Deal Drivers: Southeast Asia & India

Mergers and acquisitions in H1 2020 and beyond

Q&A with the speakers

Q: Considering all organisations are on a cost-cutting spree, do you see M&A advisory fees going down, i.e. organisations negotiating lower fees for M&A advisory services. How do you see COVID-19 impacting the advisory/consulting business?

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
Yes, there is some pressure on the M&A fee but it is not significant. As an alternative to reducing fee, M&A advisors are increasingly looking at performance linked fee structures which can help them achieve pre-COVID fee levels.

Sze Shing Tan, Principal, Baker McKenzie Wong & Leow
Organisations may find themsleves looking more carefully at the matters at which they seek advisory services on. For the larger, significant deal value transactions, organisations will be looking for competitive fee proposals, but absent that, there will nevertheless be a flight to quality for such matters.

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Q: Many times, evaluations are based on the company status and background. What about when there is unstable political situation?

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
Company status and promoter / owner background and track record will always form a critical component of transaction evaluation and hence, would be important in all scenarios whether it is post-COVID or unstable political situation.

Sze Shing Tan, Principal, Baker McKenzie Wong & Leow
An unstable political situation will affect the level of M&A activity in a particular jurisdiction, and independent of company status and background.

Q: Besides COVID, how do panelists see "international politics" impacting M&A?

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
The geo-political situation of recent times is expected to have an adverse impact on M&A, more so cross border deal activity. Select governments across the globe have made amendments in legislations pertaining to take-overs and foreign direct investments, which can lead to challenges specially for cross border deals.

Q: Do the PEs now look at a longer horizon than the usual 5 year exits (because of the slowdown and losses)?

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
There will be some delay in exits but there will be a balancing act between waiting longer vs doing opportunistic exits earlier in case their IRR thresholds are being met. PEs are working closely with their investee companies doing impact assessments, cash flow and liquidity management, accelerating adoption of technology and working towards business models for life beyond COVID. In case of buyout situatons PEs are proactively pushing their investee companies to tap into new opportunities coming up in these changing times, divest non-core assets, strengthen connects with their influencers and stake holders and look for a series of smaller acquisitions to make their investee company stronger.

Sze Shing Tan, Principal, Baker McKenzie Wong & Leow
Not all PE organsations look at a longer term horizon - but that will become one of the options if COVID-19 persists and valuations gap cannot be met.

> **There will be some delay in exits but there will be a balancing act between waiting longer vs doing opportunistic exits earlier.**
>
> **Ajay Arora**

Q: Given the opportunity created by banning Chinese apps, Indian startups would need growth funding on immediate basis. Will these be funded without conducting due diligence to grab the opportunity faster?

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
In the post-COVID environment, due diligence is very critical and most investors will continue to do detailed diligences instead of cutting corners whether they are investing for growth capital or buyouts. Overall, the diligence intensity will be higher and in addition to traditional forms there will be use of advanced tools based on AI and Analytics which are scanning through new dimensions around social media, existing customer base, operating systems, marketing and distribution channels, etc.

Q: The Indian Pharma sector has been one of the busiest in the M&A / PE space (following trends seen at global level); do you see any specific trends in deal activity in COVID era vis-a-vis pre-COVID times?

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
Apart from a broad-based step-up in Private Equity interest in the Pharma space post COVID, we see specific interest in the Pharma Bulk (active ingredients) segment, primarily because of :

(1) The global imperative to diversify away from Chinese RM sources
(2) Specific incentives announced by the Govt Of India for Indian companies to set up API / Intermediates capacities in the bid to reduce reliance on China

Q: What is your outlook for mid-cap versus large-cap market M&A over next 12 months and what would be the drivers? Please provide your perspective for key industries e.g. IT/Tech, Auto, Manufacturing etc.

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
Deal intensity in both mid cap and large cap would be impacted in short term but should claw back in the mid to long term. The level of deal acitivty could be different across different sectors subject to the impact of COVID on the sector. The key drivers across sectors would be (1) domestic consolidation, driven by divestments of non-core assets, deleveraging and distressed asset sales; (2) PEs investing in growth capital or buyouts. The bidder profile would consist primarily large strategics, PE funds for buy outs and growth capital and distressed funds.

Specific sector wise action that we could see:

1. IT / Technology - M&A is expected to be a key lever that well-capitalized companies will use to accelerate recovery. Sub-segments like Cloud, Cyber security, Analytics, Digital, Consumer tech, Ed tech, etc. are likely to see activity.
2. Auto / Manufacturing - Domestic consolidation will see the major play on the back of divestment of non-core and / or high degree of leverage or distress
3. Infrastructure and Renewable Energy - Divestments of operating platforms which are non-core assets from mid-sized players, InvITs, growth capital for greenfield projects and grid connected utility scale renewable energy projects
4. Financial Services - consolidation and need for ‘confidence capital’ will drive activity

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Ajay Arora

Q: How would private equity/strategic buyers do due diligence if there are travel restrictions?

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
To overcome the challenges posed by travel restrictions, we are seeing a growing importance of virtual meetings and data rooms and reliance on artificial intelligence and analytics-backed findings. There is greater scrutiny of the operating systems, marketing and distribution channels and existing customer base. Drones are becoming increasingly popular for virtual plant visits. IT due diligence owing to the increasing need to beef up IT infrastructure, IT security, collaboration tools and tweaked business processes for continued operation is also critical now.

Sze Shing Tan, Principal, Baker McKenzie Wong & Leow
Agreed with Ajay on the alternative methods of carrying out due diligence. For sensitive materials, we are still finding some reluctance to put information online - as there is no sure-proof manner of controlling access. Some buyers try to substitute on-site due diligence with warranties or other form of contractual performance. However these are frequently not perfect substitutes.

Q: In view of the continuing travel restrictions, are we seeing any reluctance in deals because of the lack of physical meetings, relationship building and due diligence activities, or are virtual interactions becoming a "new normal"? Is PIPE investment models becoming more attractive / popular?

Ajay Arora, National Leader and Head of Investment Banking Advisory, Ernst & Young
There was a pause button in the beginning of the lockdown but within a couple of weeks deal conversations restarted. Virtual interactions are becoming the new normal. There is active deal ideation going on resulting in meaningful conversations with the clients. Challenges remain in the virtual environment however both investment bankers and companies are moving forward with deal discussions so as to not lose momentum in the ongoing transactions.

Sze Shing Tan, Principal, Baker McKenzie Wong & Leow
Virtual interactions are now becoming the new normal. Apart from delays in the earlier part of the year when countries were beginning to lock down, investors are now comfortable participating in virtual meetings and negotiations. The key issue in transacting typically arises in due diligence and physical site visits where information cannot be provided online / virtual data rooms.

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Sze Shing Tan

Expert Insights

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Sze Shing Tan
Principal
Baker McKenzie Wong & Leow

Ajay Arora
National Leader and Head of Investment Banking Advisory
Ernst & Young

Pankaj Goel
Managing Director
Credit Suisse

Gunjan Shah
Partner
Shardul Amarchand Mangaldas

Desmond Chua
Head of Region, APAC
Datasite

Riddhima Saxena
Emerging Markets Editor
Mergermarket

#Wheredealsaremade

Get in touch, visit www.datasite.com **or contact: email** info@datasite.com |
AMERS phone +1 888 311 4100 | **EMEA phone** +44 203 928 0300 | **APAC** +852 3905 4800

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