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Online extra: India's smaller companies go on a buying spree

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High-ticket foreign purchases by Tata Steel and Hindalco have grabbed the headlines but India's SMEs are also increasingly acquisitive. Cash-rich, or funded by enthusiastic local banks or foreign investors, they are taking advantage of turmoil in the US. Elliot Wilson reports.

SAPAT TEA IS a classic Indian growth story in the making. Privately run and awash with cash after a decade of strong domestic growth, the country's third-largest tea maker and blender is on the hunt for foreign acquisitions. Armed with a war chest of more than \$60 million, Mumbai-based Sapat wants to buy at least two high-end tea brands over the next 12 months – one in the US (its budget: \$20 million) and one in the UK (budget: \$40 million). Its management will finance the deals around 50% with cash, with the rest funded by a mixture of leveraged buyouts and, says Sapat's managing director, Nikhil Joshi, "a sprinkling of private equity".



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Nikhil Joshi, Sapat Tea

Sapat isn't particularly large: Joshi declines to reveal the privately run, unlisted company's finances, although he says that by 2010 he wants Sapat's annual revenues to more than quadruple, to between \$150 million and \$200 million. But he personifies both the burning confidence of India's family-run small and medium-sized enterprises (SMEs) – the local version of Germany's Mittelstand – and their desire to grow rapidly and beyond their own borders. This is despite – and sometimes because of – the global credit crunch and fears of a US recession.

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This year hasn't been easy for India's turbulent market. Mumbai's Sensex index has tumbled 26% in the year to March 12, and foreign institutional investors (FII) have been net sellers of Indian stock this year to the tune of \$3.2 billion, after four steady years of capital accumulation. But that hasn't stopped cash-rich Indian firms from eyeing overseas acquisitions. Virtus Global Partners, a New York-based boutique investment bank, noted in a March 2008 report that 83 US-bound acquisitions by Indian corporates were completed in 2007, worth \$10 billion, up 73% year on year. A further 10 were completed in the first two months of 2008 – the same number sealed in the same period a year ago – mostly in the IT sector, as Indian firms look to grow and increase their global service offerings.

Most deals have been completed by relatively small Indian corporates. Although transactions such as Tata Chemicals' \$1 billion acquisition of New Jersey-based General Chemical Industrial Products in January tend to hog the limelight, they are

the exception rather than the rule. Smaller deals, totalling \$50 million or less, accounted for 84% of US-bound acquisitions in 2007, according to Virtus. They include the \$45 million acquisition of Chicago-based IT firm Tusc by Indian rival Rolta, and the \$35 million acquisition of Logic Bytes, another New Jersey-headquartered firm, by Chennai-based Kaashyap Technologies. Most smaller transactions tend to be in the information technology sector – an industry in which Indian firms increasingly dominate. But US-bound deals are also increasingly abundant in other growing Indian industries. India's Wockhardt Hospital's \$38 million acquisition of Illinois-based Morton Grove Pharma stood out in 2007 in the healthcare industry. In the automotive sector, Ashok Leyland, controlled by India's Hinduja family, snapped up Michigan-headquartered Defiance Testing for \$17 million.

Indian corporates are also finding it relatively easy to finance overseas acquisitions. Domestic Indian lenders, traditionally isolated from the global financial markets, have found it easier to muddle through the credit crunch. Still relatively liquid, such banks as ICICI, HDFC and Axis Bank are happy to provide sizeable credit lines to leading local corporates. Many local firms also have large reserves of cash: after hoarding it for the past decade they are now drawing heavily on it. Virtus notes in its report that most overseas acquisitions by Indian firms were 100% stock-for-cash considerations. And if that's not enough, US and European funds and private equity firms will be happy to help out: Indian firms and their local markets are growing faster than their peers in the west, while, according to Mumbai-based Yen Management Consultants, about \$70 billion to \$80 billion of private equity capital allocated to Indian investments has yet to be spent.

Hunted turns hunter

Investment banks such as Virtus are also lining up to help Indian corporates snap up foreign assets. The partners of Virtus, which was founded by mainly non-resident Indians, originally set their sights on advising US corporations on ways to expand into India in the technology and consumer goods sectors. But Anil Kumar, the investment bank's founder and managing director, soon found that interest and liquidity were flowing in the other direction. "What we found was that Indian CEOs were aggressively seeking acquisition targets in the US. They had the desire and the cash but didn't necessarily know who to buy. We had the Indian background, and we had the transactional ability and the on-the-ground presence in the US. So we started looking at viable acquisition candidates for Indian firms."

They didn't have to look far. In 2007, Virtus helped target and finance five US deals by Indian corporates, including the \$45 million acquisition of Samuels Jewelers by India's largest listed jewellery retailers, Gitanjali Gems.

Kumar says Gitanjali wanted a list of likely targets. Virtus talked to 15 viable candidates and slimmed the list down to five or six. "Gitanjali's management then moved very fast," remembers Kumar. "They homed in on the companies [they liked] and had enough money on their balance sheet [to buy them]. The US jewellery market wasn't growing quickly but it is enormous and one part that is growing [there] is the demand for Indian jewellery. The deal made perfect sense." Gitanjali has since bought two more US rivals: Tri-Star Worldwide, for an undisclosed sum, in March 2007; and Rogers Inc for \$18.5 million eight months later.

Undeterred by the troubled state of global financial markets, Virtus's management hope to do eight or nine deals in 2008. "This year we'll see even more Indian firms completing deals because of the stress of the US financial system," says Kumar. "Indian firms are looking for deals that two years ago they wouldn't have considered. And the capital is available."

Kumar adds that FIIs – notably US-based institutions – are providing a significant chunk of the capital backing these acquisitions, giving further evidence of the seismic shifts in the basic structure of the global financial markets. "A lot of cash is flooding into India from America to back US-bound acquisitions by Indian firms," he says. "With Gitanjali we raised cash via foreign convertible bonds out of London, and many medium-sized Indian firms are being backed by US-based private equity firms."

Indian firms are also benefiting from the rising value of the rupee, which appreciated by nearly 12% against the US dollar in 2007, giving them more bang for their buck with US forays. "The appreciating rupee and a concomitant fall in the US dollar, along with a dropping US stock market, have created an opportunity for Indian firms to acquire," says Deepak Lalwani, a partner at London-based brokerage Astaire & Partners.

Bangalore-based, Mumbai-listed Logix Microsystems, which develops and sells branded software to leading US auto retailers and internet portals – helping prospective customers view online the entire make-up of a Ford Bronco or Lexus before buying – bought three companies in the US in 2007, and is still on the acquisition trail. Sanjay Soni, managing director, says Logix is seeking to make two acquisitions this year, both in the \$25 million to \$50 million bracket, boosting the firm from sixth-largest globally in the auto software industry to number two, and more than doubling revenues and profits to \$200 million and \$30 million respectively. During 2009 and 2010, the firm plans to acquire several assets, including at least one in Europe.

Soni, who retains Virtus as a financial adviser, says the logic in buying US and European firms is impeccable for Indian SMEs. "In the US in particular, credit is in short supply, particularly for companies in the \$30 million to \$50 million range. Those US firms can't list, because they're too small, and they can't raise private equity, so they are perfect for a buyout. By contrast, Indian firms are determined to grow, and they have access to capital, particularly foreign capital."

If it's also rather ironic that capital is fleeing the US financial scene just when it's most needed, to fund the US-focused acquisition plans of faster-growing Indian corporates – well, that's the nature of unfettered free market capital.

Logix in the final quarter of 2007 raised \$23 million to finance its planned acquisitions, mostly from US- and UK-based institutional investors via a Mumbai-regulated qualified institutional placement of new securities. "It took two weeks to raise the money," says Soni. "It would have been harder for a US company of our size to raise that sort of money. For FIIs we are a good company – we're listed and with a good-sized market cap and a good growth rate. It says to me that there is more money coming into emerging markets from the developed world, which is being used to do deals back home. It's a reverse capital flow."

Bold expansion

Other factors are pushing Indian firms to expand overseas. Falling import tariffs at home are boosting domestic competition and forcing local firms to access established foreign markets. Relatively low Indian interest rates have also helped, as has a steady,



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Key US-bound transactions by Indian firms, 2007		
in the textile and jewellery sector		
Buyer	Seller	Size (\$mIn)
Himatsingka Seide	Divatex Home Fashions	61.75
GHCL	Best Manufacturing Group	35
Shrenuj & Co	Simon Golub & Sons	22.7
Gitanjali Gems	Rogers Ltd	18.5
in the automotive and manufacturing		

impressive upward climb in Indian corporate earnings (running at about 17% to 18% a year) since the late 1990s.

Local firms have also been encouraged, implicitly and explicitly, to prove themselves overseas. Smaller Indian corporates have been freed from their innate caution thanks to recent bold overseas forays by leading Indian blue chips. Tata Steel's \$12 billion acquisition of Anglo-Dutch rival Corus in early 2007 showed that leading Indian firms could buy big overseas, as did Hindalco, part of the Aditya Birla Group, when it bought US-Canadian rival Novelis for \$6 billion. Those landmark deals boosted the confidence of thousands of smaller Indian firms, which have also benefited from regulatory changes from the Reserve Bank of India. The country's central bank has systematically relaxed controls on outbound investments over the past three years, making it easier for smaller corporates to sell foreign currency convertible bonds and raise debt overseas.

Indian corporations also recognize that they need to build established global brands if they are to benefit from the country's strong domestic consumption story. Sapat Tea's Joshi notes that UK-based rivals such as Newby Tea and Ahmad Tea sell products grown and packaged in India, but sold as "English" tea to the wider world. "If you go to Russia, you find that people only buy high-end tea if it has a British label. We need to get to the stage where people recognize the strength of the 'made in India' brand," he says.

That sovereign brand weakness also helps explain the allure of foreign markets. Sapat's domestic Parivar brand, which makes strong, sweetened, spiced 'chai' tea, has zero presence or brand value abroad. Hence Sapat's hunger for inorganic growth, using foreign acquisitions as a way to promote its own, recently created Chaitime brand, tailor-made for foreign markets. The company last year lost out in a \$60 million bid to buy UK-based Fairtrade tea maker Clipper.

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Joshi is aware too that the market for high-end tea is both growing and consolidating fast. The market is growing at 30% a year in terms of value, but leading US and UK brands are either consolidating internally or being snapped up by larger

rivals, notably Anglo-Dutch consumer goods company Unilever and Tata Tea, a unit of India's mighty Tata Group. "Within the next couple of years the market will begin to consolidate – it will be whittled down to two or three big players," says Joshi. "We need to be there by then. Everyone has roughly the same product offering – what we bring is lower costs, a larger overall organization and, like many Indian firms, better access to capital."

Domestic business leaders also find expansion into markets such as the US and the UK – markets abounding with successful entrepreneurial, non-resident Indians – a much easier fit than, say, Indian expansion into China, or Chinese corporate expansion into either Europe or North America. In certain sectors, notably information technology, which made up 51% of all US-bound acquisitions by volume in 2007, according to Virtus, Indian corporations seem welcome, even desirable, natural corporate partners.

Take Mumbai-listed Glodyne Technoserve, a leading Indian IT firm focusing on technology infrastructure. In October 2007 it acquired New York-listed Front Office Technologies for \$3.34 million – its second acquisition in six months, after buying another US firm, Links Group International (LGI), for \$4.75 million in March 2007. That gave Glodyne a presence in New York, via Front Office, which manages websites for such institutions as American Express Bank and Standard Chartered. It also gave the Indian firm access via LGI to Washington, DC and the government-related IT sector, which has grown rapidly since the terrorist attacks of September 11 2001.

Anand Sarnaik, Glodyne's chairman and managing director, says the company's expansion is due to a shift in thinking at most

sector		
Buyer	Seller	Size (\$mIn)
Ashok Leyland	Defiance Testing	17
Setco Automotive	Haldex Brake Products	4.9
Jain Irrigation Systems	Aquarius Brands	21.5
Sintex Industries	Wausaukee Composites	20.5
in the IT sector		
Buyer	Seller	Size (\$mIn)
Wipro Technologies	Infocrossing	568
Firstsource	MedAssist	330
Apollo Health Street	Zavata	169
HOV Services	LASON Inc	148
Megasoft	Boston Communications	64.5
Quintegra Solutions	PAC Inc	49
Core Projects & Technologies	KC Management	30
3i Infotech	J&B Software	25.25
Styx Infosoft	Citizens Financial Mortgage	25
in the healthcare sector		
Buyer	Seller	Size (\$mIn)
Jubilant Organosys	HollisterStier Laboratories	122
Wodkhardt Hospitals	Morton Grove Pharma	38
Plethico Pharmaceuticals	Natrol	79
Ocimum Biosolutions	Gene Logic inc	10.2
Natco Pharma	SaveMart Pharmacy	3.45
Source: Virtus Global Partners		

aspirational Indian firms. A few, smaller Indian firms have traditionally taken on debt to finance their expansion plans but this is now happening more and more. "We were always a company that never had debt," says Sarnaik. "But we were doing so well that our financial backers decided that we could go after some takeovers and take on debt. We're highly leveraged now, at least for us, taking on \$30 million debt for \$100 million on our balance sheet."

Sarnaik says foreign funds and private equity firms are attracted by the higher rates of return offered by Indian companies, and by the weak US dollar, which he says is a "good incentive rider" for Indian firms to take over US rivals. He says his company's bankers – including ABN Amro, Barclays, Citi and Standard Chartered – have also been happy to extend financing to fund its acquisitions. ABN Amro in Singapore extended Glodyne two \$4 million plain vanilla credit lines in 2007 to complete its acquisitions and fund further purchases.

Sweet spot

Glodyne is seeking to buy more US or European firms in 2008. "Size is not important," says Sarnaik. "But a sweet spot [for a future deal size] is \$25 million to \$50 million. If the company is big enough, we could dilute equity but I don't think that will be needed. The first option would be a plain-vanilla loan, but if we have to cross our one-to-one debt-to-equity rule, we may have to dilute some equity." In these times of tightened belts and squeezed liquidity, such an array of choices shows how much belief many banks have in corporate India's growth story.

The founders and owners of US targets seem equally happy to sell – often because their Indian partners seem happy to fund their acquisitions with straight cash. Russ Rothchild, the founder and chief executive of Front Office, says the cultural fit of his Indian partner was good – he got on with and trusted the Glodyne management team when they first met – as was Glodyne's size: big enough to provide solid financial backing and the resources to facilitate growth but not so enormous as to overwhelm its US partner.

Rothchild believes the entire IT industry is going this way, with US firms falling prey to better-funded rivals from the subcontinent. "Since the dotcom bust the IT industry in the US isn't what it used to be," he says. "It's getting harder and harder for US firms to grow from being small to being mid-sized, and from being mid-sized to being large." That's clearly not the case for Indian firms, nor is it seen, increasingly in the US, as at all negative to partner with, or be taken over by, an Indian rival. "When I told my clients last year about the [Glodyne] acquisition, I didn't know what to expect," says Rothchild. "The news was actually very well received, and in most cases led to immediate conversations from our partners as to how to help them run and resource their Indian offices."

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