seen significant domestic consolidation deals with domestic deal makers outperforming their cross-border counterparts in M&A deal activity. After a gap of three years, the Indian M&A space saw domestic M&A being higher than both inbound and outbound deals put together. While the credit squeeze made outbound acquisitions tougher, India Inc. also adopted a cautious approach, focusing on synergies and cutting costs where possible in order to emerge from the downturn. In 2009, domestic deals stood at approximately US$12.5 billion which accounted for approximately 60% of the total deal activity. Some of the key domestic deals during this period include:

- Reliance Industries Ltd. acquired the remaining 24.6% stake in Reliance Petroleum Ltd., a petroleum product manufacturer and wholesaler, in a stock swap transaction valued at approximately US$1.7 billion.
- 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 US$1.3 billion.
- AAA Project Ventures Pvt Ltd. (AAA) acquired warrants convertible into a 15.93% stake in Reliance Infrastructure Ltd., a Mumbai-based electric utility company, for US$820 million.
- Jaiprakash Hydro-Power Ltd. (JHPL), a 63.3% owned unit of Jaiprakash Associates Ltd. (Associates), merged with Jaiprakash Power Ventures Ltd. (Ventures), an electric utility company and an 80.2% owned unit of Associates, in exchange for a prorated 317.7 million new JHPL shares valued at approximately US$556 million, in a reverse takeover transaction.

2009 had three major themes in the Indian corporations' outbound acquisitions: distressed assets, niche technology in IT/ITeS and emerging economies. The cross-border deals could have been a lot larger, had the US$12 billion takeover of the major global petrochemicals company Lyondell Basell by Reliance Industries Ltd. happened in 2009, and Indian telecom leader Bharti Airtel's much anticipated US$23 billion deal with South Africa's MTN not faltered on regulatory issues. Outbound investments accounted for a mere US$1.2 billion of M&A activity in 2009 spread over 114 deals, representing a fall of almost 90% in terms of value. Due to liquidity issues and lack of financing, corporations cut down on expansion both organically and inorganically. Their focus was on first completing the projects in progress and then looking at other opportunities. The few significant outbound deals announced during the year include:

- In the first acquisition of a foreign sugar and ethanol unit by an Indian company, Shree Renuka Sugars Ltd., one of the largest producers in the country, announced their acquisition of Brazil's Vale Do Ivaí SA Açúcar e Álcool (VDI) for US$240 million.
- 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 Infrastructure Ltd. (GI), a unit of GMR Holdings Ltd., acquired Barasentosa Lestari PT (BL), a coal mining company, for US$80 million.
- Infosys BPO Ltd. of India, a unit of Infosys Technologies Ltd., acquired McCamish Systems LLC, a provider of business process outsourcing services, for US$58 million.
- An example of a distressed assets deal is the Motherson Sumi Systems Ltd.'s acquisition of Visiocorp PLC (VP), the world's largest automotive rear view mirror company based in the UK, for an estimated US$31.8 million.

With acquirers in the US and Europe being in weaker positions than they were in 2008, inbound deal value in India declined by 67%, with only 244 deals worth approximately US$6.6 billion in 2009, vis-à-vis 334 inbound deals worth US$20.4 billion in 2008. However, early 2009 saw a different type of inbound transaction as stake enhancements were common, whereby multinationals were pouring more into companies they already had investments in. Companies like Pfizer and Novartis took this approach in the pharmaceutical sector. Novartis AG of Switzerland raised its interest to 79.42% from 50.93% in Novartis India Ltd., a pharmaceutical products manufacturer, for a total value of US$77 million. Presence in the Indian pharmaceutical market is also a way to hedge risk for the multinational organisations as there is opportunity to prolong the product life of products that have matured in developed economies. Going forward the key inbound interest is expected to be in pharmaceuticals, healthcare, financial services, ITeS, engineering services and the consumer sector.

Some of the other notable inbound deals in India during 2009 include:

- In one of the largest deals in 2009, the Federal Agency for State Property of Russian Federation acquired a 20% stake in telecom service provider Sistema-Shyam for US$680 million.

- Sanofi Pasteur SA of France acquired Shantha Biotechnics Pvt Ltd. (Shantha), a biotechnology company, from Merieux International SA (Merieux) for a consideration of US$780 million.
- An investor group comprising state-owned Bahrain Telecommunications Co. and Millennium Private Equity, a wholly-owned unit of Millennium Finance Corp. Ltd. acquired a 49% stake in S Tel Ltd. (STL), a telecommunication services provider for US$225 million.
- An investor group comprising of Technology Infrastructure Ltd. of Mauritius and Global Holding Corp Pvt. Ltd. planned to acquire a 14.76% stake in GTL Infrastructure Ltd., a Mumbai-based provider of wireless telecommunications services, for a total value of US$101 million.

The two years leading into the financial crisis witnessed a slow down in private equity (PE) investment activities with several deals being called off due to a mismatch in valuation expectations. There has been a decline in the volume of PE deals in 2009 as investors continue to focus on existing portfolios and apply greater caution while selecting new targets for investment. PE transactions declined from US$11 billion in 2008 to US$4 billion in 2009. The average PE deal size was US$20 million in 2009, lower than the US$35 million seen in 2008. According to investors, the average deal size is expected to continue to decrease. With respect to high value deals there were 14 deals over US$50 million and 9 deals over US$100 million in 2009 as compared to 30 deals over US$50 million and 25 deals over US$100 million in 2008. Real estate, IT and IT services and energy were the most targeted sectors for PE investment, accounting for more than 40% of the total private equity deal value during 2009. Some notable PE transactions during 2009 include:

- An investor group comprising of FIM Ltd. of Mauritius (23.4%) and LNM India Internet Ventures Ltd. (14.1%) agreed to acquire a 37.5% stake in Sophia Power Co. Ltd., an electric utility company for an estimated consideration of US$325 million.
- Omani state-owned Oman Investment Fund planned to acquire a 50% interest in the Mohtisham Estates project, from Mohtisham Complexes, a Mangalore-based real estate development firm, for an estimated US$128 million.
- An investor group comprising Court Square Capital Partners, Sequoia Capital and Bessemer Venture Partners LP, acquired an 18% stake in Ind-Bharat Power Infra Pvt Ltd., an investment company, for US$100 million.

2009 saw some significant exits by PE funds, primarily through the open market route. Funds utilised the sharp rise in stock markets to cash out and return some money to the LPs. This included Warburg Pincus selling part of its holding in healthcare firm, Max India for US$50 million, enabling the PE firm to make a multiple of nearly five times on their initial investment. Another noteworthy exit is ChrysCapital netting a multiple of around 11 to 12 times on its exit from Shriram Transport Finance Company (STFC), a commercial vehicle financier. In one of the fastest exits for a PE firm in India, Sequoia Capital invested about US$25 to US$30 million in Nasdaq-listed Cognizant Technology Solutions and exited the investment at 2.1 times within a period of eight months.

## Outlook

The Indian economy is expected to register a growth rate of over 8% for the fiscal year 2009/10 (ending 31 March 2010) on account of a revival in domestic demand, especially due to an increase in private consumption resulting from stimulus measures adopted by the government. With the Indian economy on the road to recovery, the deal activity next year is expected to rebound significantly as long as the economy continues to recover in 2010. There will be an increase in value and volume of Indian M&A activity as investors' confidence and liquidity return to the market, but it will take time for the deal values to return to 2007 levels.

Corporations and investors will return to profit from growth in the recovering markets. The coming year is expected to witness better PE investment activity fuelled by limited IPO successes in the past. However, there will be a flight to quality as competition to invest in high quality portfolio companies increases. Funds are likely to enhance diligence of proposed investments and also encourage deal making within existing portfolios to improve competitive dynamics.

The relatively healthy macroeconomic indicators in India and other emerging markets are anticipated to create greater inbound M&A in 2010. Telecom, oil and gas and banking sectors appear to be key sectors of interest, with healthcare, education and mid-market IT service segments also attracting deal interest.

Indian outbound M&A in 2010 is likely to include acquisitions of distressed assets, strategic energy sources and acquisitions in newer emerging economies. It is anticipated that 2010 will see further consolidation in the US and Europe, and this is likely to result in a number of overseas opportunities being available to Indian corporations. The key challenge to being able to avail of these opportunities is the availability and cost of debt which is 200 to 400 basis points more expensive now than in 2007. The increased cost of debt needs to be considered when justifying valuations and will be a key factor for Indian companies looking to acquire overseas assets. ■