

## M&A Hotline

January 25, 2019

### THE WAY FORWARD – INDIAN M&A AND PE PROJECTIONS FOR 2019

2018 was a blockbuster year for deal-making in India, with M&A value exceeding an unprecedented USD 100 billion mark. The year also witnessed a wide range of M&A transactions, including pure play PE/ VC deals, sophisticated platform investments, large consolidations, buy-out transactions etc. Considering the uncertain political and economic climate of 2019 (both domestic and global), we identify some of the key trends/drivers for M&A activity in 2019:

#### A. CAPITAL ACCESS CONSTRAINTS – FINANCIAL SERVICES

Historically, the financial services sector has been one of the most active in the Indian deal landscape. However, given the recent liquidity crisis spurred by asset-liability mismatches, NBFCs/ HFCs across the board are finding it difficult to find bank leverage for further business expansion. As a result, valuations are predicted to be moderated, thereby attracting equity investments into the financial services space. We also foresee significantly high level of securitization transactions, as loan houses are desperately looking for measures to manage short term liquidity requirements.

#### B. DIVESTMENT OF NON-CORE ASSETS AND BRAND ACQUISITIONS

With stretched balance sheets and the increasing bad-loan crisis, corporates are actively looking for divestment of non-core assets either to pare debt or to fund further growth (or both). To begin with, public sector banks (eg: Punjab National Bank, Canara Bank etc.) have indicated their intent to dispose-off non-core assets running into millions of dollars in order to tackle the NPA problem. In addition, several corporates (eg: DLF, Tata Power etc.) are already exploring options to sell non-core assets in order to refocus on their principal business verticals. We expect considerable financial/ strategic interest in acquisition of these assets. We also anticipate 'brand acquisitions' to be one of the key factors influencing M&A pursuant to divestments, similar to the Unilever-GSK transaction.

#### C. DISTRESSED SALE OPPORTUNITIES

The Insolvency and Bankruptcy Code 2016 (IBC) has certainly introduced newer and attractive dimensions to the Indian distressed M&A space. With banks being compelled to initiate the IBC process within 180 days of default, several assets are expected to be on the block for insolvency resolution/ turnaround. Despite the legal/ regulatory challenges of the insolvency process under IBC, foreign and domestic players are extremely optimistic about the turnaround potential of several distressed companies. While strategic investors seem to have the edge currently, private equity funds are also actively exploring various structures to fund distressed M&A (eg: platform deals, ARC and AIF set up etc.). In addition to investments, we expect fund/ consortium formation and securitization transactions to dominate activity in the distressed M&A sphere.

#### D. CONSOLIDATION

Consolidation has been the main contributor for deal volume in 2018, mostly led by transactions in the TMT and financial services space. Walmart's acquisition of Flipkart, Indus' merger with Bharti Infratel, Reliance's acquisition of Hathway and Den, and Capital First's merger with IDFC bank are some of the marquee examples for consolidation transactions. The underlying factors which have resulted in consolidations – viz. access to technology/ distribution channels, bridging resource/ market share gaps, increased operational efficiency, and competition driven activity – will continue to drive M&A in 2019. Key sectors to focus on will be financial services, technology and healthcare services. Further, given the NPA-crisis, the likelihood of consolidation across public sector/ private sector banks is expected to be considerably high in 2019.

#### E. INDIA'S GLOBAL APPEAL AND SOVEREIGN INTEREST

While private equity investors have consistently viewed India favourably over the last few years, 2018 also marked the entry of large strategic players into India. Walmart, Schneider, Amazon etc. are banking heavily on the India story, which is a great vote of confidence. In addition, several sovereign wealth funds (originating from Singapore, Middle East, Canada) have been part of some of the largest investment transactions of 2018 (eg: GIC's investment into HDFC, CPPIB's investment into Byju's etc.). With sovereign funds like ADIA, CPPIB, Temasek etc. explicitly mentioning allocations worth billions of dollars towards India investments, PE investments anchored by sovereigns can certainly be expected to rise.

#### F. CONTROL AND PLATFORM DEALS

Historically, PE players entering India preferred to don the role of financial investors, and acquire minority/ significant minority stakes coupled with standard protection rights. However, over the last 4 – 5 years, buy-out deals have certainly gained more traction, with 2018 witnessing a record value of 'control transactions' (> USD 5 billion). There is a clear indication that seasoned PE players now understand how businesses operate in India, and are willing to 'run the show' by leveraging their portfolio management experience and by assembling management teams which are in sync with the overall ideology of the investors. Buy-out deals (and consequently, formation of buy-out funds) will continue to rise in 2019, as PE players increasingly perceive complete operational and management control as an ideal mode for value realization. We could also expect growth in platform deals, as global sponsors are looking to

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partner with GPs who have a clear India play (backed by appropriate experience) instead of investing directly.

#### G. SECTOR FOCUS – FINANCIAL SERVICES AND TMT

While M&A across sectors are expected to remain active, financial services (FS), TMT and real estate will continue to see high levels of activity. Specifically speaking, in the FS domain, NBFCs, HFCs, private banks and insurance companies will likely garner maximum interest. On the TMT front, consumer internet and e-commerce companies will continue to remain relevant and attractive. In addition to primary investments, we anticipate a stark growth in PE secondary exits in these sectors because of rationalized valuations and rigors around capital access. Healthcare services may also see increased investments (and consolidation), given the lack of affordable quality healthcare across the country and the difficulties faced by smaller players to function in the current market.

#### H. US-CHINA TRADE WAR

The on-going trade war between US and China may not be entirely unfavourable from an Indian perspective. The Indian government is exploring various avenues to boost manufacturing in India, with a view to increase exports to the US and taper down the current account deficit. Certain sectors which involve manufacturing of products such as automotive parts, chemicals etc. are projected to attract large investments. In addition, while China has traditionally attracted maximum capital from the US for acquisitions, in 2019, India can be expected to see a greater share of acquisitions originating from the US.

#### I. GENERAL ELECTIONS 2019

The general perception seems to be one of excessive caution in the run up to the general elections, particularly because of the recently concluded state elections. However, we do not expect M&A to drastically slow down during this phase. The growth story of India remains intact, on the back of robust economic conditions (both macro and micro) and the investment themes mentioned above. Whilst some restraint can be observed in the first half of 2019, transactions will continue to be assessed aggressively with execution possibly being pushed to the latter half of the year.

– Shreyas Bhushan & Nishchal Joshipura

You can direct your queries or comments to the authors

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