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In association with London Stock Exchange

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India Watch

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

Grant Thornton's India Watch Index rose by 1.9% in Q2 2014 – the first rise for more than a year, reflecting greater investor optimism towards India following the country's recent general elections. This compares with a 2.2% increase in the FTSE 100 and an 11.4% decrease in the FTSE AIM 100.

The first quarter of 2014 was mixed for the economy, with a year-on-year fall in imports and exports, price rises and consumer price inflation (CPI) still at a relative high. With a newly elected government in power however, India's economy appears to be heading towards a revival. Industrial growth is on the rebound, manufacturing grew at its fastest in nine months and CPI has reached a three-month low. Investor sentiment is also high, with stock markets rising sharply and the rupee gaining ground against the dollar.

The short-term outlook for India will depend on the implementation of meaningful economic reforms and policies. The new government's inaugural Budget, aimed at balancing growth-oriented reforms with reducing the fiscal deficit, thankfully appears to have hit the right note. The increase in the FDI cap on defence, from 26% to 49%, and plans to invest in infrastructure and insurance sectors were particularly welcome and should go some way towards reinvigorating the economy.

After several cautious years in M&A and investment activity – and despite a slow start to 2014 – India finally appears to have turned a corner. Renewed interest in strategic alliances and growing risk appetite has prompted a resurgence in M&A activity in recent months.

Cash-rich companies are again starting to focus on investments, with a strong revival in inbound interest. In the year to date, we have seen 560 deals worth US$23 billion, significantly up on the 460 deals worth US$17.7 billion during the same period in 2013. While strategic deals (corporate M&A) made up 77% of overall deal activity at US$17.8 billion (273 deals), private equity accounted for US$5.3 billion (287 deals).

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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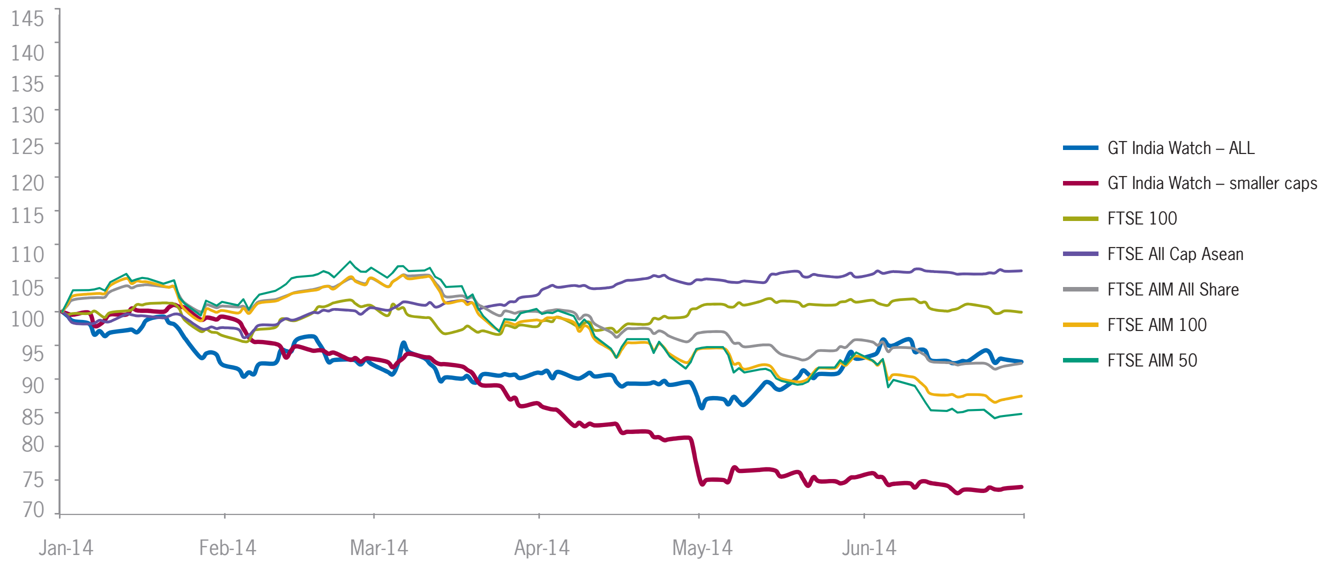
Grant Thornton India Watch Index rises in Q2 2014 after five consecutive quarters of decline

Grant Thornton's India Watch Index rose by 1.9% in Q2 2014, compared with a 2.2% increase in the FTSE 100 and an 11.4% decrease in the FTSE AIM 100. This is the first rise in the Index for more than a year and coincides with greater investor optimism towards India.



Source: Factset

The strong performers

It was a mixed bag for oil and gas producers and electricity providers. A combination of operational developments, corporate activity and anticipated economic policy changes largely drove Q2's movers and shakers with Oilex, Hardy Oil and Gas, and OPG Power Ventures all up. Indus Gas and KSK Power Ventur, on the other hand, were down.

Oilex had an exceptional quarter, with its stock price up 63.9%. In April 2014, the company reported finding a commercially viable hydrocarbon reserve at the Cambay project (in the state of Gujarat) and, in June 2014, it announced the start of fracture stimulation operations at the Cambay well. Anticipation is growing ahead of a pivotal well test in Cambay, with major shareholder Magna Energy increasing its shareholding from 17.37% to 19.11% in June 2014.

Hardy Oil and Gas was up 56.3%. The company reported a smaller pre-tax loss of $5.4 million for the 15 months ended 31 March 2014, compared with $12.7 million in the 12 months ended 31 December 2012. It appears that investors expect the company to benefit significantly from political and economic changes, as well as increased demand for natural gas in India.

Unitech Corporate Parks (UCP), an Indian commercial real estate investor, agreed to sell its entire stake in Candor Investments Limited (the holding company for UCP's property interests) to Brookfield Property Partners for a cash consideration of £205.9 million. The stock was up 36.8%, largely reflecting the estimated capital returns to shareholders.

The stragglers

KSK Power Ventur, which focuses on power generation, was down 28.2%, mainly as a result of a below-expectation trading update for the six months to March 2014. Added to this, KSK Energy Ventures (its Indian unit) raised around $67.5 million through a qualified institutional placement in June 2014, diluting KSK Power Ventur's shareholding from 74.94% to 67.6%.

iEnergizer, a provider of business process outsourcing solutions, saw its share price plummet 62.1% when the company issued a trading update in May 2014 announcing reduced profits for the year to March 2014.

Country outlook

We remain cautiously optimistic on India after the National Democratic Alliance (NDA) government came to power. The short-term outlook will depend on economic reforms and policies introduced by the new government. We anticipate that there will be renewed confidence over the next year – among investors and issuers alike – which should lead to IPO activity in the medium to long term.

A great deal will, however, depend on the decisions and actions of the NDA government. We will be watching this space closely over the coming months.

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*The India Watch Index consists of 27 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 two largest market cap entities, Essar Energy and Vedanta Resource, are excluded.

**Data sourced from Factset.

Uptick in deal momentum bodes well for 2014

After several cautious years in terms of mergers and acquisitions (M&A) and investment activity, India is now at an important juncture. The country is expecting a turnaround in corporate M&A as interest in strategic alliances and risk appetite appears to grow.

Deal Summary	Volume			Value (US$ billion)		
	2012	2013	2014	2012	2013	2014
Domestic	131	115	117	3,143	3,015	7,651
Crossborder	124	113	134	5,113	8,463	6,921
Mergers and internal restructuring	68	25	22	14,539	499	3,257
Total corporate M&A	**323**	**253**	**273**	**22,795**	**11,978**	**17,830**
Private equity	219	207	287	3,798	5,680	5,344
Grand total	**542**	**460**	**560**	**26,593**	**17,658**	**23,174**
Crossborder includes						
Inbound	76	65	89	2,974	4,095	5,355
Outbound	48	48	45	2,139	4,369	1,567

Cash-rich companies are again starting to focus on investments, with a strong revival in inbound interest. In the year to date, we have seen 560 deals worth US$23 billion, significantly up on the 460 deals worth US$17.7 billion during the same period in 2013. While strategic deals (corporate M&A) made up 77% of overall deal activity at US$17.8 billion (273 deals), private equity (PE) accounted for US$5.3 billion (287 deals).

Deal summary

Corporate M&A activity in H1 2014 saw an upsurge in deal value, largely driven by several big-ticket deals. Deal volumes also grew sharply compared to the same period last year. However, we are yet to see the overall M&A deal value of H1 2012, even though the total number of deals in the first half of the year was slightly higher by comparison.

In the domestic sphere there were a number of large deals. Sun Pharma-Ranbaxy was the largest at US$3.2 billion, followed by two deals of over US$500 million each and nine valued at over US$100 million each.

The volume of cross-border deals rose to 134, higher than in H1 2012 or 2013, largely due to an increase in inbound deals. Overall deal value was, however, only US$6.9 billion, far below the US$8.5 billion recorded in H1 2013. While inbound deals surpassed previous levels in terms of both value and volume, there was a slowdown in the overall level of cross-border deals due to the absence of any large outbound deal activity, although outbound deal volumes remained fairly consistent.

Top corporate M&A deals – H1 2014

Acquirer	Target	Sector	US$ million
Sun Pharmaceutical Industries Ltd	Ranbaxy Laboratories Ltd	Pharma, Healthcare & Biotech	3,200
Vodafone Group Plc	Vodafone India Ltd	Telecom	1,435
GlaxoSmithKline Pte Ltd	GlaxoSmithKline Pharmaceuticals Ltd	Pharma, Healthcare & Biotech	1,032
Adani Ports and Special Economic Zone – Adani Group	Dhamra Port Company Ltd – joint venture between L&T and Tata Steel	Transport & Logistics	932
Emperador Inc	Whyte & Mackay Group – United Spirits	Retail & Consumer	725
Reliance India Ltd through Independent Media Trust	Network 18 Media & Investments Ltd (including TV 18 Broadcast Ltd)	Media & Entertainment	678
Vodacom – Arm of Vodafone	Neotel – Tata Communications Ltd	Telecom	455
Aman Resorts Group Ltd – joint venture between Peak Resorts and Adrian Zecha	Silverlink Resorts – owner of Amanresorts (excluding Lodhi Hotel, Delhi)	Hospitality & Leisure	358
Essar Oil	Vadinar Power Company Ltd	Energy & Natural Resources	355
Flipkart	Myntra	IT & ITES	340

M&A sector focus

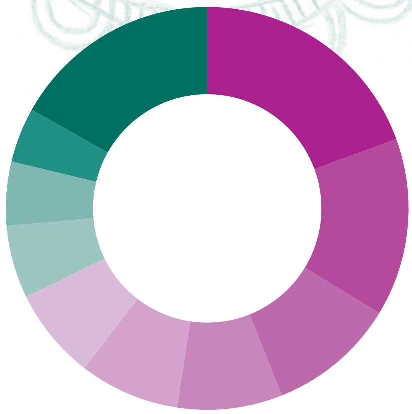
A number of sectors contributed to M&A activity in H1 2014. IT & ITES, however, continues to top the charts in terms of deal volume, which is consistent with H1 2012 and 2013 figures. Close to 50% of deal flows into IT & ITES were captured by e-commerce businesses, making it the largest sub-segment within the sector for M&A, closely followed by IT services. Flipkart's acquisition of Myntra has been the biggest deal in the sector so far. Pharma & Healthcare appears to be fast catching up, with several deals announced in the pharmaceuticals segment and further growth expected during the second half of the year.

PE focus

While PE investments were higher in volume terms (287 deals in H1 2014 compared to 207 in H1 2013), they were fairly consistent in value terms (US$5.3 billion and US$5.7 billion, respectively). Deal flow during the period has been fairly stable, with the overall value of deals only catching up in June when US$1.7 billion worth of deals were announced. This compares to an average of US$700 million per month between January and May 2014.

Several investors exited their investments with high multiples, particularly in June. With 2007 and 2008 vintage deals fast approaching their five to seven-year investment horizon and an improvement in market conditions generally, we are likely to see more investors exit their current investments and walk away with a healthy profit.

Top M&A sectors in H1 2014

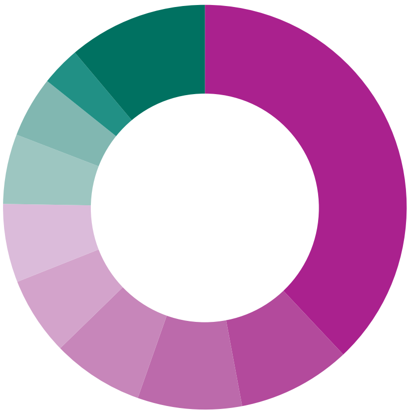


- IT & ITES **[20%]**
- Manufacturing **[14%]**
- Pharma, Healthcare & Biotech **[10%]**
- Banking & Financial Services **[9%]**
- Retail & Consumer **[8%]**
- Energy & Natural Resources **[7%]**
- Media & Entertainment **[6%]**
- Real Estate **[5%]**
- Infrastructure Management **[4%]**
- Others **[17%]**

Top PE deals – H1 2014

Investor	Investee	Sector	Stake	US$ million
Canada Pension Plan Investment Board	Kotak Mahindra Bank	Banking & Financial Services	3%	367
Brookfield Property Partners	6 IT Parks in India	Infrastructure Management	N.A.	347
Capital Square Partners, CX Partners, etc	Aditya Birla Minacs Worldwide	IT & ITES	100%	260
Naspers Ltd; Tiger Global Management; DST Global; ICONIQ Capital	Flipkart Private Ltd	IT & ITES	N.A.	210
Temasek, IDFC Alternatives	GMR Infrastructure	Infrastructure Management	12%	183
Canada Pension Plan Investment Board through its Singapore-based wholly-owned subsidiary	L&T Infrastructure Development Projects Ltd	Infrastructure Management	N.A.	161
Warburg Pincus	Laurus Labs Pvt Ltd	Pharma, Healthcare & Biotech	25%	150
Temasek Holdings	Intas Pharmaceuticals	Pharma, Healthcare & Biotech	10%	140
Xander Group	7.8 lakh square feet commercial space – Infinity Tech Park	Real Estate	100%	108
Premji Invest, Temasek Holdings, BlackRock, Myriad and Tybourne	Snapdeal.com-Jasper Infotech Pvt Ltd	IT & ITES	10%	100

PE sectors in H1 2014



- IT & ITES **[38%]**
- Pharma, Healthcare & Biotech **[9%]**
- Banking & Financial Services **[9%]**
- Retail & Consumer **[7%]**
- Education **[6%]**
- Real Estate **[6%]**
- Manufacturing **[6%]**
- Media & Entertainment **[5%]**
- Professional / Business Services **[3%]**
- Others **[11%]**

IT & ITES is again the top sector for PE investments, with a 38% share in total deal volume. The Banking, Financial Services & Insurance sector, along with Pharma & Healthcare, were a distant second and third, accounting for 9% of total deal volume each, with Retail & Consumer contributing 7%.

The IT & ITES sector has seen significant growth in the first half of this year, compared to the same period in previous years. This has been driven by increasing interest in the e-commerce market, with two of this year's top ten deals in this space. While sectors like Retail, Media and Manufacturing experienced a better performance than in the last two years, Pharma & Healthcare is yet to match the levels seen previously. Nevertheless, it is the second-best performer of the year so far and increased consolidation in the industry means it is bound to recapture PE interest sooner or later.

Final words

Despite a slow start to the year, there has been a resurgence in M&A activity during recent months. There was US$12 billion worth of M&A deals in April and May alone. With this positive trend continuing in June, following the elections, the deal landscape appears primed for some exciting times ahead.

The Ukraine-Russia impasse seems to be easing and troubles on the Iraq-Syria front are yet to create a major change in sentiment. Calm on the international scene should support the current resurgence.

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Indian economy: Promising signs of a revival

The fiscal year 2014-15 began on a celebratory note for India, as the reform-oriented National Democratic Alliance (NDA) government came to power with the strongest parliamentary majority of an elected government in 30 years. This result has brought with it an expectation of a new era of economic growth and prosperity for Asia's third-largest economy, which, for years, has been battling sluggishness, policy paralysis, fiscal indiscipline and high levels of inflation – among other economic woes.

The previous coalition government, led by the United Progressive Alliance, focused excessively on the social sector at the cost of economic reforms. High levels of subsidies put pressure on government coffers, while an environment of policy paralysis sent out negative signals to Indian and foreign businesses. This was reflected in the performance of the Indian economy, which expanded by 4.7% in 2013-14 – an increase of just 0.2% on the previous year.

Hopes for a revival now rest with the new government, led by Prime Minister Narendra Modi, which has promised a major turnaround in the country's fortunes by putting large-scale economic and regulatory reforms at the top of its agenda. With its huge parliamentary majority, the government has enough elbow room to bring about sweeping changes to the regulatory environment. It spelt out its agenda for inclusive growth – aimed at reducing inflation and poverty and kick-starting economic reforms – in its first address to parliament. It has also promised to create a policy environment that is predictable, transparent and fair, making it easier to do business.

Investor confidence

With a reformist government in power, investor sentiment is now riding high. The stock markets have risen sharply and the rupee has gained considerable ground against the dollar.

On the Bombay Stock Exchange, the 30-share S&P BSE Sensex jumped 20% this year, compared with a 9% gain for the whole of last year. The Sensex hit a new high of 25,419.14 points on 6 June, having broken the 25,000 mark on 16 May – the day the election results were announced. India's stock markets are now among the best global performers this year compared, for example, to Brazil's Bovespa Index, which rose 3% in 2014, and China's Shanghai Composite Index and Russia's RTS Index, which declined 6.1% and 4.1%, respectively.

Meanwhile, the rupee surged to 58.78 against the US dollar following May's election results and was the best performer among 78 global currencies tracked by Bloomberg.

Foreign institutional investors (FII) are making a beeline for India, which is now seen as one of the most promising economies in Asia. The country has seen FII inflows of over $8.5 billion so far this year – the highest among its BRIC (Brazil, Russia, India and China) counterparts.

Where next?

The new government seems to have started on a firm footing, with India's recent economic data pointing towards a revival. Industrial growth is on the rebound and consumer price inflation has eased to a three-month low of 8.28% in May from 8.59% in the previous month. Industrial production (measured by the Index of Industrial Production – IIP) grew at a rate of 3.4% in April – a 13-month high – driven by manufacturing and power generation. This compares to a decline of 1.7% and 0.5% in February and March this year, respectively. Manufacturing grew at its fastest in nine months, along with the capital goods segment, which received a boost from the electrical machinery and equipment sector. Continued growth will, however, depend on the monsoons, which are predicted to be less favourable this year.

While the outlook is promising, the government clearly has its work cut out. It plans to launch a single-window system of clearances, as well as improving road, rail and air connectivity. A plan for a diamond quadrilateral project of high-speed trains is also on the agenda.

Sources:
1. The Economic Times
2. Business Standard
3. The Mint
4. Bloomberg

Meanwhile, a host of social reforms, including educational measures and cleaning the river Ganga, are likely to complement the economic agenda.

The people of India have spoken decisively in this general election, giving the NDA Government a clear mandate. It remains to be seen to what extent the new prime minister can deliver on his promises, which resonated in his election slogan, "Achchhe din aane wale hain" or the good days are coming. With the political storm now settled, it's time for the new government to pick up the pieces and rebuild the India story that it has promised its voters.

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Budget 2014: Balancing growth-orientated reforms with fiscal repair

Less than two months after winning power in Delhi, the Bharatiya Janata Party (BJP) delivered its inaugural Budget, focusing firmly on growth and job creation, while curbing the fiscal deficit and rightly steering clear of 'blockbuster' populist policies.

FDI

The FDI limit on defence was increased to 49% in order to expedite the replacement of India's Soviet-era weaponry. India has become one of the world's largest arms buyers in recent years, which should encourage global manufacturers to set up a domestic base in the country.

Tax

The long-awaited unified indirect taxation regime is set to see the light of day through the introduction of the GST, with a commitment to making it fairer to the states. There was a stated intention by the government to avoid changing tax policies retrospectively and creating liabilities, following high-profile tax cases such as Vodafone and BP. While no immediate resolution has been announced in relation to these cases, the Indian government has agreed to fast-track pending disputes.

Highlights:

- Foreign direct investment (FDI): Cap on defence and insurance investment limit up 23% to 49%
- Taxation: Introduction of General Sales Tax (GST) to be fast-tracked; assurances on retrospective taxation
- Infrastructure: 100 'Smart' cities to be built, along with new roads, ports and airports
- Manufacturing: Inversion in import duties to be corrected; improved access to bank credit

Infrastructure

Infrastructure is a key focus for the government, with national/state highways, metro-rail projects and 16 new seaports and airport construction projects being implemented through public-private partnership.

Urbanisation is another priority, with the proposed construction of 100 new 'Smart' cities at a cost of around £700 million. Furthermore, the government plans to relax FDI rules in construction and announce tax sweeteners in the form of real estate investment trusts.

Manufacturing

An inverted customs duty structure, with component parts attracting higher duties than end-products, has been a noticeable feature of India's manufacturing sector for years. A reduction in customs duties on components used in the electronics, garments and food-processing sub-sectors, among others, is likely to provide a significant boost to value-added manufacturing. Plans are also afoot to make it easier for the sector to access bank credit.

Capital markets

Capital markets also get a boost through initiatives including clarity on income earned by foreign funds, the liberalisation of norms for American Depository Receipt/ Global Depository Receipt issuances, the revamping of norms for Indian Depository Receipts covering the domestic listing of overseas companies and the introduction of the Bharat Depository Receipt programme, uniformity of know-your-customer norms across the financial services sector and the international settlement of Indian debt securities.

Looking ahead

The Budget should go a long way towards reinvigorating the economy and putting India on track to reach a growth rate of 7-8% over the next few years. While more measures were expected, fiscal restraint is clearly important to limit the disapproval of ratings agencies.

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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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