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India Watch

Welcome to the Winter edition of Grant Thornton's India Watch, in association with the London Stock Exchange

A look back at the performance of the Grant Thornton India Watch Small Cap Index in 2014 shows that the Index fell by 40% during the year, reflecting the negative impact of investors' concerns over the slowing down of the economy, inflation and the fiscal deficit.

However the Index remained relatively flat in the fourth quarter of 2014, with a fall of just 4%, suggesting greater yet cautious investor optimism following the change in government and a number of new measures introduced to bolster inward investment. Despite this apparent rally in investor confidence in the fourth quarter, there is some way to go before we see a full recovery in confidence in Indian issuers in the London markets.

The Indian economy has gathered pace as the government tries to 'walk the talk' on key reforms.

Prime Minister Narendra Modi is riding high on the improving prospects for the economy, with business sentiment picking up and foreign investors betting big on a market of 1.2 billion people.

Estimates by a number of international agencies and think tanks point to a sustained economic recovery.

Indian M&A and private equity activity was at a three-year high in 2014 on the back of these more bullish expectations for economic growth. There were eight separate billion dollar-plus M&A transactions during the year, with more big ticket deals in the pipeline for 2015.

In this issue we also discuss the potential benefits of depository receipts (DRs) for Indian companies looking to raise capital in foreign countries that has been largely inaccessible to them previously.

While foreign investment in India has increased from US$2.3 billion to US$27.3 billion over the last decade, the DR investment route has failed to keep pace, necessitating significant revisions to India's existing DR scheme.

If you would like to discuss any of the matters arising in this issue or how Grant Thornton's South Asia group can help you, please contact us.

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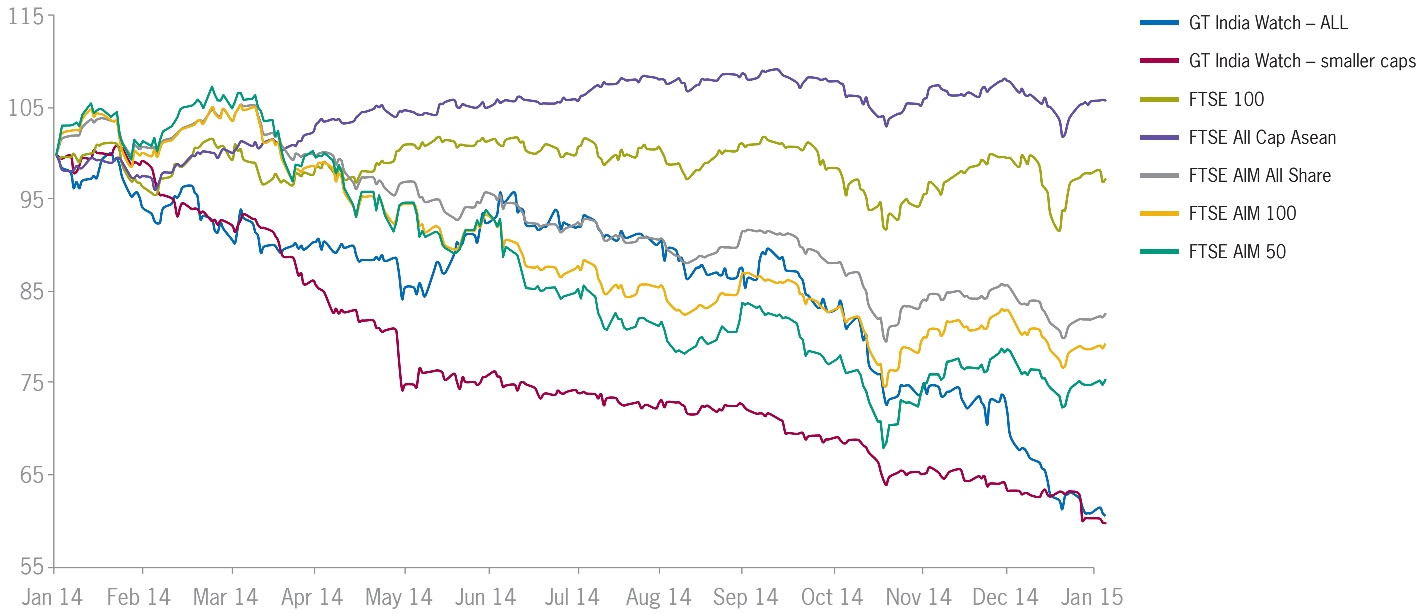
Grant Thornton India Watch Small Cap Index reflects more upbeat last quarter

The Grant Thornton India Watch Small Cap Index fell by 40% during 2014 compared to falls in the FTSE 100 and FTSE AIM 100 Indices of 3% and 21% respectively. However the Index remained relatively flat in the fourth quarter, with a fall of just 4%, reflecting cautious investor optimism following the change in government and a slew of measures introduced in the second half of the year to bolster inward investment.



Source: Factset

The decline in the Grant Thornton India Watch Index* over the course of 2014 suggests that investors' concerns regarding the slowing down of the Indian economy, inflation and the fiscal deficit had a largely negative impact. One of the largest losers of 2014 was metals and mining giant Vendanta Resources, which, due to its market cap weighting, brought the All Company Index down to the same level as the Small Cap Index in the fourth quarter. The overall decline of the India Watch Index was mainly concentrated in the first three quarters of 2014, with a relatively small decline in the fourth quarter. Despite the apparent rally in investor confidence following the raft of new measures introduced to allay their concerns since the election of India's new government in May, there is some way to go before we see a full recovery in confidence in Indian issuers in the London markets.

Winners and losers

The biggest losers in the fourth quarter were oil and gas company Oilex and biofuels producer Nandan Cleantec, losing 59.6% and 46.7% respectively. Oilex's share price has been greatly affected by the falling price of oil, despite the company stating that this would be offset by a 250% increase in the oil/gas ratio. The company recently issued 61 million shares at a 20% discount to its average share price, raising AUS$2.5 million.

Shares in Nandan Cleantec, a vertically integrated biofuels producer, were 46.7% down in the fourth quarter due to the company's lack of working capital as it continued to post losses. Nandan's inability to secure additional funding has resulted in the company's shares being suspended and it has now entered into administration.

Vedanta Resources' share price fell 42.5% over the quarter due in a large part to the continuing fall in the price of oil, but also as a result of falling zinc and aluminium prices. This resulted in the 13 analysts who cover the stock giving a hold rating for the company. The analysts cited ongoing operational difficulties and a rise in net debt at the company due to the share purchase of Sesa Sterlite and Cairn India.

Focusing on more positive performances, EIH, a private equity investment company, and India Capital Growth Fund were the winners in the quarter, up 15.9% and 15.3% respectively. Following EIH's sale of its shareholding in Gland Pharma Limited in November 2013 and the receipt of distributions from EIF-Coinvest X and EIF, EIH returned US$16.8 million to shareholders in July 2014. India Capital Growth Fund benefited from a strong performance by the India equity markets, driven by dominant macro factors including the fall in oil prices and further positive policy-related news flow.

The quarter also went well for security company Mortice, which saw its share price rise by 10.7% due largely to its announcement in October that it had won 150 new contracts across its subsidiaries. Furthermore, the company released interim results in November which showed an increase in revenues and profits of 19.4% and 14.1% respectively, compared to the six months of the previous year.

Country outlook

The Indian government recently announced a number of new initiatives including the 'Make in India' campaign aimed at giving the Indian economy global recognition. This initiative is expected to increase the purchasing power of the Indian consumer, which would further boost demand, and hence spur development, in addition to benefiting investors. The 'Make in India' initiative is expected to be a vital component in India's quest for achieving wholesome economic development. Meanwhile, the fall in oil prices is expected to assist the country's fiscal deficit and balance of payments.

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*The India Watch Index consists of 26 Indian companies listed on AIM or the Main Market (excluding GDRs). We only consider companies to be Indian if they are domiciled in India and/or foreign companies holding Indian assets or Investment companies with Indian promoters. The index has been created via Factset and is weighted by Market Value. To avoid distortion of index trends, the largest market cap entity, Vedanta Resource, is excluded.

**Data sourced from Factset.

Indian M&A and private equity activity at a three-year high

Despite a slow start last year, the second quarter of 2014 set off a resurgence of deal activity as India Inc. went bullish on expectations of economic growth returning after the general election. A clear mandate for the BJP provided further momentum which sustained through the year, leading to 1,177 deals – the highest for a decade – worth over US$50 billion. Corporate M&A activity contributed close to US$38 billion from 573 deals, with private equity contributing US$12 billion from 604 deals.

Deal summary	Volume			Value (US$ billion)		
	2012	2013	2014	2012	2013	2014
Domestic	233	218	253	6,088	5,636	16,316
Crossborder	262	221	283	14,507	17,985	17,809
Mergers and internal restructuring	100	58	37	14,789	4,541	3,989
Total M&A	**595**	**497**	**573**	**35,384**	**28,162**	**38,114**
Private equity	401	450	604	7,378	10,007	12,358
Grand total	**996**	**947**	**1,177**	**42,761**	**38,169**	**50,472**
Crossborder includes						
Inbound	140	139	166	5,955	8,736	11,829
Outbound	122	82	117	8,552	9,249	5,981

2014 saw eight M&A deals grace the billion-dollar club, while 54 deals were valued at over US$100 million each, paving the way for more big ticket deals in the pipeline for 2015. While the buoyant market can largely be attributed to the keenly-awaited, decisive election results, intrinsic business strength, the underlying drivers of consolidation and unlocking value are still the mainstays driving successful deal closures.

M&A contributed close to US$38 billion from 573 deals. Domestic and inbound deals provided the highlights of 2014 as we saw global players betting on the revival of India's growth story or consolidating their existing holding in Indian subsidiaries. Domestic deals largely rode on the consolidation bandwagon, with Sun Pharma acquiring Ranbaxy, Kotak merging with ING Vysya, Flipkart looping in Myntra and a few large power sector mergers and acquisitions. 2014 also witnessed one of the lowest levels of outbound M&A by deal values at just US$6 billion, although volumes remained robust at 117 deals. Overseas investors continue to tap the potential in Indian markets, resulting in a 35% increase in inbound values compared to 2013 and a 19% increase in volume of deals.

Top M&A deals in 2014

Acquirer	Target	Sector	US$ million	Deal type	% Stake
Sun Pharmaceutical Industries Ltd	Ranbaxy Laboratories Ltd	Pharma, healthcare & biotech	3,200.00	Acquisition	100%
Cognizant Technology Solutions	TriZetto Corp	IT & ITES	2,700.00	Acquisition	100%
Kotak Mahindra Bank Limited	ING Vysya Ltd	Banking & financial services	2,500.00	Merger	100%
Diageo Plc	United Spirits Ltd	Retail & consumer	1,903.33	Increasing stake to 54.78%	26%
JSW Energy	Jaypee Group-Jaiprakash Power Ventures Ltd (JVPL) hydropower assets	Energy & natural resources	1,570.00	Acquisition	N.A.
Vodafone Group Plc	Vodafone India Limited	Telecoms	1,435.48	Internal restructuring	11%
American Tower Corp	Bharti Airtel Ltd – Nigeria telecom towers	Telecoms	1,050.00	Acquisition	N.A.
GlaxoSmithKline Pte. Ltd.	GlaxoSmithkline Pharmaceuticals Limited	Pharma, healthcare & biotech	1,032.26	Increasing stake to 75%	24%
Adani Ports and Special Economic Zone Adani Group	Dhamra Port Company Limited – JV between L&T and Tata Steel	Transport & logistics	932.20	Acquisition	100%
UltraTech Cement Ltd	Jaiprakash Associates Ltd – two units	Manufacturing	853.00	Acquisition	100%

The IT & ITES sector was the largest contributor to M&A by deal value in 2014, followed by the pharma & healthcare sector and telecoms. Based on volume of deals, IT & ITES continues to top the charts, followed by manufacturing and pharma.

Private equity

It was also a blockbuster year for private equity activity, which saw the highest number of deals and second highest in terms of value for a decade – 604 deals worth US$12 billion. India witnessed a 23% increase in deal value and a 34% increase in deal volumes compared to 2013. The continued uptick in volumes was marked by 22 investments worth over US$100 million each.

Top private equity deals in 2014

Investor	Investee	Sector	% Stake	Investment value in US$ million
Morgan Stanley Investment Management, GIC, Accel Partners, DST Global, Iconiq Capital and Sofina	Flipkart Online Services Pvt Ltd	IT & ITES	N.A.	1,000.00
Softbank Corp	Snapdeal	IT & ITES	N.A.	627.00
Canada Pension Plan Investment Board	Kotak Mahindra Bank	Banking & financial services	3%	366.67
Brookfield Property Partners	Six IT parks in India	Infrastructure management	N.A.	347.00
Capital Square Partners, CX Partners etc	Aditya Birla Minacs Worldwide	IT & ITES	100%	260.00
Naspers Ltd.; Tiger Global Management; DST Global; ICONIQ Capital	Flipkart Online Services Pvt Ltd	IT & ITES	N.A.	210.00
Softbank Corp	Olacabs	IT & ITES	N.A.	210.00
Warburg Pincus	Kalyan Jewellers India Pvt Ltd	Retail & consumer	24%	195.60
Temasek, IDFC Alternatives	GMR Infrastructure	Infrastructure management	12%	183.00
KKR	GMR Holdings Pvt. Ltd	Infrastructure management	N.A.	164.20

The IT & ITES sector took the lead in private equity deals, largely driven by the e-commerce sector, raising about US$4 billion from over 100 deals, contributing over 30% of overall private equity deal value. Other key sectors were real estate and infrastructure, with over US$2.4 billion, and banking & financial services, contributing over US$1.4 billion, with investors speculating on promising growth in these sectors driven by reforms being pushed by the new government. Intense competition in the e-commerce sector between Flipkart, Snapdeal and Amazon is expected to keep stakeholders on the edge of their seats in 2015.

2014 also saw several private equity players cashing in on exits from vintage investments – notably the Bain-Hero Motocorp, ChryCapital-HCL and Intas exits – a welcome trend for long term investors who have ploughed close to US$90 billion into Indian companies over the last decade. The investment window of five to eight years has already passed for several private equity investments, making a wave of exits imminent. The exit market will benefit from the overall capital market recovery, strong inbound interest and improved business sentiment driving fundamental operational metrics. The year also saw a peak in both the number of and money raised by Qualified Institutional Placements (QIPs) – over US$5 billion – making this the preferred route for corporates to raise funds in the capital market in 2014.

Top M&A sectors in 2014

- IT & ITES **[17%]**
- Pharma, Healthcare & Biotech **[15%]**
- Energy & Natural Resources **[13%]**
- Telecom **[12%]**
- Retail & Consumer **[9%]**
- Banking & Financial Services **[9%]**
- Manufacturing **[7%]**
- Real Estate **[6%]**
- Others **[12%]**

Top private equity sectors in 2014

- IT & ITES **[43%]**
- Banking & Financial Services **[11%]**
- Infrastructure Management **[10%]**
- Real Estate **[10%]**
- Retail & Consumer **[6%]**
- Pharma, Healthcare & Biotech **[5%]**
- Others **[15%]**

Final words

2014 was important in many respects for India Inc. After a rather cautious start to the year, we witnessed an unleashing of deals from the second quarter. We saw the year ending on a high note, with US$50 billion worth of deals, the highest since 2011.

We expect 2015 to benefit from a combination of stable government, significant reforms, falling commodity prices and minority foreign investors increasing control of their investments, all of which should continue to drive deal activity across all sectors.

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Indian economy gathers pace as the government tries to 'walk the talk' on key reforms

With foreign investment, energy security and strategic partnerships at the top of his agenda, the Indian Prime Minister Narendra Modi criss-crossed eight countries, including the US, Australia, Japan and Nepal, meeting more than 40 international leaders in the first six months of his tenure. Mr Modi is riding high on the improving prospects for the Indian economy, with business sentiment picking up and foreign investors betting big on a market of 1.2 billion people.

Estimates by a number of international agencies and think tanks point to a sustained economic recovery. The World Bank recently raised India's gross domestic product (GDP) growth rate projection for 2015 to 6.4% and for 2016 to 7%. Growth had slipped to below 5% in the previous two fiscal years. Net foreign direct investment (FDI) into India stood at US$14.47 billion in the first six months of 2014-15, up 15% year-on-year. The inflow is expected to grow significantly in the next few quarters as the government has announced easing of FDI rules for the construction sector and is ready to 'walk the talk' on the insurance sector as well.

However, one of the key concerns among foreign investors has long been India's low ranking (of 142) on the World Bank's Ease of Doing Business parameter. This too may change in the near future, with the introduction, by the previous (UPA) government, of The Companies Act 2013, which replaced nearly 60-year-old legislation and is aimed at aligning India's corporate regulatory framework with global best practices.

These developments resonate with court verdicts in two important cases relating to tax disputes between the government and large multinational companies – Vodafone and Shell. The Bombay High Court has ruled in favour of the Indian unit of Vodafone Group in a case involving Rs 3,200 crore. This gives a major confidence boost to foreign companies with subsidiaries in India. In another case involving a dispute over transfer pricing share valuation, the court passed a judgement in favour of Shell, the global oil giant. Both of these cases made headlines across the globe, risking India's reputation as a favourable investment destination. While the government is pondering whether to challenge the court orders in the country's Apex Court, for now, these judgements have calmed the nerves of large multinationals with significant presence in the country. For Vodafone, however, the court battle is not yet over as it is contesting a bigger tax dispute of around Rs 10,000 crore in the Bombay High Court. The judgement is eagerly awaited.

Even as the government battles it out in the courts, the Indian stock market remains on a roll. The market capitalisation of the Bombay Stock Exchange (BSE) touched US$1.6 trillion on 28 November 2014, a growth of over 40% since the previous year. Foreign portfolio investors put in almost US$40 billion in Indian stocks in 2014, raising the stakes in an economy driven by positive investor outlook and reform-oriented government policies.

The government's mission to make India a manufacturing hub has been hit by a slump in industrial output in October at -4.5%, as against 2.5% in September. This was on the back of negative growth in manufacturing and consumer goods, although both mining and electricity grew on a year-on-year basis. However, there was good news on retail inflation, which eased to 4.4% in November, compared with 5.5% in the previous month.

The auto sector also registered growth in November after a lukewarm Diwali festive season. Commercial vehicle sales in India grew 9.05% during the month, led by a 40.1% growth in sales of trucks and buses. In the eight months to 30 November, car sales have grown 3.8% over the same period last year.

While the government tries to 'walk the talk' on its economic agenda, all eyes are on the upcoming Union Budget, which will be presented in February. The Finance Minister, Arun Jaitley, has indicated that the Budget will usher in a "second generation of reforms". Despite optimism, India Inc. wants to see more action, particularly on infrastructure, manufacturing and taxation, as it strives to grow rapidly after the years of lull that the Indian economy has seen.

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Sources
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4. New Indian Express
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Liberalisation of India's depository receipts regime to further help companies raise overseas capital

Issuing depository receipts (DRs) – foreign currency denominated instruments issued by a foreign depository on the back of permissible securities of domestic (Indian) corporates – is beneficial for Indian companies in opening up a new avenue to raise capital in foreign countries. DR enables Indian companies to tap overseas resources of capital that have been largely inaccessible to them previously.

However, investment through the DR route has typically not found favour with foreign investors in Indian companies in the past. Although many foreign investors have a 'home country bias', preferring investment in securities in their home country and local currency, that trend has not been visible in foreign investments in India. While foreign investment in India has increased from US$2.3 billion to US$27.3 billion[1] over the last decade, the DR investment route has failed to keep pace, necessitating significant revisions to India's existing DR scheme.

The Depository Receipts Scheme 2014 (2014 Scheme) which came into effect on 15 December 2014, is designed to bolster foreign investment and further streamline access to capital for Indian companies. The 2014 Scheme expands the range of permissible asset classes of underlying securities, allows unlisted companies to issue DRs and also permits DRs to be issued for non-capital raising purposes. DRs issued under the 2014 Scheme will be available to investors in 34 countries, subject to the conditions under the foreign investment regime, including the conditions in relation to sector specific caps and pricing.

Under the 2014 Scheme, Indian companies (whether private or public, listed or unlisted) as well as holders of permissible securities can issue DRs. The scope of permissible securities has been expanded under the 2013 Scheme to include equity, equity derivatives, debt securities, government bonds and corporate bonds, which can be acquired by a person resident outside India and are in dematerialised (non-physical) form.

Further, the 2014 Scheme introduces a new concept of unsponsored DRs – issued without the permission of the issuer company – for DRs that are listed on international exchanges and give the holder the right to issue voting instructions.

Notwithstanding the need for some consequential amendments to related laws and regulations and clarity on the tax impact of the transfer of DRs, the 2014 Scheme is a welcome step, and presents a great opportunity for Indian companies as well as foreign investors. With the renewed interest of foreign investors in India, coupled with the government's steps towards growth through campaigns such as 'Make in India', greater stability in India's regulatory environment and the relaxation of foreign investment caps and conditions, it is hoped that the 2014 Scheme will have more success than its predecessors.

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1. Report of the Committee to Review the FCCBs and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993, Ministry of Finance, Government of India, November 2013.

About Grant Thornton UK LLP

Grant Thornton UK LLP established a dedicated South Asia Group in 1991 to serve Asian owned businesses in the UK as well as those investing into and from the Indian subcontinent. We are proud to be one of the first UK accountancy firms to focus on this region.

We are widely recognised as one of the leading international firms advising on India-related matters and have been in involved in every IPO involving an Indian company on AIM, with the exception of the real estate sector.

For those clients requiring advice in both the UK and India we offer a seamless service building on the already strong and close relationship between Grant Thornton UK LLP and Grant Thornton India.

About Grant Thornton India LLP

Grant Thornton India LLP is one of the oldest and most prestigious accountancy firms in the country. Today, it has grown to be one of the largest accountancy and advisory firms in India with nearly 1,500 professional staff in New Delhi, Bangalore, Chandigarh, Chennai, Gurgaon, Hyderabad, Kolkata, Mumbai and Pune, and affiliate arrangements in most of the major towns and cities across the country.

The firm's mission is to be the adviser of choice to dynamic Indian businesses with global ambitions – raising global capital, expanding into global markets, adopting global standards or acquiring global businesses.

International and emerging markets blog

As part of our commitment to remaining at the forefront of changes and developments in regards to UK-India relationship we will be using this space to post original thought leadership and research relevant to the industry. The idea is to encourage discussion around these issues and to open up new areas and debate.

To participate:
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