Crowe Horwath

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Welcome to the September 2016 issue of Global Corporate Advisor.

In this issue, we discuss the strategic role that a corporate finance advisory firm can play when entrusted with the buy-side mandate. From research to strategic repositioning and creating a diversified product offering, the buy-side mandate can be interpreted widely to the company's advantage.

The second article addresses the start-up climate in India, which is seeing a policy level push by the government. To be effective, start-ups need to identify the pain points in various sectors and undertake initiatives that address these, whether in the food technology, e-commerce or in overall research and development. India has the potential to become a global driver of innovation by harnessing its strong domestic market, deep talent pool, and underlying culture of frugal innovation.

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The GCA team is here to respond to your needs relating to M&A transaction support, valuations and advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don't hesitate to contact Peter Varley, Chairman of GCA, at *peter.varley@crowecw.co.uk.* Alternatively, please contact your local GCA team member to discuss your ideas.

A Case Study on Strategic Role in a Buy-Side Mandate

By Paolo Ragazzi, Milan

Fratelli Pagani (FP) is the Italian leader in the field of spices, aromas and ingredients for the meat industry. Across 2014 and 2015, the company implemented a diversification and expansion process of the business through two major acquisitions, and was driven in such deals as advisor by Crowe Horwath Italy (via Next Advisor, its corporate finance advisory firm).

The original buy-side mandate was directed to competitors of FP, essentially companies whose core business was the supply of spices, aromas and ingredients for the treatment of meat, pre-finished products, for the industry, for professional butchers and delicatessens.

Research and the analysis of the potential target, interested in selling showed, however, that the acquisition of potential competitors could only substantially benefit FP in terms of acquisition of new clients, and not with gaining specific know-how and diversification in the market. In any case, as a market leader FP is already in a position to acquire new clients through aggressive market policies.

We then interpreted the mandate more widely, targeting a strategic repositioning of the group directing research into growing new sectors and markets, with a focus on generating strong synergies.

The greatest competitive advantage of FP is their ability to individuate and build strong relationships with international suppliers in countries as varied as India, China and, Vietnam, traditionally renowned for their spices, which allows FP to obtain supplies at competitive prices.

Consequently, Next Advisor directed the search towards companies that were operating in the world of spices and aromas, but were business to consumer. This would enable the client's entry into a market segment that they were not hitherto present in, while leveraging their core strength of product supply.

Keeping in mind the fact that the meat market, while driven by large volumes, is already quite mature, we focused on companies not particularly linked to the meat market.

Based on this strategy, FP undertook a 45% acquisition of La Collina Toscana, a company with a turnover of more than €20 mn, focused on retail of spices, herbs and seasonings.

For FP, this has created a major diversification both in terms of market and products, since La Collina Toscana is not only servicing the meat market, but also caters to fish, vegetables, pasta, and rice, among others.

Having ended this first successful deal, Next Advisor continued the search for targets in line with this new diversification strategy, resulting in a second acquisition in 2015.

This time the acquisition marks FP's entry into a related but completely different, high growth segment. Cerreto has been active in the organic food market in Italy for over two decades, as a food and agricultural company offering organic products of the typical regional and Mediterranean cuisine: herbs, spices, legumes and cereals, minestrone soups and risottos, soups, flavor enhancers and mixes for pasta sauces, seeds.

With this acquisition, FP entered the world of organic foods, which is showing high growth rates, following the trend of healthy food. In terms of synergy, the company's core products – salts, spices, seeds, legumes and cereals are familiar to FP.

Once Cerreto was identified, the deal was closed within six months with FP acquiring 93% of the capital, leaving 7% to the founder of Cerreto.

The entry of Cerreto in the world of FP has an immediate benefit in terms of strong synergies with a cost-saving plan in the next couple of years, especially in raw material, leading to an expected improvement of the EDITDA of more than five points.

FP thus enters a completely new and fast-growing market, acquiring credibility and know-how in organic products, which could enhance the brand-image of FP's core business and consequently of the other diversification processes.

Today FP is the Italian reference company in the world of organic and non-organic aromas, seasoning, spices, herbs, vegetables and grains in the industrial and the retail markets. Between 2014 and 2016, the group's revenue has grown from €30mn to more than €70mn.

With this consolidation in Italy, FP is ready to look outside and Next Advisor's buy-side mandate has the goal to identify new future acquisitions in Europe, in countries such as Poland, East-Europe, Germany and Spain.

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Don’t Just Start Up – Solve the Right Problem

By Shitij Bahl, New Delhi

India is heading towards being the next big start-up hub and a lot of buzz has been created around the recently launched Start-up India movement. The initiative aims at fostering entrepreneurship and promoting innovation by creating an ecosystem conducive to growth of start-ups. The objective is that India must become a nation of job creators instead of being a nation of job seekers.

Highlights of the start-up India program

- Compliance regime based on self-certification
- Legal support and fast-tracking patent examination at lower costs
- Relaxed norms for public procurement for startups
- Faster exit for start-ups
- Tax exemption on capital gains
- Tax exemption to start-ups for three years in a block of five years, if they are incorporated between April 1, 2016 and March 31, 2019
- Tax exemption on investments above fair market value
- Launch of Atal Innovation Mission (AIM) with self-employment and talent utilization (SETU) program
- Launching of innovation focused programs for students
- FAQs for startups hosted online
- List of incubators hosted online

Source: http://startupindia.gov.in

Fund of funds

A ‘fund of funds’ of INR100 billion for startups has been established by the government of India. The fund will invest in Securities and Exchange Board of India (SEBI) registered Alternative Investment Funds (AIFs) which, in turn, will invest in start-ups. Thus, this fund will act as an enabler to attract private capital in the form of equity, quasi equity, soft loans and other risk capital for start-ups.

Highlights of the status report published in September 2016

- 1010 applications received between April 1, 2016 and September 18, 2016
- 77 applications can be considered for tax benefits
- The Start-up India hub has been able to resolve 19,566 queries received from startups through telephone and e-mails
- Module to recognize incubators launched enabling them to obtain recognition from the government, which will allow them to issue recommendations
- Seven proposals for research parks, 16 proposals for Technology Business Incubators (TBIs) and 13 proposals for start-up centers have been recommended for assistance by the National Expert Advisory Committee

Source: http://startupindia.gov.in/uploads/pdf/Status_Report.pdf

It’s common to hear a new start-up story every day; some are inspiring, some are disappointing and some just don’t make any sense, either in terms of the usefulness of the product, or in terms of being a worthwhile investment opportunity.

It is a great thing to start-up, and we must give it a try, but successful start-up ideas should be in sync with what is required on a long-term basis, fulfilling a need in the catchment. In the excitement and eagerness to start something new, keeping some basic rules of the game in mind would help organizations look at the big picture.

E-commerce websites

Do we need another one? Are any of them actually making money? If we review the financials that are on the portal run by the Ministry of Corporate Affairs (MCA), available on paying a simple fee of INR100, we can see that most of these financial statements are not showing any profits, and are bleeding investor funds. In fact, India’s e-commerce startup losses grew 293% to INR7,88.4 million in FY15.

Despite the seeming ease in setting up an e-commerce start-up, online shopping ventures are a long-term play and require strategic inputs to make them profitable.

Overall, the positive impact of this proliferation of e-commerce websites is the opening up of a whole new marketplace and related ecosystems. Consumers appreciate the fact we can order almost anything online and get it delivered in a couple of hours.

In stage two of their operations, most e-commerce companies have realized the importance of investing in backend support and related activities. Many e-commerce ventures are scouting for companies providing innovative warehousing and logistics solutions, which makes entry into this sector a viable idea for those looking to jump into the start-up wave.

The ecosystem can get better only if more start-ups focus on improving the ecosystem at each and every step, eventually improving the online experience.

Instead of focusing on another consumer-facing online venture in the fiercely competitive market, startups may be more effective if they focus on related activities, solving problems that are currently a hindrance to the success of the online shopping world.

Food technology

Anecdotally speaking, and from scanning media reports, it appears that food technology is currently a hot topic among potential start-ups and investors. However, unless new companies are willing to tackle the underlying dynamics of the sector, start-ups in the high-waste food sector may be doomed to failure.

Many start-ups in this sector have closed or are about to. Examples include Bangalore-based Dazo, which shut down within te year despite changing its business model from being an internet kitchen to a restaurant aggregator. Restaurant delivery service, Tinyowl shut operations in all cities except Mumbai, and Mealhopper, a service connecting customers to home-cooked meals has been facing operational difficulties too.

According to a Vision 2050 paper by the Indian Council of Agricultural Research, published in 2015, agricultural commodities post substantial incremental losses, estimated to be from 6 to 18% in 2012 during post production operations such as collection, cleaning, sorting/grading, decortications/shelling, drying, milling, packing, transportation, storage and value addition before reaching the consumer.[1]

Among its short-term challenges, the paper lists using food technology to identify on-farm losses during storage by providing cost-effective cooling solutions. Technology for primary processing, safe packaging and transportation is also needed.

In this scenario, successful start-ups will need to focus on resolving issues in the present ecosystem. They need to find solutions to first enable an ecosystem, which comprises elements such as home chefs, professional chefs, delivery people, kitchen equipment, delivery vehicles, quality control, food labs and test labs. There are many variables involved in this business, and many areas for potential success. An infrastructure-first approach is necessary for a food technology start-up to be profitable.

While apps and enabling technology are good, it is important for stakeholders in this sector to introduce the government to new infrastructure development, support new ideas for employment and address wider issues.

Taxi aggregation

Due to the entry of taxi aggregation companies, customers can find a reliable, fast and cheap mode of transport and drivers can look forward to a higher standard of living.

Currently, the major players are Uber and Ola; the two rival companies with foreign funding trying to capture market share.

However, beyond the entry level disruptor stage, things are likely to get complicated. In countries where taxi aggregation has been around for a while, the maturing market is scrambling to address issues such as driver training, costs and dynamics of car servicing, social profiling and driver behavior mapping to ensure safety.

Having solved a problem with an app, start-ups need to look beyond the first stage towards building a start-up to help in the evolution of this sector so they can continue to be meaningful and relevant.

Research and Development

To be truly competitive and hold its own against technology majors, Indian start-ups will need to begin focusing on research and development (R&D).

Rather than focusing on smaller app projects, which will always depend on Apple, Google and Microsoft, start-ups need to focus on R&D. Unless Indian start-ups start ideating on a bigger scale and support large R&D projects, the bigger chunk of profit will always go to these companies.

India has been ranked 66 on the Global Innovation Index (GII) 2016 released this August. It has climbed 15 spots, from 81 in 2015, and maintained the top spot in the Central and South Asia regions. Worldwide the top spots are occupied by Switzerland, Sweden, the UK, the US, Finland and Singapore. In 2016, China has climbed to number 25, becoming the first middle-income country to enter the top 25 of the index in its nine editions of ranking the innovative capacity of 128 economies.

[1] *http://www.icar.org.in/Vision%202050%20CIPHET,%20Ludhiana.pdf*

India's rank was low (117) in business environment. And while the overall education scoring was low, it was among the top 10 in graduates in science and engineering. It scored well in global R&D in the top three companies, in university rankings and in creative goods exports. Number 1 in information and communication technology service exports and number 3 on the domestic market scale that is measured by gross domestic product (GDP) based on the purchasing-power-parity (PPP) valuation of country GDP, the country is said to have all the ingredients needed to become a global driver of innovation. Its strong market potential, a deep talent pool, and underlying culture of frugal innovation brings India second on innovation quality among middle-income economies, overtaking Brazil.

The index's report underlined that India's priorities for innovation need to be in the areas of energy, water, transport, health care, food security and digital consumption.[2]

A startup needs to focus on ingenious ways to solve problems, starting with fixing roads faster and making them more durable, and enabling every house to generate its own power and utilize resources efficiently. New and innovative housing and building material will enable the government to achieve its ambition of providing shelter to all. Ingenious ways for revolutionizing agriculture and community building will enable self-sufficiency, even as e-schools ensure that education reaches every village.

Efficient start-ups don't aim to dazzle with another temporary viral idea; they create good, reliable solutions that address vital issues relevant to large sections of the population. This will enable holistic growth and create a foundation for entrepreneurs to thrive in.

So don't just start up, please take the time to solve the right problem.

[2] *https://www.globalinnovationindex.org/analysis-economy*

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