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In association with London Stock Exchange

India Watch

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

Grant Thornton's India Watch Index fell by 7.5% in Q3 2014, compared with a fall of 4.7% in the FTSE AIM 100 and a fall of 1.8% in the FTSE 100. This quarter saw several India-focused investment vehicles raise new money or make distributions from the sale of investments. We explore the consequences in this issue.

The election of the new Indian government has led to a more optimistic investment climate, with positive indicators in all key areas of deal activity. Domestic mergers and acquisitions, as well as private equity deals, have increased in both value and volume to reach a three-year high. Overall deal activity rose to US$36.2 billion. There were 52 M&A transactions valued at over US$100 million each in 2014, compared to 32 of this scale in the previous year, indicating a clear revival in big ticket deals. This momentum looks set to continue and, with uncertainty waning, core sectors such as infrastructure, energy, consumer and financial services are expected to see renewed activity.

There are certainly visible green shoots of economic recovery on the horizon, coupled with signs of improving business sentiment as the new government attempts to address India's economic woes. This involves steps to fast-track decision-making, unleash reforms and reassure foreign investors. Notable recent examples include the government's 'Make in India' campaign urging global manufacturing companies to set up in India and its attempts to boost relations with the US.

Also in this issue we discuss our new research into the key drivers of corporate social responsibility for Indian businesses. It shows that in India, as in much of the world, CSR is not only increasingly seen as making good business sense, but more than ever before is a key business differentiator.

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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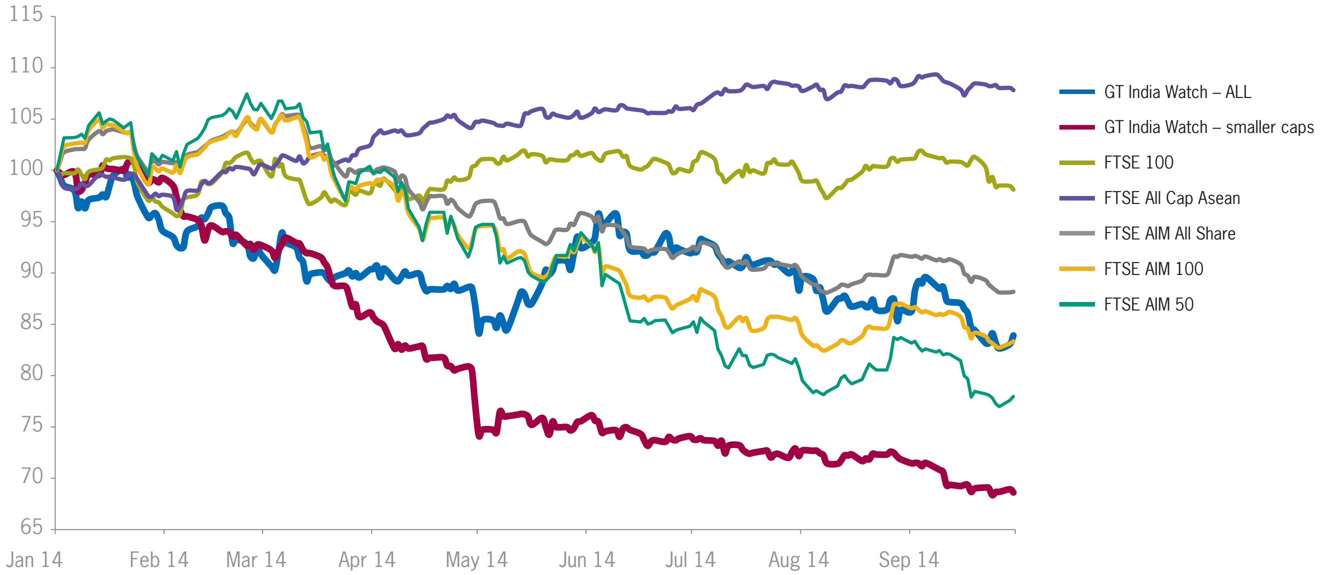
Dip in Q3 Grant Thornton India Watch Small Cap Index following rise in Q2

Grant Thornton's India Watch Small Cap Index falls by 7.5% in Q3 2014, compared with a fall of 4.7% in the FTSE AIM 100 and a fall of 1.8% in the FTSE 100.



Source: Factset

Winners and losers

This quarter saw several India-focused investment vehicles raise new money or make distributions from the sale of investments with varying consequences.

EIH (a private equity investment company) was down 40% in the quarter. This was mainly due to EIH announcing in July a capital distribution of approximately US$16.8 million to shareholders following the sale of its stake in Gland Pharma Limited (shares marked ex distribution on 23 July 2014).

It was an interesting quarter for Infrastructure India (an investment company investing in Indian infrastructure assets), down 20.7%. On 22 August 2014, Infrastructure India announced that it had closed the placing of new ordinary shares at 18 pence per share (a 24 % premium to the mid-market closing price prior to the initial announcement in July 2014), raising approximately US$102 million before expenses. However, investors seemed disappointed with the annual results announced in September 2014. Two of its investments performed below expectations – Vikram Logistic and Maritime Services Private Limited – suffering continued delays in disbursement of approved debt funding during the fiscal year and uncertainty around terms and timing of developments at Shree Maheshwar Hydel Power Corporation Limited, resulting in a significant decrease in the portfolio valuation of the asset.

India Capital Growth Fund was up 10.6% in the quarter. The company issued 37.5 million subscription shares at a subscription price of 61 pence per share. Each subscription share confers the right (but not the obligation) to subscribe for one ordinary share upon exercise of the subscription share rights and on payment of the subscription price. The company reported strong results in its half-yearly report to June 2014. The company benefited from a very strong performance by the Indian stock market, which was captured in the performance of the company's net asset value and share price. The NAV per share grew by 29.4% for the first six months of the year.

The quarter saw some companies report lower than expected results leading to a fall in share price.

SKIL Ports & Logistics, which is developing a modern port and logistics facility at Karanja Creek in the Raigad District of Maharashtra, declined by 31% in the quarter. It seems the investors were not pleased with the company's interim results for the period ended 30 June 2014. Based on the progress to date, the company expects to deliver a fully developed and operational facility by the end of 2015.

In August 2014, shares in DQ Entertainment plc fell 17% before staging a slight recovery, after its 75%-owned Indian unit reported a 32% fall in first quarter revenue, blaming commissioning delays of new projects by clients and saying this will impact its full year figure. The company booked a INR3.92 million foreign exchange loss in the quarter, compared with a gain of INR183.96 million for the same period last year. The stock was down 26.6% in the quarter.

The quarter went well for Jubilant Energy with stock up 48.4%. In July 2014, the company announced an increase in reserves and resources for the Kharsang Field in Arunachal Pradesh. In August 2014, the company's operating subsidiary company in India entered into a funding arrangement with Jubilant Enpro Private Limited for an unsecured loan facility amounting to approximately US$8.3 million with a tenor of one year and an interest rate of 15.5% per annum.

Country outlook

We continue to remain cautiously optimistic about India as we expect the BJP government to provide the political stability and implement the much-needed economic reforms. This in turn should lead to renewed investor confidence in the London markets over a period of time.

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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 deal activity at a three-year high

A revival in investment activity following the election of the new Indian government has led to positive indicators in all key areas of deal activity. Domestic mergers and acquisitions (M&A), inbound and outbound M&A, as well as private equity (PE) activity have all increased in both value and volume. Domestic M&A saw the sharpest jump with the overall value more than doubling during the year-to-date compared with the same period last year. Merger and internal restructuring activity correspondingly continues to fall as the economy improves.

Deal Summary	Volume			Value (US$ billion)		
	2012	2013	2014	2012	2013	2014
Domestic	177	166	194	4,431	4,319	9,717
Crossborder	180	168	214	9,124	13,385	14,787
Mergers and internal restructuring	79	38	33	14,614	4,264	3,313
Total corporate M&A	**436**	**372**	**441**	**28,168**	**21,969**	**27,817**
Private equity	311	322	445	6,052	7,806	8,454
Grand total	**747**	**694**	**886**	**34,220**	**29,775**	**36,271**
Crossborder includes						
Inbound	100	103	129	3,669	5,685	9,698
Outbound	80	65	85	5,455	7,700	5,089

During YTD 2014, overall deal activity rose to US$36.2 billion (886 deals), significantly higher than the US$29.7 billion (694 deals) in YTD 2013, also surpassing corresponding YTD 2012 levels. The increase was driven by the 30% rise in volumes over the same period in 2013. There were 52 M&A deals valued at over US$100 million each in 2014 compared to 32 such deals in the previous year, indicating a clear revival in big ticket deals and overall a more positive investment climate.

Overall M&A activity crossed the YTD 2013 mark at just under US$22 billion growing to nearly US$28 billion, reversing the trend seen during 2012-2013, driven primarily by the 70% rise in inbound deal values and more than a 100% increase in the domestic deal values over that seen in 2013. Q3 2014 was the best quarter in the last three years with a 60% increase in domestic values and 71% increase in cross-border deal values over Q3 2013.

It is interesting to note that while outbound values have not significantly outpaced those seen in the previous years, there was a 135% jump in Q3 2014 outbound volumes compared to Q3 2013, indicating active scouting of global assets by Indian companies on the back of reviving business sentiment.

Topping the deal-board during the year-to-date period was Sun Pharma's acquisition of Ranbaxy for US$3.2 billion, creating the world's fifth largest specialty generic pharma company. Following this was Cognizant's outbound acquisition of TriZetto Corp for US$2.7 billion.

Top corporate M&A deals in YTD 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%
Diageo Plc	United Spirits Ltd	Retail & Consumer	1,903.33	Increasing Stake to 54.78%	26%
Vodafone Group Plc	Vodafone India Limited	Telecom	1,435.48	Internal Restructuring	11%
GlaxoSmithKline Pvt 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%
Emperador Inc	Whyte & Mackay Group – United Spirits	Retail & Consumer	725.00	Acquisition	100%
Reliance India Ltd through Independent Media Trust	Network 18 Media & Investments Limited (including TV 18 Broadcast Limited)	Media & Entertainment	677.97	Majority Stake	78%
Teleperformance	Aegis Limited USA Inc – Aegis Group	IT & ITES	610.00	Acquisition	100%
Vodacom – Arm of Vodafone	Neotel – Tata Communications Limited	Telecom	455.25	Majority Stake	68%

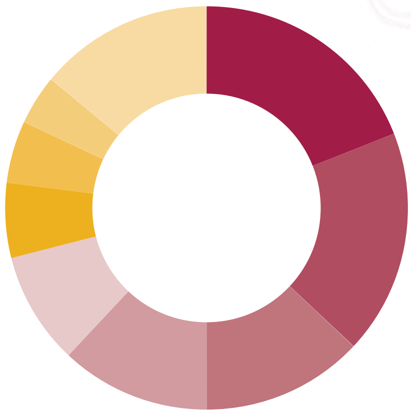
M&A sector focus

The pharma sector was the largest contributor to M&A deal values during the YTD 2014 period. Indian generic players continue to consolidate assets and product portfolios in order to capitalise on India's position in the global generics market, as more and more products go off patents globally. IT & ITES continues to top the charts based on the volume of deals completed.

Private equity

Whilst PE investment activity rose a mere 8% in value during Q3 2014 over Q3 2013, deal volumes grew by around 38% indicating strong investor interest in Indian corporates. There were 17 investments with values in excess of US$50 million each, including five deals over US$100 million each and one billion dollar investment. In comparison, Q3 2013 had only nine investments worth over US$50 million each.

M&A sectors by value in YTD 2014

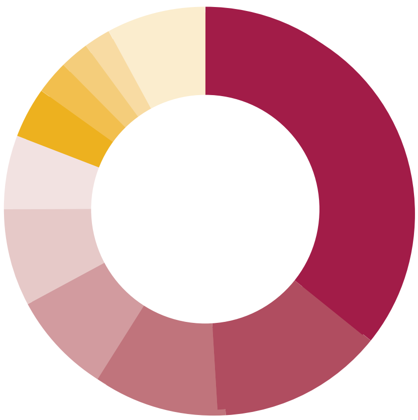


- Pharma, Healthcare & Biotech **[19%]**
- IT & ITES **[18%]**
- Retail & Consumer **[13%]**
- Telecom **[12%]**
- Energy & Natural Resources **[9%]**
- Real Estate **[6%]**
- Manufacturing **[5%]**
- Media & Entertainment **[4%]**
- Others **[14%]**

Top M&A deals in YTD 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
Canada Pension Plan Investment Board	Kotak Mahindra Bank	Banking & Financial Services	3%	366.67
Brookfield Property Partners	6 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
Temasek, IDFC Alternatives	GMR Infrastructure	Infrastructure Management	12%	183.00
KKR	GMR Holdings Pvt Ltd	Infrastructure Management	N/A	164.20
Canada Pension Plan Investment Board (CPPIB), through its Singapore-based wholly owned subsidiary	L&T Infrastructure Development Projects Ltd	Infrastructure Management	N/A	161.29
Warburg Pincus	Laurus Labs Pvt Ltd	Pharma, Healthcare & Biotech	32%	150.00
Goldman Sachs, Asian Development Bank and South Asia Clean Energy Fund	ReNew Power Private Limited	Energy & Natural Resources	N/A	140.00

Top PE sectors in YTD 2014 by value



- IT & ITES **[36%]**
- Infrastructure & Management **[13%]**
- Banking & Financial Services **10%]**
- Real Estate **[8%]**
- Pharma, Healthcare & Biotech **[8%]**
- Retail & Consumer **[6%]**
- Energy & Natural Resources **[4%]**
- Manufacturing **[3%]**
- Transport & Logistics **[2%]**
- Media & Entertainment **[2%]**
- Others **[8%]**

Yet again, the IT & ITES sector topped both investment values and volumes during YTD 2014, primarily led by the eCommerce segment. eCommerce businesses accounted for 38% of total PE deals in this sector and cornered almost 70% of the money invested, led by the billion dollar investment in Flipkart.

PE exit activity also picked up with improved appetite in the IPO and QIP market. We expect more PE exits to follow in the months to come.

Final words

Although the year began on a rather cautionary note, deal pace started picking up during the months closer to the elections and the momentum has kept building since then, signalling positive vibes for the months and quarters to follow. With uncertainty beginning to reduce, core sectors like infrastructure, energy, consumer and financial services are expected to see renewed deal activity. Valuations should also benefit from renewed business sentiment, which will create both a challenge and an opportunity for dealmakers to close deals in the coming quarters. Momentum in deal activity should continue to build and we look forward to closing the year on a high note.

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India economy on the rebound as government rolls out red carpet for foreign investors

As India's new government completed its 100 days in power last month, there are visible green shoots of economic recovery on the horizon, coupled with signs of improving business sentiment. The National Democratic Alliance (NDA) government, which stormed to power in May this year with a thumping majority in parliament, is trying to address India's economic woes by taking steps to fast-track decision-making, unleash reforms and reassure foreign investors.

All change

Soon after assuming power, the government, led by Prime Minister Narendra Modi, announced the abolition of the 19 Group of Ministers (GoMs) and eight Empowered Groups of Ministers (EGoMs). Instead, the Prime Minister has asked his ministers and bureaucrats to take decisions directly without referring every matter to the Cabinet. In another such move, the government announced the dismantling of the Planning Commission, a 64-year old Soviet-style institution that has been at the heart of India's economic planning for development. It is soon to be a replaced by a group of experts who will advise the government on key economic matters. The decision to dismantle the legacies of the previous regime stems from the government's drive to speed up decision-making.

Opportunity for foreign investors

In addition, two major decisions by the new government are expected to infuse fresh confidence among potential foreign investors. The commerce ministry announced new, relaxed rules for Foreign Direct Investment (FDI) in Indian Railways to modernise and expand the railway infrastructure. So far, India has allowed foreign investment only in Mass Rapid Transit (MRT) railway systems. With this decision, the government will open its doors to foreign capital in construction, operation and maintenance of suburban corridor projects, high-speed trains, dedicated freight lines, rolling stock and coach manufacturing facilities through Public Private Partnerships (PPP).

The government has also announced an increase in cap for FDI in the defence sector from 26% to 49%. However, the hike is on the condition that the control of joint ventures for manufacturing defence equipment stays in Indian hands. This move is likely to reduce the country's reliance on purchase from outside the country, as 70% of India's military hardware needs are met through imports.

In another policy move, India is fast embracing its neighbours to re-ignite economic cooperation. The Prime Minister's recent visit to Japan was considered hugely successful as the Japanese Government has promised to invest US$35 billion into infrastructure projects in India over five years to help India upgrade. He was also successful in extracting some big promises from China. India signed a five-year trade and economic cooperation pact with China, with the aim of improving India's trade balance. The agreement will bolster trade relations between the two Asian giants and pave the way for US$20 billion worth of investments in India over the next five years.

FDI into India more than doubled to US$3.5 billion in July, compared to US$1.65 billion in the same period in 2013. During April-July 2014, foreign inflows grew by 52% to US$10.73 billion, in contrast to US$7.05 billion in the same period last year. Funding in the telecommunications sector led the way, followed by services, pharmaceuticals and construction.

In the last few months, India's economic recovery has been modest and there is an expectation that the government should do more quickly. India's economic growth for the April-June 2014 quarter was 5.7%, as opposed to 4.6% for the same period last year. This is the highest that the country has clocked in the last two-and-a-half years.

'Make in India' campaign

However, the country's manufacturing sector is currently going through a rough patch. The Index of Industrial Production (IIP) rose 0.5% in July from a year ago, the slowest in four months. Ten of the 22 manufacturing sub-sectors contracted in July. However, in June and May, the IIP figures stood at 3.9% and 5% respectively. To urge global manufacturing companies to set up in India, the government launched the 'Make in India' campaign.

The July figures are seen by many, as an aberration as the economy appears on the right track and manufacturing is likely to pick up in the next few quarters. This could be true, given that the automotive sector witnessed brisk sales in August. Car sales jumped 15% after a consecutive lull for nine months. In August, the top three car-makers saw double-digit sales growth over the same month in 2013.

Optimistic about economic growth

India's stock market has been north-bound since the new government came to power. The Sensex of the Bombay Stock Exchange (BSE) breached the psychological barrier of 27,000, up 13%, since May this year. Foreign institutional investors (FIIs) have also been making a beeline to pump money into India.

The government is still battling with retail inflation (as measured by the consumer price index) slipping marginally to 7.8% in August from 7.96% a month earlier. It is still far from the 6% target that India's central bank wants to achieve by January 2016. However, the wholesale price index stood at 3.74% year-on-year in August, its slowest pace since October 2009. Export growth also slipped to a five-month low in August, as a result of a downward spiral in the eurozone. This was balanced by lower oil imports which helped taper the trade deficit to its lowest in three months.

Despite mixed economic trends, India Inc is optimistic about the growth of the economy and is betting big on reforms that the new government has promised. With FDI in multi-brand retail not on the agenda and a decision on a Goods and Services Tax (GST) regime not in sight, there is a lot to be done by the government before it can live up to its poll promise of 'acche din' (good days).

Boosting relations with the US

As the Prime Minister recently concluded his five-day visit to the US, there are clear signs of a diplomatic breakthrough between the two nations. Not only did India and the US issue a vision document, Modi and the US President Barak Obama jointly penned an opinion editorial in a reputed daily, sketching the roadmap for collaboration between the two nations. The highlights of the Prime Minister's visit included meetings with CEOs of 11 large American corporations, where he is believed to have pitched for big-ticket investments in India whilst reaffirming his promise to improve the ease of doing business in the country. Modi also kept his date with the Indian American community when he addressed a large gathering at the iconic Madison Square Garden in New York and promised a visa-on-arrival facility for American tourists and a lifetime visa facility for Persons of Indian Origin (PIO) cardholders. With bilateral trade between India and the US growing rapidly, it remains to be seen how this visit by the Indian Prime Minister will translate into greater economic benefit for the two countries.

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Key drivers of corporate social responsibility for Indian businesses

The impact of business on the economy, the environment and society receives ever-greater attention, with increasing investor calls for transparency and greater scrutiny of corporate activity by customers, particularly via social media.

On 1 April this year, the Indian Government implemented new corporate social responsibility (CSR) guidelines requiring companies to spend 2% of their net profit on social development. India is the first country in the world to mandate CSR.

For our latest International Business Report, we asked 2,500 businesses across 34 economies about what is driving their CSR activity, examples of CSR initiatives and how these are being reported.

CSR drivers

Globally, businesses report increasing moves towards more environmentally and socially sustainable business practices. The vast majority of businesses surveyed are involved with local charities, either through donating time, money or products/services. Businesses are also working to reduce their environmental impact, with increasing numbers calculating the carbon footprint of their operations.

The survey shows that corporate responsibility increasingly makes good financial sense. Cost management (67%) is the main driver globally, followed by customer demand (64%) and being the 'right thing to do' (62%). The impact on company reputation is an increasingly important factor in many countries.

Similarly, in India, cost management topped the list of key CSR drivers, equal with tax relief. These were followed by, customer demand, brand building and staff recruitment/retention issues.

This growing recognition of the potential cost savings of CSR both in India and globally suggests that the benefits of running a strong CSR programme are becoming more tangible. The most popular initiatives undertaken by businesses – donating money to charities and improving energy efficiency and/or waste management – can impact the bottom line, either indirectly through tax relief, or directly through lower utility bills.

Our new research highlights the key factors behind more socially and environmentally sustainable business practices in India and around the world.

An increasing awareness of the benefits of reporting on sustainability measures and not just financials, is also evident. Sustainability reporting has increased significantly since 2011, with more than half of businesses now viewing integrated reporting as best practice.

Global trends

The research shows that, generally, CSR and broader business objectives are becoming more aligned across the world. Despite the overall recognition of cost benefits, however, it's interesting to see that, by contrast to India, consumer demand is the top driver of CSR for UK businesses; it seems that British businesses are more reactive in their approach to CSR, largely responding to stakeholders' needs.

In India, as in much of the world, CSR is not only increasingly seen as making good business sense, but more than ever before as a key business differentiator. The leadership of dynamic Indian businesses towards more socially responsible and transparent practices is likely to emerge as a competitive edge to unlock their potential for growth in an ever more crowded marketplace.

The full report, 'Corporate social responsibility: beyond financials', is available at: www.grantthornton.co.uk/en/Thinking/Trends-in-corporate-social-responsibility-2014

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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:
www.grant-thornton.co.uk/thinking/international-markets

More information about our South Asia Group can be found at:
www.grant-thornton.co.uk/sectors/emerging-markets/south-asia

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