Cross-Border Acquisitions Are Powering Growth India Goes Global

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Introduction

The "India story" has seen a profound shift in gear and direction during 2006. While in recent years most media references to India's growth have focused on the sub-continent as a destination for outsourcing and investment, this year has seen the arrival of India as a shaping force evident in the powerful new trend towards overseas acquisitions by Indian companies. Indian cross-border mergers and acquisitions (M&A) is the search for top-line revenue growth through new capabilities and assets, product diversification and market entry. This trend is not driven purely by opportunistic factors: Indian companies are in many cases motivated to look abroad in response to newly competitive, complex or risky domestic markets or to find capabilities and assets that are lacking in India. The steep increase in the number of major cross-border transactions in recent years - from 40 in 2002 to more than 170 in 2006 - has been facilitated by the relaxation of regulations on overseas capital movements as well as a more supportive political and economic environment, including deeper currency reserves, and easier access to debt financing, both at home and from international banks. This M&A trend is a key factor helping Indian companies to emerge on the global stage. Six Indian companies feature in the Fortune Global 500 list of the biggest companies in the world. These are Indian Oil, Reliance Industries, Bharat Petroleum, Hindustan Petroleum, Oil & Natural Gas, and the State Bank of India. Based on current growth and M&A trends, we would expect this number to double by 2010. The strategy by which many Indian companies are expanding globally is also distinctive. As Indian companies are relatively small by the standards of global multinationals, their cross-border acquisitions also tend to be smaller. These deals are therefore often carried out as part of a broader globalisation drive involving a string of strategically targeted acquisitions. This is particularly the case for India's larger corporate groups, for example Tatas that look to strengthen specific parts of their value chain and develop globally integrated offerings. The locations of the acquisitions also reflect the strategies of India's globalisers. Attracted by the markets and higher-value offerings of developed economies, Indian companies are making the vast majority of their transactions in North America, Europe and the more developed economies in Asia, with transactions equally distributed between these locations.

Mergers and Acquisitions

A new class of business leaders fuels India's current success in overseas acquisitions. The confidence within the Indian business community, combined with its natural entrepreneurial zeal and intuitive ease with global business models, creates a formidable force. India's economic liberalisation in 1991sparked fears that the country would be overrun by foreign multinationals. However, Indian companies have not only managed to fight off competitors on their home ground, they also have taken the commercial battle abroad. Moreover, India's cross-border M&A activity is anticipated to accelerate dramatically in the immediate future. A recent Grant Thornton study found that 94 percent of Indian companies that expect to do a deal in the next three years expect it to involve foreign acquisitions. As Indian companies mature, overseas acquisitions offer the most tangible evidence yet of their new found readiness to compete on the global stage.

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Entry to overseas markets via M&A may be attractive for reasons that include increased proximity
to customers, access to resources, competition at home, or domestic regulatory barriers. From 1995 to August 2006, 29 percent of Indian cross-border M&As occurred in the European Union and 20 percent in North America. These developed economies are attractive because of their large consumer markets, transparent business processes, and rule of law, advanced technologies, skills and knowledge capital. Moreover, as the markets in these economies tend to be mature and saturated, it often proves difficult for Indian companies to gain market share without acquisitions. In line with this trend, the more developed economies of Singapore, Hong Kong and South Korea together account for 40 percent of the cross-border acquisitions conducted by India within Asia in the first half of 2006. Targeting established firms, particularly in developed economies, is an effective way to gain market share as well as provide a platform for regional growth. Further, it is usually easier to access other resources and benefits once a company is established in a foreign market. Once companies have a foothold in a market, they can explore further acquisition opportunities to consolidate their local presence, reach new customers, and acquire new sources of supply and further assets and capabilities. Less developed economies also have their attractions, such as low acquisition costs and favourable terms due to a high demand for foreign direct investment (FDI) and capital. The recent global spending spree by Tata – which has concluded deals in the United States (Eight O'clock), the United Kingdom (Tetley) and Thailand (Millennium Steel) - illustrates some of the strategic thinking behind location decisions: the group's industrial and manufacturing businesses have clearly found it more attractive to target acquisitions in developing markets, while the services companies in the group tend to seek opportunities in developed markets. Emerging markets also may be attractive to Indian companies because they provide access to consumer markets, which are often overlooked by Western firms. In contrast to India, China has invested heavily in emerging economies in Africa, Central Asia and Latin America, largely to secure the natural resources essential for its own economic growth. The urgency for India to step up its efforts to do the same is quickly becoming apparent. But competing with China on this global hunt for resources will prove a major challenge for India, which cannot begin to match its neighbour's state-leveraged financial power. After years of anticipation, Indian companies have finally arrived, and seem set to leave a lasting impression on global markets and competition in the decade ahead.

With India Inc making more and more acquisitions overseas, investment abroad by Indian companies will perhaps surpass foreign direct investment (FDI) inflows in the country. The bulk of the outward FDI flow, estimated at $15 billion, will be driven mainly by India's booming manufacturing sector, said the 'Study on FDI Outflow & Role of Manufacturing in the Mergers & Acquisitions Front, 2007', by the Associated Chambers of Commerce and Industry (Assocham). Indian companies' preferred investment destinations are the European countries and the US as also Africa, taking advantage of its cost competitiveness. Sectors such as pharma and automobiles will give a major thrust to the FDI outflow, though IT will continue to dominate the scene, said the report released Friday. The main factors fuelling the growing hunger for mergers and acquisitions (M&A) among Indian companies are huge fund supply, globally competitive business practices and favourable regulatory environment, besides higher margins, revenue, volumes and growth prospects. The number of outbound M&A deals has increased sharply over the past six years from about 37 in 2001 to more than 170 in 2006. The transactions gathered tremendous momentum in 2005. The total number of deals actually doubled in 2005 from 2004 to reach a figure of close to 150 from 70 in previous year. According to Assocham, the Indian conglomerates that are upbeat on inorganic growth are the Tata group, Bharat Forge, Ranbaxy, ONGC, Infosys and Wipro. The sectors attracting investments by Corporate India include a whole gamut of sectors - metal, pharmaceuticals, industrial goods, automotive components, beverages, cosmetics and energy in manufacturing; and mobile communications, software and

financial services in services. Nicholas Piramal India Ltd plans to invest $50 million over a three-year period in its plants in the UK and India. In the energy sector, India's Suzlon Energy Limited, the world's fifth largest wind turbine manufacturer, has offered $1.3 billion for Germany's RE Power.

Leading financial consultancy Thomson Financial has said that 2006 was a mega-merger year for India: 1,164 deals valued at a total of $35.6 billion as against 1,011 deals worth $21.6 billion in 2005.
After the Tata-Corus and Vodafone-Hutch mega-deals, conservative estimates by Indian analysts have pegged mergers and acquisitions (M&As), including outbound and inbound deals involving Indian firms, to reach $100 billion in 2007. Another recent study by the Institute of International Finance, a Washington-based global association of financial institutions, has predicted that the desire of India Inc to operate in foreign lands will lead to a threefold rise in direct investment flows out of the nation in 2007.
The figure might appear meager weighed against the frequent investment announcements of hundreds of millions of dollars abroad by Indian majors, because of big foreign financing components or debts. In 2006-07, India has already seen mergers worth more than $40 billion that include Tata Steel's acquisition of Anglo-Dutch steel maker Corus ($12.2 billion), Hindalco's buyout of Novelis ($6 billion), and Suzlon's bid for Germany's REpower ($1.3 billion, a figure likely to go up because of a higher rival bid), besides Vodafone's acquisition of a majority in Hutchison Essar Ltd ($18.8 billion). Others could include Reliance Industries' interest in the plastic division of General Electric, a deal that could top $5 billion. Comparable figures are being quoted for Ranbaxy and a private-equity firm's interest in German pharmaceuticals major Merck.
The main factors driving the M&As among Indian companies are surplus funds, globally competitive business practices and a favorable regulatory environment, besides higher margins, revenue, volumes and growth prospects, says the Assocham report.

The latest Forrester research report says that even the top-tier Indian firms will have to rely on acquisitions to compete with global giants like IBM, EDS or CSC. The report further predicts that global outsourcing industry could face sweeping consolidation in the next two years, mainly driven by low-cost global competition and broken business models, a latest Forrester research report says.
The report - "Are Barbarians at the gates of outsourcing?" - delves into the potential buyouts of global outsourcers by private-equity firms as well as the trend among the outsourcing industry's long-standing leaders' scramble to buy or be bought.
It indicates that leading equity buyers believe there is an opportunity to make money fast in the outsourcing space, and that mergers and acquisitions could dominate this space mainly due to double-digit growth in new deals, long-term contracts and popularity of outsourcing. Further, given the recent hostile takeover attempts in this space globally, the report sets expectations of seeing many of the leading outsourcers making aggressive moves to protect their businesses. These strategies will range from acquiring other competitors to acquiring their own stock. Already, there are firms (like EDS, CSC, ACS) that have made moves on these lines, the report says. For the top-tier Indian firms, the report asserts they will likely have to acquire either BPO firms with vertical industry knowledge or - infrastructure outsourcers with experience of managing servers, desktops, or networks if they are going to compete head-to-head with top global firms like IBM, EDS and CSC.

Why M&A?
• Opportunity for growth • Need for faster growth • Access to capital and brand • Gaining complementary strengths • Acquire new customers • Need to enhance skill sets • Expand into new areas • Widen the portfolio of addressable market • Meet end-to-end solution needs

Competitiveness of the Indian Auto Component Industry – A Case Study

The Indian auto component manufactures are moving up the value chain to integrate themselves with the global auto component industry. In recent times, the industry has adopted three-pronged strategy to go global. First, giving thrust to exports. Exports are growing at a compounded annual rate of 20-25%. Second, Indian companies have started acquiring plants abroad. Third, many Indian manufacturers have started collaborating with foreign players. By collaborating with foreign companies, the Indian companies are learning the high-end designing and development skills of the major auto component manufacturers in the world. Reverse engineering is one area where the Indian auto component manufacturers have proved successful. Recently, the Pune-based Commercial Vehicles Systems Research Center of Anand Group added two new products - a self-steer axle and an air suspension for its partner Dana Corporation of US. These products were developed within seven and nine months respectively, against the 22 months it takes to manufacture these products in the US. Ten more products are under development in the research labs of Anand Group for its partner Dana Corporation. Many Indian companies are trying to become Tier I suppliers to the global automakers. Bharat Forge, India's largest auto component exporter is trying to exploit its available resources and expertise to become a Tier I supplier. The company has indigenous design and development capability; it has the world's largest single location plant. Bharat Forge has some inherent strengths like it takes 3-4 weeks to market a product against the global standard of 6-12 months and it has the experience of working with the world's leading clients like Toyota, Ford, Honda and Volvo. Bharat Forge has 50% of the US market for front axle beams for trucks. Recently the company has made some overseas acquisitions to expand its customer base in original equipment market. In the auto component industry original R&D is a highly capital intensive. The global tier I players invest 5-7% of their turnover in R&D whereas; Indian companies spend less than 1% of their turnover on R&D.

Acquisitions by major Indian Players

Indian Company	Company/Plant acquired/Set-up abroad	Located in	Size of the deal ($ mn)
Amtek Auto	Smith Jones Inc.	US	20
Amtek Auto	GWK Group	UK	37
Bharat Forge	Carl Dan Peddinghaus GmBH*	Germany	116#(euro)
Sundaram Fasteners	Dana Spicer Europe* (Forging unit)	UK	2.6
Sundram Fasteners	Sundram Fasteners (Zhejiang)**	China	5
G. G. Automotive Gears	Name not disclosed. US company that manufactures high precision custom gears and planetary gears.	US	110

*Source: Businessworld, 23rd February 2004 * Plant **Plant set-up #Approximate*

According to Suresh Krishna, Chairman and Managing Director, Sundaram Fasteners, there are three basic reasons that prompted Indian component companies to venture abroad. First, having established a reasonable domestic presence, big Indian component makers are now looking for an international presence. Second, having improved their productivity, quality and reliability, Indian companies feel more confident venturing abroad. Third, the Indian government's investment friendly policies and hassle-free environment for overseas acquisitions have encouraged Indian companies to take the acquisition route. With these overseas acquisitions, the Indian companies can tap the original equipment (OE) market abroad. The Indian companies can supply their own products to these customers.

R&D Capability

In recent years the world's leading automakers and Tier I suppliers have opened their R&D centers in different parts of the country. The cost of R&D in India is low compared to any developed country and skilled manpower is available. In the long run the entry of foreign companies would benefit the Indian industry as people working in foreign firms would acquire insights and skills which otherwise would be impossible to acquire. In India there is not a single auto component manufacturer which does original R&D. Only a few companies have recently started design and development (D&D). D&D is the initial stage of R&D and it works as a support function for R&D in auto component industry. Every major auto component manufacture starts with D&D before venturing into full scale R&D. R&D in auto component industry involves developing a component as per the requirement of vehicle maker/OEMs/Tier I supplier. It involves developing the original design of the component, making prototypes and testing and then mass production of the component. R&D in auto component industry requires high technological capabilities and Indian companies are on a learning curve.

Design and Machining Capability (Scale 1 = Low, 10 = High)

	Germany	India	US	Brazil	Mexico	Che. Republic	China
Availability of Skilled Labour	7.5	7.4	7.2	6.4	6.3	5.9	4.8
Availability of Qualified Engineers	8.5	7.5	7.4	6.6	6.6	6.3	4.2

Source: Automotive Component Manufacturers Association of India

India's strength in software can be utilized in R&D in the auto component sector. Already some of the major Indian companies have started working in this direction. Companies like Rico Auto and Sundaram Fastners have set up laboratories that are equipped with the latest CAD/CAM/ CAE software. They are using these software for reverse engineering, designing and testing auto parts.

According to ACMA, India has the huge potential to export embedded software (for automobiles) for the developed markets. According to Vishnu Mathur, Executive Director, ACMA, "The major demand for such products will, however, principally come from the developed markets"[1]. To leverage the strength of India's software skills, ACMA has recently entered on an agreement to network Indian software companies with its members. ACMA is currently in talks with several software companies and is also trying to identify systems/sub-systems in which manufacturing can take place. Embedded software handles many critical control functions such as ABS braking systems, airbags etc. Embedded software is also used for safety, climate control and so on.

Where does India Stand?

Parameters	India	China	Thailand	Taiwan
Quality of Supply	1	4	2	3
Ability to Supply Consistent Quality	3	4	2	1
Price Competitiveness	4	1	3	2

Design and Engineering Capability	1	4	3	2
Customer/ After-Sales Support	3	4	1	2
Maturity of the Auto Components Industry	1	4	3	2
Government Regulations	4	3	1	2
Attractiveness of the Domestic Market	2	1	3	4
Compliance and Transparency	2	4	3	1

Source: Frost & Sullivan

Sona Koya, an Indian auto component maker has set up an engineering designing solution center in Gurgaon and world's leading OEMs outsource their engineering designs from Sona Koya. Sona Koya's strengths lies in 3D digital image of a component, prototype and testing. The Indian companies have also proved their competence in making minor modifications to existing products that either result in new uses for the product or significant cost cutting. For example, Bangalore-based Motor Industries Company (Mico) has indigenously developed a high-pressure single cylinder pump for its parent company, Bosch. The newly developed pump was highly advanced compared to the existing pump. Though Bosch did not handhold Mico by providing drawings, the product was derived from an existing product. Today, Mico has been designated Bosch's global development centre for single-cylinder, multi-cylinder and mechanical rotary pumps.

Product Liability

The Indian auto component companies need to adhere to strict quality control to prevent any defects in the designing and manufacturing of their products. The World's leading OEMs follow strict product liability rules while going for any contract with their suppliers. Under product liability rules any supplier could be penalized by its client if the product fails to meet the set quality standards and results in line stoppages, recalls and claims. In India the domestic insurance companies such as Tata AIG started providing product liability insurance to the Indian auto component makers. This will give the Indian auto component manufacturers the confidence to do more business with foreign automakers. With product liability insurance in place the acquisition and execution of export contracts will be easier for the Indian companies.

The Road Ahead

World's major automakers have announced their intention to develop India as a major sourcing hub for auto components. Indian enjoys enormous cost advantage in manufacturing, R&D, skilled labor and software. However, it can't relay on its low cost advantage for a long time. Countries like China, Thailand and Mexico are also becoming very competitive so far as cost is concerned. Moreover, over the years these countries have built large scale of production and technological competence. The recent success of Indian auto component industry is partly due to the fact that major automakers in the world were compelled to outsource from countries like India and China to cut costs. Sooner or later the global auto industry will come out of recession. Then cost won't be the only deciding factor for the automakers while sourcing components. The majority of the Indian auto component companies operate in the lower end of the value chain (like casting and forging) of the industry. Globally, the product life cycle and the product lead-time is shrinking fast. To succeed, Indian auto component companies should develop capabilities to keep pace with major automakers.

Indian textile firms eye global brands – A Case Study

Having created capacities, home textile players are on the prowl for global brands to enter foreign markets. Ever since the dismantling of quotas in 2005, Indian textile players are obsessed with three words - scale, competitiveness and market share. Companies chalked out massive expansion plans to build size and to become more competitive. And at a time when most weavers and garment manufacturers have been in the news for raising money and expanding capacities, home textile players have been catching attention for a different reason - buying foreign brands. Instead of taking the traditional route of entering into foreign markets by selling their own branded

products, they have adopted a more ambitious strategy of acquiring well-established foreign brands.

Two companies - Welspun and GHCL- recently acquired top global brands. These are the first such acquisitions by the Indian home textiles industry. India's largest terry towel producer and exporter and Asia's fourth largest terry towel player, Welspun India acquired 85 per cent stake in CHT Holdings, the holding company of UK's largest and number one terry towel brand Christy, also the world's oldest towel company. The acquisition, announced earlier this month cost Rs 132 crore (Rs 1.32 billion). GHCL a domestic soda ash major with no major presence in textiles followed suit and announced two acquisitions in the last six months for about Rs 450 crore (Rs 4.5 billion). After buying the third largest US home textiles player, Dan River, in December 2005, the company bought UK's largest home textile retailer, Rosebys last month. Even Alok Industries, which is predominantly a supplier of apparel fabrics, has now chalked out plans to expand its range from bed linens to terry towels and is looking for a marketing tie-up in foreign markets, if not an acquisition. There is already a huge opportunity in terms of outsourcing of home textiles to the world's biggest markets like the US and EU, which account for 60 per cent of the $70 billion global home textile market. India occupies a competitive position when compared with equally low-cost producing countries, particularly Pakistan and China. India's exports to these markets are also growing at a scorching pace - terry towel exports to the US grew at 26 per cent and bed sheets at 35-40 per cent in calendar year 2006. In a nutshell, these acquisitions will help the companies create a foothold in the brand conscious markets such as the US and EU, which are otherwise difficult to get into. So far, Asian companies have gained from a surge in sales to developed markets primarily driven by shutting down of capacities in those markets. However, since these companies are into the commodity business of manufacturing products for leading brands, expanding margins beyond a point would be difficult. But with branding and retailing, companies can hope to improve their margins substantially. Welspun is currently into the mid-range of the terry towel market and supplies to a balanced mix of mass merchandisers, specialty and fashion stores and well established designer brands such as J C Penney, Kohl's, Target, Nautica, Tommy Hilfiger, Polo Ralph Lauren, Umbro, Bed Bath & Beyond and Macy's. The company at present does not have a brand of its own in the global home textiles market though it has license to market the Nautica brand in India and Tommy Hilfiger in the US and Canada. With exports accounting for 90 per cent of the total turnover, Welspun entered the domestic retail business last year through its brand Spaces and Welspun Home Mart under the aegis of Welspun Retail Limited. With the acquisition of the premium brand Christy, 20 per cent of the company's consolidated sales would come from branded products by FY07. Currently, Christy is a Rs 300 crore (Rs 3 billion) profit-making company with 22 standalone stores and has well-established relations with 98 concessions (shop-in-shops), which includes Marks & Spencers, House of Frasers, Debenhams among others. It is the sole supplier of the towels used at Wimbledon Championships. Apart from manufacturing, Christy supplies a wide range of its own label products for leading retailers. Revenues grew by 9 per cent in 2005-06 and are expected to touch approximately Rs 330 crore (Rs 3.3 billion) in 2006-07. It is a win-win situation for both. While Christy has considerable retail experience, it can go deeper into the US and European markets with the help of Welspun, where it does not have a strong presence. Analysts predict that Welspun should be able to grow its top line and bottom line by 30-35 per cent per annum till fiscal 2008. Last fiscal, the first year after the quota regime was abandoned, the company saw its sales grow 37 per cent while net profit grew in single digits at 7.7 per cent.

In case of soda ash producer, GHCL with revenues of Rs 475 crore (Rs 4.75 billion), the textile business comprising of spinning, forms 19 per cent of sales. The company is expanding its spinning capacity by 65 per cent to 1.4 lakh spindles to be operational by January 2007. It is also setting up a new home textiles manufacturing facility at Vapi with 36 mn mtrs per annum of processing capacity and 9 mn mtrs of weaving capacity, at a cost of Rs 230 crore (Rs 2.3 billion). At 90 per cent capacity utilisation, the Vapi unit would be capable of producing at least Rs 400

crore (Rs 4 billion) worth of goods, which equals the entire turnover the company recorded last fiscal. With a turnover of about Rs 1,125 crore (Rs 11.25 billion), Dan River is well known for its own brands in the high-end segments such as 'Bed In a Bag', Marquis Home Collections and also the well-known Alexander Julian, in addition to other high margin juvenile segments. It has the widest sales and distribution network within the US catering to the largest retailers. It is a preferred supplier to large retailers like JC Penny and Linen & Things, Wal-Mart and Bed, Bath & Beyond. The company has, however, filed for Chapter 11 in the US. Rosebys, with a turnover of Rs 930 crore (Rs 9.3 billion), has a strong presence in bedding, curtains and kids garments with over 300 retail outlets across the UK. Along with a strong presence in the world's biggest markets, GHCL will benefit by sourcing from alternate locations like China and Pakistan, where Rosebys and Dan River have sourcing arrangements.

The company is also expected to benefit from the rise in soda ash prices leading to higher realisations aided by higher volumes in CY2007 due to its acquisition of a Romanian soda ash player. The next one is expected to happen very soon in the same region. According to broking firm Kotak Securities, the company's sales are expected to touch Rs 2,380 crore (Rs 23.80 billion) and net profit Rs 120 crore (Rs 1.2 billion) in CY 2006. In CY07, sales are expected to grow by 25 per cent to Rs 2,970 crore (Rs 29.70 billion) and net profit will reach Rs 200 crore (Rs 2 billion). Welspun is an established player and is present in the higher end of the value chain compared to GHCL. Moreover, it is present both in terry towels and bed linen, which are growing at a fast pace. Apparel fabric producer Alok Industries is also planning to go the whole hog in the home textiles space. Its export revenues for FY2006 stood at Rs 389 crore (Rs 3.89 billion) of which 95 per cent came from home textiles. Its present home textiles portfolio covers bed sheets and pillow cases and the company is increasing its product offerings from bed sheets to terry towels.

Conclusion

Until the 1990s, not many Indian companies had contemplated spreading their wings abroad. An Indian corporate or group company acquiring a business in Europe or the U.K. seemed possible only in the realm of fantasy. The reasons why overseas acquisitions are becoming more common are many. The reform era and the march of globalisation have obviously made the environment more conducive. Globalisation forever changed the rules of the game. Indian entrepreneurs had gained confidence to compete with well-established multinationals from abroad in the domestic market place. It was only a matter of time before some of them would shift their focus beyond the Indian shores, not just in selling their products but in setting up manufacturing facilities as well.

A whole range of companies in fields such as pharmaceuticals, automobile ancillaries, IT, banking and steel have ventured abroad. In general, the factors favouring foreign forays in most cases are the availability of affordable human resources, willing to adapt to the global scenario. The contribution of economic reform at home to the outward focus of companies can hardly be overstated. For instance, the rupee's exchange rate is market determined and all current account transactions have been freed from controls.

Indian companies enjoy substantial freedom to invest abroad even though there is no full convertibility of the rupee as yet. Indian businessmen too have, albeit more slowly than those in the West, chosen to invest abroad through acquisitions. The good news is that what started as a trickle in the 1990s, has been growing in size. Today outward fund flows from India almost match those coming in from abroad.

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