PDB

Deal or No Deal?

Cash flow trend suggests M&A season is around the corner, but not all deal-makers agree

:: Suman Layak & Baiju Kalesh

If money could talk, it would have whooped last year.

Consider this: in 2017, India saw more than 1,000 mergers and acquisitions (M&As), the highest in the current decade. The deal-making happened on the back of a record year in terms of raising equity. A total of ₹1,81,605 crore was raised in 2017.

"Investments by local MFs have started directing the flow of the market, replacing foreign institutional investors"

Ashok Wadhwa, Group CEO, Ambit

Private equity players, too, had their best year in India in 2017. An EY report says private equity players invested a record $25 billion in India in 2017 and also had a record number of exits.

The year 2018 has started on a positive note, with a flurry of initial public offerings (IPOs) in March and M&As surpassing the corresponding 2017 January-February numbers. The really big deals, though, have not yet happened. The number of billion-dollar deals, at eight, had declined in 2017, against 12 in 2016.

But appetite for domestic assets is strong. While the number of cross-border deals fell to 340 in 2017 from 368 in 2016, the number of domestic deals increased to 682 in 2017, from 528 in 2016. By deal count, the domestic number is double that of the cross-border one. By sheer value, domestic deals make up more than 75% of the total.

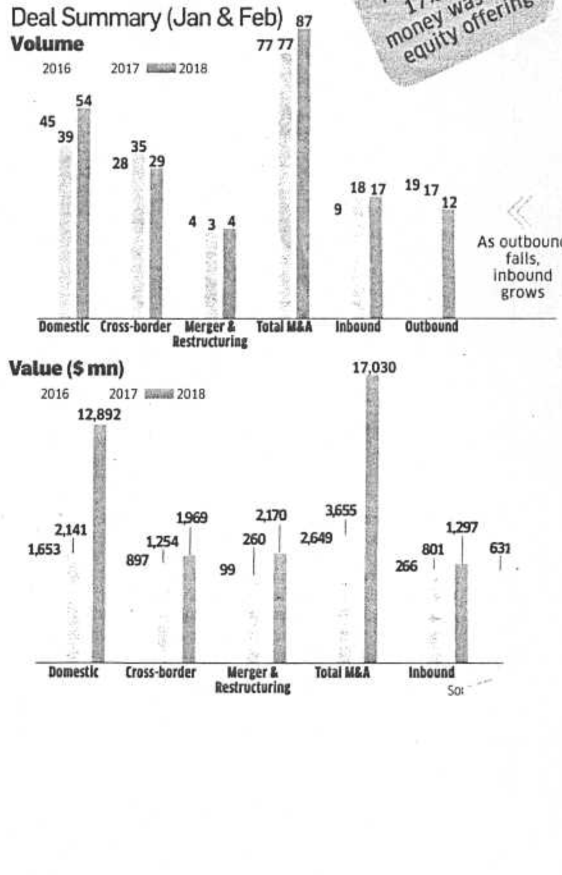
A period of high capital-raising can be a double-edged sword for M&As. It can point to a deal-making spree or to a listless period for big-bang M&As

A period of high capital-raising can be a double-edged sword for mergers and acquisitions. It can indicate that a season of M&As is around the corner, like in 2006-07, or it can point to a listless period for deal-making. After all, only 20% of the IPOs that happened in the last year raised fresh equity; the rest were promoters or private equity funds offering their shares for sale.

So what does this capital-raising trend suggest? *ET Magazine* spoke to at least 10 senior deal-makers in Mumbai and no one was confident of experiencing the exhilarating M&A days of the last decade

Homeward Bound

Deal Street action in 2018 is all about winning domestic deals

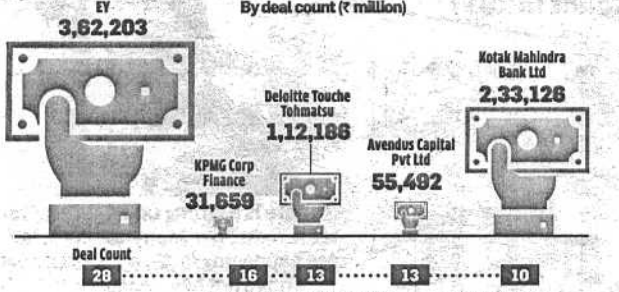


Top 5 Advisers*

By deal value (₹ million)

* April 1, 2017-March 21, 2018 Source: Bloomberg

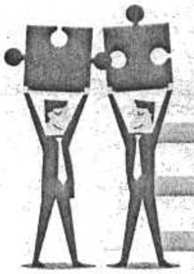
Top 5 Advisers*



* April 1, 2017-March 21, 2018 Source: Bloomberg

Restructuring Activities of India Inc

Source: EY analysis of Thomson ONE data



India M&A Fee Rankings

Rank	Bank Name	Fees ($ mn)
1	JM Financial Group	23
2	Standard Chartered PLC	22
3	Axis Bank Ltd	14
4	Ernst & Young LLP	14
5	ICICI Bank Ltd	14

Source: Thomson Reuters M&A Review for 2017

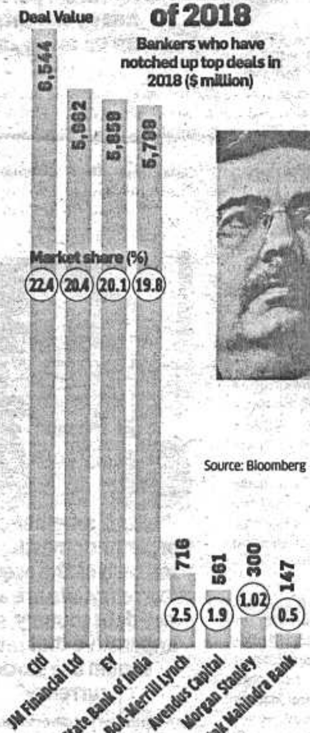
– which saw the Tatas buying Corus and Jaguar Land Rover, and Hindalco buying Novelis. Yet, says veteran deal-maker-turned-banker Uday Kotak, this phase might redefine Indian business as we know it. "The fundamental basis of doing business in India will change. This round of M&A activity will be around consolidation of business and upgrading to a formalised economy," says the executive vice-chairman and managing director of Kotak Mahindra Bank.

A Brave New World

KPMG, too, seems to be thinking on these lines. The audit and consulting firm has been trying hard to break into the big league of deal-makers. In February 2018, it hired Srinivas Balasubramaniam, 43, to head its India M&A business. Balasubramaniam was with Arpwood Capital and had recently advised on marquee multi-billion-dollar deals, such as HDFC Standard Life-Max Life and Ajay Piramal's purchase of a larger pie of Shriram. The HDFC Standard Life-Max Life deal was called off, but Balasubramaniam's work was noticed. He had also had stints at Goldman Sachs and UBS.

KPMG's M&A play in India has been largely limited to a series of small-ticket deals. Its Big Four brethren EY is one of the M&A leaders in India, often leading the league tables by the sheer number of deals. Between April 1, 2017, and March 21, 2018, for example, KPMG had advised on 16 deals against EY's 28. KPMG's deals by value added up to a little more than ₹3,000 crore, while EY's was more than ₹36,000 crore in 2017.

Fast Movers of 2018



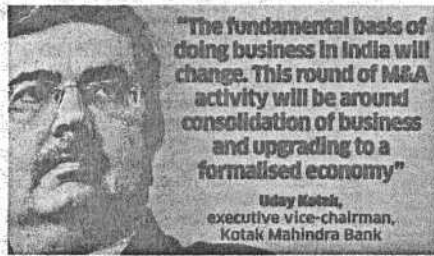
Source: Bloomberg

EY, too, is anticipating a surge in mergers and acquisitions. Ajay Arora, partner and head of M&A transaction advisory at EY, says: "There is a strong undercurrent for M&A right now. Many conversations are happening, even if the deal news has not been announced."

Every phase of strong capital-raising is followed by a period of M&As and that phase is just starting in India, says Ajay Garg, managing director of Equirus Capital.

Ganeshan Murugaiyan, managing director and head of investment banking for India at BNP Paribas, says: "The M&A situation is very active and there are several deals under discussion in the strategic and private equity domains."

Atul Mehra, who heads investment banking at JM Financial, identifies five drivers for M&As. "The factors driving the growth of M&A activities in India are debt reduction,



sectoral consolidation, fatigue and challenges of succession planning in family-run businesses, and harvesting by private equity funds. Sale of stressed assets under the Indian Bankruptcy Code is a new chapter in the Indian context."

Most M&As are expected to be led by the bankruptcy proceedings at the National

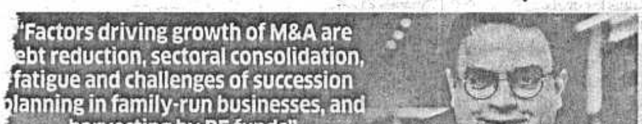
Now, a narrative seems to be developing around how Indian investment banking firms are doing better, especially with the domestic M&A scene looking up

Company Law Tribunal (NCLT). The Reserve Bank of India had kicked off the process by asking banks to take the cases of 12 wilful defaulters to the NCLT courts. Corporate heavyweights such as Essar Steel and Bhushan Steel and Power are part of the list. The initial list was followed by a second list. The courts now have more than 400 bankruptcy proceedings. As Kotak pointed out earlier this week, the process at the NCLT courts would now be tested as a bad debt resolution process, but the hope was it would turn out to be better than the Corporate Debt Restructuring and the Strategic Debt Restructuring mechanisms tried out earlier.

Equity: Enabler or Dampener?

It may be tricky to guess how the effect of capital raising would play out for M&As, say many investment bankers. First, not all the raised cash is available for companies to buy assets. As Sourav Mallik, joint managing director of Kotak Investment Banking, points out, the bulk of the equity raised in the last one and a half years was via offers for sale of equity by promoters. Only a small share was raised by the companies. Out of that, some money was kept aside to retire debt.

Second, as E&Y's Arora points out, IPOs can also act as a dampener. "IPOs can provide an exit route for PE investments. Also, a buoyant IPO market as of today is able to provide better valuation for a promoter,

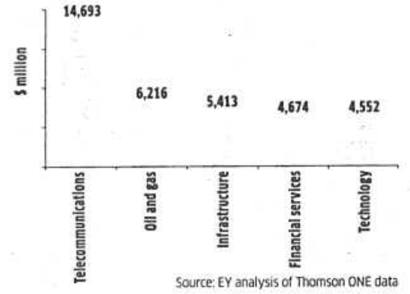


Geographical Distribution

	2016		2017	
	No. of deals	Value ($ mn)	No. of deals	Value ($ mn)
Domestic	528	22,658	682	37,939
Inbound	204	20,901	203	6,517
Outbound	163	9,640	137	2,356
Total	895	53,199	1,022	46,812

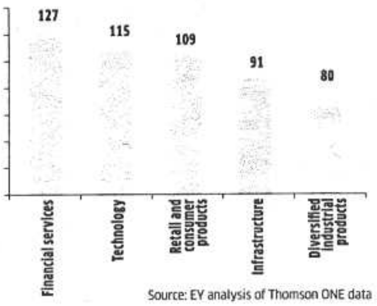
Source: EY analysis of Thomson ONE data

Five Most Active Sectors by Deal Value in 2017



Source: EY analysis of Thomson ONE data

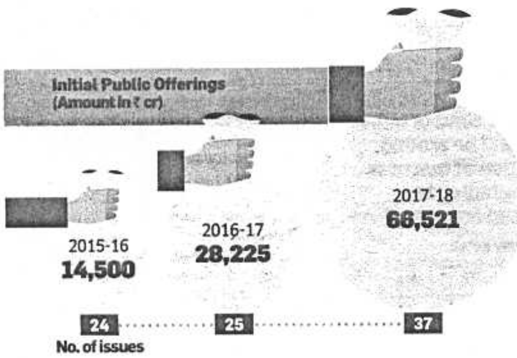
Five Most Active Sectors by Deal Count in 2017



Source: EY analysis of Thomson ONE data

"There is a strong undercurrent for M&A right now. Many conversations are happening, even if the deal news have not been announced"

Ajay Arora, partner & head-M&A, EY



Fresh Equity vs Offer for Sale

Year	No of IPOs	Fresh equity (₹ cr)	Offer for sale (₹ cr)	Total (₹ cr)
2015-2016	24	6,805	7,695	14,500
2016-2017	25	10,188	18,038	28,225
2017-2018 (Till February 2018)	37	11,006	55,515	66,521

Source: Prime Database

"It is not correct to relate this phase with what happened 10 years ago. I see capital-raising as a normal activity to cater to the needs of sectors"

Kaustubh Kulkarni, head of investment banking, JP Morgan

than being something of interest for a strategic investor." For example, strategic investors recently valued a consumer company at 20-25 times of earnings before interest, taxes, depreciation and amortisation (EBITDA). Merchant bankers pushing the IPO option, however, pegged the valuation at 30-35 times EBITDA, effectively closing the strategic investment option.

Most M&As are expected to be led by the bankruptcy proceedings at the National Company Law Tribunal, especially as several corporate heavyweights are up for grabs

Kaustubh Kulkarni, head of investment banking at JP Morgan, does not agree with the argument that equity-raising can boost M&As.

"First, it is not correct to relate this phase to what happened 10 years ago. India was a $1 trillion economy then and is a $2.2 trillion economy now, and I see capital-raising as a normal activity to cater to the needs of sectors." Kulkarni also points out that much-needed reforms are pending in important sectors such as natural resources, roads and electricity, and so one should not expect a spurt in M&A in these areas.

Murugaiyan of BNP Paribas says the recent capital-raising spree was primarily either to correct balance sheets (repay loans) or to provide an exit to shareholders. However, he sees other drivers of growth. "The key drivers of M&As are strong growth momentum returning in some of the developed markets, especially the US and Europe; growth and margin pressures in Indian markets leading to capital allocation outside India, and consolidation in the domestic market, driven by distressed assets," says Murugaiyan.

Game is Changing

The investment banking universe in India is a storied affair, with foreign banks such as JP Morgan Chase, Citi and Morgan Stanley having access to global funds and eyeing only the very large deals. Players such as JM Financial and EY aims for deals across the spectrum. There are, of course, smaller players, working with smaller deals. The M&A league table, by deal value, is dominated by foreign names. Morgan Stanley is the top dog. In deal numbers, EY leads – for calendar year 2017. JM Financial tops the list of investment bankers based on fee income ($23 million in fees). In fact, three Indian players – JM, Axis and ICICI – are part of the top five.

"M&As, whether cross-border or domestic, always used cash as the acquisition currency. We are a high net-debt country, so it is imperative that mergers should use stock as currency"

Srinivas Balasubramaniam, senior partner & head of corporate finance, KPMG

Now, a narrative seems to be developing around how Indian investment banking firms are doing better, especially with the dominating domestic M&A flavour. Mehra of JM says Indian investment banking firms understand bankruptcy issues here much better and are best poised to benefit.

Three broad changes have led to the evolution of investment banking in India, says Ashok Wadhwa, founder of Ambit Capital: the emergence of local banks, equity capital market becoming a dominant source of funds for companies and resolution of stressed assets under the IBC. And, Wadhwa feels, the first and second are linked. "Investments by local mutual funds have started directing the flow of the market, replacing foreign institutional investors, as there is a shift in investment from gold and real estate to financial intermediaries," Wadhwa says.

With desi money becoming more prominent, desi banks have started aiming higher. "It took a longer time for local banks to become stronger after India opened the gates to global banks, unlike in other countries," says S Subramanian, managing director-M&A, Axis Capital.

Relationships with global banks are not unique anymore, adds Wadhwa of Ambit, which itself is one-fourth owned by a sovereign fund from West Asia. "For financial sponsors, there is no distinction between global and local firms. Access is no longer unique."

There is another way the game is changing. KPMG's Balasubramaniam says M&As in India have traditionally had a heavy cash element. That is set to change. "M&As, whether cross-border or domestic, always used cash as the acquisition currency. We are a high net-debt country, so it is imperative that mergers should use stock currency. It's the only way shareholders, promoters and strategic investors will be on a par and the underlying company will benefit."

The process of a merger can be protracted, as compared to a cash acquisition, he says. "But advisors need to realise that while cash, in an Indian context is critical, shares as currency will increasingly find acceptance." ■