Financial Advisory Services
Mergers & Aquisitions

Opening the flood gates*

Half year India M&A update
June 2007

Current Environment

The Indian economy grew at 9.4 percent during the fiscal year end March 2007 (2006-07), its strongest performance in the last eighteen years. This was possible on account of strong performances by the industrial and services sectors, both of which grew at approximately 11 percent. The growth in industrial sector was fuelled by the manufacturing sector, which grew at over 12 percent and the services sector which grew at over 13 percent on account of the growth in trade, hospitality and transport segments, apart from the IT sector. While the growth was commendable, it fell short of the growth that appeared possible earlier in the year, primarily on account of the sharp decline in the agricultural growth rate, which declined to 2.7 percent.

Inflation of over 4 percent and the steadily widening current account deficit are the other key concern areas for the Indian economy. The good news however is that these are known challenges, and the Government has been working on them. In the fourth quarter of 2006-07, the current account deficit turned positive by US $2.5 billion there-by reducing the overall current account deficit from US$ 12.1 billion to US$ 9.6 billion. Significantly no newer macro economic challenges emerged during this period. The Finance Minister, Mr P Chidambaram, in his budget blue print for 2007-08 also focused on improvements in the agricultural sector and increased investment in infrastructure, and the overall sentiment has been positive.

All of the above resulted in an increase in business confidence levels, and made global investors keener on India – this resulted in increased levels of foreign direct investment (FDI), which went up to US $19 billion in 2006-07 – almost 75 percent higher than the US$ 11 billion of in-bound investments in 2005-06. This is the highest FDI equity inflow into the country during any financial year since the commencement of economic reforms.

The bullishness of financial institutional Investor and the rise in FDI investments resulted in India's foreign exchange reserves increasing to over US$ 190 billion for 2006-07. Based on these trends, the Ministry of Commerce and Industry expects FDI flows in the current fiscal year to touch US$ 30 billion.

India witnessed heightened deal activity in the first half of 2007 with the value of M&A transactions crossing US$ 55 billion, spread over 550 deals, far exceeding the total deal value recorded for all of 2006. Notable amongst deals during the period were the sharp acceleration in outbound activity by Indian corporates, and significant growth in private equity investments in the country.

Outbound investments, which included Tata Steel's US$ 13.6 billion acquisition of Corus and Hindalco's US$ 6 billion acquisition of Novelis, exceeded US$ 28 billion. In a way these two large deals have brought Indian M&A to the global forefront – India's outbound M&A during the first six months of 2007 was second only to Australia. It has also broken the myth that Indian businesses are all about IT and outsourcing, as most of the outbound M&A were by companies belonging to the "traditional old economy sectors". Sectors such as energy, oil & gas, steel, cement, aluminum and other metals accounted for over 50 percent of the total deal value compared to just 20-25 percent of deal value a couple of years back. This is reflective of the fact that Indian companies in these sectors are looking to be competitive globally and not seeking protectionism. A number of these deals were debt funded, highlighting the tremendous confidence that the Indian and overseas banking and finance community has in the Indian companies and their ability to make these acquisitions work.

Some of the other key out-bound deals reported during this period included the following:

- Tata Power's acquisition of PT Kaltim Prima Coal and PT Arutmin Indonesia for US$ 1.1 billion. This deal has given Tata Power access to one of the largest exporting thermal coal mines in the world.
- Essar Steel's acquisition of Canada-based integrated steel producer Algoma Steel Inc. for US$ 1.58 billion.
- United Spirit's acquisition of premium scotch distillers Whyte & Mackay, Scotland for US$ 1.17 billion.
- Suzlon Energy Limited's acquisition of a 74.6 percent stake in REpower Systems AG, the German manufacturer and supplier of wind-powered generating facilities for US $ 1 billion.
- Sun Pharmaceuticals acquisition of Israel's generic manufacturer Taro Pharma for US$ 446 million, making it the second largest overseas acquisition by an Indian drug company.

While outbound deals were clearly the flavour of the season, domestic and in-bound investments too scaled new peaks for any first half on record. The most significant of these being Vodafone's acquisition of a 52 percent stake in India's fourth largest mobile service operator Hutchison Essar for a consideration of US$ 10.9 billion. Other key deals were as follows:

- Vedanta Resources Plc, acquired a 51 percent controlling stake in Sesa Goa for US$ 981 approximately million.
- Mittal Investment's (a wholly-owned unit of Arcelor Mittal NV) acquisition of a 49 percent stake in oil & gas refinery, Guru Gobind Singh Refineries Ltd. for approximately US$ 747 million.
- Matsushita Electric Works' acquisition of an 80 percent stake in India's oldest and largest electrical accessories and wiring devices company, Anchor Electricals for a consideration of US$ 420 million.
- Jet Airways' acquisition of Air Sahara for approximately US$ 339 million.

The domestic deal activity during the period also highlighted consolidation, notably in the telecom and aviation sectors. The Vodafone – Hutch transaction signaled the commencement of what should be the last phase of consolidation in the Indian telecom space; likewise the Jet – Sahara and the Kingfisher – Air Deccan deals signified the consolidation of the Indian aviation sector which has been bleeding for a bit.

Private equity investments have also been rising steadily, with over 200 deals during the first half of 2007 – in value terms the private equity deal activity crossed US$ 6 billion, compared to the US$ 7.9 billion for the whole of 2006. There has also been a shift in sector focus by private equity with industries such as real estate, banking and financial services, media & entertainment witnessing tremendous growth in investment vis-à-vis traditional sectors such as IT & ITeS, pharmaceuticals & healthcare and telecom. For instance, investment in banking & financial services accounted for over 20 percent of total private equity investment in H1 2007 vis-à-vis just 7-8 percent in 2005 & 2006. Some of the notable private equity deals during the first six months of 2007 include:

- Carlyle Group and Citigroup Inc invested US$ 786 million for a 7.11 percent stake in Housing Development Finance Corporation Limited.
- National Stock Exchange ('NSE') and Bombay Stock Exchange ('BSE'), two of the biggest stock exchanges in India, saw private equity firms pick up stakes in them following the change in FDI norms. NYSE Group Inc, Goldman Sachs Group Inc, General Atlantic LLC, and Softbank Asian Infrastructure Fund, invested approximately US$ 500 million in NSE for a 20 percent stake. Deutsche Bourse and Singapore Stock Exchange each picked up a 5 percent stake in BSE, wherein each party paid an amount of US$ 42.7 million.
- US based hedge fund, Avenue Capital Group, invested US$ 500 million in SKIL Infrastructure for a 26 percent stake.
- Blackstone Group acquired a 26 percent stake in Ushodaya Enterprises Ltd, a television stations owner and operator, for US$ 275 million, and invested an amount of US $ 200 million for an 80 percent stake in Intelenet BPO.
- In one of the largest FDI deals in Indian realty, Morgan Stanley invested US$ 152 million in Oberoi Constructions, a real estate development firm for a 10.75 percent stake.

Outlook

M&A activity is expected to remain on an uptrend in the second half of 2007, and the dominance of cross border deals is expected to continue. Consistently strong economic growth, combined with continuation of the reform process and improvements in infrastructure by the Indian government, is likely to boost FDI too, but significant policy changes appear unlikely. Segments where an FDI cap is expected to be relaxed further include, petroleum refining (from 26 percent to 49 percent) and civil aviation businesses such as ground handling, maintenance and repair and air charter services, where up to 100 percent foreign investment is expected to be permitted, as against 49 percent at present. The Indian government is also expected to finalize the guidelines for allowing up to 49 percent foreign investment in commodity exchanges, a move which is expected to result in significant investments. Further liberalisation of the FDI regime is also expected with a plan to exempt several sectors from the mandatory requirements under Press Note 1 (PN 1), which requires multinational corporations in existing joint ventures to obtain no-objection from its Indian partners before starting another venture in a similar line of business. Sectors such as advertising, hospitality and franchisee operations are being considered to be kept out of the purview of PN 1.

Private equity and venture capital investments are expected to rise even further, and exceed US$ 10 billion in 2007. While there have been some valuation concerns within the private equity community, the sequential growth experienced by the Indian economy has meant that the private equity investors have stayed interested. Consumer facing businesses, including retail, which ride on the growing consumerism in the domestic market are expected to be favoured by them, together with power equipment, healthcare, entertainment & media and the banking and financial services sectors.

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