India

Down, but not out

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Current Environment

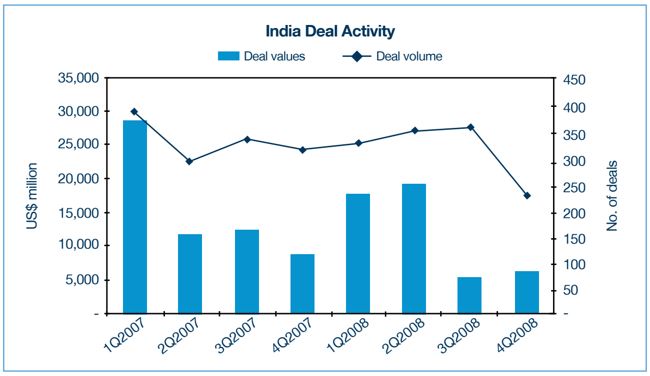
The Indian economy grew by a little under 8% p.a. during the first half of fiscal 2008/09 (April to September 2008), as compared to the 9.3% p.a. growth registered for the same period the prior year. This marked the first time in 10 quarters that the Indian economy grew at less than 8% p.a. The key contributors to this drop were the agriculture sector, which registered a growth of 2.9% p.a. compared to 3.7% p.a. in the previous fiscal year, and manufacturing which grew by 5.3% p.a., significantly lower than the 9.7% p.a. in the first half of the previous fiscal year. The services sector continued to be the main driver of growth recording 9.8% p.a. growth; albeit lower than the 10.7% p.a. seen during the same period in the prior year. Growth in the services sector is attributed to the double digit growth of 11% p.a. in the trade, hotels, transport, and communications segments. The construction sector also witnessed significant growth at 10.5% p.a. during this period versus 9.7% p.a. during same period last year.

Inflation peaked at 12% p.a. during the period, primarily attributed to the rising crude oil prices, but had declined to approximately 6.4% p.a. by the end of December, with a further correction expected in January. The fall in crude oil prices, together with the measures taken by the government (primarily raising interest rates and restricting export of commodities) have helped to lower inflation levels.

The Indian stock markets have been severely impacted by the global credit crisis, and saw significant selling pressure by foreign funds, causing some panic-selling by local investors as well. The Bombay Stock Exchange, which touched a high of 21,700 points in January 2008, plummeted to below 8,500 in November. It has since made a partial recovery, but continues to stay range bound. With foreign institutional investors being net sellers in the Indian equity markets, and the rupee depreciating by over 25% against the US Dollar during 2008, India's foreign exchange reserves fell from approximately US$300 billion to US$254 billion by end December 2008.

According to the World Investment Report 2008 released by United Nations Conference on Trade and Development ("UNCTAD") in September, India has retained its position as the second most preferred global location for foreign investment in 2008. Foreign Direct Investment ("FDI"), at US$17.2 billion, went up by a staggering 137% in comparison to the same period the previous year. A large part of this was directed at greenfield projects in the telecommunications, construction, and software segments. The government expects the year to close with FDI flows in excess of US$35 billion.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 31 December 2008

2008 witnessed a significant fall in deal activity, both in value and volume terms, as the impact of economic slowdown spread across emerging markets. While the total number of transactions fell slightly from 1,327 in 2007 to 1,254 in 2008, aggregate deal value declined by over 20% from US$61 billion in 2007 to US$47.4 billion in 2008. The average deal size also fell from approximately US$46 million in 2007 to US$38 million in 2008. This was attributed to fewer large outbound deals in 2008 vis-à-vis 2007. In addition, extremely high price expectations for the most part of 2008, combined with a lack of liquidity, made private equity and outbound transactions tougher in 2008. Pharmaceuticals, financial services, telecommunications and the IT/ITES sectors were the most significant contributors to deal activity during the year.

Private equity transactions accounted for around US$11 billion of deal activity in 2008. Although a weak secondary market resulted in some correction of valuations, this was largely restricted to the public markets. In the private markets, promoter valuation expectations remained relatively unchanged, and this resulted in considerably fewer PE deals. As a result, private equity investors appear to have turned their

attention to PIPE deals, where valuations have corrected, the investee managements are known to them, and exit routes are visible. ChrysCapital acquired around a 5% stake in HCL Technologies for approximately US$220 million, and slightly more than 1% in Infosys for about US$200 million during 2008, through secondary market transactions. Some of the notable PE transactions during 2008 were:

- Providence Equity Partners' investment of US$640 million in Aditya Birla Telecom Ltd, a wireless telecommunication services provider, for a 20% stake.
- Farallon Capital's investment of around US$246 million in Indiabulls Power Services Ltd.
- Government of Singapore Investment Corp's ("GIC") investment of US$209 million in apparel firm, Reid & Taylor India.
- Goldman Sachs' investment of US$172.5 million in Mahindra & Mahindra Ltd.
- International Finance Corporation's investment of US$120 million in Polycab Wires, which is one of India's largest cable manufacturing companies.
- TPG Capital's investment of US$120 million in Shriram Retail Holdings Pvt. Ltd.

Outbound investments accounted for US$12.9 billion of M&A activity in 2008, spread over 227 deals, representing a fall of over 10% in value terms. Significant outbound deals, announced during the year include:

- Tata Motors Limited acquiring Jaguar and Land Rover of Ford Motor Company for US$2.3 billion.
- Great Offshore Limited acquiring Seadragon Offshore Limited for US$1.4 billion.
- GMR Infrastructure Limited acquiring a 50% stake in InterGen NV for US$1.1 billion.
- Tata Chemicals Limited acquiring General Chemical Industrial Products Inc for approximately US$1.1 billion.
- Suzlon Energy Limited acquiring a 30% stake in Repower Systems AG for US$546 million.
- RFCL Limited, a subsidiary of ICICI Ventures, acquiring Mallinckrodt Baker for US$340 million.
- Siva Ventures Limited acquiring JB Ugland Shipping A/S for US$300 million.
- Jubilant Organosys Limited acquiring Draxis Health Inc for US$255 million.

As both the equity and debt financing options dried up, outbound acquisitions were adversely hit, despite much lower valuations in the Western markets. Volatility in the foreign exchange rate, the depreciating rupee, rising inflation and its impact on domestic demand and exports has created an environment of conservatism, with Indian corporates following a 'wait and watch' approach at the moment. While companies are open to opportunistic purchases, the outlook for outbound M&A will depend on the impact that the financial crisis has on the rest of the economy.

Domestic deal activity remained more or less stagnant in 2008 compared to previous years. 2008 saw the value of domestic deals at US$13.9 billion, spread over 706 deals compared to US$14.5 billion spread over 721 deals in 2007. Key domestic deals during 2008 included:

- Tata Consultancy Services' acquisition of Citigroup Global Services Ltd, for an estimated consideration of US$505 million.
- WNS (Holdings) Ltd's acquisition of Aviva Global Services Pvt Ltd, for a consideration of approximately US$228 million.
- IDFC's acquisition of Standard Chartered Mutual Fund, a financial services provider, for a consideration of US$205 million.
- State Bank of India's acquisition of a 91% interest in Global Trade Finance Pvt. Ltd., for a consideration of around US$132 million.

Inbound transactions also fell. The total value of overall inbound deals announced during 2008 was US$20.5 billion; a fall of over 35% versus 2007. Similarly, total inbound deals in volume terms declined by 14% from 2007 to 2008. Some key strategic inbound deals announced during 2008 were:

- Daiichi Sankyo's acquisition of a 63.2% stake in Ranbaxy Laboratories, for a consideration of approximately US$5.1 billion.
- NTT DoCoMo Inc.'s acquisition of a 26% stake in Tata Teleservices for a consideration of approximately US$2.6 billion.
- Telenor ASA's proposal to acquire a 60% stake in Unitech Ltd's telecoms arm for around US$1.2 billion.
- CRH Plc's acquisition of a 50% stake in My Home Industries Ltd, for a consideration of US$452 million.
- Lafarge SA announced the acquisition of the ready mix concrete business of Larsen and Toubro (L&T) for approximately US$350 million.

Outlook

There is definite slowdown in economic activity which is expected to continue into the first half of 2009. The Reserve Bank of India ("RBI") has forecast GDP growth for the current fiscal year ending March at 7.5% to 8.0%; some analysts place this lower. The government has been working on the twin tasks of controlling inflation (in which it has met with fair amount of success) and also ensuring a step up in demand, to boost growth in the economy. As a result, it has recently announced measures to provide growth stimulus to the economy, and has also attempted to ease financing options for Indian corporates. In addition, RBI has eased a number of regulations, which include reducing lending rates, advancing more credit to productive sectors, special treatment for commercial real estate exposure, and encouraging banks to consider applications for the buyback of foreign currency convertible bonds.

While outbound M&A is likely to be challenging in the first half of 2009, private equity investments are expected to pick up from the second quarter, though deal activity may actually be more visible in the second half of 2009. PE investors continue to wait for promoter expectations to moderate. Sectors expected to see particular activity this year include education, healthcare, and infrastructure. Domestic M&A activity is also expected to pick up, as businesses try to consolidate operations, and exit operations which are not adequately profitable. Inbound transactions will possibly comprise a very significant component of the M&A activity for the year, as overseas investors continue to be excited about the large domestic market, and the cost arbitrage opportunities available in a number of sectors, in particular IT and pharmaceutical R&D. This is likely to be aided by "realistic" valuations in the Indian market. ■