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In association with London Stock Exchange

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India Watch

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

In this issue we highlight that the full year performance of the Grant Thornton India Watch Index remained strong, although growth in the fourth quarter was flat. It appears that the positive impact of the series of reforms announced by the Indian government was offset by investors' concerns about the growing fiscal deficit, inflation and the slowing down of the Indian economy.

A cautious deal making environment prevailed in 2012 with a significant decline in strategic M&A deal values and fewer bulge bracket deals as compared to 2011. The year saw M&A and PE in India clock up 1,001 deals totalling US$49 billion, as compared to 1,017 deals amounting to US$53 billion in 2011. Contrary to most expectations inbound M&A deal activity reverted to the single-digit levels seen in 2010 whereas outbound activity improved in 2012 as compared to 2011; PE activity continued its momentum driven by IT/ITES, pharma & healthcare and the real estate sectors.

We take a look back at the Indian economy over the course of 2012 and look forward to what the future may hold. India's economy was dogged by low growth, economic policy stagnation and persistent high inflation, however, 2012 might yet be seen as the year in which the Indian economy turned the corner.

Ibukun Adebayo, Head of Equity Primary Markets at the London Stock Exchange, gives an overview of the AIM market in 2012 and explains that, from an Indian perspective, 2012 was a slow year. There are, however, positive signs that show robustness in the market and, in his opinion, AIM will continue to be a major source of funding for Indian businesses.

Lastly, Sai Venkateshwaran, Partner at Grant Thornton India LLP, gives an update on the much awaited Indian Companies Bill 2012 which is expected to become law in 2013. The bill is a significant step towards making India's corporate legislation contemporary and in line with current business practices.

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's India Watch proves investor interest in India continues albeit at muted levels

The full year performance of the Grant Thornton India Watch Index remained strong, although growth in the fourth quarter was flat. It appears that the positive impact of the series of reforms announced by the Indian government was offset by investors' concerns about the growing fiscal deficit, inflation and the slowing down of the Indian economy.

Source: Thomson Datastream

In 2012 the Grant Thornton India Watch Small Caps Index closed 8% up, outperforming the FTSE100 (6%) and FTSE AIM All Share Index (2%). The full year performance suggests continuing investor interest in India, albeit at muted levels compared to prior years.

In the last quarter, however, the Grant Thornton India Watch Small Caps Index remained flat. Trinity Capital and Mytrah Energy were the winners in the quarter gaining 61% and 46% respectively. Trinity Capital sold its entire shareholding in DB Realty Ltd for £12.1 million and returned five pence per share to shareholders, equivalent to £10.5 million. Mytrah Energy, which operates wind energy farms as an independent power producer, reported strong pre-tax profits in the first half of fiscal year 2013. The strong progress on asset growth and a promise to pay a dividend in fiscal 2014 has been positively viewed by investors.

There was a major boost to the Indian retail sector as Foreign Direct Investment in multi-brand retail was approved by the Parliament in December 2012, which improved confidence in the retail sector. This was probably reflected in the share price of West Pioneer Properties increasing by 35% in the quarter.

The quarter was not so good for investors in DQ Entertaiment and Hardy Oil and Gas, losing 35% and 32% respectively. DQ Entertainment reported lower profitability driven by foreign exchange loss. The liquidity squeeze in the global markets also impacted the company, resulting in delays in recoveries of receivables. However, the share price recovered partially on the appointment of Sun-Mate Corporation as the global master toy partner for the new 3D, CGI international animated TV series 'The Jungle Book'.

Shares of Hardy Oil and Gas, an upstream oil and gas company, were 32% down in the quarter despite the information disclosed in the company's interim management statement. The company plans to drill two exploration wells on the D3 block in India's KG basin in 2013. Further the arbitration process on the CY-OS/2 asset is expected to conclude in the near term. These could both provide catalysts to demonstrate the value in the shares.

A series of reforms were unveiled by the Indian government in December 2012, including allowing overseas multinational retail giants to own up to 51% of multi-brand stores, foreign investors to own up to 49% of domestic air carriers, and foreign media conglomerates to increase their ownership of broadcast media from 49% to 74%. Further, more reforms were promised by the Finance Minister to reduce government spending and implement a more transparent, non-retroactive tax regime for investors. The timely and effective implementation of these reforms should support the medium to long term growth prospects of the Indian small caps for 2013.

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* The India Watch Index consists of 31 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 Datastream, a Thomson Reuters product 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 Thomson Reuters.

With special thanks for his contribution to Vishal Jain, Manager, Grant Thornton UK LLP

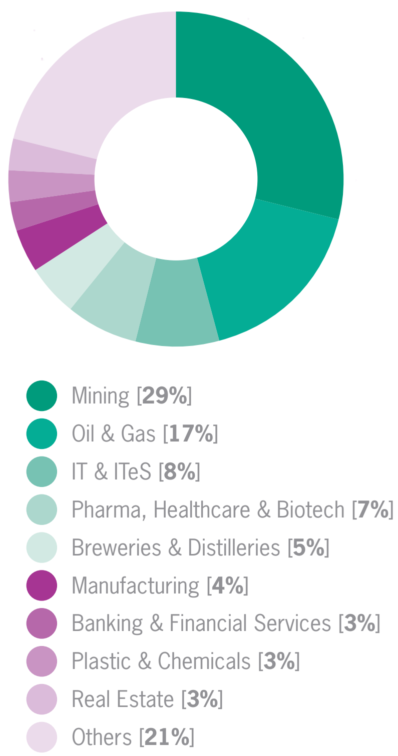
Slow and cautious 2012, deal activity set for recovery in 2013

A cautious deal making environment prevailed in 2012 with a significant decline in strategic Mergers & Acquisitions (M&A) deal values and fewer bulge bracket deals as compared to 2011. The year saw M&A and Private Equity (PE) in India clock up a total of 1,001 deals totalling US$49 billion, as compared to 1,017 deals amounting to US$53 billion in 2011.

Though overall M&A in the year amounted to US$42 billion, this included internal mergers and restructuring to the tune of US$15 billion. Domestic and crossborder M&A deal values in 2012 amounted to US$27 billion compared to US$44 billion in 2011, marking a 39% decline. However, the number of deals for 2012 were very similar to those in 2011, indicating steady activity with a fall in the average size of deals. It is also worthy to note that the last quarter of 2012, November in particular, accounted for over US$10 billion worth of deals, perhaps heralding a revival in deal-making sentiment that augurs well for 2013.

Deal summary	Volume			Value (US$ million)		
Year	2010	2011	2012	2010	2011	2012
Domestic	222	216	234	7,317	5,036	6,078
Cross border	281	278	265	31,460	39,046	20,854
Mergers and internal restructuring	159	150	102	11,006	531	14,799
Total M&A	662	644	601	49,783	44,613	41,731
PE	253	373	400	6,233	8,751	7,353
Grand total	**915**	**1,017**	**1,001**	**56,016**	**53,363**	**49,083**
Cross border includes						
Inbound	91	141	140	8,962	28,732	7,077
Outbound	190	137	125	22,498	10,313	13,777

Top M&A sectors 2012



Contrary to most expectations, inbound deal activity reverted to the single-digit levels seen in 2010, with deals worth US$7 billion, after putting in a robust performance at US$29 billion for 2011. Further, the stake acquisition in USL by Diageo was the only inbound deal that managed to enter the billion dollar deal club, of the six deals featuring therein. The declining Indian Rupee should have resulted in cheaper Indian targets for foreign acquirers. However, moderation in India's growth rates, lack of government reforms, a proposed introduction of tax regulations such as those relating to General Anti Avoidance Rule (GAAR) together with the global economic weaknesses kept inbound deals at bay. In 2012, Japan was the third largest country, after the UK and US, to make acquisitions in India with over 25 deals amounting to over US$1.5 billion; the highest ever by Japanese companies. Some key deals in this regard included the Mitsui Sumitomo – Max New York Life Insurance, Ostuko Pharmaceuticals – Claris Lifesciences and Nippon Life Insurance – Reliance Capital.

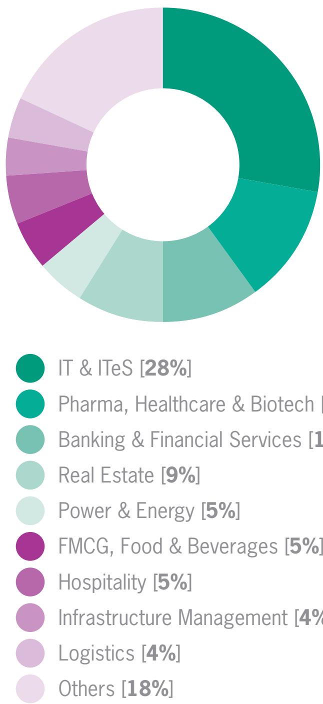
While outbound activity improved in 2012 with deals worth US$14 billion as against US$10 billion in 2011, it did not recover to levels seen in 2010. However, the fundamentals of crossborder M&A have remained intact as Indian acquirers continue to view foreign markets as strategic to their global growth plans, as witnessed in deals such ONGC's stake acquisition in the Kashagan oil field, Gulf Oil Corporation's acquisition of Houghton International, and Rain Commodities' acquisition of Ruetgers N.V., among others.

M&A sector focus

The mining and oil & gas sectors contributed 46% of M&A deal activity in 2012, recording values of US$12 billion and US$7 billion, respectively. We expect the oil & gas sector to witness more activity in 2013, as Indian oil & gas companies continue to look for oil, gas and coal assets abroad in a bid to secure natural resource flows. The telecom sector, which typically used to contribute multi-billion dollar transaction levels, was caught up in regulatory problems in 2012 and we saw muted activity here. Going forward, we expect consolidation in segments like aviation, media and retail on account of the relaxation of foreign direct investment rules.

The year gave us some big ticket restructuring deals, such as the Vedanta group restructuring and the Tech Mahindra – Satyam deal. We also saw some game changing deals with Diageo's stake acquisition in USL and Aditya Birla's acquisition of the Pantaloon format from Future group. We expect similar consolidation in the domestic and cross border space as debt laden companies look at strategic stake sales to unlock cash and reduce interest burdens.

Top PE sectors 2012



Private Equity in 2012

PE activity continued its momentum driven by IT/ITES, pharma & healthcare and the real estate sectors. Though there was a marginal volume uptrend, no considerably large deals were announced in the year barring the US$1 billion-Bain Capital-Genpact deal. Hence, despite resurgence, we are yet to reach the high levels of PE activity seen in 2007 and 2008.

PEs showed increasing interest in the healthcare space. Care Hospitals, DM Healthcare and Vasan Healthcare each managed to raise over

US$100 million with premium valuations during the year.

The year also witnessed over 70 deals in the e-commerce space, with combined capital raising over US$0.7 billion from PE and venture capital firms. Despite the large number of players in this space, as well as the prolific deal making, a few companies also received premium valuations at over US$250 million, implying EV/Sales multiples of 10x to 15x.

PE firms also showed an interest in the dairy space with Rabo PE and Abraaj Capital investing in Prabhat Dairy, followed by IDFC PE investing in Parag Milk Foods.

As it is now widely reported, returns to LP's have not been as expected in 2012, with this impacting fund raising during the year. PE Funds are facing challenges on exits from their portfolio companies given the weak IPO market and fall in inbound deal interest.

However, given the recent government reforms, we expect an increase in M&A inbound deal activity in 2013 which should help PE Funds to exit their portfolio through the M&A route.

The year also saw the biggest IPO in two years with Bharti Infratel raising over US$750 million.

The second half of 2012 saw a slew of reforms being announced, paving the way to restoring much needed investor confidence and bringing back deal momentum. However, there is still a lot to be done with respect to policy implementation in 2013. India is still one of the fastest growing economies globally despite its internal woes - we believe that 2013 could yet see a revival in the country's deal making prospects, given the right stewardship at home.

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With special thanks for their contribution to Ankita Arora and Sowmya Ravikumar of Grant Thornton India Dealtracker team.

An update on the Indian economy

In this update we take a look back at the Indian economy over the course of 2012 and look forward to what the future may hold.

For India's economy, 2012 as a whole, like the year before it, was dogged by low growth, economic policy stagnation and persistent high inflation. For the fiscal year 2012-2013, Indian GDP is expected to grow at around 5.5 per cent, the slowest since 2002-2003, compared with around 6.5 per cent in the previous fiscal year. This represents a significant decline in the country's growth rates since 2008 which reported growth of around 8 per cent.

While India's economy, like the majority of the world's, was severely affected by the global economic crisis in 2008-2009, the effect was heightened by misguided economic reforms put in place to help counter the impending troubles. What India needed was increased spending, particularly in infrastructure, to help encourage medium to long term economic development but instead it got lacklustre economic stabilisation policies leading to spiralling inflation rates and a number of bribery and corruption charges against senior officials.

Notwithstanding the ambivalent political leadership the country has received over the last few years, 2012 might yet be seen as the year in which the Indian economy turned the corner. A report from UN ESCAP forecast GDP growth of 6.8 per cent for the fiscal year 2013-2014 following the recent show of strength by the government to push through important economic reforms which, as discussed in our last issue, included greater foreign direct investment in multi-brand retail and civil aviation as well as the partial phasing out of diesel subsidies. The report also said that last year's monsoon season was not as weak as initially feared – providing some much needed relief to India's agricultural sector.

While these are, of course, encouraging developments for India's economy, there is still a significant amount of work to be done from an economic policy reform point of view. The government must look to allow greater foreign direct investment in other key sectors as well as increase spending on education and the development of the country's young workforce. Most importantly, however, and this is an area which we have discussed in detail previously, the government must look to increase spending on much needed infrastructure development. Without this development, India's economy will forever struggle to reach its full economic potential.

These goals are clearly long-term priorities and will only be realised over a period of decades but they must remain in sight when looking to resolve shorter-term issues.

The government will of course be able to outline its plans for increased and sustainable economic growth in its forthcoming budget and, while the last few budget announcements have been rather anti-climatic, the policy changes implemented in September and the continued investment friendly policies such as the deferment of GAAR, have renewed hopes that the economy will turn the corner. With sound initiatives and careful implementation, both domestic and international investor confidence should return, leading to increased investment opportunities and growth.

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AIM momentum picking up

We believe momentum is picking up behind the junior stock market: there are encouraging signs of imminent listings and a more favourable climate for investors and growing companies.

The growth market was hit hard during the downturn, as the number of Initial Public Offerings (IPOs) worldwide fell and some companies went private or failed.

From an Indian perspective, 2012 was a slow year with no new IPOs and just two secondary offerings by existing AIM companies. The slow conditions mirror the slowdown in growth in the Indian economy over the same period and further reflects the relative standstill in corporate investment activity across the sub-continent.

There were, however, some very positive signs last year:

- As reported in this issue, Grant Thornton India Watch Small Caps Index increased by eight per cent outperforming the FTSE AIM 100 and FTSE AIM all-share indices
- The average daily trading volumes of the 26 Indian companies listed on AIM was two per cent higher than in 2011
- Trading volumes in the same stocks were five per cent higher than 2010
- The best performing stocks last year were Unitech Corporate Parks (+46%), Indus Gas (+44%), iEnergizer (+34%) and OPG (+33%) with only 9 of the 26 stocks trading below their level at the beginning of the year
- Only one Indian company, India Hospitality Corporation, left AIM last year and that was for non-market related reasons

Other general market highlights for 2012 included:

- 45 AIM IPOs raised US$1.1 billion. US$4 billion was raised by existing companies through follow-on offerings
- The average share price return of companies that undertook IPOs in 2012 was +15%
- The average funds raised was US$27.2 million up from US$24 million in 2011 and US$19.6 million in 2010
- FTSE AIM 50 Index (includes largest companies with UK incorporation) rose 13.4%

We consider the improving regulatory environment and the FTSE 100 surging above 6,000 points 'good indicators' of future AIM performance. We continue to see robustness in our pipeline from India and, in our opinion, AIM will continue to be a source of funding for the India growth story.

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The India Companies Bill 2012 – a necessary change

The much awaited Companies Bill 2012, passed by the Lok Sabha in December, will replace the 56-year-old Companies Act. The Bill is expected to be taken up in the Rajya Sabha in its next session, will receive President's assent thereafter, and it is expected to become law early in 2013.

It has been over ten years since the last major overhaul of the existing Act and, in many ways, this change has been long overdue. The Companies Bill is a significant step towards making India's corporate legislation contemporary and in line with current business practices.

The Bill brings in measures to improve governance in the corporate sector, whether aimed at owners, managers or other stakeholders, including auditors, and the protection of investors interests. The Bill also proposes several positive measures on e-governance and simplification of several procedural aspects, which are also welcome. There are also changes relating to corporate restructuring, reorganisations, etc, which would also help corporates immensely.

The roles and responsibilities of directors, independent directors and auditors have also been dealt with in great detail; however, it would be good to ensure when the rules are framed to bring in adequate checks and balances, to serve as anti-abuse provisions.

Certain provisions in the Bill, however, should be made applicable to a smaller subset of companies before they are more widely implemented. Some of the provisions, such as those relating to auditors, concern matters which are still up for debate internationally, and where the views are divided – such as the PCAOB concept release on auditor independence and mandatory auditor rotation.

The Bill both simplifies and complicates Indian corporate law. On one hand it reduces the number of sections from over 650 in the 1956 Act to 470 in the Bill, but on the other it increases substantially the extent of delegated legislation; there are over 300 places where the rules need to be prescribed, and these clauses would only be effective when the related rules are framed and notified. So while the Bill per se is shorter and structured in a manner that gives flexibility to the government to amend the rules as and when required, it also makes the legislation complex for the corporates to apply. The law is also expected to be strewn over numerous rules and notifications in addition to the Bill.

While the Bill is now on the verge of becoming law, it is important that developments around the implementation of the rules are closely monitored. It is expected that the draft rules will be made public in the coming weeks to seek comments from stakeholders before they are finalised. The rules should be completed after careful evaluation as several clauses are intended to be applied to all the 800,000+ companies or the 8,000+ listed companies. It would be ideal if some of these requirements are implemented in a phased manner, which would help in managing the implementation challenges as well as learning from the experiences of the initial application of these requirements.

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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 1,000 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/emergingmarkets

More information about our South Asia Group can be found at:
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