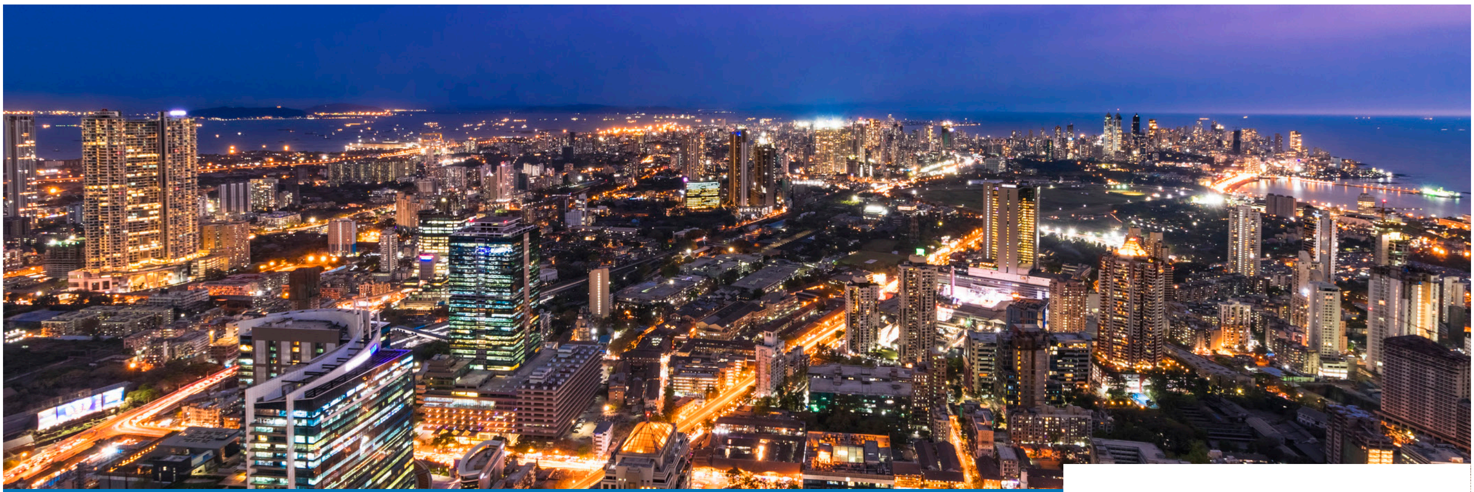


The Other Asian Giant: Developing a Stomach and Appetite for the Indian Market

Regulatory Risks, Investment Sentiment and the India/Bharat Conundrum

The national elections currently underway in India will see about 970 million eligible voters (out of a 1.4 billion population) exercise their right to vote and bring in a government of their choice. This fabled dance of democracy would have made Athens proud. The ruling Bharatiya Janata Party ("BJP") is expected to return to power, led by the populist incumbent Prime Minister Narendra Modi – a consummate political leader with mass appeal.

The capital markets have factored in a BJP win and counting on the stability of economic policies, and this is reflected in the pathway of the BSE Sensex which is up over 22 percent in the last one year. During this time, large global investors, both portfolio investors as well as strategic investors have re-discovered India. Apple and Tesla are recent marquee investors stepping up on their India exposure with entry/expansion plans, with others expected to follow through, on the back of China-plus-one strategies for global supply chains.

Policy Continuity and Regulation Risks

While elections can always bring surprises, the Indian stock markets anticipate that economic policies will likely maintain their current course under the new government. They foresee more divestment of public sector enterprises, capitalising on the increased valuations seen alongside the growth of market indices. We believe that public spending on large infrastructure projects is likely to continue, with global capital placing larger bets on the market.

Tax Reform

The new Government is expected to prioritise direct tax reform and the streamlining of the indirect tax code, building upon the economy's adjustment to the introduction of Goods and Services Tax ("GST") despite the initial challenges. The next few years could see a rationalisation of the GST slabs and gradually bringing in petroleum products under its ambit. India's Tax-to-GDP ratio is 11.6 percent, a 16-year high, and market commentators believe it will likely to grow higher to cross 12 percent on the back of tax buoyancy;[1] one of the few economies where tax revenues have grown since the pandemic.

Tech Regulations

The Digital Personal Data Protection ("DPDP") Act, 2023, enacted last year, still awaits the “rules” which would guide its actual implementation. These rules have been drafted by the IT Ministry ("MeitY") but are likely to be released for consultation only after the 2024 elections.

Apart from those DPDP Act rules, the next government is likely to prioritise the passage of the Digital India Bill and the Digital Competition Bill, as it pushes for more accountability and scrutiny of global tech majors operating in India, driven by imperatives such as privacy and citizen rights, data protection and fraud prevention, market dominance and level playing field, contestability and fairness, cybersecurity concerns, and the desire to increase tax revenues from the sector.

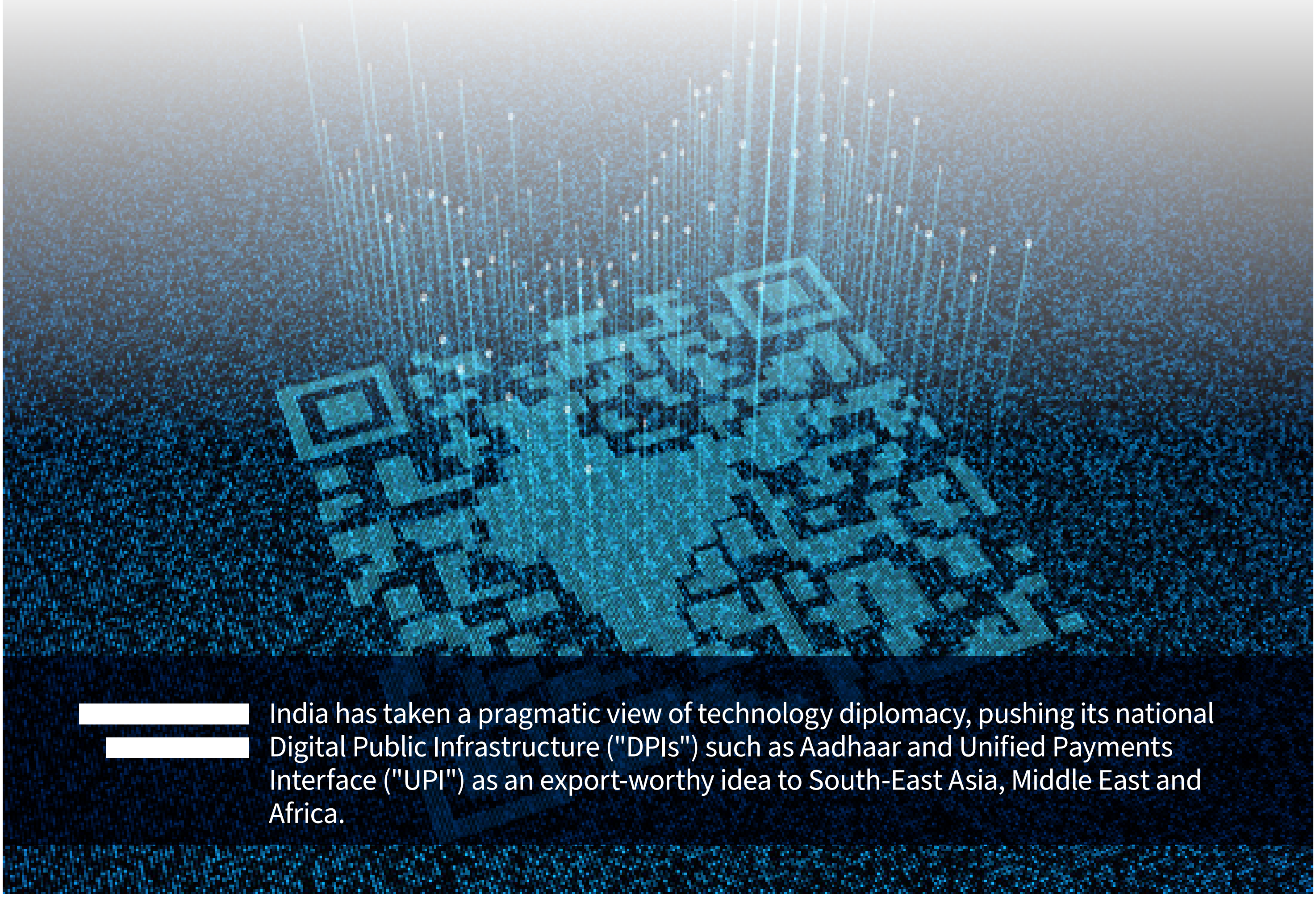
New Delhi is also expected to come up with an AI regulation[2] framework by July 2024, though it is unclear if it would finally be a part of the future Digital India Act. India has taken a pragmatic view of technology diplomacy, pushing its national Digital Public Infrastructure ("DPIs") such as Aadhaar and Unified Payments Interface ("UPI") as an export-worthy idea[3] to South-East Asia, Middle East and Africa. This reflects the actions in Brussels, as European Union ("EU") policy makers balance global and local priorities when engaging with global tech companies on tax and competition matters.[4]

New Energy and Industrial Decarbonisation

New energy regulations have moved surprisingly quickly in the last 18 months and that momentum is likely to hold, as more institutional climate finance flows into India. There are indications that the government may take stronger policy actions to decarbonise hard-to-abate sectors such as petroleum, steel, fertilizer, cement and heavy-duty transport, though not as fast as the EU’s Carbon Border Adjustment Mechanism ("CBAM") framework would like it to.

Energy transition is likely to be gradual in deference to the size of the economy and the limited energy options, despite significant progress on renewables. A nascent carbon pricing and emissions-trading platform is yet to emerge and the first steps in this direction are likely to be measured, despite early progress last year from the Bureau of Energy Efficiency ("BEE"), Ministry of Power.

Despite significant climate finance funds flowing into India, there is limited appetite due a lack of sufficient pipeline of large green projects in hard-to-abate sectors. Stronger policy actions and an increase in sovereign green bond issuances in the new government would be welcome.



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Domestic Manufacturing, Exports & Global Value Chains

Trade and economic diplomacy are expected to be strong levers as India moves towards concluding Free Trade Agreements ("FTA") negotiations with UK and the EU in the months after the General Elections.

India's ambition to increase its share in global value chains, positioning itself as a stronger China-plus-one alternative to Vietnam, or Malaysia, may see a stronger pitch of its fast-growing domestic consumption market to global industrial majors in engineering and manufacturing, chemicals, electronics and food processing. This will be a tough challenge to resolve given India's high corporate taxation and its relatively weak infrastructure and logistics maturity, as compared to other Asian peers.

The outcomes of the Make-In-India domestic manufacturing incentive scheme have been mixed and is likely to see changes in some of the sectors where it has been ineffectual.

State-Centre Dynamics

State governments are expected to be more aggressive to attract investors for industrial projects in their respective states, with two serious contenders — Maharashtra and Tamil Nadu — aspiring towards building state GDPs worth USD 1 trillion.

The state-centre political dynamic is not always smooth, even when it is the national ruling party at the state-level, although it certainly helps. Dynamic state leaders (bureaucrats as well as political) are drawing out ambitious plans for economic growth, digital transformation and decarbonisation.

When these plans look beyond the state capital and cover the hinterland, they become significant drivers of regional growth – this is something that businesses should focus on to tap the rising economic prosperity in tier 2 and 3 cities.

Inward Investments, Inclusion in Global Bonds Indicies & Factors Driving M&A

If investment inflows are any indication, India is hot, with expected GDP growth of 7-8 percent driving it up by 2027 to USD 5 trillion – the third-largest economy by that year, overtaking Japan and Germany.[5] From June 28, 2024 onwards, India will be included in the JP Morgan's Government Bond Index-Emerging Markets, and followed up in the following six months with integration of Indian government bonds into the Bloomberg Emerging Market Local Currency Index, effective January 31, 2025, with the possibility of other global indices adding Indian bonds.

Although not immediate, these developments help pave the way for a consistent influx of capital into India, with the potential to attract substantial investment inflows ranging from USD 20-30 billion from passive and active investors in debt.[6]

Institutional Investment Flows

Portfolio investments into infrastructure and energy transition (climate finance) are expected to accelerate and cross USD 1 trillion by 2030.[7] Aggressive energy transition positions are being taken by multiple institutional investors, from sovereign wealth and pension funds (ANZ and Australian Pensions' recent announcement about looking at Indian infra assets);[8] to multilateral funding agencies and PE majors.

PIF, Mubadala and ADIA from the ME; Temasek, GIC and Gentari from SEA and CPPIB and CPDQ from Canada have been very active in infrastructure. On private equity side, Global players such as KKR, Actis, Advent, and Bain Capital, have unveiled plans to deploy multi-billion dollars in India over the next three to five years. Bain and Company's 2024 Asia-Pacific Private Equity Report ranks India number one among emerging markets for investment opportunities.

Early movers like TPG, Blackstone, Bain and I Squared Capital are also leading a steady pipeline of secondary deals to new investors in the India consumption and infrastructure story.[9]

M&A Activity in Q1 2024

Strategic investments and mid-sized M&A deal activity has continued to hold steady. Despite an 8 percent decline from the previous year, Q1 2024 witnessed investments (PE and Venture Capital) totalling USD 6.2 billion.[10]

Additionally, companies are racing to file for IPOs ahead of the 2024 Indian elections, with Q1 2024 marking the second-highest quarterly count of IPO issues.[11] This underscores sustained investor enthusiasm and substantial capital infusion into the market, spotlighting compelling investment prospects amid evolving economic dynamics.

Data Investment Trust's acquisition of ATC India Tower Corporation and Highways Infrastructure Trust's strategic move in acquiring 12 highway assets from PNC Infratech Ltd, are two billion-dollar investments totalling USD 3.6 billion that signal the strong interest in technology, industrial and infrastructure sectors.

Beyond the domestic market story, M&A activity and additional investments in IT/Tech, Healthcare and Financial Services are also driven by the strong talent pool and Global Capabilities Centre ("GCC") model that can be deployed in these sectors.[12]

Major PE Transactions in Q1 2024[13]

ACQUIRER	TARGET	SECTOR	DEAL VALUE (USD MN)	PERCENTAGE STAKE
Data Investment Trust (sponsored by Brookfield Asset Management)	ATC India Tower Corporation Pvt Ltd	Telecom	2,500	100%
Highways Infrastructure Trust (KKR's road InvIT)	PNC Infratech Ltd -12 highway assets	Infrastructure Management	1,090	100%

ACQUIRER	TARGET	SECTOR	DEAL VALUE (USD MN)	PERCENTAGE STAKE
GQG partners	Bharti Airtel Ltd	Telecom	710	0.8%
CPPIB and Ontario Teachers' Pension Plan	NHAI InvIT – National Highways Infra Trust	Infrastructure Management	438	NA
Advent International and Multiples Private Equity	Svatantra Microfin Pvt. Ltd	Banking and Financial Services	233	NA
India Grid Trust (IndiGrid)	ReNew Solar UrjaPvt Ltd	Energy	199	100%

Major M&A Transactions in Q1 2024[14]

ACQUIRER	TARGET	SECTOR	DEAL VALUE (USD MN)	PERCENTAGE STAKE
Reliance Industries Ltd., Viacom18 Media Pvt. Ltd.	Star India Pvt Ltd (Disney Star)	Media and Entertainment	8,500	NA
Sumitomo Mitsui Financial Group, Inc	SMFG India Credit Company Ltd	Banking and Financial Services	700	25.1% (now owns 100%)
Tata Consumer Products Ltd	Capital Foods Pvt Ltd	Retail and Consumer	614	100%
Reliance Industries Ltd	Viacom18 Media Pvt Ltd	Media and Entertainment	516	13%
Mitsui & Co Ltd and VDL Groep	Pinnacle Mobility Solutions Pvt Ltd - Eka Mobility	Automotive	100	Undisclosed
Mizuho Bank Ltd	Kisetsu Saison Finance Pvt Ltd – Credit Saison India	Banking and Financial Services	145	15%
Eris Lifesciences Ltd	Swiss Parenterals Ltd	Pharma, Healthcare and Biotech	77	51%

Conclusion

There is much that is lucrative driving investors, strategic and financial, in droves to India. Global investors are refreshing India investment plans, and negotiating market entry, as they continue to make sense of the different central and state government dynamics, and wrap their heads around the diversity of the marketplace.

The myriad flavours and colours of the Indian bazaar reflect regional differences as well as the India-Bharat Conundrum between urban India and semi-urban/rural Bharat. Businesses seem to have woken up to Connected Bharat and the rapid upward mobility of digital-first young adults in India's hinterland.

Early movers – Indian business houses and institutional financial investors – are keen to make quick bets and scale-up presence.

Global businesses are ramping up local leadership capacity, to make sense of these changes, before they make additional investments to expand. Few bold global players have decided to double their bets on India.

The animal spirits are clearly visible, but learning to ride them without being reckless is important. It is an entrepreneurially driven market with structural strengths and a strong domestic consumption story.

While political and policy continuity seems assured, making money in the Indian bazaar requires one to be adept at understanding the landscape. It is a competitive place for deals and with high growth comes with a significant premium. For long investors in the Indian story, concerned about policy stability, the key question would be what next beyond the next five years.

For additional India market information

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