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India deals
taking stock of the tiger

July 2013

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Welcome

Decades ago Cambridge economist Joan Robinson quipped that the exact opposite of any accurate generalisation about India will be true. Welcome to doing business in India, which, as both domestic and international investors know, is as exciting as it is complex.

Despite its inherent challenges, India remains at the top of investors' lists of target markets and Indian investors are leaders among emerging market buyers for western companies. In this report, we look at what has influenced M&A flows between India and Europe in the past, and explore some of the factors that will drive deal flow to and from India over the coming years.

What next for India's growth trajectory?

Our analysis points to a potential surge in deals in both directions. At this moment, it appears that international and Indian investors are curious and uncertain about what India will do next. There are several reasons for this. At the macro level, growth has slowed recently. After several years of near double digit growth, India rode out the global economic storm with growth of over 6% in 2008 and 2009, rebounding to 10% for 2010. Though the 2012 figure fell to 5%, it is still among the best of the BRIC nations.

Economic growth x1 billion

While sustaining high growth is still necessary for further economic development, India's force of attraction for investors remains its billion strong population. Improvements in their living standards and spending power will cement India's emergence. And as India's economy has grown, so has the level

of optimism among its citizens. A 2007 McKinsey study[1] noted that average household income had roughly doubled from 1985 levels. Middle class India is a well-known phenomenon. At the upper middle level, the number of high-income families has more than quadrupled since 2002. An emerging middle class, of low-but-rising income group are also joining the ranks of Indian consumers. PwC research shows that group will number 470 million and have an aggregate spending power of US$1 trillion by 2021.[2]

Shape-shifting – India's new demographic

As we drill down into India's changing demographics, (more urban, more educated, more disposable income, and even more discerning), it is interesting to see how Indian companies are using M&A not just to grow their business by entering new markets abroad but to also to seize opportunities at home. Some are acquiring brands to meet the needs of well-informed consumers, with international tastes, while others are buying into state of the art technology to make the transition from low-cost to higher value manufacturing. From the figures in this report, it is clear that Indian companies already have a robust track record in outbound M&A. Europe, which as a region absorbs over 30% of Indian investment (based on a number of deals), more than any other single country or region, could have much to gain from the increases we expect to see in Indian deals.

Reforming the tiger

In recent times FDI into India and cross border M&A have become more susceptible to political crosswinds surrounding regulatory and tax reforms. As for many governments, introducing pro-business reforms, however necessary in the end, can prove unpopular with the electorate. On the other hand, while investors will welcome changes to reduce the complexity of India's tax environment, some measures under review may act as a brake rather than support more FDI. Overall, the government has a very full agenda, as it attempts to push through reforms before campaigning for the 2014 general election begins. Beyond what has already been achieved in the retail and aviation industries, we see the spread of reforms to other sectors as having great potential to growth and deals.

With some promising constants, such as demographic shifts, and many variables, the M&A equation for Indian deals is a testing one. We take an in-depth look at how investors wishing to enter the Indian market through M&A can get to a valuation that reflects the risks and the rewards. We hope this report reveals some facets of Indian deals that are pertinent to your business and I look forward to being involved in the discussions that generates.

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Nick is a partner in Transaction Services in London and has a focus on investment activity with emerging markets. He worked in Moscow in the mid-1990s and has been active in M&A with emerging markets ever since. He is also the head of the financial services team.

1 "The "bird of gold": the rise of India's consumer market", May 2007, McKinsey Global Institute

2 "Profitable growth strategies for the Global Emerging Middle: learning from the "next 4 billion" markets", January 2012, PricewaterhouseCoopers

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Industry classification used in the above document:

- Energy, Utilities, Mining and Infrastructure (EUMI) - Mining, Metal & Ore. Utility & Energy, Construction/Building and Agriculture
- Industrial Products (IP) - Industrial Products, Chemicals, Automotive
- Telecoms, Media & Technology (TMT) - Media & Telecoms, Technology
- Business Services (BS) - Professional Services, Transportation, Real Estate, Healthcare, Pharmaceutical
- Financial Services (FS) – Finance, Insurance, Other finance related services
- Retail and Consumer (R&C) – Retail, Food & Beverage, Hospitality & Tourism, Consumer Products Manufactured

Foreword: UK India Business Council

Twenty years ago, in our initial incarnation as the Indo-British Partnership, with the backing of the Indian Prime Minister Narashima Rao and the UK Prime Minister John Major, UKIBC set about developing trade ties and encouraging investment with India.

Richard Heald

Richard Heald joined the UK India Business Council as its Chief Executive Officer in 2010. Before joining the UKIBC, he was Vice Chairman, N.M.Rothschild & Sons Limited, India, where he advised UK and Indian companies on spin-offs and capital raisings, secondary capital raisings, outbound and inbound M&A as well as the provision of debt and restructuring. His transactions include advising the Mahindra Group on their acquisition of Ssangyong Motors and the sale of up to 51% of Cairn India by Cairn plc. He has over 30 years' experience in the international financial markets, 20 years of which have been focused on advisory and capital raisings for governments and major corporates across the globe. Richard has a degree in law from Oxford University.

UK INDIA BUSINESS COUNCIL

It was 1993, India's GDP was approximately GBP161 billion and Prime Minister Rao and his then Finance Minister, Manmohan Singh, were launching a process of economic liberalisation to allow FDI. Twenty years on, India's GDP is worth GBP1.18 trillion and the nation's image is now more associated with its corporate giants and IT entrepreneurs than with the Taj Mahal or tea-growers.

Steady economic liberalisation, coupled with Indian entrepreneurship, enabled this rise. But trade and investment flowing into and, increasingly, from India have undoubtedly accelerated it. We were delighted to be invited to contribute to this report as it takes stock of what is driving deals in and by Indian companies. Many of our members have first-hand experience of such deals and the UK remains the number one destination for Indian investors among advanced economies. For UK companies – big and small – a trio of features enhance India's growth appeal: an Anglophone market, familiar with UK products and services; a rapidly emerging, brand-savvy middle class; and demand in a number of industries in which British firms have expertise and world-class technology.

Even for large companies, the sheer scale, diversity, and regulatory and tax complexity of India can be daunting. As many of our members recommend to investors new to India, "approach India as a continent rather than a country". While heading to Mumbai or Delhi can give the prospective investor or seller the sense of going to where the growth is, we encourage people to look beyond the big four metro areas (Delhi, Mumbai, Kolkata and Bangalore), to the 53 cities that already have over a million inhabitants, a list that will lengthen over the next decade. Though the rural–urban divide is still acute in India, it is narrowing and public investment in infrastructure, from roads and sanitation, to education and health, is making doing business easier throughout the country while also creating opportunities for companies operating in those sectors. The figures back this up, with telecoms, media and technology and engineering, utilities, mining and infrastructure sectors drawing the most FDI.

In any new market, on the ground knowledge is key to success and this is particularly true for companies entering India. Getting to grips with a continent-sized market, even approaching it one state or city at a time requires a long-term plan, contacts and support. Working with UK companies desirous of building business with and in India, we see how mergers and acquisitions can offer a good entry method for some. In sectors that are already open to foreign investors, there appears to be plenty of competition for good targets – investors need to be prepared if they are to win deals. As reforms continue and restrictions on foreign ownership are relaxed in different sectors, it will be interesting to see how UK companies take advantage of them.

Our ambition of twenty years ago has not changed. We continue to work with and for our corporate members to improve trade and investment ties between India and the UK. Both countries still have a lot to gain from that process and while much progress has been made, there is still a lot to be done and a lot of opportunities to be had in the future. Whether you are a potential investor or seller, in India, the UK or elsewhere, we hope that you find this report insightful and that it helps you in your thinking about the openings India has to offer.

Executive summary

By 2050, the three largest economies in the world are likely to be China, the US and India. The US is also flanked by the twin propellers of the E7, the group of rapidly growing economies that also includes Russia, Brazil, Mexico, Indonesia and Turkey.

Their combined GDP, measured by purchasing power parity (PPP), is already on the way to convergence with that of the G7 (the US, Germany, Japan, Canada, the UK, France, and Italy). China and India are the twin propellers of that rise.

In this report, we focus on India and the bi-directional M&A flows between India and Europe. Drawing on an analysis of the deals from the last seven years, we look at the factors driving M&A choices by Indian and European buyers and sellers; the often contradictory forces on valuations in the Indian market; and the implications of India's regulatory and tax reforms for investors.

Indian deals: the growth context

After a promising start to this decade, with GDP about 8% in 2010 and 2011, India's economy slowed to 5% in 2012, one of the lowest rates in the past seven years. If lacklustre by past standards, India continues to outperform the global economic growth and has done so by about 5% year on year for the past seven years. GDP (PPP) is projected to grow at approximately 8% over the next five years, as per the Economic Survey report published by the Government of India in March 2013, albeit the growth forecast for 2014 was revised to approximately 5.3% in the midst of the global recessionary environment and European crisis. India's growth raised tens of millions out of poverty and gave rise to an affluent middle class. This new spending power is opening numerous opportunities, from education and leisure, to personal care, loans, transport, communications and travel. Total consumer spending is expected to quadruple by 2020. India also continues to benefit from her demographics: with a median age of 26.2 and rising levels of literacy and education. Nonetheless, while India traversed the global economic storm more successfully than the mature markets and many other emerging markets, her economy is still operating below its potential. An inflationary environment is depressing growth and, with over 15% of the country's GDP (nearly 50% of the population) dependent on agriculture, 2012's weak monsoon is likely to place a drag on growth in 2013.

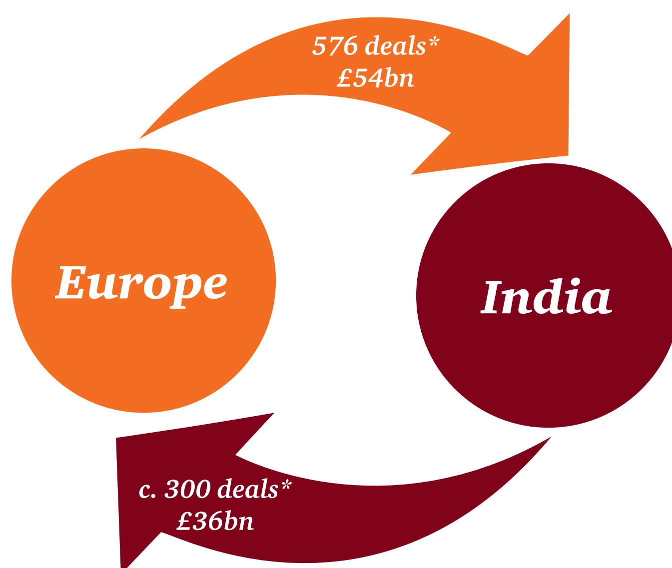
India's growth trajectory

GDP by PPP

2011: US$4,531 billion
2030: US$ 13,716 (projected)
2050: US$ 34,704 (projected)
Consumer spending up x4 by 2020

Investors were not immune to Europe's ills

Between 2006 and 2012, there were about 875 cross border deals[3] between Europe and India, worth about €90 billion. After a drop in 2009, M&A volume from Europe to India remained at about 65 deals a year from 2009 to 2011. The figure fell to 51 in 2012, as the Eurozone travails dented investor confidence.



*Number of deals where transacting value has been disclosed between 2006 and 2012

3 Based on number of deals where transaction value was disclosed.

Figure 1: No. of inbound and outbound deals between India and Europe

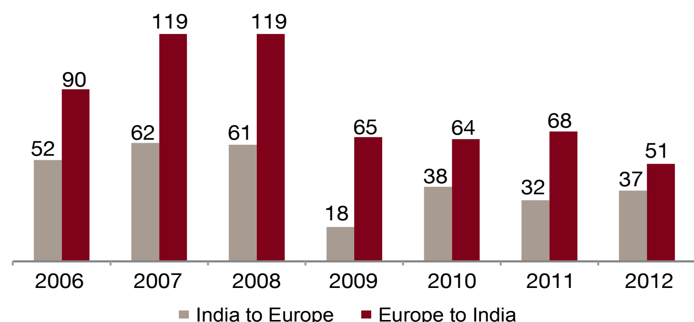
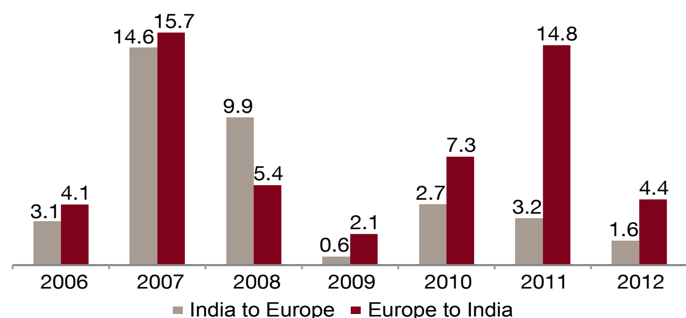


Figure 2: Value of inbound and outbound deals between India and Europe



As the gap narrows, <€100m deals attract most activity in both directions

As Figures 1 and 2 above show, historically, European investors have been more acquisitive in India than vice versa. But the gap in deal volume is narrowing. The Business Services (BS) and Industrial Products (IP) sectors generated most M&A activity – both ways. To date, the majority of the very high value transactions have been in the telecom, automotive, and industrial products (IP) sectors. However, while several billion Euro deals happen most years, a large proportion of all deals, in both directions, fall under the €100m mark. When it comes to location, the UK leads its fellow European states for M&A to and from India. But companies in other parts of Europe are also benefitting and nearly all have seen an increase in Indian investment, and increased their investment into India over the past years.

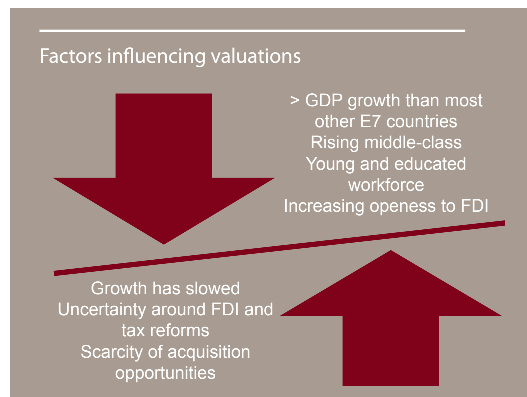
India's outbound M&A drivers: brands, technology and global growth

Though Indian M&A has followed the global trend and shown signs of slowing, Indian investors appear more ready to mobilise resources when a good opportunity arises. Indian investors in mature markets have a focused, twofold strategy for pursuing deals: a potential transaction will either allow them to adapt new technologies or help them establish a business reputation that will allow them to operate in other large developed markets.

The US and the UK remain the biggest target destinations for Indian companies in absolute terms, however, Indian investors are showing increasing interest in deals in other emerging markets.

Buying in India: a complex equation for valuations

Generally, the valuation multiples paid for Indian business are significantly higher than those for comparable mature market operations and, indeed, higher than those in other BRIC countries. European buyers are faced with a set of diametrically opposite factors influencing valuations. Set out briefly in the chart (below), we look at those drivers in depth in section 5 of this report and consider how a buyer can arrive at an offer with which they can be comfortable. On the plus side, India offers growth, through its rising middle class and young and increasingly educated workforce, and is open to foreign investors. On the down side, though more reforms – relaxing restrictions on FDI – have been announced recently, there are concerns about the pace of reforms to both FDI and the tax system as a general election approaches in 2014.



For India Inc and Europe Plc M&A spells opportunity

This Indian deals report is intended to give potential deal-makers a sense of the opportunities and challenges when doing deals with and in Indian companies. From our analysis, we can see that even with current uncertainties around growth or reform, both Indian and international investors are taking the medium to long- term view to doing business in India. For Indian companies seeking deals overseas, European targets can meet their strategic needs for technology and brands and provide access to markets on the continent and beyond. Deal flow to and from India Inc and Europe Plc looks set to thrive.

Still a roaring force

Indian M&A – the macro context

India's role in the rise of the E7

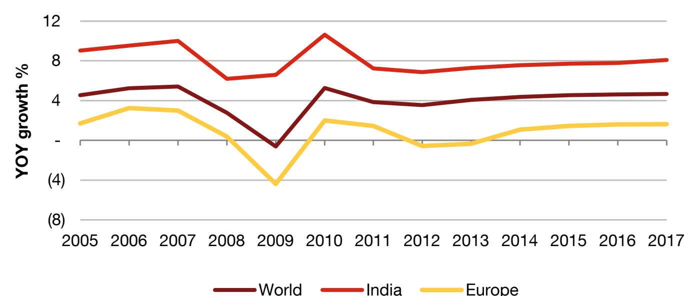
If the BRICs acronym is not inclusive enough, the term "emerging markets" casts the net too wide. For our analysis, we prefer to focus on a group of seven countries we call the E7 – emerging seven, i.e. India, Brazil, China, Indonesia, Mexico, Russia and Turkey. Our estimates[4] suggest that the E7's aggregate GDP, at purchasing power parity (PPP), could overtake that of the G7 countries (the US, UK, Japan, Germany, France, Italy and Canada) as early as 2017. The fact that the G7 countries were more affected by and slower to recover from the recession of 2008–09 than their E7 counterparts has probably contributed to this convergence. Based on current trends, we see the gap between the E7 and G7 economies continuing to widen after 2017, with the E7's combined GDP (in PPP terms) potentially becoming 75% larger than the G7's by the end of 2050. What is clear from current projections is that China and India will drive much of the E7's future growth. India's GDP is projected to grow from US$4,531b in 2011 to US$ 13,716b and then US$ 34,704b by 2030 and 2050 respectively. By 2050, the world's two most populous nations and the US will be the world's three largest economies.

4 International Monetary Fund, World Economic Outlook Database "World in 2050, The BRICs and beyond", PwC Economics, January 2013
Economic Survey 2012–13 published by Ministry of Finance, Government of India

Slower growth prompts reforms

Though this decade began well for the Indian economy, with growth holding at around 8%, it has since slowed, to just 5% in 2012 – the lowest rate in the past seven years. Several sectors of the economy, such as industrial products, services and agriculture, fell short of expectations. This relatively weaker performance is partly attributable to the global context and in part, to what some see as a lack of national governance and unity around a vision of India's economic future. However, slower growth has led to a slew of proposed pro-market financial reforms, ranging from new rules around foreign investment in certain sectors, which, if implemented successfully, could attract more investors into the country and bolster Indian business confidence. However, we do not expect to see any immediate reforms pending the general election in 2014.

Figure 3: FY05–FY17 (F) India vs World GDP YOY growth%



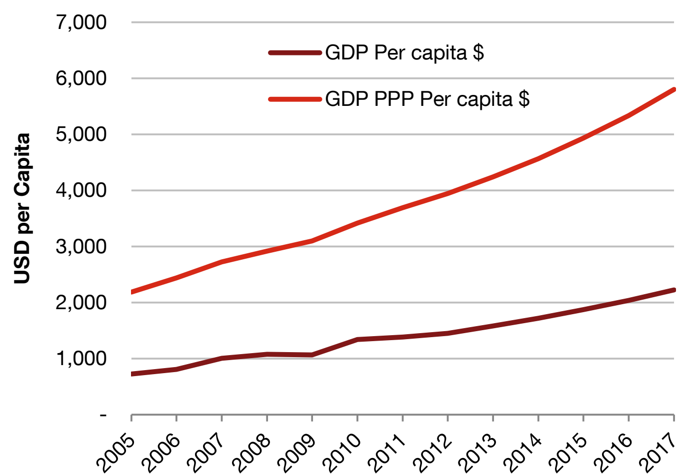
Source: International Monetary Fund, World Economic Outlook Database April 2012

Factoring in India's demographic dividend

Despite its more moderate growth performance, India still continues to outperform the global economy by around 5 % on a year on year basis for the past seven years. GDP PPP per capita is projected to grow at approximately 8% over the next five years, albeit the growth for 2014 was reforecast to approx 5.3%. Rising incomes and, in particular, the emergence of an affluent middle class, are creating numerous opportunities across a variety of sectors powered by greater consumer spending, notably in the retail & consumer goods, telecommunications & media, and services sectors.

While India's business environment may be affected by external factors and regulatory or other uncertainties, several fundamental growth factors remain unchanged. Firstly, India has a relatively young population and workforce (median age of 26.2 years), whose productivity continues to improve as literacy and training levels rise. Secondly, India's cities are growing: it is estimated that around 13 million people enter India's urban labour force every year. The confluence of these two demographic trends has transformed India from a traditional agrarian economy into a fast-paced, service based economy in a few decades. As India has become more urban, the flow of educated and skilled people to cities has created not just large markets but also hubs for new business and innovation that will drive future growth.

Figure 4: FY05–FY17 (F) India GDP per capita and GDP PPP per capita



Source: International Monetary Fund, World Economic Outlook Database April 2012

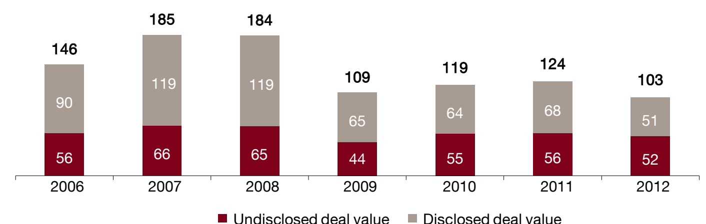
The modern spice trade

Investing in India: Europe's track record

Deals from Europe still off their peak

A glance at the figures for European investments into Indian companies over the past years shows how the economic turbulence of 2008–09 and Europe's on-going recovery have affected deal volume. The total number of deals per year is still down from its pre-recession peak of 184 in 2008. Although an upswing in 2011 brought 124 deals, Europe to India deals dropped again to just 103 in 2012. About 40% of deals show in figure 5[5], were for an undisclosed transaction value but we believe they were genuine deals, for majority equity stakes[6].

Figure 5: Europe to India – Number of Deals



If the most likely cause of the 2012 dip in acquisitions by European investors was the prevailing uncertainty in their domestic markets, they may also have been deterred by multiple corruption scandals that India experienced during the year. The Indian federal government spent much of 2012 being criticised for their handling of issues from coal allocations to public sector entities and private companies to the cancellation of 2G bandwidth licences, and their perceived lack of drive to push through pro-industry reforms. 2012 did end with some reforms getting through parliament, including the relaxing of restrictions on foreign ownership in the retail and airline industry but the impact of these will really only be felt in coming years.

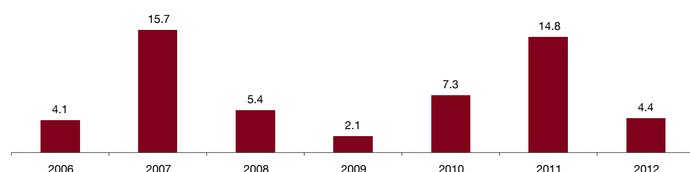
5 Unless otherwise stated, details on the deals throughout this document are sourced from Deal Logic, Mergermarket and Thomson Reuters

6 We note that about 40% of the total number of deals did not have a disclosed deal value based on publically available information. Although such deals are genuine (and include acquisitions of majority equity stakes), in our analysis we have excluded them, unless otherwise stated, to arrive at a comparable total deal value as shown in this section.

European investors favour India

Between 2006 and2012 European companies completed 970 deals (including deals for undisclosed amounts), investing €54billion (in nominal terms) in Indian companies. In comparison, European acquisitions of stakes in mainland Chinese companies totalled just over €27billion during the same period. While both countries offer the advantages of large, lower cost labour pools, India has a longer history of entrepreneurship and its private sector is more developed in almost all sectors. English is also far more widely spoken in India than in China, making it easier for European investors to approach and develop relationships with Indian targets.

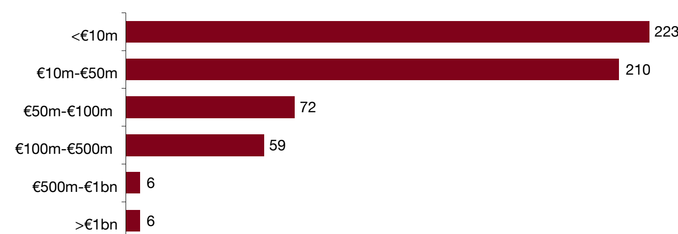
Figure 6: Europe to India – M&A value (€b)



Smaller deals drive M&A volume

Billion Euro deals such as Vodafone's acquisition of successive stakes in Hutchison Essar, for €9.4bn and €3.9bn in 2007 and 2011 respectively, and BP's €6.6bn investment into Reliance Industries, Vendanta's purchase of Cairn's Indian assets for €4.2bn in 2010, all add to India's reputation as a home to global business. However, as figure 7 highlights, approximately 88% of all Europe to India deals are less than <€100m, and the average deal value was about €45m for the period of 2006 to 2012.

Figure 7: No. Of deals from Europe to India by deal value range (2006–12)



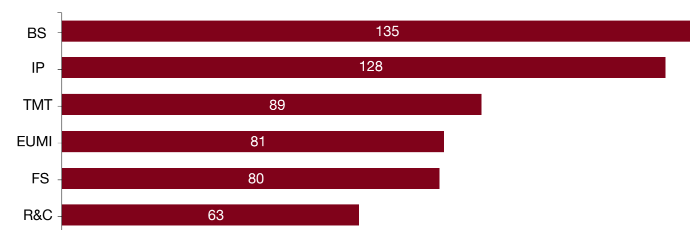
Which sectors are attracting European investors?

Engineering growth

With about 400,000 engineers graduating every year from Indian universities and entry-level engineers' salaries as low as US$ 8,000 per year, it is hardly surprising that India accounts for 26% of the world's Engineering Service Outsourcing. Equally, Industrial Products (IP) and Business Services (BS) are the most favoured sectors for European companies, accounting for 45% of 576 investments in India between 2006 and 2012. Low cost labour and an abundant supply of skilled workers also draw investors in manufacturing and people based services.

Within Industrial Products, the automotive sector (including auto components) and chemicals constitute 40% of the total deals. As our recent "Autofact" report discusses[7], after China, India is the second largest emerging country for Light Vehicle assembly. All the major original equipment manufacturers already have production facilities on the subcontinent. With its growing domestic market, we believe that India's auto sector is poised for more growth, particularly in auto components, as it can become a major global component sourcing country, and so is likely to attract more investment.

Figure 8: Europe to India – Number of deals by sector (2006–12)[6]



New rules will equal more opportunities

In the Business Services sector, Healthcare and Professional Services account for 30% of all deals. Recent Healthcare deals include the French food company Danone's acquisition of Wockhardt's Nutrition business for €250m in 2011 and the UK's Reckitt Benckiser acquiring Paras Pharmaceutical for €540m in 2010. Professional Services have also attracted deals, such as the UK government services firm Serco's acquisition of Intelenet in 2011 for €446m, following Barclays Plc investment of €87m for a minority stake in 2010 in Intelenet, and the British publishing group Pearson's investment in TutorVista for €95m in 2011. We believe that, within Professional Services, targets in education and security services would be very attractive to European buyers if, and when, investment restrictions in these sectors are relaxed.

While the Retail & Consumer (R&C) sector attracted the least number of investments, only 11% of total deals, we expect to see far more deals in this area following the recent relaxation of Foreign Direct Investment (FDI) restrictions allowing foreign investors to acquire up to 51% of retailers. Historically, R&C deals have been for Food & Beverage companies, an example being the UK beverage and distilling company, Diageo's investment in United Breweries for €2.6b for 2012 (completed in 2013).

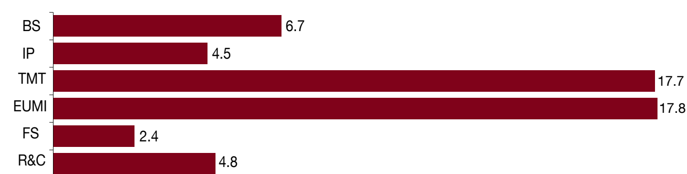
7 "Autofact", PricewaterhouseCoopers, Quarter 3, 2012

Investors bet on India's infrastructure

BS and IP may dominate in terms of volume but it is Technology, Media and Telecommunications (TMT) and Energy, Utility, Mining and Infrastructure (EUMI) that attracted the most value, with €35.5b, the equivalent of 66% of all inbound M&A value from Europe. From its plans to extend and improve the road, rail and air networks between states and cities to the need to connect rural populations to the national electricity grid, India has a massive need for infrastructure investment. As the life blood of business – and indeed of daily life in a country of over a billion people – telecommunications is a critical sector. As mentioned earlier, Vodafone's acquisition of Hutchison for €9.4b dominated the TMT deals. Other significant deals included Siemens increasing its stake in its Indian subsidiary to 75%, buying c.20% (from public shareholder in India) for €992m in 2011 and Norwegian telecommunications company Telenor, buying 67% of Unitech Wireless (a telecom company with a 2G license) for €923m in 2008.

Reflecting the capital-intensive nature of the industry, deal values in the EUMI sector are much higher than other sectors. Nearly 40% of all EUMI deals were in the energy sector. In 2011, BP Plc acquired a 30% stake in 23 Oil and Natural Gas fields operated by Reliance Industries for €6.6bn, proof again that investors see opportunities in infrastructure – related sectors as India invests in its mobility, power and utilities.

Figure 9: Europe to India – Value (€b) of deals by sector (2006–12)



European companies target both high and low stake sizes

European investors seem to be interested in both ends of the spectrum when it comes to stake size. Around 30% of all deals since 2006 have been for stakes of more than 75% but another 33% of deals were for stakes of less than 50%. The latter may be a reflection of large family run businesses present in India's private sector and the fact that sellers often have a strong emotional attachment to their business and prefer to retain majority ownership. It might also be a sign that, with India still growing at 5%, some entrepreneurs prefer to wait before selling a majority stake in order to benefit from future growth and then exit with a higher valuation.

Figure 10: Number of deals from Europe to India by equity stake (2006–12)

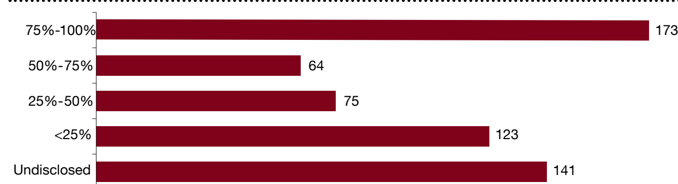
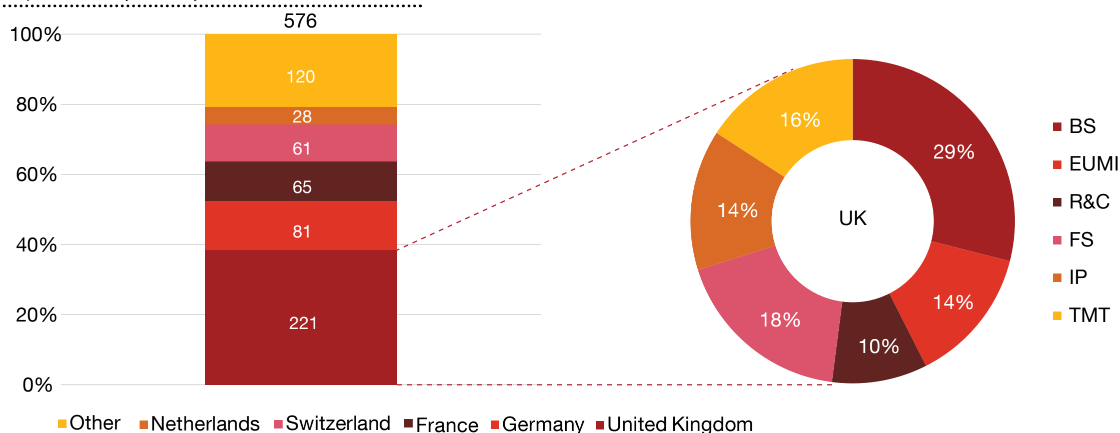


Figure 11: Number of deals from Europe to India by Country (2006–12)



India and the UK

The UK is the single biggest European investor in India, with UK companies responsible for approximately 38% of all deals since 2006. Germany, France and Switzerland are the next biggest group of investors, with their combined deals accounting for 36% of Indian inbound M&A from Europe. The UK has a strong track record of deals in the Business Services (BS) sector, contributing 29% of the total UK deals, followed by Financial Services (FS), which attracted 28 deals or 18% of UK corporate investment. However, most of those FS investments were made before the 2008–09 downturn. Only twelve UK-India deals have happened in FS since 2009 and there were none in the sector in 2012. The FS sector in the UK was significantly affected by the recession and some elements are still recovering. In terms of deal value, UK companies invested over €36b in India over the last seven years. The TMT and EUMI sectors, which we have already mentioned, have been the recipients of several mega deals, greater than €1b, and drew the most British investment value-wise. Though deals were down in 2012, recent reform measures should improve M&A prospects, particularly in R&C and Aerospace and Defence, which are both big sectors for the UK.

India shops abroad

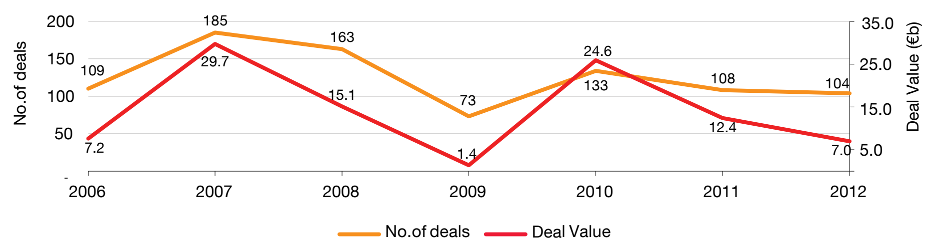
Indian M&A – a global perspective

India's strategy of proactively seeking foreign direct investment (FDI) to stimulate growth is well established since the wide-scale economic reforms of the 1990s. More recently, we have seen a surge in the number of mid-sized Indian companies involved in, or actively contemplating, outbound transactions in the range of US$10 million to US$500 million. To put the India to Europe investments in context and to understand why Indian companies are buying abroad, we will first look more broadly at India's global outbound M&A over the past years.

India's global outbound M&A

Between 2006 and 2012, Indian companies acquired about 875 companies worldwide for a total of €97 billion[8]. Although they have not returned to levels attained before the global financial crisis of 2008–09, both deal volume and value picked up again after 2009. Indian outbound activity increased from 73 deals, worth €1.4 billion in 2009, to a total of 133 deals, worth €24.6 billion in 2010 but then plateaued at around 100 deals in 2011 and 2012. In comparison to China's outbound deal record, which was heavily state-led, most Indian outbound deals were driven by the private sector.

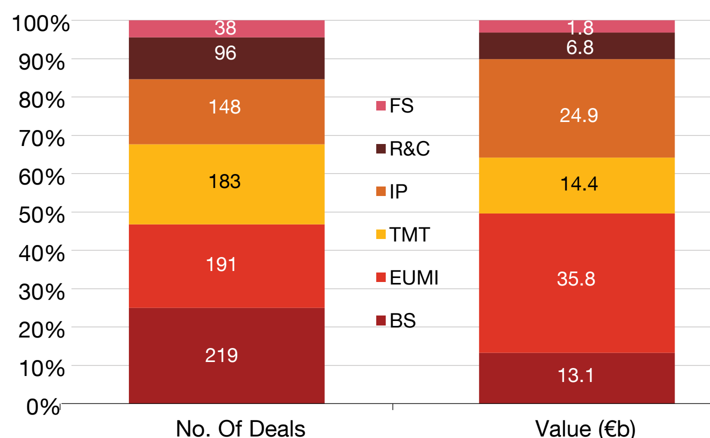
Figure 12: India investing abroad



Rationale for investing abroad

An analysis of the number of deals in the period reviewed shows that 70% of all deals were in three sectors: Business Services, Energy, Utilities, Mining & Infrastructure, and Technology, Media & Telecommunications. Multiple factors can motivate Indian companies to venture overseas but we see the following as being the key deal rational.

Figure 13: Deals by sector – a world view (2006–12)



8 Based on deals where transaction value was disclosed. Deal value is in nominal terms.

- ***Access to foreign technology and intellectual property*** lures many Indian companies into the international M&A game, especially those in the automotive, pharmaceuticals and engineering sectors. As inflation dents cost advantages, acquiring technology and know-how enables Indian companies to move up the value chain towards more high-end value services. However, in the short term, matching technology with their low cost manufacturing base in India continues to drive some deals. Suzlon's acquisition of REpower in Germany in 2011 gave it access to state of the art technology that it can produce cost-effectively in India.
- ***Becoming a global player***. For many large Indian companies, well established in their domestic market, going global is a means to growing their top line. In 2010, Bharti Airtel's US$11 billion acquisition of Nigeria's Zain Africa BV made it the world's fifth largest mobile telecommunications operator by subscribers, with 180 million customers[9].
- ***Buying into brand or management expertise*** to gain an edge on the competition is another key driver for Indian investors to look for deals abroad. A high profile example was Tata Motor's acquisition of Jaguar Land Rover in 2008, which brought Tata a stable of globally reputed automobile brands to complement their domestic brands and operations.
- ***Access to sales channels for their goods and services***. Investing into companies with established distribution channels opens the way into new markets for emerging market companies and many Indian firms have taken this route. TVS Group's 2012 acquisition of Universal Components, a wholesale distributor of commercial vehicle parts in the UK for €20m is just one example of this sort of deal.
- ***Diversification of natural resources***. In recent years, growing domestic energy consumption has led to Indian companies doing deals abroad to secure resource supply. An example of this would be a consortium of Oil and Natural Gas Corp (ONGC) partners Indian Oil Corp (IOC) and Oil India Ltd (OIL) undertaking a US$5 billion acquisition of Venezuelan oil and gas stakes in the Carabobo region. Another example is Aditya Birla Group buying the Terrace Bay Pulp Mills in 2012.
- ***Seizing opportunities created by divestments***. The 2008–2009 financial crisis and ensuing uncertainty particularly in the Eurozone, made some Western companies re-assess their core businesses and/or restructure their debt and operations. This trend has resulted in some divesting parts of their businesses, affording Indian, and other emerging market investors, a source of interesting deal opportunities eg Godrej Consumer Products Ltd (GCPL) through its subsidiary in the UK, acquired women's deodorant brand Soft and Gentle, from Colgate-Palmolive Co for an undisclosed sum.

9 "Bharti Airtel Completes Acquisition of Zain's Africa Assets", Bloomberg.com, June 8, 2010

Indian M&A: destinations of choice

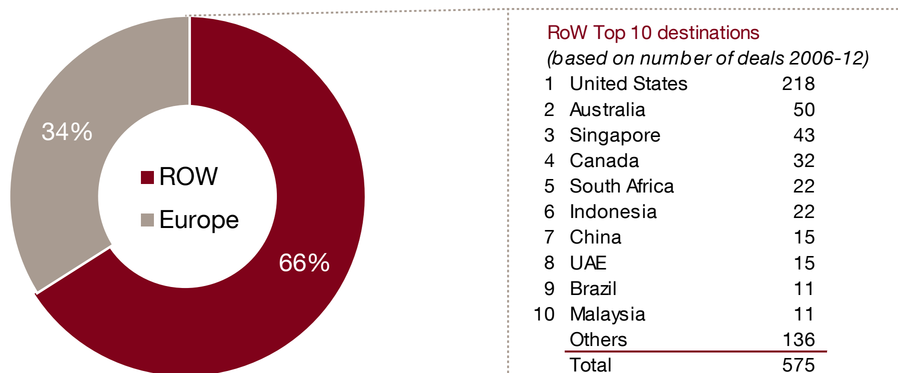
As reflected in the chart on the following page, Europe attracted 34% of all Indian outbound deals for the period of 2006 to 2012, with the remaining 66% divided among the rest of the world. Outside of Europe, the US is the Indian investor's favourite destination, representing 38% of total number of deals outside Europe. Big ticket deals in the US included Reliance Industries' 2010 shale gas investments through joint ventures with Atlas Energy Inc. and Pioneer Natural Resources for €1.2billion and €1.1billion respectively. More recently, in late 2012, Elgi Equipment made an outright acquisition of the US compressed air equipment manufacturer Patton's Inc.

For a wider discussion about M&A drivers for companies from emerging markets, see our March 2013 publication 'Resetting the compass'.

Resource needs drive much of India's emerging market deal flow

Indian companies have also been doing deals in other emerging markets such as Indonesia, China, Brazil and Malaysia. Much of this outbound M&A is motivated by a strategic need to secure natural resources supply, with deals in the EUMI sector representing nearly 50% of all Indian acquisitions in emerging markets. Tata Group's investment of nearly €2billion in two coal mines in Indonesia in 2012 is an example. Tata Power, the subsidiary which bought the stakes, is India's biggest private power generator. Many Indian companies have also invested into African businesses, drawn by the continent's large population and rising incomes. Indian companies are furthering their skills in servicing large, low income consumer markets as their needs are similar to those of India's own low disposable income and rural population. Bharti Airtel's acquisition of Zain Africa in 2010, mentioned earlier in this section, which gave Bharti access to 15 African countries, exemplifies how Indian companies are leveraging their core skills to grow their business abroad.

Figure 14: Europe v RoW number of deals (2006–12)



RoW Top 10 destinations
(based on number of deals 2006-12)

1	United States	218
2	Australia	50
3	Singapore	43
4	Canada	32
5	South Africa	22
6	Indonesia	22
7	China	15
8	UAE	15
9	Brazil	11
10	Malaysia	11
	Others	136
	Total	575

Regulatory and tax constraints

India's foreign exchange regulations allow Indian companies to enter into joint ventures (JV) or to acquire wholly owned subsidiaries (WOS) abroad. However, their ability to invest overseas is limited to 400% of their net worth for making investments outside India. The Reserve Bank of India ('RBI') has granted general permission to Indian parties to make direct investment in JV/WOS outside India. However, Indian parties are prohibited from making investment in any banking and real estate business without the prior approval of the RBI.

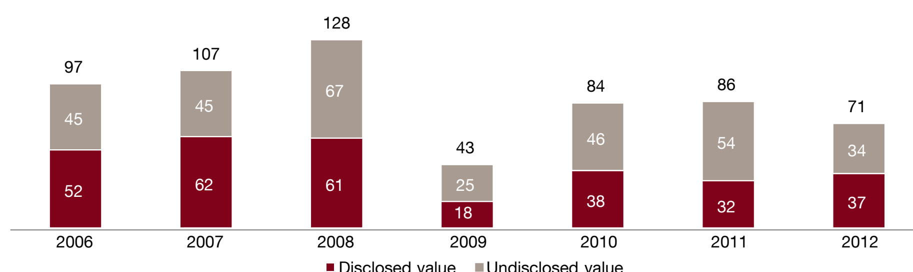
The Indian tax system is also a challenging one resulting in economic double taxation on investments made overseas, putting Indian groups at a disadvantage over their European rivals. Government proposals to introduce stringent tax residency rules and Controlled Foreign Company (CFC) regulations to tax accumulated profits of offshore subsidiaries can only make this worse unless steps are taken to align the tax system with international norms. Investments out of India therefore need to be structured carefully to avoid tax leakages and to achieve optimal tax efficiencies.

Down but not out: Europe still appeals to Indian investors

As we noted when discussing the rationale for Indian outbound investment above, the vagaries of the Eurozone markets have led to some European businesses restructuring their divestments, creating opportunities for buyers. Indian investors have seen an increase in leads for deals in mature markets over the last few years, with more approaches from intermediaries looking to match emerging market buyers with mature market sellers.

Both in and outbound Indian M&A (including deals with undisclosed value) declined significantly after 2008. Though Europe-bound deal volume recovered in 2010, it remains at about 70% of 2006–2008 levels. However, Indian companies are investing more in Europe than in any one other region or country. The percentage of total Indian outbound deals going to Europe has risen from 26% in 2009 to 39% in 2012, indicating that the region is still favoured by Indian companies[10].

Figure 15: India to Europe (number of deals)



Comparing Chinese and Indian investments into Europe

When compared with deals from China to Europe, the total number of deals from India to Europe was higher, at 547 for 2006 to 2011 when compared with 347 from China to Europe in the same period. However, Chinese investments into Europe included several multi-billion Euro deals. Few multi billion investments, particularly in the energy sector e.g. a €9billion investment in Rio Tinto, resulted in deals from China to Europe totalling €43 billion, compared to the €36 billion paid by Indian companies during the same period. Of the high growth market countries, India remains the most prominent investor into Europe.

Fit matters more than size

Indian companies have also made some big ticket investments; between 2006 and 2012, there were 14 deals worth more than half a billion Euro. The biggest deal of 2012 by value was Braj Binani Group's €275million acquisition of the Belgian company 3B Fibreglass. Other mega deals included Tata's acquisitions of steel company Corus and of Jaguar Land Rover for €10b in 2007 and €1.5b in 2008, respectively. Indian infrastructure group, GMR's acquisition of the licence to operate Sabiha Gokcen International (Istanbul airport) in 2008, and Indian energy company Essar's acquisition of Stanlow Refinery in the UK for €936m in 2011 were also large deals. In general, the figures show that Indian companies' appetite tends to be for deals under €50million. Mega deals aside, the average deal size for 2006 to 2012 was €47million. Our survey of companies who have acquired internationally also suggests that deal size matters less to Indian investors and that many prefer smaller deals as it is much easier to integrate and/or restructure operations.

Figure 16: India to Europe (€b)

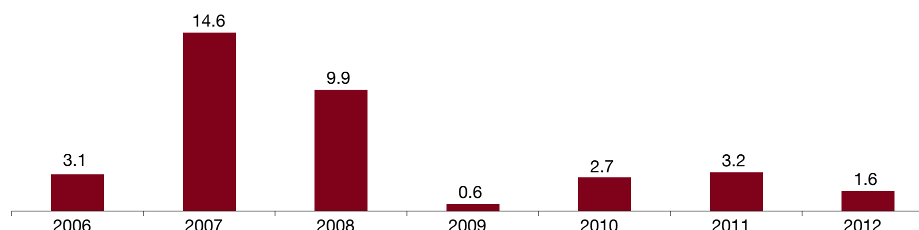
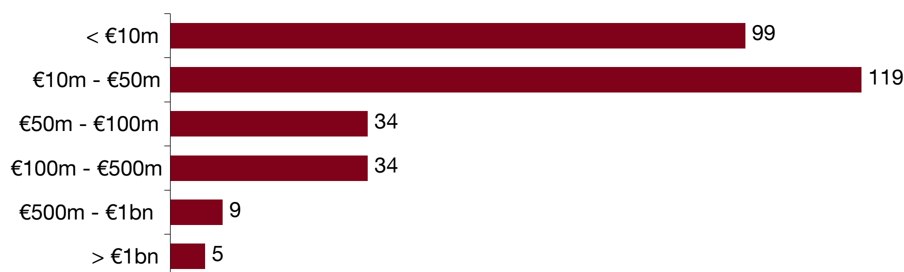


Figure 17: India to Europe - Number of deals by range



10 We note that about half of the total number of deals did not have a disclosed deal value based on publically available information. Although such deals are genuine (and include acquisitions of majority equity stakes), in our analysis we have excluded them, unless otherwise stated, to arrive at a comparable total deal value as shown in this section.

Figure 18: India to Europe – Number of deals (2006–12)

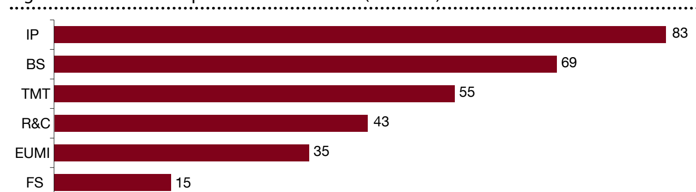
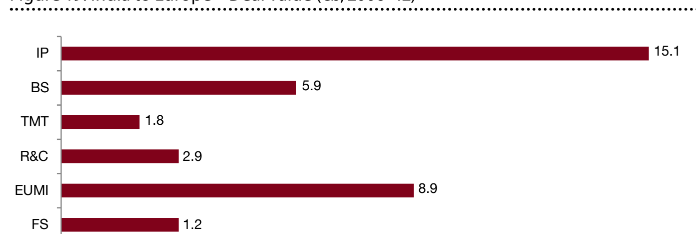


Figure 19: India to Europe – Deal value (€b, 2006–12)



Europe's IP and BS sectors attract most deals

As for European investment into India, the Industrial Products and Business Services sectors drive much of India's M&A activity in Europe. Of the 300 outbound deals made between 2006 and 2012, 50% were in the IP and BS sectors. Whilst the IP sector generates most deals, BS acquisitions have increased significantly– from three in 2009 to 14 in 2012, a level similar to the that seen before the global downturn.

The automotive sector accounted for about 40% of all IP deals, mainly in auto components. We believe this sector will continue to attract interest as Indian companies decide to move up the value chain, acquiring technology rather than being licensed manufacturers. India's growing domestic demand for cars will also fuel more deals in this sector. The future may hold more transactions such as Sona Koyo Steering Systems' 2007 acquisition of ThyssenKrupp Präzisionsschmiede, a Munich based manufacturer of steel and automobile parts for €100m. Total deal value in the IP sector was skewed by Tata Group's acquisition of Corus and JLR (total deal value of €11.9b).

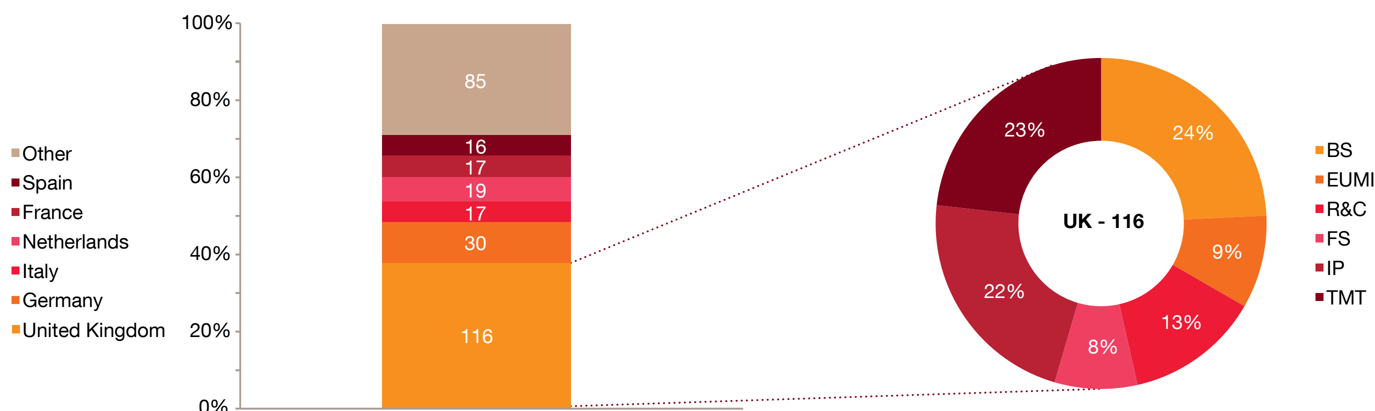
Healthcare deals drove 40% of BS deal flow. Most were either for pharmaceutical manufacturing or for access to brands and patents, such as Serum Institute's acquisition of the vaccine production unit of Nederlands Vaccin Instituut (NVI) for €32m in 2012. A further 30% of deals were in Professional Services, mainly security, back office and call centre operations. Indian investments in this area included Topsgrup's acquisition of The Shield Guarding, a UK security company in 2012 and call centre operator Hero Ites' acquisition of their Scottish peer, Telecom Service Centres, for €57m in 2007.

TMT is the next biggest sector to attract Indian investment, with 65% of the deals in technology space. This is driven by Indian IT companies widening their customer base and moving to high-end products and services, as illustrated by HCL's acquisition of Axon Group (an SAP implementation consultancy) for €557m in 2008.

Within EUMI, about 35% of deals came from mining and energy. Deals in this sector included Hindustan Zinc's acquisition of Lisheen/ Killoran Mining (a unit of Anglo American plc) for €405m in 2011 and Suzlon's acquisition of REpower mentioned previously. We see the growing domestic demand for energy and resources driving more overseas acquisitions. Indeed, outside Europe, the EUMI sector is the second biggest recipient of Indian investment after business services by deal volume and the biggest by value, attracting €35.8billion, vs €13.1 billion invested into Business Services. Between 2006 and 2012, Indian companies completed 156 EUMI deals worldwide compared to 35 in Europe.

UK attracts most of India's outbound M&A

Figure 20: No. Of deals from India to Europe by country

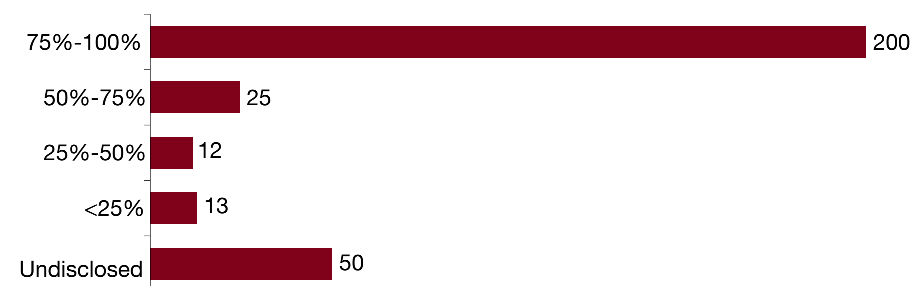


About 40% of all Indian investment into Europe is for UK targets. While the fact that English is a common business language is probably one of the key drivers, there are several other reasons why UK companies attract Indian investors. The UK market is a platform not just for Europe but is also a hub for international business and a meeting place for customers from both mature and emerging markets. Doing deals in the UK is probably much easier than doing deals in Asia as there is flexibility to restructure the business to suit Indian needs. In addition to those advantages, the UK government actively welcomes foreign direct investment in manufacturing, R&D, and service sectors and encourages innovation. By offering the same incentives to foreign owned companies that British owned companies receive, the UK provides a level playing field for all businesses – an appealing combination for Indian investors.

Indian investors prefer majority stakes

From our analysis, we conclude that Indian companies prefer to acquire majority stakes when investing overseas. Of the 302 deals we looked at between 2006 and 2012, around three quarters of them were for stakes of 50% or more. This clearly reflects an appetite among Indian companies to acquire controlling stake for various strategic reasons including customer acquisition, entry into new markets, and technological advancements to name but a few.

Figure 21: Number of deals from India to Europe by stake %



Conclusion

Indian companies' favourable financial positions, and agility when operating in both emerging and developed markets, make them robust competitors in the global deal arena. Although Indian GDP slowed to 5% in 2012, we believe that deal demand by the private sector is set to increase as the need to secure technology and resources to move to the high end of product chain becomes critical. We see sectors such as technology, healthcare, energy and mining attracting more interest from Indian buyers. In some European sectors, the availability of distressed assets could draw even more investment from Indian companies. While the average deal size is about €45m, as we have seen from sectors such as energy and mining, Indian companies do not shy away from mega deals when the target and strategic fit are right. Overall, Indian investors are ready to invest and equipped to make some good deals over the coming years.

A value proposition

Doing deals in India – reassuringly expensive?

The combination of India's growth prospects, her expanding middle class with a growing appetite for global brands and her progress towards deregulation undoubtedly appeal to corporate and financial acquirers. These same factors have also driven valuation multiples for Indian businesses significantly above those for comparable developed market operations and, indeed, higher than those in other BRIC territories.

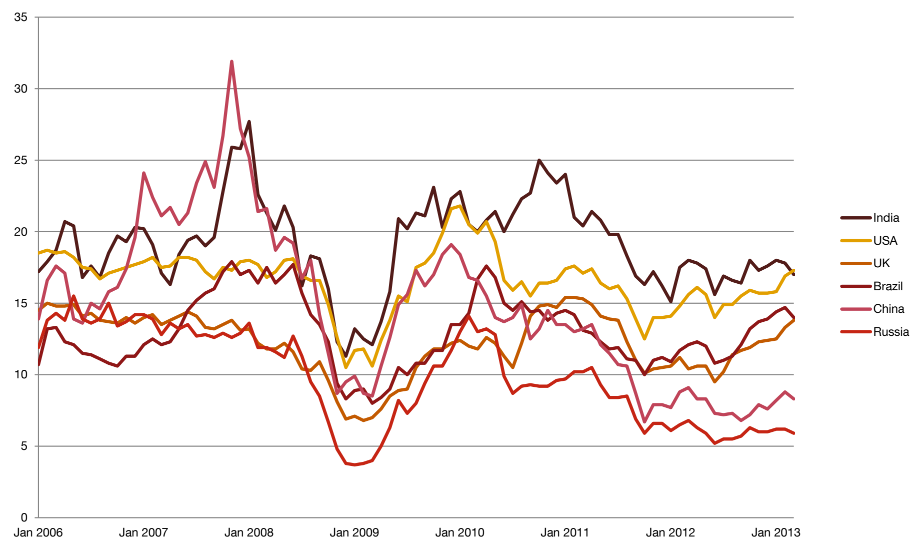
Are such high valuations justifiable given India's risk profile? Surely the current uncertainty within the political arena, the need for more robust corporate governance procedures, and concerns about corruption should increase perceptions of risk and exert a downwards pull on multiples?

For this piece, PwC's Valuations team considered these diametrically opposed value drivers using observable valuation benchmarks in the Indian market to try to determine whether such valuations are merited. How can acquirers get comfortable that they are getting value for money, given the significant strategic premia they are likely to be expected to pay to secure the target asset? Are Indian deals reassuringly expensive or are sellers profiting from information asymmetry?

India's higher P/E multiples are an indication of strong investor sentiment

Indian businesses have been trading at higher Price to Earnings (P/E) multiples than their fellow BRIC counterparts and UK, US and European companies since 2008. Indian companies typically trade on a long-term average P/E multiple between 17x and 19x. However, this varies significantly by sector. For example, Retail and Consumer (R&C) and Technology, Media and Telecommunications (TMT) companies within the index typically trade at higher P/E multiples. Multiples in these sectors averaged around 40x and 30x respectively over the period from 2006 to February 2013. This is compared with Energy, Utilities, Mining and Infrastructure (EUMI) sector, for instance, which averaged a P/E multiple of about 17x over the same period.[11]

Figure 22: Trading PE multiples for India, China, Brazil Russia, UK and USA



Source: Datastream

11 Source: Datastream data from 1st January 2006 to 1st March 2013

The decline in trading P/E multiples in 2008, reaching a low of 11x in Dec 2008, is attributable to a collapse in investor sentiment resulting from the global financial crisis. This was a period of high volatility, with the Bombay Sensex Exchange Sensitivity Index (SENSEX) dropping by approximately 50%[12] during the year: an astonishing drop that mirrored the decline seen in other markets around the world.

However since 2009, Indian trading P/E multiples have remained high relative to other markets, even with the current slowdown in its economy, suggesting that investors believe the long-term fundamentals are still intact and are still ready to invest.

Looking at transaction data of Indian targets between 2003 and 2012, the average transaction P/E multiple was 27x[13], with foreign investors typically paying a premium in the region of 30%[14] on quoted multiples. The premium paid by acquirers is not uncommon to gain control of an asset in any market. The focus is therefore on the P/E multiples for Indian companies that are notably high, partly reflecting the investor confidence in the outlook for this market.

Furthermore, competition for scarce acquisition opportunities may be driving up transaction prices in auctions; the core question for an investor is whether the higher multiple typical for Indian targets is justified.

Is India a seller's market?

It can be challenging to find suitable acquisition targets in India, as sellers are aware of the competition for assets and superior growth prospects compared to those in inbound investors' home markets. The greater prevalence of family-owned businesses is also a factor. These sellers are less willing to relinquish businesses in which they have been deeply involved, in some cases for generations, and the prestige it brings, for anything less than a significant premium.

The two main forces driving valuations, with opposing effects on value, are growth and risk. High multiples in India imply that promising growth prospects outweigh concerns over risk profile. However, we need to take a closer look at how investors perceive these factors when looking to invest in the subcontinent and whether the resulting impact on valuations stacks up.

Is the current slowdown a blip or symptomatic of deeper concerns?

Despite the recent slowdown, India's growth prospects are still more favourable than in the West. Long-term growth rates of 2.7% and 3.3% for the UK and US respectively[15] mean investors from developed markets are turning to high growth emerging economies for investment opportunities. Indian GDP growth in 2012 was around 5%[16], just more than half the annual GDP growth recorded between 2003 and 2010 (with the exception of 2008 as a result of the global financial crisis), which has led some to question how long it might take to get back to such strong growth levels.

In the long-term, economic forecasters are still anticipating economic growth in India to top 7%[17], one of the highest levels among the BRIC countries. The elevated multiples we highlighted would suggest that the market shares this view, further strengthened by transaction evidence. BP's acquisition of a 30% stake in Reliance in 2011 for £5.4bn was reportedly at a premium of 24%, driven by the expectation that as the economy returns to stronger growth levels, the demand for natural gas is expected to outstrip supply, creating significant opportunities[18].

12 Source: Capital IQ, 1st January 2008 to 1st January 2009

13 Source: Capital IQ. Our transaction analysis focuses on acquirers from Europe and transactions completing between 10th August 2003 and 10th August 2012

14 Source: Capital IQ – average target stock premium one month prior to transaction, January 2006 to August 2012. Our transaction analysis focuses on acquirers from Europe and transactions completing between 10th August 2003 and 10th August 2012

15 Source: 2017 forecast GDP growth by International Monetary Fund (World Economic Outlook Database, October 2012)

16 Source: 2012 GDP growth by International Monetary Fund (World Economic Outlook Database, October 2012)

17 Source: 2017 forecast GDP growth by International Monetary Fund (World Economic Outlook Database, October 2012)

18 Source: Capital IQ, Broker report: RBS 21Feb 2011, IDIB capital

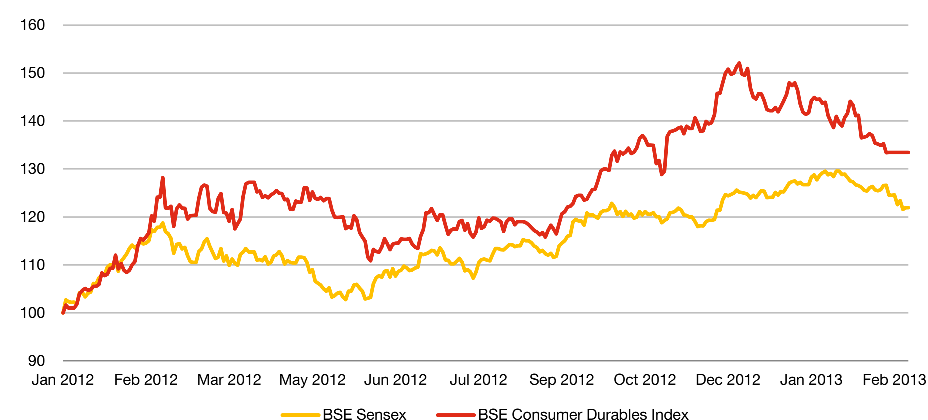
Global companies are attracted to India's growing middle class

We noted previously that India's Retail and Consumer industry has attracted some of the highest multiples. One clear reason for this trend is the appetite of India's emerging middle-class for global brands, often seen as status symbols. Global retailers are keen to tap into this ever-expanding consumer market. The international luxury clothing brand Tommy Hilfiger, for example, is keen to expand its direct network and investments in India. In September 2011, Tommy Hilfiger not only bought the license to its trademarks in India but also acquired a 50% stake in a joint venture with Arvind Murjani Brands Private Limited (who sells the brand in India) from the Murjani Group.

In addition to the appeal of a large middle class, reforms to FDI rules on foreign ownership in the sector have also played an important part in attracting foreign retailers. Retailers such as Ikea have been quick to take advantage of these reforms, also drawn by the potential of India's growing middle class consumers.

The Bombay Stock Exchange (BSE) consumer durables index has outperformed the BSE Sensex Index in recent times. It appears that investors remain convinced of the consumer story[19] and we do not foresee a significant reversal in this trend.

Figure 23: Sensex vs Consumer Durables Index (Rebased to 100)



Source: Capital IQ

Do risk concerns cancel out higher growth prospects?

It is clear that India has not evaded the drag on growth exerted by the global economic slowdown, potentially exacerbated by local issues. However, the fundamental drivers of growth remain and so, if the right structures are in place, we expect a return to stronger growth levels in the not too distant future. That said, there is no denying that India faces internal challenges that may increase the risk perception in the eyes of investors. We need to consider if the negative impact on value exerted by these risk factors is significant enough to cancel out any premium for growth.

Risk factor 1: Political uncertainty around the progress of reforms

Some investors may be more concerned by the political uncertainty, and risk of policy reversals or protests against reforms than by the recent slowdown. The economic reforms for the retail sector, passed in September 2012 are a case in point. These reforms, long awaited by the investor community, were met with great resistance from opposition parties when they were first introduced at the end of 2011. Political opposition was so strong at the time that the Prime Minister was forced to make a U-turn on his announced policy.

The proposed General Anti-Avoidance Rules (GAAR) (see the next section of this report for more detail), which could lead to a retrospective tax on cross-border transactions, is also a cause for concern for foreign investors. These rules would add to the complexity of investing in India and, if passed, would force all investors to examine their Indian shareholdings and investments. However, since being introduced in March 2012, the proposals have somewhat been watered down[20], allaying the fears of investors.

19 Source: 'Chart of the week: the Indian consumer', FT.com 25 June 2012.

20 At the time of writing, the proposed GAAR has yet to be finalised.

This environment of uncertainty has meant investors are becoming more cautious, leading to deals taking longer to complete and placing a downward pressure on valuations. However, the general view is that the government is under increased pressure to provide positive economic leadership and will therefore have to address the current regulatory uncertainty. As such, most believe that both political and economic conditions will improve in the medium term.

Risk factor 2: Weak corporate governance and a lack of publically available data

The lack of publically available information in India makes it difficult for investors to find benchmarks when determining values. This scarcity of comparable valuation multiples makes it challenging to get comfortable with an asking price. Weak corporate governance within some companies means internally generated information may require further scrutiny. There may not be a business plan available, or if there is, it may not be rigorous or based on readily verifiable information. This makes any type of detailed valuation work difficult.

Both of these factors would appear to increase the uncertainty around any valuation exercise. Increased uncertainty equates to higher risk and hence a discount to value.

Conclusion

The risk factors set out above are significant. Yet the market is assigning more value to the growth opportunities in India than to any discount to value to reflect such risks and uncertainties. The premium attached to growth in India is undeniable and highlights the quest for investors in sluggish developed markets to seek out growth where they can find it. Given the uncertainties around valuation inputs, judgement becomes ever more important when information is scarce and potentially unreliable. However, continually relying on judgement without sound analysis to support it is a risky business.

So how can a buyer get comfortable with the strategic premium they are likely to have to pay to enter this market? One way of aligning the goals of both the buyer and the seller is by using earn-out mechanisms when structuring the deal, an approach now used more frequently. This typically involves lower up-front payments, with additional payments if performance criteria are met. The approach can help to reduce the valuations gap typically seen between buyers and sellers.

Creative application of consideration mechanisms can mitigate some of the risks we have outlined. This should be supported by relevant analysis – running scenarios can compensate to some extent for uncertainty around key assumptions. The design of the package offered to the seller should reflect the key sensitivities in the analysis to reduce risk to an acceptable level. Optionality can be factored in where appropriate to get a better handle on uncertainties

Retaining and incentivising a local partner may help a buyer navigate regulatory issues and local cultural differences. This carries its own risks and may not necessarily reduce the overall risk profile of an investment. However, keeping the seller involved and onside may help facilitate the transaction, particularly when looking at a family business that has been built up over a considerable period of time.

Deal pricing in India shows no sign of converging with developed markets or even other BRIC territories, despite the brakes on economic growth at the current time. Competition for assets remains fierce and only the canniest investors will succeed in getting the right assets at the right price. For those who do get it right, India offers a rare opportunity to access a powerhouse economy. Expensive? No doubt, but reassuringly so for the winners in the deal market.

Article contributed by Sona Davda

A moving goalpost – FDI and tax

FDI regulations – a high level view

As is the case in most countries, foreign investments into India are subject to regulatory restrictions, so potential investors need to be aware of the restrictions they may face.

Since the Indian Industrial Policy of 1991, the Indian regulatory environment for foreign investment has been relaxed to promote and encourage foreign direct investment (FDI). Under the current FDI framework, foreign investment is permitted in the majority of sectors (with some sector caps) with a small number of exceptions for sectors of national strategic importance. These include atomic energy, railways, real estate, etc.

Many foreign investments can now be made via an automatic route, which does not require any prior approval from the Foreign Investment Promotion Board (FIPB). However, there are exceptions for investments in specified sectors, such as defence, mining, broadcasting etc., or investments beyond permitted sector specific caps, where prior approval is necessary. A careful assessment of the regulatory regime is therefore important.

Changing Regulatory Scenario

The Indian government has recently introduced regulatory reforms intended to widen the opportunities open to foreign investors. Some of the key developments are discussed below:

Retail:

After a lengthy political debate, new regulations now permit FDI of up to 51% in multi-brand retail trading with prior government approval. This significant change should help to generate more employment opportunities and benefit consumers as well as the agricultural community. However, this new regulation does impose certain conditions, such as minimum investment requirements; initial investment in back end infrastructure and restrictions on e-commerce. As yet, the regulation has only been adopted in nine states and one Union Territory. This restricted opening is not seen as a deterrent by overseas investors as many large states are amongst the first movers and most investors would in any event take several years to roll out a pan-India strategy.

Conditions governing FDI in single brand retail have also been liberalised, resulting in the approval of some 63 proposals over recent months. It has also been clarified that the restrictions on 30% sourcing of products from local markets can now be undertaken from anywhere in India (with only a preference for the use of small and medium enterprises). Following the changes, IKEA has already led the way in retail and a cabinet committee has approved their entry into India. While the opening up of retail is a positive move, any investment into India's retail sector will require substantial investment and careful planning.

Broadcasting:

The government has raised the foreign investment caps in all the broadcasting carriage segment to a uniform 74% Previously there were different caps in related sectors. This helps to address the convergence challenges between the telecom and the broadcasting carriage segment.

Civil Aviation:

While FDI up to 49% was permitted in scheduled and non-scheduled air transport services, foreign airlines were prohibited to invest in this sector. In September 2012, the Indian government liberalised this segment to permit foreign airlines to invest within this composite limit of 49% but with prior government approval. This is in line with global standards, including those of the UK, which allow foreign investment up to 49% in civil aviation. Air Asia of Malaysia has already announced the first of the FDI investment in this area. Etihad Airways has also recently announced a substantial stake in Jet Airways subject to regulatory approval.

Apart from the ones discussed above, there are also other positive developments, such as the proposal to allow FDI of up to 49% in the insurance, defence and pension sector. The guidelines for foreign debt funding, known as External Commercial Borrowings (ECBs) guidelines, have also

been relaxed. The changes indicate that the Indian government is committed to encouraging more foreign investment into India, even in those areas which were historically seen as controversial in nature. This should promote more deals flowing into India. Further, the Indian Finance Minister ('FM') has reiterated the importance of FDI and said

> *"If I may be frank, foreign investment is an imperative. What we can do is to encourage foreign investment that is consistent with our economic objectives."*

India's tax environment

Taxation has always been one of the most important aspects while planning acquisitions or deals in India primarily because of the interplay of various taxes, company law and the foreign exchange regulations. Companies looking to invest in India need to consider a variety of tax issues and regulations at a relatively early stage. Overall, the tax rates and compliance burdens are high, so careful planning is vital to avoid pitfalls and manage tax efficiencies. The table below lists some of the relevant taxes:

Nature of tax	Rate#
Corporate tax	
- Indian Company	Up to 33.99%*
- Foreign Company	Up to 43.26%
Minimum Alternate Tax ('MAT')	Up to 20.96%*
Dividend Distribution Tax ('DDT')	16.995%*
Capital Gains ('CG') Tax	Rates ranging from 0% to 43.26%**

 # Applicable rates of taxes as per the proposed India Budget 2013[21].

** Inclusive of applicable surcharge and cess*

*** Depending upon residential status and nature of capital asset and subject to fulfilment of conditions as prescribed in the Indian Income Tax Act and tax treaty benefits*

21 yet to be enacted

International tax structuring

The effective rate of tax in India is high and its tax system less developed in comparison to many in the European jurisdictions. The level of aggregate taxes suffered has a clear impact on the post tax return on deals, making it imperative for international investment opportunities to be structured appropriately. Some of the key taxation aspects to consider for deals in India include:

Entry, exit and finance straegy

Local holding company structures are relatively common in the West. However, this is less so in India due to its tax and regulatory regime which makes multi layered structures cumbersome and relatively expensive from a tax perspective. Flat structures are therefore often preferred.

India imposes substantial taxes on capital gains arising on direct or indirect transfer of Indian shares/assets. India has certain tax treaties that offer favourable tax treatment for investment into India and these are commonly used where commercial circumstances permit. Overseas investors should therefore evaluate their options carefully.

Any acquisition is likely to involve a combination of debt and equity. Debt funding in India can be expensive and foreign debt in particular is highly regulated. Different forms of financing structures are therefore important to consider from a tax and non tax perspective.

Repatriating cash and profits

There are various options for repatriating profits from India, such as dividend distribution, share buyback, capital reductions, all with differing tax implications. An illustration showing the net profit from an Indian company that can be remitted (as dividends) to a foreign investor after payment of appropriate taxes is given below:

Particulars	Amount (€m)
Net profit before tax	100
Income tax	33.99*
Transfer to General Reserve**	6.60
Dividend distribution tax @16.99%	8.63
Net profit after transfer and taxes	50.78
Total tax outflow	42.62

** Effective income tax rate for domestic companies having total income more than INR 100 million is 33.99%*

*** Transfer to General reserve is a mandatory requirement under the Indian Companies Act, 1956*

The effective rate of tax of 42.62% is significantly higher than countries like the UK (23%) and this, coupled with the premium associated with acquisitions in India, mean that the impact of tax on shareholders and deal value requires careful consideration.

With effect from 1 June 2013, the Government is proposing to levy tax at 22.66% (inclusive of applicable surcharge and cess) on buyback of shares by Indian unlisted companies. This tax is over and above the normal tax liability of the unlisted company resulting in extra cost on cash repatriated in this way.

Other key tax considerations for doing business in India are the transfer pricing aspects associated with transactions between group companies, creating a taxable presence of the foreign company in India and withholding tax implications on cross border charges, such as royalties, licence fees and interest payments. India follows a stringent withholding tax regime in relation to payments made to non-residents with significant penalties for failure to comply. With the withholding tax rate on royalty and fees for technical services ("FTS") paid to non residents going up from 11.24% to 27.04% (inclusive of applicable surcharge and cess) under the budget. Ensuring treaty relief is obtained is therefore very important.

Recent developments

India has been extensively in the news for matters relating to tax and its aggressive approach to collection of taxes in recent years. The Vodafone dispute was a landmark case and of significant interest to multinational investors. It tested the principles of Indian taxation on indirect transfer of shares in an Indian entity and whether India had the ability to tax this and collect the tax from the buyers of the business. The Supreme Court's ruling in favour of Vodafone brought clarity to the position but to the dismay of investors, the Indian government then introduced retroactive legislation to counter the Supreme Court's decision. The buyer's obligation to deduct tax on an acquisition involving Indian assets therefore remains an area that commands much discussion in M&A deals.

Another significant change that has raised concerns is the introduction of the General Anti Avoidance Rules (GAAR). These rules are very widely drawn, override existing tax treaties and enable the tax authorities to deny tax benefits on transactions that they perceive have the main purpose of obtaining tax advantage. Many fear these provisions will bring further uncertainty and adversely affect both Indian and International business. Originally due to come into effect as of 1 April 2013, their introduction is postponed until 1 April 2015 to allay the apprehensions of foreign investors.

Amidst the slowdown of the Indian economy, falling rupee, and debate about legislative changes, the Indian Prime Minister re-appointed the Finance Minister, Palaniappan Chidambaram. He has pledged to clarify tax laws and to take measures to promote investment in the Indian economy and boost economic growth. An expert committee was formed to review the legislative changes concerning taxation. This committee has made some significant and welcome recommendations to simplify the tax measures, though little was said about these at the time of the Budget 2013. If implemented, these should help revive investor confidence and that of the broader business community.

A less complex future

Although the proposed changes have been in the making for several years, the Indian government is still looking to introduce a new direct tax code ('DTC') with the aim of moderating tax rates and simplifying direct tax laws. In addition, the government has plans to integrate all indirect taxes into one goods and services tax ('GST'), which would simplify India's indirect tax regime. It also recently introduced Advance Pricing Arrangements (APA) to reduce transfer pricing disputes. It remains important for the longer term that the government remains committed to simplifying the tax regime, creating greater tax certainty for corporates, and improving the ease of doing business in India.

Conclusion

Both India's government and business leaders recognise the importance of FDI to economic growth and employment. India's regulatory and tax environment is complex and investors need advice and careful planning to make the most of the deal opportunities India offers. Clashes around reforms and tax liabilities are detrimental to investor confidence but the government's commitment to safeguarding that confidence appears strong and progress should be made on key reforms over the coming years.

A final word

Interview with NV Sivakumar, Leader, Financial Advisory Services, PwC India

N V Sivakumar, "Shiv", leads PwC's Financial Advisory Services practice in India and has over three decades of experience. Having advised many corporate and private equity clients on transactions in the technology, fast moving consumer goods and manufacturing sectors, Shiv is well placed to see how the factors discussed in this report play out in the reality of the market.

What do you see driving Indian companies to invest abroad and what sort of overseas assets are they buying?

Whilst the drivers are different for different sectors, brands and technology are the primary reasons for an Indian investor to look at European targets. Acquiring international brands remains an attractive proposition to achieve overseas market penetration and also leverage on it to create dominance in domestic markets. Specific to technology, an increasing number of companies are looking at platform deals to spur their growth. With margins in Services shrinking, more software companies are looking for a platform play. Having said this, IT companies are also keen to do deals in foreign markets to "near shore" their services to existing customers. For instance, for customers located in Europe, Indian IT companies are actively scouting for deals in the Central and Eastern European region and the Latin American region for customers based in the United States.

A third factor driving acquisitions is immediate access to new markets, though this is compelling only if the investor believes that there is room to add-on/cross-sell their domestic products into that market. Meaning they have the ability to leverage the seller's existing channels/customer base to expand their domestic product range.

What are the typical issues that worry Indian companies when doing deals in Europe?

The difference in the way business is done is probably the single biggest challenge. Most Indian promoters typically have a very hands-on approach – key business decisions tend to rest with the promoter. The distinction between ownership and management is often blurred. This can come across as a bit stifling for a team used to operating in a professionally managed company with clearly laid-down structures in Europe. Apart from that, the inability to integrate people, systems and processes can sometimes also be a huge challenge.

A number of acquisitions by Indian companies in Europe have not been successful. Where do some Indian companies go wrong?

In my view, Indian companies tend to underestimate the cost of doing business in the West. The rigorous regulatory set-up and strict adherence to compliance requirements create hidden costs that Indian companies often fail to see at the time of acquisition. Applying an Indian approach to a Western market is a recipe for disaster. Some of the biggest causes of post-deal value erosion are that buyers underestimate the need to manage cultural differences, and fail to factor in the time-cost of integration. In addition, the cost of financing for Indian investors tends to be high; most financing is typically counter-guaranteed by the parent company, which can be onerous for them.

Are Indian companies shifting their focus from Europe and other western markets to emerging markets like Africa and Latin America?

Yes, Africa is definitely a market that Indian companies are actively looking at. The size of the market and access to natural resources are what attract Indian companies to Africa. Also there is a huge Indian diaspora in Africa, who are a ready market for Indian products and services. However, in my view, Latin America is a market that Indian companies will look at only at a later stage, once they have already scoured other important markets.

Finally, looking at inward investments, do you believe that India is still a preferred investment destination?

I have no doubt that India remains a favoured investment destination, although it is fair to say that the euphoria has declined to an extent, due to certain ambiguities in the policy framework, resulting in conflicting messages being sent to the investor community. However, given the size of the market and our strong constitutional foundation, where the roles of the executive and judiciary are separate and the Government upholds the rule of law, India is and will remain a promising market for investors..

Basis of preparation

The data is for the period January 2006 to December 2012

Deal data has been sourced from Thomson Reuters, Mergermarket and Deal logic through our research on the below where an Indian company was a target, an acquirer or acquirer's parent company

Unless otherwise stated, only announced/completed transactions have been included in our analysis.

Deals which were terminated/aborted have been excluded.

Deal values have been taken as stated in the respective databases or as confirmed with the press release of the company. All amounts are in Euro (€) unless otherwise stated.

The deals extracted have been classified and analysed as below:

- Industries based on target's business description
- Inbound/Outbound based on the target/acquirer countries
- Deal size based on announced deals, any analysis that is reflective of deal values excludes deals for which values have not been disclosed in public domain.
- The numbers have been rounded off wherever necessary
- FY denotes period commencing 1 January 20XX – 31 December 20XX

Glossary

APA – Advance Pricing Arrangements

BSE – Bombay Stock Exchange

BRIC – Brazil, Russia, India and China

CAGR – Compounded Annual Growth Rate

CFC – Controlled Foreign Corporation

DDT – Dividend Distribution Tax

DTC – Direct tax code

ECB – External Commercial Borrowings

E7 – India, China, Russia, Brazil, Indonesia, Mexico and Turkey

FDI – Foreign Direct Investment

GAAR – General Anti Avoidance Rules

GDP – Gross Domestic Product

GST – Goods and Service Tax

OEM – Original Equipment Manufacturer

PPP – Purchasing Power Parity

P/E – Price to Earnings ratio

M&A – Merger and Acquisition

RoW – Rest of World (excluding Europe)

VAT – Value Added Tax

y-o-y – Year on year

€m/b – Euro in millions/billions

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