

Indian Electronics Companies Focus on Strong Growth and the Future

Rajoo Goel, secretary general for the Electronic Industries Association of India (ELCINA) sat down with *M&A Review* on our recent India trip.



M&A: *What is driving this strong growth in the electronics segment when the rest of the world is in so much economic trouble?*

Goel: The strong growth in the Indian electronics market is demand-driven and growing at 22-25% per annum year over year. India's huge 1.1 billion population has an expanding middle class (300 million) with purchasing power. The GDP growth rate has been above 7-8 % over the last 5 years and even during 2008-09, when most economies witnessed negative growth, India managed a respectable 6%.

One of the prime reasons for this sustained growth is a relatively low dependence on export markets. However, it would be wrong to say that Indian electronic companies were not impacted by the economy. Barring consumer electronics, all other sectors saw a significant dip in growth rates from 15-20% to less than 5%.

Telecom is the one sector which is driving up the average growth rate. Mobile phone sales have soared from 2-3 million per month 3 years ago to over 12 million now and there seems no let up. Growth in Indian markets is expected to continue for some time as market penetration levels are still quite low for most products, other than mobile phones which has reached 50% with over 500 million connections in the country.

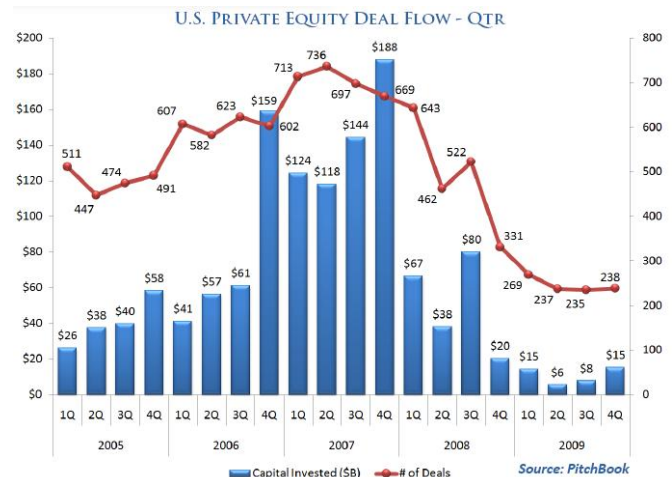
M&A: *How are electronics companies taking advantage of the current strength in the Indian electronics market? Is ELCINA playing a role here?*

Goel: The total market for electronics hardware expanded to US\$ 45 billion during 2008-09 (ending March 2009) while domestic production remains at about half of that level. There is a huge gap in supply and demand which creates a great opportunity for electronics companies. Multinational Companies (MNC) have taken the route of low value-added manufacturing where limited production is done in India with an assemble, test and pack business model and largely imported inputs. Companies unable to start manufacturing locally have established their marketing arms in India to cater to growing demand here.

However, companies in the consumer electronics sector have been working on expanding local sourcing and have achieved success by locally sourcing most wound and electromechanical components. Nokia serves as a good example of a company coming in with their global supplier base, and though progress has been slow, local (See page 2, col. 1)

Private Equity in a State of Flux

Has private equity investing returned to the market or will it ever? This question is on the minds of many middle market companies seeking investment capital. According to a recent *PitchBook* report, private equity investment started showing signs of life again and the strength in IT transactions could bode well for capital starved tech companies. It is unclear yet if the recent strength is a bump on the bottom or indicative of a trend.



To put it in perspective, the private equity deal flow peak in 2007 was 33 times higher than the trough in 2009. The year-end *PitchBook* reports U.S. private equity deal flow for 2009 was down 50% from 2008 and 65% from 2007. Deals under \$250 million accounted for more than 86% of the deal flow.

The first three quarters of 2009 were extremely difficult for private equity on all fronts. Investors spent more time with their portfolios, and bankers and advisors focused on how to survive rather than thrive. However, in the fourth quarter, debt markets began to thaw and deal flow showed signs of recovery with numbers increasing for (See page 2, col. 2)



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Mr. Goel *(From page 1, col. 1)*

content has been increasing. Nokia's volumes are so huge that it is difficult to find a local source who can meet their requirements. These volumes are also instrumental in enabling Nokia to convince their vendors to set up base in India. The presence of their tier-1 suppliers, who are all very large global players, offers opportunities for Indian manufacturers to become tier-2 vendors and set up joint ventures. A few other large multinational companies have also begun localization of their component procurement. This is a very encouraging sign and enables Nokia's vendors to expand their customer base in India once the process is set in motion and investments in manufacturing increase.

ELCINA has worked to support local as well as global companies interested in manufacturing in India.

M&A: *I understand that interest rates of debt financing are high in India and that investment capital can be difficult to find. How are companies able to fund the tremendous growth?*

Goel: MNCs and large Indian companies are able to source funds from global financial markets and thus have the advantage of obtaining competitive finance rates. Local small and medium enterprises (SMEs) however are at a disadvantage as they have to pay 10-12% interest rates for bank financing.

There is some relief, however, for exporting companies because they are able to get special export credit rates through Export Credit Guarantee Corporation which is set up to support exporters who are competing in global markets. Finance for small companies at lower rates is also available from SIDBI, Small Industries Development Bank of India.

M&A: *As Secretary General for ELCINA, what are you and your team working on to bridge any gaps between political and economic policy to enable Indian companies to cope with the growth challenges of today and in the future?*

Goel: ELCINA is focused on promoting manufacturing of electronics and IT products and components, and enhancing competitiveness of companies operating in India. Our focus is on the following critical factors which impact industry performance: Promote and influence policy formulation which supports electronics manufacturing and value addition; Enable business development by bringing buyers and sellers together and encourage R&D; Empower industry by providing training across all functions of manufacturing and HR; Collect and disseminate information to keep industry and all stakeholders abreast of the latest developments in industry and global markets; Market and industry research to keep track of industry output and markets and trends to facilitate decision making by all stakeholders and investors.

M&A: *Is this kind of growth sustainable and for how long?*

To see Mr. Goel's response to this question along with the entire interview, please click on the following link:

<http://www.esgibank.com/documents/ELCINAInterview.pdf>



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Private Equity *(From page 1, col. 2)*

the first time in a year and total capital invested jumping to its highest quarter total of the year at \$15.3 billion.

"I have seen a reemergence of interest in deals among my private equity clients," said Loren Lancaster, managing director with Core Capital Group's Electronic and Semiconductor Group. "At the same time, I am seeing strategic buyers looking for opportunities to buy – disproportionately so."

In the second half of 2009, the median deal amount rose to \$50,000 – a level comparable to pre-crash medians – signaling that middle market valuations are stabilizing and the deal landscape is regaining some semblance of normalcy.

The information technology (IT) sector, which includes communications and networking, IT hardware, semiconductors, IT services and software sub-sectors, represented 14% of total PE deal flow, the highest ever for the industry. There were 137 IT deals completed in 2009 vs 183 last year, a 25% decline. The top investors in the segment were Marlin Equity Partners, The Carlyle Group, Thoma Bravo and Warburg Pincus with four deals apiece.

Private equity exits were also down a stunning 50% from last year to 161 exits for the year. The decline is attributed to a number of credit crisis and recession related factors including declines in valuation tied to public markets, an all but shut IPO market, poor portfolio company performance, a lack of available leverage for all investors, and a limited availability of capital for corporate acquirers. In addition, private equity firms were feeling a great deal of pressure from their limited partners to provide distributions to help ease liquidity issues and to fund capital calls. Still many investment firms focused on improving portfolio company balance sheets and performance in preparation for better exit opportunities in 2010 and 2011.

"While the turn around in private equity deal flow is significant, the devastating blow private equity groups and their investors received of late is hard to recover from. Institutional investors might be looking at private equity groups differently making it difficult for small to mid sized funds to attract additional capital," Lancaster commented. "Middle market companies seeking capital, may need to shift away from relying on private equity investment and look at strategic transactions to create and fund growth going forward."

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Our website contains additional information about Core Capital Group's Electronic and Semiconductor Group and the investment banking services we provide. Please take a moment to visit us on the web! You can also sign up to receive this newsletter by writing to info@esgibank.com.