Deals in India: Mid-year review and outlook for 2019

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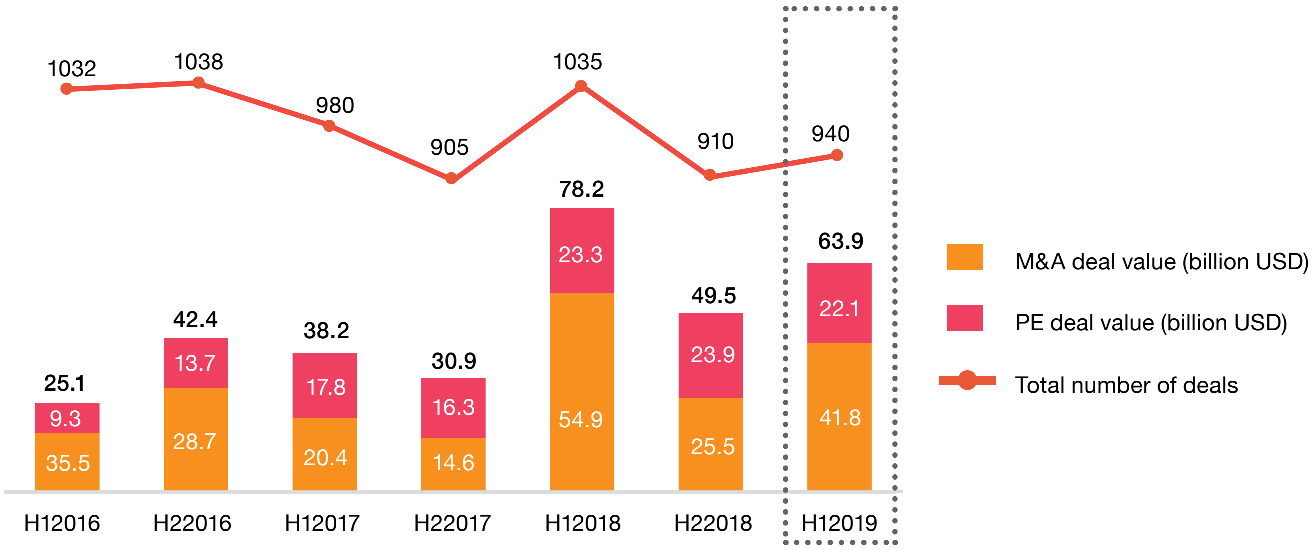
pwc

In 2018, India's deal landscape witnessed a turning point in terms of activity, recording deals worth over USD 120 billion across both private equity (PE) and strategic (M&A) transactions combined. Despite a moderate start, the level of activity in the deals space picked up in the second quarter of 2019 and appears to be keeping pace with last year.

H1 2019 recorded 940 deals aggregating USD 64 billion, an 18% decline in terms of value as compared to H1 2018. However, this marked a 29% increase over the second half of 2018. While fewer billion-dollar deals have been seen thus far this year as compared to the same period last year, 2019 witnessed a major leap for India in the aerospace and defence segment, with Singapore-based Dreamvision Overseas' USD 15 billion acquisition of a 37% stake in Tzar Aerospace Research. This deal is the second-largest transaction recorded in India, preceded by Walmart's acquisition of a 77% stake in Flipkart for USD 16 billion last year.

Deal activity in India



Source: Venture Intelligence, VCCEdge and PwC analysis

PE deals in India appear to be retaining their momentum, having recorded over 500 investments worth USD 22.1 billion, with Sovereign Wealth Funds (SWFs) holding their position at the forefront of this activity. On the contrary, M&A activity in H1 2019 recorded a 24% decline in value and a 15% decline in volume as compared to same period last year. This slowdown in deal activity could be attributed to hesitation prior to the elections, changing government policies and regulations, and uncertainty on the global front.

With liquidity concerns on account of the non-banking financial company (NBFC) crisis, the financial services sector retained its position among the top sectors attracting PE inflows. It was closely followed by the technology sector which continued to witness traction in the online segment.

Energy, infrastructure and real estate also garnered significant interest from the PE community. These sectors could witness increased traction going forward, with specialised investment vehicles such as the Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) gaining popularity within the PE community, particularly on the back of eased foreign institutional investment (FII)/foreign portfolio investment (FPI) norms.

The focus on the further liberalisation of foreign direct investment (FDI) norms, bridging the gap between urban and rural India, infrastructure development, women empowerment and the much-needed support for micro, small and medium enterprises (MSMEs) and NBFCs were some of the key highlights of the recently announced Budget, which will now pave the way for deal activity over the remaining part of the year.

The Indian market has entered a more developed stage on the back of positive investor sentiment, evident through the number of big-ticket deals and a growing pool of funds looking to tap the opportunity in India. A few notable factors have bolstered the country's deal landscape and should continue to do so over the course of the year:

Key Budget announcements for Foreign investment

- Government proposes to consider liberalisation of FDI in Animation, Visual effect, Gaming & Comics (AVGC) sector basis consultations with relevant stakeholders
- It also proposes considering easing local sourcing norms for FDI in Single Brand Retail Trading
- Easier KYC norms for FPIs
- Enhancement of FPI investment limit from 24% to the permitted sectoral limit at the option of the concerned investee company
- Permitting FPI investment listed debt securities issued by REITs and InvITs
- Merging of NRI Portfolio Investment and FPI Investment windows.

Source: *PwC's Union Budget 2019–20 analysis*

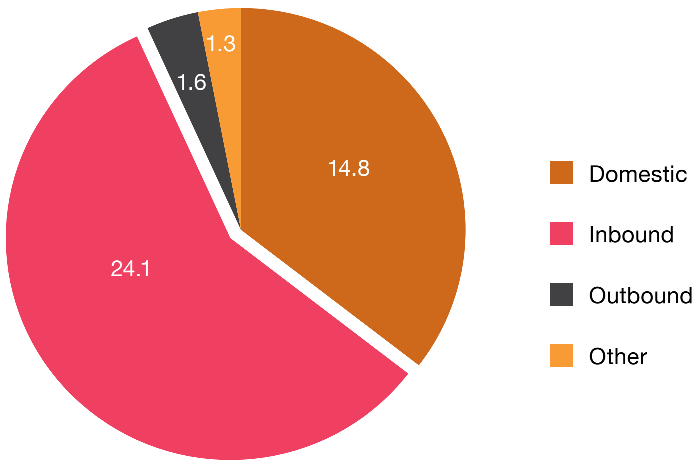
1. Uptick in inbound activity

Inbound activity in India has hit a new high, recording strategic deals worth over USD 24 billion and surpassing 2018, which recorded inbound deals aggregating USD 22.4 billion across the entire year.

This surge in deal value was mainly on the back of two marquee inbound deals, i.e. Dreamvision Overseas' USD 15-billion acquisition of Tzar Aerospace and ArcelorMittal's USD 6-billion agreement to acquire Essar Steel in a joint venture with Sumitomo Metal Corporation and Nippon Steel.

Both transactions have highlighted foreign investors' growing confidence in India's entrepreneurial skill sets, as well as the vast opportunities presented by distressed assets across key sectors in the country. With an aim to increase their exposure and unlock the potential in India's market landscape, global players are increasingly flocking towards the country and are expected to continue to do so going forward.

M&A activity by deal type in H1 2019 (billion USD)



Source: VCCEdge and PwC analysis

2. Insolvency drive

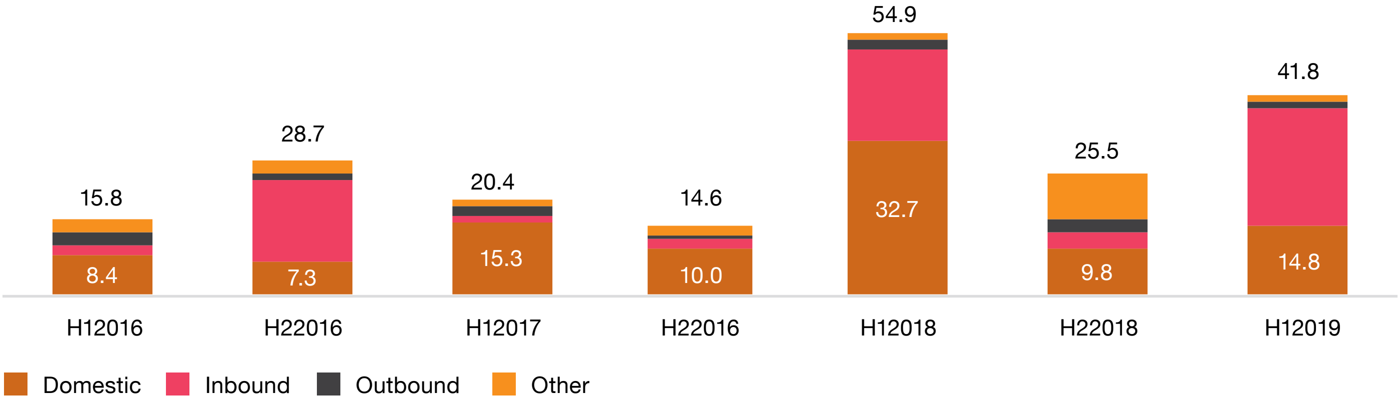
While we have been witnessing a number of domestic players jump onto the Insolvency and Bankruptcy Code (IBC) bandwagon by entering into fierce bidding wars to acquire a number of stressed companies, 2019 has witnessed a surge in foreign interest in India. 2018 witnessed two major acquisitions of stressed assets in the steel space, namely JSW and AION's acquisition of Monnet Ispat and Energy and the Tata–Bhushan Steel merger. ArcelorMittal's commitment to acquire Essar Steel in partnership with Sumitomo and Nippon Steel this year not only ranks amongst the top steel acquisitions in India, but also underlines foreign interest in the country's distressed opportunities.

Simultaneously, with the Reserve Bank of India (RBI) permitting asset reconstruction companies (ARCs) to acquire financial assets from other ARCs, the resolution process could be speeded up, leading to an increasing number of PE funds exploring this option.

The IBC has presented a more structured approach for addressing the problem of stressed assets in India. The code has not only garnered the interest of investors at the insolvency stage, but also opened up the possibility for funds and strategic players to tap the pre-insolvency opportunity.

3. Focus on scalability

M&A activity by deal type (billion USD)



Source: VCCEdge and PwC analysis

Domestic activity in the first half of 2019 witnessed a 55% decline in terms of value as compared to the same period last year, but a 51% increase as compared to H2 2018. Domestic deals accounted for over one-third of deal activity thus far, highlighting consolidation across sectors including financial services, technology, energy, agriculture and logistics.

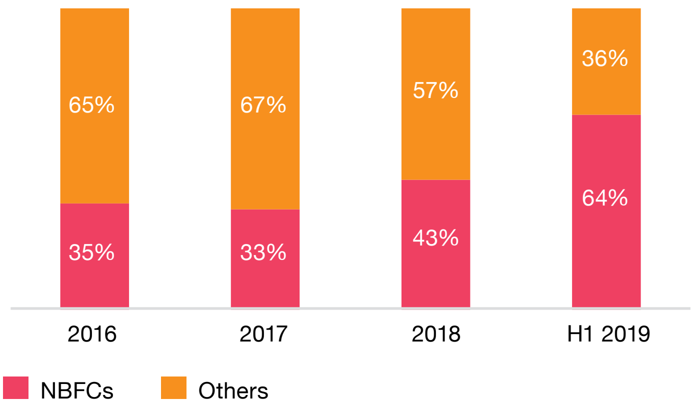
Within the financial services space, banks' acquisitions of housing finance companies (HFCs) accounted for around 50% of the domestic M&A value in H1 2019. Through these acquisitions, banks could scale up operations and outreach by leveraging the capabilities of their recently acquired HFCs. Likewise, the technology sector has already witnessed a few acquihires and could see more corporations exploring this route going forward. Walmart's acquisition of Dataturks and Pine Labs' acquisition of Qwikcilver Solutions are two such deals highlighting the growing need to expand technological capabilities so as to complement or even expand existing offerings. Deals of a similar opportunistic nature have also been recorded in the agriculture and logistics space.

4. NBFCs: Crisis or opportunity?

Much like the stressed asset scenario in India, PE players are now looking at the NBFC crisis as a vital opportunity to pump capital into these financial institutions that are coping with a major financial crunch. PE investments in NBFCs touched USD 3 billion in the first half of this year, in comparison to 2018 which saw the same amount invested in this space across the entire year.

Among investors tapping the NBFC opportunity, IFC was particularly active this year, diversifying its investments across various segments from truck financing to educational loans. Simultaneously, Blackstone and General Atlantic also placed sizeable bets in the housing finance segment. With these activity levels, it becomes evident that the investor community has not only retained but possibly increased its confidence in the NBFC space here.

PE investments in financial services : NBFCs versus other sub-sectors



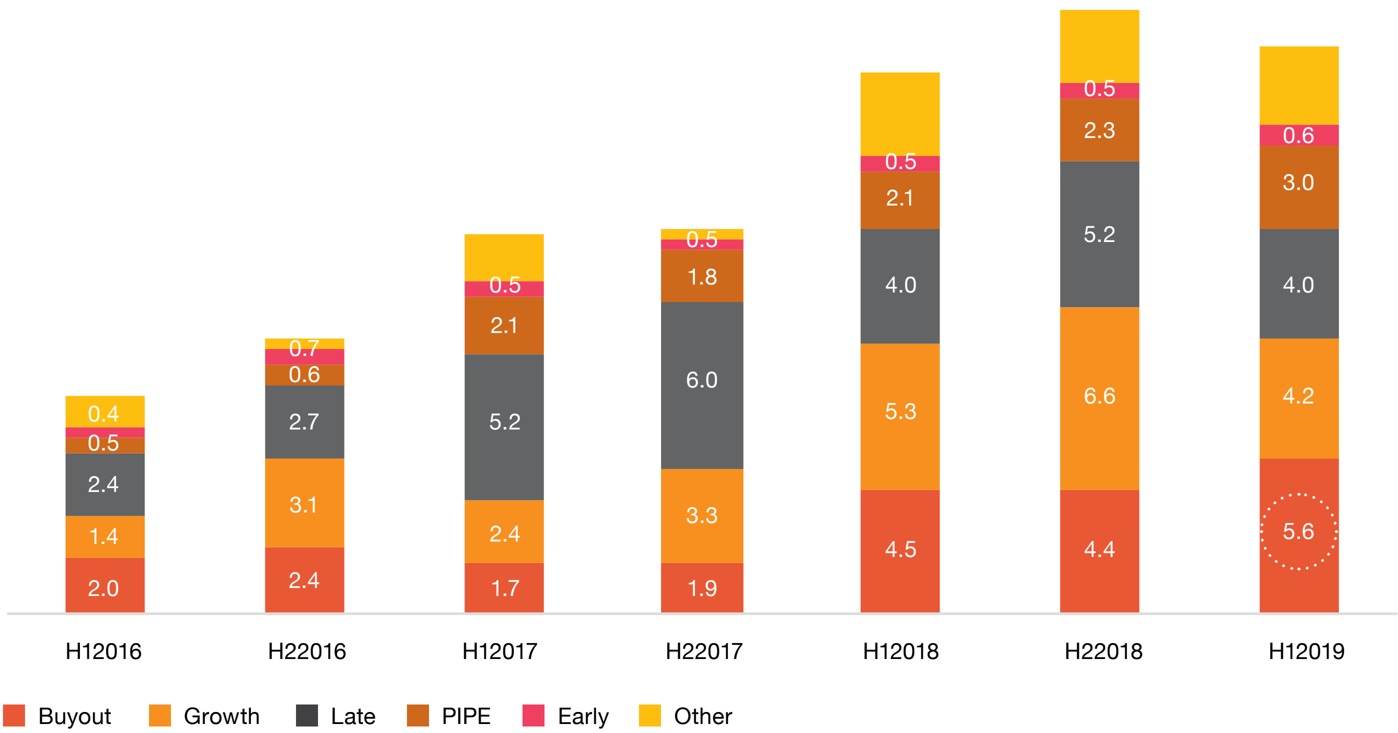
Source: Venture Intelligence and PwC analysis

5. Buyouts continue to stay on an upward trajectory

Buyout deals are currently at an all-time high, with the first six months of this year having witnessed 25 investments worth USD 5.6 billion, a 25% growth over the same period last year.

Value creation and value protection have become key priorities for investors in the current market scenario. Investors are now looking to acquire a controlling stake in their portfolio companies so as to be a part of the operational and management aspects of the companies. As per the *PwC India Family Business Survey 2019*, 56% of family-owned businesses plan to expand or grow their operations by bringing in PE backing, which in turn will continue to drive buyouts.

PE investments by stage (billion USD)*

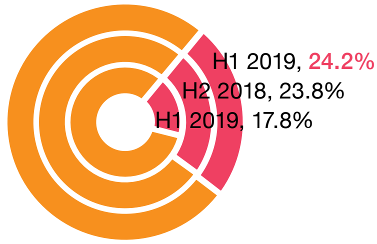


Source: Source: Venture Intelligence and PwC analysis (*Excludes real estate deals)

6. Investing with an impact

Concerns regarding the depletion of natural resources, climate change and a need to protect the environment have gained focus across the globe. In addition to these factors, India has highlighted the need for improved healthcare facilities, upliftment of rural areas, financial inclusion and infrastructural development, amongst others, and investors have taken note of this. Impact funds were a part of investments worth over USD 3 billion in the first six months of this year, a significant surge over the previous years. A majority of these investments were focused on the financial services sector, followed by infrastructure and renewables.

SWFs and pension funds' involvement in PE investments in terms of deal value



Deals where SWFs were involved

Other PE investments

Source: Venture Intelligence and PwC analysis

While social impact funds are increasingly gaining traction across these sectors, sovereign wealth funds (SWFs) and pension funds have already established a stronghold in these sectors.

SWFs and pension funds were a part of investments, accounting for over 24% of the PE deal value in the first six months of 2019, indicating an upward trend over the last 18 months. These funds have made sizeable investments across sectors, including infrastructure, renewables, real estate and telecom, and continue to seek opportunities in the country. This enthusiasm is likely to continue to grow going forward on the back of India's demographics and favourable regulatory reforms.

7. Flourishing start-up ecosystem

With the Flipkart-Walmart merger in 2018 and the recent Tzar Aerospace–Dreamvision Overseas deal, start-ups in India have entered a new phase of funding. India's entrepreneurs are witnessing renewed interest from domestic as well as global investors. The surge in exits in 2018 may have also extinguished investors' concerns with regard to profitable exits and accordingly boosted investor sentiment.

With a number of global players entering the market, as well as the launch of a number of domestic funds, the capital available to start-ups is no longer limited to venture capital, and has extended to larger PE players as well. Simultaneously, large corporations are also placing sizeable bets on these companies.

The recently announced Union Budget has put in place a number of incentives to further boost the start-up ecosystem in the country. From relaxation of FDI regulations for e-commerce players to the proposed reduction of Goods and Services Tax (GST) on electric vehicles (EVs), the Budget has proved to be beneficial to existing start-ups across sectors and will further spur activity going forward.

8. Alternative investment vehicles

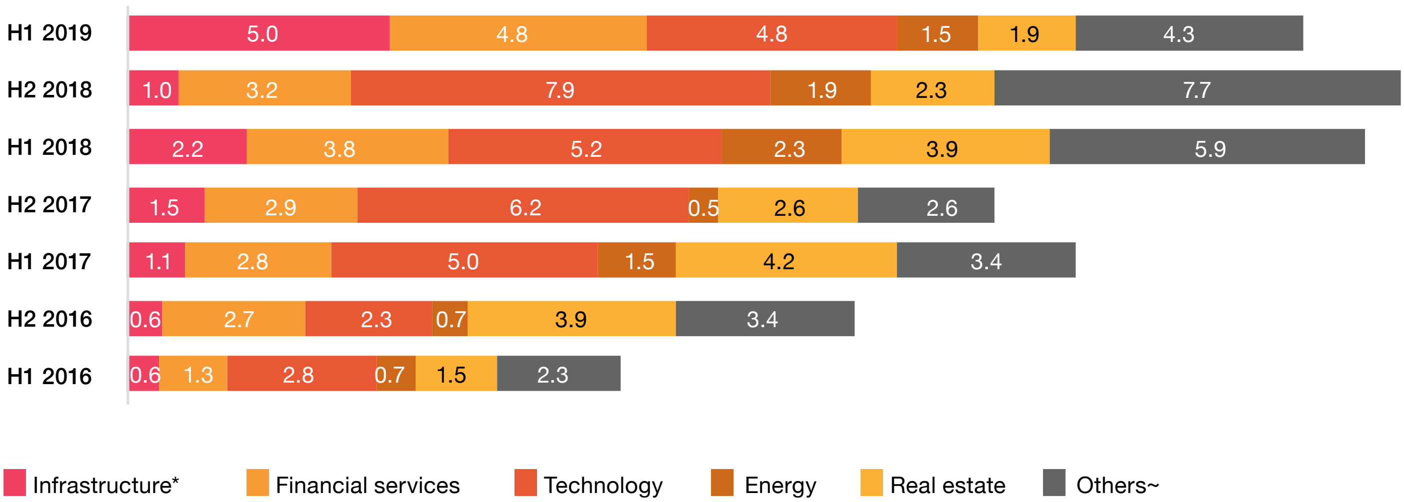
Real estate and infrastructure are vital to the development of the Indian economy. In order to fuel that progress, the Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) were introduced a few years ago. These investment platforms have started gaining traction recently.

2019 witnessed the launch of India's first REIT, namely the Blackstone-backed Embassy Office Parks REIT. Likewise, the USD 1.8-billion investment made by Brookfield's InvIT in Pipeline Infrastructure India was the second largest PE investment recorded in India. These investment vehicles have opened a new route for funding India's growing infrastructure and real estate demands, and accordingly created a huge opportunity for foreign investors looking to enter these segments.

9. Sector prospects

While financial services, technology, energy and real estate retained their position among the top five sectors attracting investor interest, the infrastructure sector has also garnered significant interest this year. The hotel segment has also witnessed a leap over the previous years, recording investments worth around USD 1.2 billion across two deals, i.e. Brookfield's agreement to pump around half a billion dollars into the debt-ridden Hotel Leela and GIC's investment of USD 0.6 billion in a special purpose vehicle (SPV) of Indian Hotels Company.

Top 5 sectors attracting PE investments (billion USD)



Source: Venture Intelligence and PwC analysis

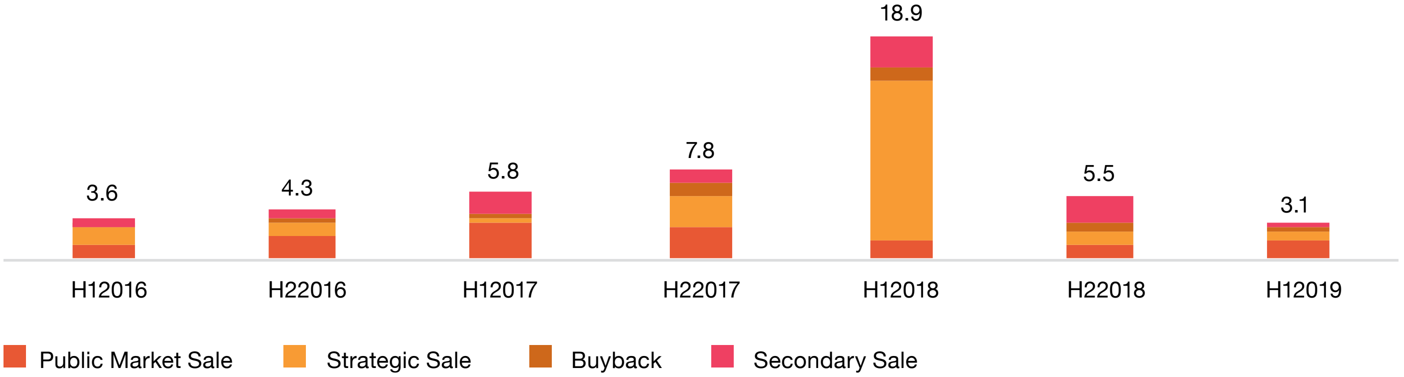
*Includes travel & transport, shipping & logistics, engineering & construction

~ Includes healthcare, telecom, FMCG, food and beverage, manufacturing, education, among others

10. Drop in exits

Exit activity has witnessed a decline as compared to the same period last year. However, 2018 witnessed a marquee strategic exit from Flipkart which accounted for over 60% of the exit value.

PE exit activity in India (billion USD)



Source: Venture Intelligence and PwC analysis

Public market sales accounted for around 50% of the exit value in the first six months of this year, which was concentrated in the financial services and technology space. The exit value from PE-backed IPOs cumulatively exceeded USD 3 billion from January 2016 to date, with 2017 being the pinnacle in terms of value and volume for this type of exit. Public market sales have been gaining importance over the last few years and IPOs could boost liquidity for PEs.

Gearing up to be fit for future

In conclusion, a focus on infrastructure, liberalisation of the FDI policy, the IBC and incentives pertaining to start-ups among other noteworthy Government reforms have piqued the interest of domestic and global players, and this interest can be expected to continue going forward. Simultaneously, consolidation, an increase in buyouts, platform play and technology disruption have further impacted deal activity in the country. With the Budget in place and an increasing quantum of funds entering the country, we can expect to see deal activity regain momentum over the next six months.

Notes:
Data as on 30 June 2019
Sources: Venture Intelligence (PE) and VCCEdge (M&A)

Notes

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