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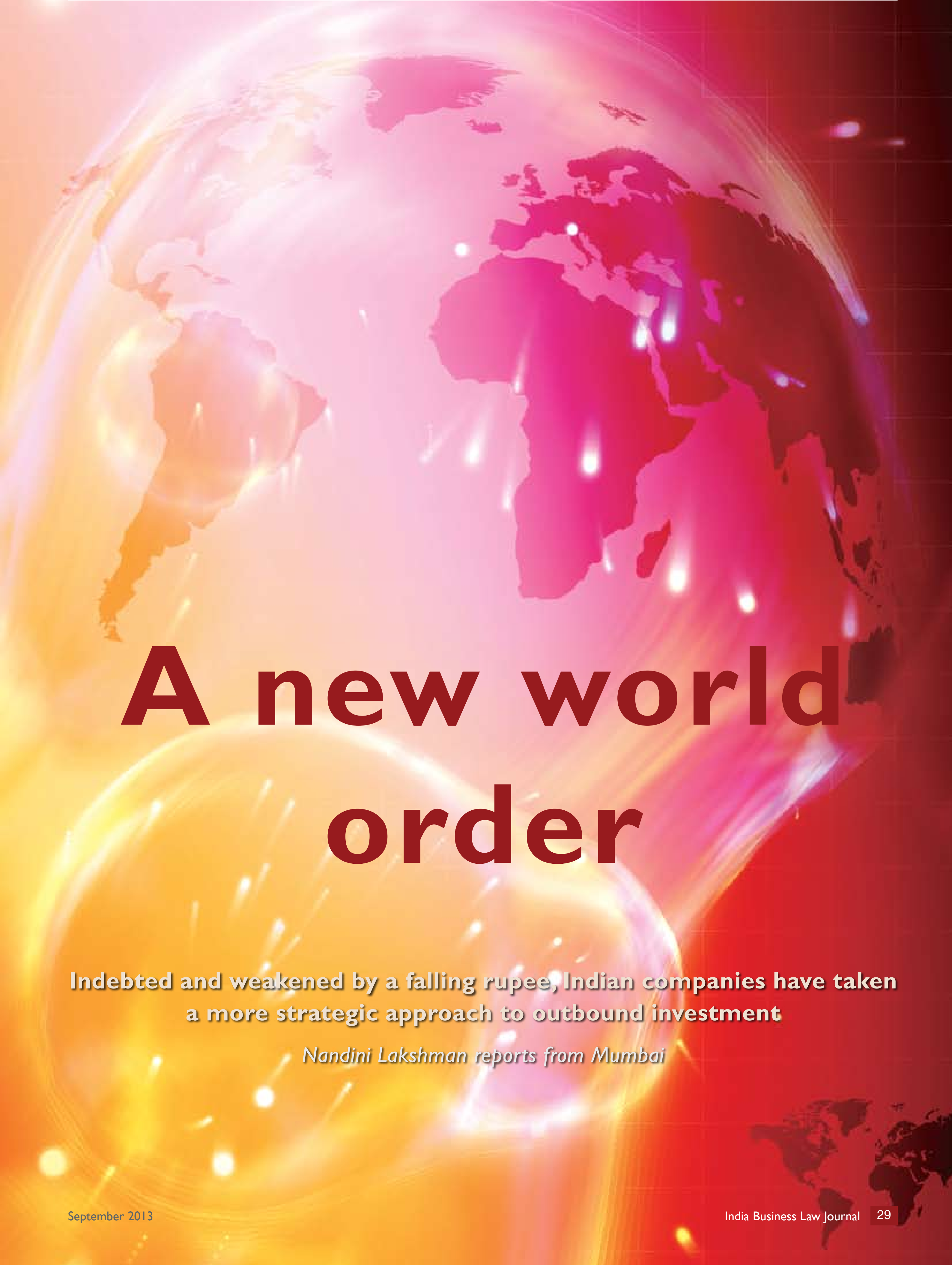


A new world order

Indebted and weakened by a falling rupee, Indian companies have taken a more strategic approach to outbound investment

Nandini Lakshman reports from Mumbai

A few years ago, corporate India embarked on a global acquisition spree, buying up pretty much whatever was available. The global financial crisis meant that bargains were in abundance and Indian companies snapped them up with glee. In many cases the acquisitions were driven primarily by rock-bottom valuations and there was scant regard for the strategic fit between target and the acquirer.

Today, as major world economies begin to show signs of recovery, Indian companies are not in such a hurry to buy overseas assets. Although it is still a good time to purchase undervalued companies, India Inc is acting with caution while jostling for position in the global marketplace. Strategy has overtaken affordability as the primary driver of overseas acquisitions.

“The focus on outbound investment clearly remains to drive the growth agenda for Indian companies,” says Raja Lahiri, a partner in transaction advisory services at Grant Thornton. “The associated drivers include new products, services and customers and not just the acquisition of distressed assets.”

The focus on outbound investment clearly remains to drive the growth agenda for Indian companies
Raja Lahiri
Partner, Transaction Advisory Services
Grant Thornton

Lahiri points to the US$2.6 billion in outbound investments by ONGC in overseas oil-fields, and Apollo Tyres' recent US$2.5 billion acquisition of Cooper Tyres in the US as examples of this trend.

Today, the rationale for outbound investment is threefold: entering new markets to drive growth; monetizing assets to retire debt; and exiting businesses which are a financial drain. Natural resources such as oil, gas and coal may be the need of the hour (see *Searching for coal in Australia*, page 31), but other popular sectors this year have included information technology and services, auto components, engineering goods and healthcare.

Measured optimism

Surprisingly, although deal sizes are getting smaller, corporate cautiousness has not dented outbound investment numbers. Data from the Reserve Bank of India (RBI) show that India Inc spent US$36.52 billion on outbound investments from August 2012 until July 2013, up from US$27.3 billion the previous year. In the first five months of the current fiscal year, beginning 1 April, Indian companies invested US$16.4 billion in global assets, compared to just US$13.2 billion in the same period last year.

More importantly, India is emerging as a key player in major western markets such as the US and the UK. According to UK Trade and Investment figures, India is now the second largest investor in Britain. A wave of Indian investment flowed into the country following the 2012 Olympic Games in London, and more is on its way. Tata Motors has announced plans to increase its investment in its UK engine plant in Wolverhampton, and Tata Steel, which bought British steel giant Corus in 2007, has said it will spend an additional US$1.2 billion at its Welsh steel plant in Port Talbot over the next five years. Axis Bank, meanwhile, opened its doors in London in July.

Other European dealmakers include cash-rich Infosys, which shed its conservative image by acquiring Zurich-based Lodestone Holdings for around US$350 million in September 2012. The deal gives Infosys a presence in Europe, the Middle East and Africa.

Indian companies are also inking deals in Italy, where they are “trying to use Italian acquired targets as vehicles to expand globally,” says Arianna Carlotti, the head of the

The IT sector has experienced considerable interest in the last year
Carlos Roberto Siqueira Castro
Senior Partner
Siqueira Castro Advogados

Indian companies today are showing a great interest in multiple outbound investment activities
Vinay Ahuja
Partner and Head of India Desk
DFDL Legal

Indian companies are facing difficulty in accessing capital due to tight liquidity in the Indian financial markets

Yash Rana
Partner and Asia Chairman of Goodwin Procter in Hong Kong

India desk at Pirola Pennuto Zei & Associates in Rome. Carlotti says investors may encounter difficulties with labour and tax laws in Italy, but that they may be resolved by drafting detailed business plans, conducting thorough due diligence and seeking advice from Italian advisers.

Latin America is also seeing some Indian interest, particularly in the IT, telemarketing and energy sectors. Wind power generator Suzlon has invested in wind farms in the region, while according to Carlos Roberto Siqueira Castro, a senior partner at Siqueira Castro Advogados in Brazil, "the IT sector has experienced considerable interest in the last year".

In other parts of the continent, such as Argentina, Indian activity has been more subdued. "Due to an economic and financial crisis, the government was obliged to impose a series of restrictions on the repatriation of capital and distribution of dividends abroad, import of goods, and foreign exchange," says Carlos Alfaro, the managing partner at Alfaro Abogados in Buenos Aires. "These policies were pegged with price controls and a substitution of imports policies."

In Asia, lawyers report steady levels of outbound investment by Indian companies.

"Indian companies today are showing a great interest in multiple outbound investment activities and have become extremely active in global markets with a focus to achieve the next level of growth," says Vinay Ahuja, a partner who heads the India desk at DFDL Legal in Laos. "They are searching to enter markets where there are achievable growth opportunities." DFDL's deals in the last year include assisting Tata International to expand its footprint in Laos and Cambodia; advising the Export Import Bank of India on a US$2 million loan to a Vietnamese coffee manufacturer; and counselling Nav Bharat Ventures on setting up a 108MW hydro power project in Laos.

Calculated moves

Indian companies borrowed heavily to fund earlier rounds of acquisitions and many are now overleveraged as a result. "The question now is about financing and liquidity," says Sameer Tapia, a senior partner, at ALMT Legal. Government statistics peg external commercial borrowings (ECBs) at US$85.3 billion and foreign currency convertible bonds around US$7 billion, some of which are due to mature shortly. As a result, many of the current wave of outbound

Searching for coal in Australia

Following a lull, outbound investment in mining may be set to rebound

Philip Catania, a partner at Australian law firm Corrs Chambers Westgarth, notes that there has been a slowdown in Indian investment in overseas coal assets in the last 12 to 18 months. "We believe that this slowdown is partly due to the difficult market circumstances that currently exist," says Catania. He suspects that Indian companies interested in Australia are waiting and watching how two acquirers – Adani and GVK – which have invested in coal mines, progress in developing their projects.

One reason for the lull in demand following the initial burst of interest from Indian companies in coal resources in Africa and Australia is that imported coal is expensive and the Indian government hadn't allowed producers to pass on the extra costs to consumers. But with a serious power shortage to contend with – a quarter of India's population has no access to electricity and there is a power deficit of 8-12% during peak hours – India has to almost double its generation capacity over the next decade. Imported coal may be the only way to achieve this.

As such, in June the government finally bowed to industry pressure and said that producers could pass on the cost of imported coal to customers. "As previous power price restrictions made imported coal an unfeasible option for many power companies, we believe that this announcement will provide the impetus for renewed demand for Australian coal," says Catania. "In addition, we believe that Indian companies are beginning to see the lower coal prices as an opportunity to invest in, or acquire, Australian coal projects at a lower cost, and we believe that M&A activity in the mining sector will begin to increase steadily."

Other sectors of Australia's economy are also attracting Indian investments. Tata Motors, the maker of the world's cheapest car, the Nano, announced plans in July to enter the Australian market with a range of light commercial vehicles.

In July, Indian waste management company Ramky bought Enviropacific for US$40 million, while Punj Lloyd bid for Australian mining and construction company Macmahon. "These deals confirm that there is more to Indian investment in Australia than just coal," says Richard Gubbins, a partner and head of the India business group at Ashurst's London office.

Practitioner's perspective

Moving into Mozambique

Faizal Jusob explains how the African country is attempting to entice Indian investors

Mozambique welcomes Indian investors. The country has established a framework for ventures that involve state or private foreign direct investment (FDI) and foreign investment is allowed in all economic sectors, except for those reserved for domestic companies.

The country has a well-developed arbitration system that enables effective dispute resolution through: (i) Arbitration through the International Centre for the Settlement of Investment Disputes (ICSID) under the Washington Convention of 15 March 1965; (ii) ICSID arbitration under the ICSID Additional Facility Rules, where the investor is a national of a state that is not a signatory to the ICSID Convention; and (iii) Rules of the International Chamber of Commerce.

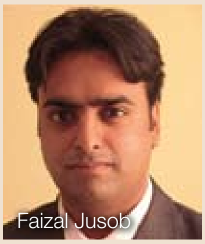
The key laws governing FDI into Mozambique include: The Law on Investment (LI); the Regulation of the Investment Law (RIL), 2009; the Code of Fiscal Benefits for Investments (CFBI), 2009; and the CFBI's accompanying regulations.

To qualify for an investment authorization, a company must hold at least US$100,000 in (i) freely convertible currency; (ii) equipment and relevant spare parts, materials and other imported goods; and/or (iii) the transfer of land usage rights, patented technologies or registered trademarks, for which remuneration is limited to the participation in the distribution of profits resulting from the activity in which such rights, technologies or trademarks have been, or will be, used.

The LI, RIL and CFBI guarantee the security and legal protection of goods and rights, including industrial property rights, in investments that comply with the LI and its regulation. The Mozambican government, in line with conditions set out in relevant legislation, guarantees the remittance of funds in connection with: (i) exportable profits resulting from investments eligible for export of profits under the provisions of RIL; (ii) royalties or other payments for remuneration of indirect investment linked to the transfer of technology; (iii) amortization of loans and payment of interest on loans contracted in the international financial market and applied in investment projects in the country; (iv) proceeds of any compensation by the government; and (v) invested and re-exportable foreign capital, independent of eligibility, if the investment project is to export profits under RIL.

Tax benefits

Foreign investors in Mozambique can enjoy a number of fiscal benefits and incentives, including exemption from import duties and value added tax (VAT) for imported goods that are classified as "class K" of the Customs Tariff Table, (subject to certain restrictions). They may also enjoy tax credits for investment equal to 5% of the total investment realized for a period of five tax years from the beginning of their investment. This tax credit will be deductible from the corporate income tax assessed up to the total amount of the tax assessment. The tax credit will be between 10-15%, depending on the province in which investments have been made.


Faizal Jusob

Such tax credits are not available on investments in corporeal assets resulting from the construction, acquisition, reparation and extension of buildings; non–commercial vehicles; furniture and articles of comfort or decoration; social equipment; specialized equipment seen as state-of-the-art technology; other equipment not directly related to and associated with the productive activity of the project.

Accelerated appreciation is permitted for new immovable assets used towards an investment authorized under the IL. Accelerated depreciation at twice the normal rate set by law to calculate the depreciation that is treated as a deduction is also permitted for rehabilitated immovable assets, machinery and equipment used in industrial and agro–industrial activities.

Furthermore, Mozambique offers tax deductions of up to 5% on investment expenditure used for the professional training of Mozambican workers.

The regime established under IL and its associated regulations does not apply to petroleum operations. A different fiscal incentives package has been developed for projects in the oil and gas sector.

Opportunities

Infrastructure shortages in Mozambique are creating a bottleneck in the production and export of coal, which has the potential to be a pillar of economic growth. At least US$50 billion in infrastructure investment is needed to support Mozambique's coal and gas sectors alone.

Agribusiness is another untapped investment opportunity: 57% of land in Mozambique is arable, yet the country still relies on imports of fresh produce and no big international players are active in the sector.

Recent discoveries of 100 trillion cubic feet of gas reserves, combined with a proposed LNG plant with capacity of 10MTpa, have the potential to transform the country's economy. They also present extremely attractive opportunities for investors from India.

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Indian companies are making small but strategic investments … purchasing assets … or companies that have the relevant technology or intellectual property
Nipun Gupta
Partner
Bird & Bird

investment deals are motivated by the desire to consolidate existing business interests. "The tightening of debt availability has resulted in caution with large outbound investments," says Lahiri at Grant Thornton.

The home turf too has become a cause for concern. As Indian prime minister Manmohan Singh tried to assuage investors' fears about economic growth, which slid to 4.4% in the first quarter of this fiscal year compared to 4.8% in the previous quarter, business sentiment took a beating. In addition, rising inflation, policy inertia, a bulging fiscal deficit and a volatile rupee – which briefly touched a record low of ₹69 to the dollar – have all conspired to haunt debt ridden companies.

The rupee's fall has made markets such as the US and the UK more expensive, increasing the cost of acquisitions and decreasing the value of available funds. "The volume of transactions by India into the US has slowed down with the weakening of the rupee. Indian companies are facing difficulty in accessing capital due to tight liquidity in the Indian financial markets," says Yash Rana, a partner and

[The Indian economy has led] many companies to … 'get their house in order' at home before looking to expand abroad
Russell Holden
Partner, India Group
Taylor Wessing

Asia chairman of Goodwin Procter in Hong Kong.

"The more challenging outlook for the Indian economy has led many companies to focus on their existing Indian businesses and to 'get their house in order' at home before looking to expand abroad," says Russell Holden, a partner in the India group at Taylor Wessing in the UK. The firm is working on several refinancing arrangements for Indian companies, where it is putting foreign currency loans in place or issuing bonds in overseas markets such as Singapore.

Ambition and restraint

Some highly leveraged Indian companies are actually selling their overseas assets in an attempt to reduce their debt burdens. In May, Apollo Tyres, India's largest tyre maker, sold its South African business to Japan's Sumitomo Rubber Industries for US$60 million.

Indian investors are slowly approaching Spain, focusing on several areas but, above all, automobiles and pharmaceuticals
Sergio Sanchez Sole
Partner
Garrigues Abogados

Bangalore-based GMR Infrastructure, meanwhile, has unlocked US$258 million by shedding its 70% stake in a gas-fired power project in Singapore. It has also sold its 50% stake in Intergen, given up its holding in South African coal mines, and backed out of two domestic road projects. There is speculation that GMR will also pull back its 40% stake in Istanbul's Sabiha Gokcen International Airport in Turkey.

The new era of corporate restraint is reflected in deal sizes. The big mergers and acquisitions of five years ago – when Tata Motors bought Jaguar Land Rover, Tata Steel snapped up Corus and the Birla group acquired Novelis – have made way for more modest deals. "Given the current state of the market, Indian companies are making small but strategic investments by either purchasing assets or companies from liquidators or companies that have the relevant technology or intellectual property," says Nipun Gupta, a partner at Bird & Bird. Adds Suresh Talwar, a partner at Talwar Thakore & Associates: "Large acquisitions cannot take place as many companies have no cash flow and they are unable to even borrow funds."

Indicative of this new breed of strategic and measured outbound investments is Mahindra & Mahindra's recent

foray into Spain. In June, in an attempt to gain access to new markets and supply chains, Mahindra & Mahindra's auto components and forgings businesses entered into a merger and share swap with Spain's CIE Automotive SA. The new entity – christened Mahindra CIE Automotive – is 51% owned by CIE, with Mahindra holding a stake of around 20%. "We do achieve consolidation of our own entities which has been on the cards for a while ... we also create a global entity simply by this alliance with CIE," Anand Mahindra, the chairman of the Mahindra group, told reporters in Mumbai.

The Mahindra deal is not the only Indian activity in Spain. "Indian investors are slowly approaching Spain, focusing on several areas but, above all, automobiles and pharmaceuticals," says Sergio Sanchez Sole, a partner at Spanish law firm Garrigues Abogados.

Push and pull

If the "pull" of overseas opportunities is driving some outbound investment deals, the "push" of challenges at home is driving others.

Indeed, with New Delhi dragging its feet on key policy decisions, a jittery India Inc is finding the path to domestic growth unappealing. In March, Kumar Mangalam Birla, the head of the US$40 billion Birla group, said he would rather invest overseas – including in the US, Brazil, Thailand and Indonesia – than in India. Speaking to Bloomberg TV, he cited frequent policy changes at home as the reason for his current global push. "We are in 36 countries around the world," said Birla. "We haven't seen such uncertainty and lack of transparency in policy anywhere."

In its latest outbound excursion, the Birla group is preparing to invest US$500 million in Turkey to set up a viscose staple fibre plant with a captive power plant in Adana. However, it may find that it runs into exactly the same problems it is trying to escape back at home. "Turkey is a country where laws and regulations frequently change," explains Orcun Cetinkaya, a partner at Mehmet Gun & Partners in Istanbul, adding that "it is not possible to give a list of expected changes in the legislation".

There is more to Indian investment in Australia than just coal

Richard Gubbins
Partner and Head of
India Business Group
Ashurst

Currency forecast: The rupee's tumultuous journey in recent months has led the Reserve Bank of India to impose curbs on foreign currency outflows.

All eyes on the rupee

While Birla's in-house lawyers will no doubt be keeping one eye on investment regulations in Turkey, it's likely that the other will remain firmly focused on the value of the rupee.

On 14 August, with the rupee continuing its downward spiral, India's central bank imposed curbs on foreign currency outflows. Companies could make outbound investments of no more than 100% of their net worth, said the RBI, lowering the earlier limit of 400%. The ensuing brouhaha suggested that India was going back to capital controls. But just three weeks later, in a dramatic u-turn on 4 September, the RBI announced that companies could again invest up to 400% of their net worth on outbound investments, but only if their investments were funded by ECBs.

Such flip flops continue to drive capital out of India. ■