



India

Record M&A activity will continue apace across a variety of industry sectors and private equity will play a larger part

Current Environment

The Indian economy grew by 8.4% during the fiscal year ended March 31, 2006 (fiscal 2005), surpassing the 8.1% growth estimated by the Central Statistical Organisation in its advance estimates. A normal monsoon led to a significant recovery in the agriculture sector which grew by 3.9% in fiscal 2005 versus 0.7% in the year before. A significant portion of the GDP growth was contributed by the robust performances from the industrial and services sector clusters, which grew by 8.7% and 10% respectively.

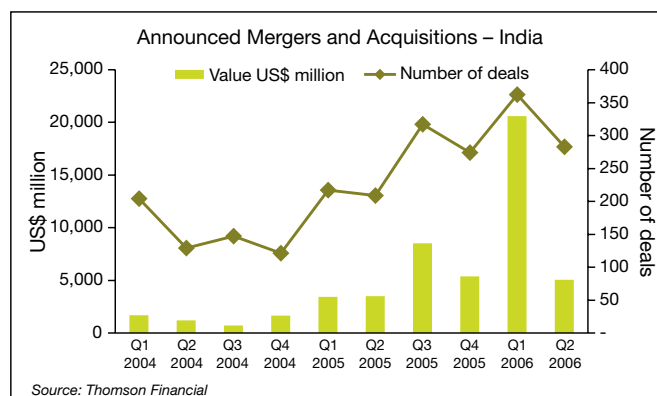
The growth in the industrial sector cluster was driven by the manufacturing sector, which accelerated steadily from 8.1% in fiscal 2004 to 9.0% in fiscal 2005 and the construction sector, which grew by 12.1% in fiscal 2005, showing continuous double digit growth for the last three years. Substantial investment in housing and real estate, especially after the Indian Government permitted 100% FDI in the real estate sector, has led to continued growth in the construction sector. However, the mining and quarrying sector recorded a sharp decline to 0.9% in fiscal 2005 as compared to 5.8% growth in fiscal 2004. The Government has shown concern over the disappointing performance of this sector and plans to introduce reforms and strategies to tackle it. Trade, hotels, transport and communications continued to be key growth drivers for the services sector, exhibiting growth of 11.5% in fiscal 2005 versus 10.6% in fiscal 2004.

Rising inflation of over 5% and the steadily widening current account deficit, primarily on account of increasing oil imports, estimated at US\$17.9 billion for fiscal 2005, are matters of concern for the Indian economy. However, these factors are not expected to have any immediate dampening effect.

A significant political event was the announcement of the fiscal year 2007 budget by the Indian finance minister P. Chitambaram; stability of policies and the fiscal regime being the underlying tone.

This better investment climate has led to an increase in business confidence in India, a fact that is corroborated by the increasing level of foreign direct investment (FDI) in the country. India attracted FDI worth US\$8.3 billion in fiscal 2005, up 50% from US\$5.5 billion recorded in fiscal 2004. FDI in equity alone stood at US\$5.3 billion, the highest ever FDI equity inflow into the country. Principal recipients were the electrical equipment, telecommunications, transportation and services sectors. Mauritius and the US continued to be the major contributors to FDI Inflows in the country accounting for over 50% of the share. India's foreign exchange reserves stood at US\$145.1 billion at the end of March 2006, the sixth largest in the world. Based on these trends, the Commerce and Industry Ministry expects FDI Inflows in the current fiscal year to touch US\$12 billion, with growing interest among companies from Japan, South Korea and Taiwan.

Deal Activity



In the first half of 2006 India witnessed a record number of M&A deals - collectively worth US\$25.6 billion. Both inbound and outbound cross-border mergers were on the upswing. Key drivers fuelling M&A activity during this period were entry into new markets, establishment of leadership positions by existing players, extension of domain knowledge by acquisition of know-how, a much awaited focus on infrastructure, and the potential to enter in the fast liberalising Indian market. To an extent the ease in regulations also helped, although this was towards the end of June 2006. Major deals during the period included:

- Aditya Birla Group taking complete control of Idea Cellular, India's fifth largest cellular company, by acquiring a 48.1% stake in Tata Group for a consideration of about US\$979 million
- Hutchison Whampoa's acquisition of a 5% stake in Hutchison Essar, for a consideration of approximately US\$580 million
- Electronic Data Systems Corporation's acquisition of a 52% stake in IT services and BPO firm, Mphasis BFL in a US\$380 million cash deal
- US oil major Chevron's acquisition of a 5% stake in Reliance Petroleum for US\$300 million

This period will also be remembered for the successful completion of Mittal Steel's five-month battle to take control of the world's No. 2 steelmaker Arcelor and the unsuccessful Jet Airways merger with Air Sahara, announced earlier this year at a valuation of US\$500 million. Various reasons have been cited for this failure, including disagreement over deal valuation, delays in obtaining regulatory approvals and failure to comply with conditions precedent. Should this deal have been consummated, it would have been a first in India's fast growing aviation segment, which is expected to see further M&A action in the future.



As expected, a significant trend in M&A in the last six months has been the sharp increase in the number of outbound deals. In the month of June 2006 alone, ten cross-border, large-scale deals with a combined transaction value of US\$1.5 billion, (a monthly record for India so far) were finalised. Around 76 cross-border deals worth US\$5.2 billion were finalised in the full six month period. The largest proportion of outbound acquisition targets by volume continued to be in Europe, which accounted for over half the deals, while South America took the lead in value terms, primarily on account of some weighty oil and gas deals in the region. High growth sectors such as pharmaceuticals, IT and automotive ancillaries are poised at an inflection point and growing competitive pressure has been a driving force behind the overseas acquisition in these sectors. The pharmaceuticals sector, in particular, has witnessed an unprecedented rise in cross-border deals, primarily in the generics space with the European Union being a preferred market.

Four years of sustained growth have boosted the profitability and strengthened the finances of Indian companies, as is evidenced by the fact that it is not just the blue chip companies, but a number of mid-cap companies that too have been very active and aggressive in the overseas markets. Some of the other notable outbound deals included the following:

- ONGC Videsh's 15% acquisition of Petrobras' BC-10 block in offshore Brazil valued at US\$1.4 billion
- Dr Reddy's Laboratories' acquisition of the fourth-largest German generic drug maker Betapharm Arzneimittel for US\$572 million, from private equity house 3i
- Suzlon Energy's acquisition of Belgium's Hansen Transmissions International for US\$372 million
- Ranbaxy Laboratories' acquisition of a 96.7% stake in Romania's generic pharmaceutical company Terapia, from Advent International for US\$324 million
- Ballarpur Industries, along with JP Morgan, acquired a 97.8% stake in Sabah Forest Industries, Malaysia for a consideration of US\$261 million. The acquisition is the largest ever by an Indian company abroad in the paper & pulp industry

Private equity investments have also been rising steadily with IT and IT Enabled Services continuing to be the most favoured industry sectors, followed by manufacturing. However, other sectors such as real estate, travel & tourism, hospitality and financial services have seen a noticeable quantum of private equity investments.

Some of the notable private equity deals during the first 6 months of 2006 include:

- In the largest leveraged buyout and technology investment in India to date, an affiliate of Kohlberg Kravis Roberts of the US acquired an 85% stake in Flextronics Software Systems (software development unit of Flextronics International headquartered in Singapore), for US\$900 million
- Silver Peak Investments (a subsidiary of JP Morgan Chase) and India Development Fund (IDFC Private Equity) invested US\$122 million in a 21.6% stake in L&T - Infrastructure Development Projects
- General Atlantic invested US\$68 million in a 15% stake in IT&BPO services company Hexaware Technologies

Various private equity and venture capital players continue to raise India specific funds. Goldman Sachs is reportedly launching a US\$1 billion India-dedicated proprietary fund. Also, BTS Investment Advisors, a joint venture between the Switzerland-based BTS group and the State Secretariat for Economic Affairs of the Swiss Federal Government, is raising a US\$80 million private equity fund targeted at investing in small and medium enterprises in India.

Outlook

M&A activity is expected to remain on an uptrend with cross border deals continuing to maintain their momentum. Consistently strong economic growth, combined with continuation of the reform process and improvements in infrastructure by the Indian Government, will provide a boost to FDI and deal activity. According to the Ministry of Commerce and Industry, India has investment opportunities of around US\$500 billion over the next five years. Significant deal activity is expected in auto ancillaries, domestic retail, real estate, hospitality, real estate, oil & gas and the financial services segments.

Private equity and venture capital investments in India are expected to continue to rise. There has been a feeling that the overheated stock markets have had an adverse impact on the quantum of private equity investments in the country. However, now that the markets appear to have cooled off a little, we expect to see increased activity from these investors in the coming six to twelve months.