Grant Thornton
An instinct for growth™

In association with London Stock Exchange

ISSUE 28 APRIL 2015

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 Small Cap Index fell by 21.7% in Q1 2015, compared with a fall of 3.2% in the FTSE 100 and a fall of 4.8% in the FTSE AIM 100. We look at the reasons behind the performance of some of biggest the winners and losers on the Index. It is heartening to see that interest in India remains strong with several companies across a variety of sectors seeking an IPO in the next few months.

The Modi government has been in power for almost a year and has started to implement its much-anticipated economic reforms. Among those announced in the Budget in February were a number of measures designed to attract foreign investors, including tax changes and efforts to make it easier to trade. Along with increased political stability, it's hoped that reform will, in time, lead to renewed economic confidence in the London markets.

The government's pro-reform agenda has undoubtedly bolstered economic sentiment in India and the country is poised for growth, with projections for GDP to grow by 8% in 2015/16 and 8.3% in 2016/17. Overseas investors also continue to be optimistic about India's prospects. For example, in January foreign direct investment (FDI) more than doubled to US$4.48 billion – the highest inflow in 29 months.

Meanwhile, the first quarter of 2015 has seen a significant uptrend in values and volumes for M&A deal activity, with 350 deals totaling US$8.2 billion. Private equity investment over the quarter saw a 30% increase in deal value and a 67% increase in deal volume against the same period in 2014.

In this issue we also discuss the rise of shareholder activism following reform to the regulatory framework in India and its potential role in improving corporate governance in India.

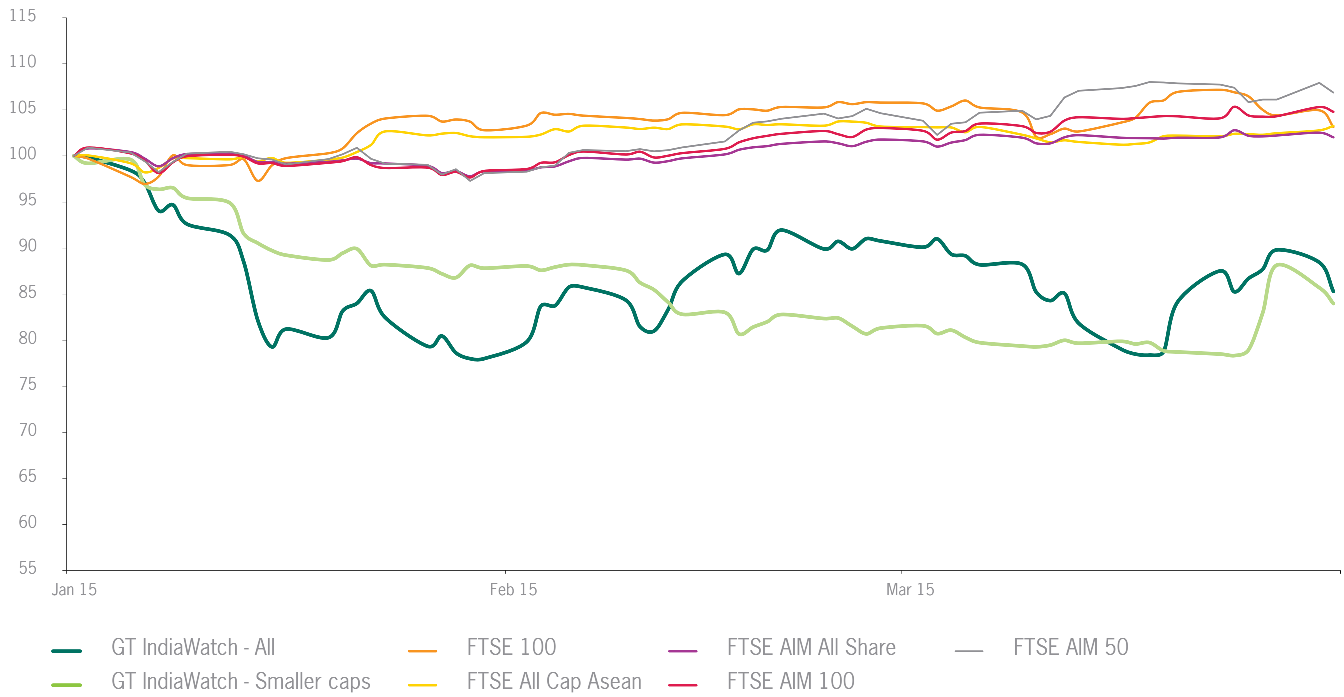
If you would like to discuss any of the matters arising in this issue or how Grant Thornton's South Asia group can help you, please contact us.

Anuj Chande
Partner, Corporate Finance
and Head of South Asia Group
Grant Thornton UK LLP
T +44 (0)20 7728 2133
E anuj.j.chande@uk.gt.com

Arjun Mehta
Partner
Grant Thornton India LLP
T +91 124 4628 000
E arjun.mehta@in.gt.com

Grant Thornton India Watch Small Cap Index falls below the FTSE AIM 100 for the first time since 2007, although interest in India remains strong

The Grant Thornton India Watch Small Cap Index fell by 21.7% in the first quarter of 2015, compared with increases in the FTSE 100 and FTSE AIM 100 indices of 3.2% and 4.8% respectively.



Source: Factset

The Grant Thornton India Watch Small Cap Index continued to fall during the first quarter of 2015, compared with other UK indices, although it did start to rise in February. It has been falling ever since the second quarter of 2012. The underperformance has been mainly due to Indus Gas Limited and Vedanta Resources – heavyweight stocks which have been a drag on the Index's overall performance. Despite this, we continue to see strong interest in India with a number of companies seeking an IPO over the next six months in various sectors including hospitality, pharmaceuticals and power.

Winners and losers

Entertainment and production company DQ Entertainment plc was the biggest loser on the Index in the first quarter with a fall in the share price of 56.9%. This was largely due to investors' disappointment after the company reported that profits were down to INR35 million for the first six months to the end of September 2014, from INR214 million in the previous year. The company's share price did not improve despite approval being granted for the registration of The Jungle Book trademark and the agreement with iStorySM for the development and production of 52 episodes of the animation series Peg Heads.

Hardy Oil and Gas plc was another big loser in the first quarter of the year, with a share price drop of 53.2%. Hardy, along with the majority of its peers, has been greatly affected by the falling price of oil. However, its share price did rally slightly following the announcement that one of its significant shareholders Richard Griffiths had increased his holding from 13% to 19%.

KSK Power Ventur plc, a company engaged in the development, operation and maintenance of private sector power projects, saw its share price fall by 40.7%. This was due to uncertainty during the build-up to the recent auction of six Indian coal mines. KSK took part in the auctions in an attempt to secure its fuel requirements for the longer term, but it was unable to secure any mines during the first round of auctions.

By far the best performer over the quarter was the Indian commercial real estate company Unitech Corporate Parks plc, which saw its share price rise by 346.7% in the first quarter of 2015. This was largely due to the company's announcement of an initial cash return to shareholders of 49.25 pence per share, equating to approximately £177.3 million.

Despite the falling price of oil, Oilex Limited was up 52.6% having been the worst performing company in the Grant Thornton India Watch Small Cap Index in the previous quarter, when it fell by 59.6%. The dramatic u-turn in its share price was due to the announcement that Oilex plans to drill up to four additional Cambay wells in 2015 and that it continues to make progress on the construction of oil and gas production facilities.

The quarter also went well for Skil Ports & Logistics Limited with a rise of 36.6% in its share price during the first quarter. The company is developing a modern port and logistics facility at Karanja Creek in the Raigad District of Maharashtra. Skil announced plans to build a 200-acre multipurpose terminal at Karanja at an estimated cost of INR10 billion. The company expects to deliver a fully developed and operational facility by the end of 2015.

Country outlook

The Indian government announced the Budget for the 2015/2016 financial year on 28 February. Although it contains a number of potentially beneficial policies, including increased spending on infrastructure and significant tax reforms, it fell short of introducing any groundbreaking changes. GDP is forecast to increase by 8% in 2015/16 and by 8.3% in 2016/17, and the fall in oil prices is expected to assist the country's fiscal deficit and balance of payments.

We continue to remain cautiously optimistic about India as we expect the government to provide the political stability and implement the much-needed economic reforms. In time, this should lead to renewed investor confidence in the London markets.

Anuj Chande
Partner, Corporate Finance
and Head of South Asia Group
Grant Thornton UK LLP
T +44 (0)20 7728 2133
E anuj.j.chande@uk.gt.com

*The India Watch Index consists of 24 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 activity in 2015 kicks off with an impressive start

Overall deal activity in the first quarter of 2015 stood at US$8.2 billion (350 deals) compared with US$6.4 billion (257 deals) over the same period in 2014 and US$6.5 billion (220 deals) in 2013, showing a significant increase in M&A activity both in terms of values and volumes. We continued to see active inbound interest in Indian targets and consolidation in the domestic market, with the e-commerce sector driving some of that momentum.

Top M&A deals – Q1 2015

Deal summary	Volume			Value (US$ million)		
	2013	2014	2015	2013	2014	2015
Domestic	66	50	65	1,344	853	1,478
Crossborder	51	67	64	3,810	2,479	4,113
Mergers and internal Restructuring	13	9	2	60	1,107	11
Total M&A	**130**	**126**	**131**	**5,214**	**4,439**	**5,602**
Private equity	90	131	219	1,301	2,004	2,610
Grand total	**220**	**257**	**350**	**6,515**	**6,443**	**8,212**
Crossborder includes						
Inbound	30	43	29	2,957	1,987	3,544
Outbound	21	24	35	853	492	569

Deal summary – Q1 2015

The M&A market witnessed an increase in deal activity in the first quarter of 2015, with 131 deals worth US$5.6 billion, showing a 26% increase in the deal values compared to 126 deals worth US$4.4 billion over the same period in 2014. Domestic deal values rose by 73% and volumes by 30% compared to Q1 2014. This marks an active domestic market where larger players are looking at acquisitions as part of their growth strategy to consolidate market position in their sectors and geographies.

Total crossborder deal values increased by 66%, largely due to big ticket inbound deals. Inbound deals alone contributed 63% of the overall M&A deal values with eight deals valued over US$100 million. Although outbound deal volumes increased by 46%, values remained stable due to the absence of larger deals.

Top M&A deals – Q1 2015

Acquirer	Target	Sector	US$ million
Harman International Industries	Symphony Teleca Corporation – Symphony Technology Group	IT & ITES*	780
Mylan Inc – Mylan Laboratories	Famy Care	Pharma, healthcare & biotech	750
Alibaba Group	One97 Communications	IT & ITES	575
Undisclosed (secondary share sale)	Bharti Airtel	Telecom	310
Silver Eagle Acquisition Corp	Videocon D2H	Media & entertainment	300
Infosys Technologies	Panaya Inc	IT & ITES	200
ANI Technologies – Olacabs.com	Serendipity Infolabs – TaxiForSure	IT & ITES	200
Sembcorp Industries	Green Infra	Energy & natural resources	169
Balasore Alloys Ltd – Ispat Group	Rohit Ferro-Tech	Manufacturing	165
Reliance Infrastructure	Pipavav Defence & Offshore Engineering	Infrastructure management	132

* Information Technology Enabled Services

M&A sector focus – Q1 2015

A broad range of sectors contributed to M&A activity in the first quarter of 2015, led by IT & ITES followed by pharma, healthcare & biotech, media & entertainment and telecom.

The IT & ITES sector led the M&A sector pack – both in terms of volume (31%) and values (37%). The largest deal in the sector was Harman International Industries' acquisition of Symphony Teleca Corporation for a total consideration of US$780 million. Mylan Laboratories' acquisition of Famy Care's women's health care business for US$750 million was the fourth largest inbound M&A deal ever in the pharma sector. It is interesting to note that just over a year ago, Mylan Laboratories acquired Agila from Strides Arcolab for US$1.65 billion.

We believe that India's growing generics market is driving the M&A activity in the pharma sector and highlights India's important strategic position in the global generics market.

Top M&A sectors

Top private equity sectors

Private equity

Private equity investment in the first quarter of 2015 witnessed a 30% increase in deal value and 67% increase in deal volume compared with the first quarter in 2014. There were four deals each worth over US$100 million and over eight deals each worth more than US$50 million. The largest deal involved TPG Capital acquiring a 24.75% stake in Manipal Health Enterprises for US$150 million.

Private equity deal volumes have steadily been increasing and now contribute more than 50% to overall deal volumes, surpassing M&A.

We also had around 40 private equity exits during the quarter. This trend is expected to continue going forward given the rise in M&A activity among strategic trade buyers.

Private equity sectors – Q1 2015

Over the first quarter of 2015, the IT & ITES sector attracted the highest share of private equity investments followed by pharma, healthcare & biotech, real estate, banking & financial services and energy & natural resources.

Top Private Equity deals – Q1 2015

Investor	Investee	Sector	Investment value in US$ million
TPG Capital	Manipal Health Enterprises Private Limited	Pharma, healthcare & biotech	150
Equis Funds Group	Assetz Property	Real estate	116
Rocket Internet AG and other investors	Foodpanda	IT & ITES	110
Tiger Global, Helion Venture Partners and Nexus Venture Partners.	Clues Network – ShopClues	IT & ITES	100
CDC Group, CX Partners, Bajaj Group	Ujjivan Financial services	Banking & financial services	97
IDFC -India Infrastructure Fund II	DB Power Limited- Diligent Power	Energy & natural resources	81
Tybourne Capital, Valiant Capital Sequoia Capital, Sofina and ru-Net	Accelyst Solutions – Freecharge.in	IT & ITES	80
KKR, India Value Fund Advisors (IVFA) and LeapFrog Investments	Magma Fincorp	Banking & financial services	80
SAIF Partners	One97 Communications	IT & ITES	60
Temasek and Norwest Venture Partners	Manthan Software Services	IT & ITES	60

The IT & ITES sector contributed 43% of the deal values and 58% of the volumes – this was higher than the numbers seen during the corresponding period in the last two years and was largely driven by e-commerce. The pharma, banking & financial and real estate sectors showed positive trends compared to the previous quarter, while the retail & consumer and media & entertainment sectors were less active. Recently, the Indian government allowed 100% foreign direct investment (FDI) under the automatic route in the medical devices sector in order to encourage manufacturing of equipment, including diagnostic kits and other devices. This could result in increased foreign investment in companies with niche technology.

Conclusion

Measures announced in the recent Budget aim to increase economic growth and spending on infrastructure, while committing to fiscal consolidation. The importance of manufacturing in India was also emphasised.

The technology and pharma sectors have traditionally been active in M&A and this is expected to continue in 2015. Given the positive macroeconomic environment and strong activity over the first quarter, we expect 2015 to be a plentiful year deal-wise.

Atul Monga
Director
Grant Thornton UK LLP
T +44 (0)20 7865 2534
E atul.monga@uk.gt.com

India's economy poised for growth as government woos foreign investors

In February, in its first full-year Budget, the government announced a number of pragmatic measures designed to continue to bolster the economy, attract foreign investors by dispelling uncertainty around tax laws and make it easier for businesses to trade.

Rolling out the red carpet

In moves akin to rolling out the red carpet for foreign investors, the General Anti-Avoidance Rules were postponed for two years and foreign funds were excluded from the scope of minimum alternate tax on their capital gains income. The government also reduced the corporate tax rate to 25% (on a par with China) over four years, and reiterated its commitment to introduce the Goods and Services Tax regime in 2016.

These measures came close on the heels of India's parliament ratifying the 49% cap for foreign direct investment (FDI) in insurance, an increase from 26%. Since storming to power in May 2014, the government has already liberalised FDI investment in railways, defence and medical devices. To further simplify the FDI regime, the government plans to do away with the distinction between different types of foreign investments, for example foreign institutional investor (FII) and FDI. This is intended to give greater flexibility to Indian companies to raise foreign capital, while removing ambiguity around sectoral foreign investment caps.

In an effort to make it easier to do business, the government recently reduced the number of mandatory documents required to import and export goods – from ten to three in each case. This follows the Ministry of Corporate Affairs' move to ease compliance requirements for corporates by amending a number of rules related to e-voting, board powers and debenture issues.

GDP growth forecast up

There is no doubt that the government's pro-reform measures in the last few months have bolstered economic sentiment. Projections for India's GDP for the current fiscal year have improved dramatically, with ratings agency Fitch forecasting India's GDP to grow by 8% in 2015-16, and 8.3% the following year. This is up from its previous forecasts of 6.5% and 6.8%, respectively.

These GDP projections complement the recent findings of the Grant Thornton International Business Report (IBR), which reveals that, globally, Indian businesses are the most optimistic about the economy for 2015, with 98% saying they are pleased with the policies of the government. This compares to a global average of 35%.

According to the IBR findings, optimism among Indian businesses has continued to improve throughout 2014, from 89% in Q1 to 95% in Q4. However, 70% of Indian businesses cite regulations and red tape as a constraint on growth – the highest around the world. It shows that India Inc expects the government to ease regulatory shackles and enable faster decision-making.

Mixed signs of recovery

Despite the optimistic outlook, the economic recovery is still experiencing a few jolts. The pace of industrial production growth slipped to a three-month low in January, with the index of industrial production only rising by 2.6%, as against 3.2% in December. After seeing inflationary pressures ease over the last few months, the Reserve Bank of India has cut the key policy rate by 0.5% since the start of 2015. However, in February retail inflation inched up to a four-month high of 5.37%, which may put a stop on any further interest rate cuts.

The automotive sector also showed mixed signs of recovery. Domestic car sales jumped by 7% in February while commercial vehicle sales grew by 10%. However, the industry remained cautious with a 9% drop in rural motorcycle sales in February, while the overall two-wheeler market witnessed a 1% decline in sales.

India's stock markets have remained turbulent since the start of this year. As of 31 March, the Sensex benchmark has gained only 4.5% so far in 2015, after rising almost 30% last year. Although the markets welcomed the announcements made in the Union Budget, Sensex fell by 700 points on the Bombay Stock Exchange on Budget day, although it finally closed 141.38 points up. This was the first rise on a Budget day in four years.

Foreign investment pouring in

Overseas investors, however, continue to bet big on India's long-term economic prospects, with FIIs having pumped in US$43.5 billion net over 2014-15, as of 31 March. Of this, US$26.3 billion has been invested in debt. According to data from Bloomberg, Indian debt has been the third-highest recipient of foreign fund inflows in the current financial year after Japan and South Korea in the Asia-Pacific region, excluding China. FDI more than doubled to US$4.48 billion in January, the highest inflow over the past 29 months.

With the government ready to run the extra mile on key reforms including land acquisition and infrastructure, the economy is poised for growth in the coming months. However, while India Inc has welcomed the measures announced in the Budget, it still wants to see more, fast-paced action on the ground to make it easier to do business and alleviate regulatory bottlenecks.

Arjun Mehta
Partner
Grant Thornton India LLP
T +91 124 4628 000
E arjun.mehta@in.gt.com

References

1. Car sales surge 7% in February on better consumer sentiment [Economic Times]
2. Consumer inflation inches up to 5.37% in February, IIP grows at 2.6% [Economic Times]
3. As inflation dips, RBI must continue slashing rates: India Inc [Economic Times]
4. Ease of Doing Biz: Only 3 documents needed for imports, exports [Zeebiz]
5. Why Sensex fell over 3% after Feb 28 despite widely accepted Budget [Economic Times]

Will shareholder activism improve corporate governance in India?

Changes to the regulatory framework, the presence of institutional investors and proxy voting have all contributed to the surge in shareholder activism in India in the last few years. The question is whether such activism improves corporate governance.

Since the dawn of liberalisation, the government, companies, stock exchanges and institutional investors – both domestic and foreign – have been taking measures to empower and disseminate information to shareholders. As part of the effort to improve corporate governance, the Indian government has recently empowered the market regulator, the Securities and Exchange Board of India (SEBI), to increase transparency in corporate India and encourage the influx of foreign capital.

SEBI is working closely with the Reserve Bank of India to ensure that banned entities cannot raise funds from naïve retail investors. Both the Bombay Stock Exchange and the National Stock Exchange have introduced stringent standards for new listings that have greatly increased retail participation in the capital markets. Furthermore, minority shareholders' grievances and issues can now be heard in boardrooms through the e-voting mechanism.

Casting a vote of dissent

Boards of directors and audit committees are increasingly independent and can now convey their dissent on votes for management proposals. Similarly, shareholders are also exercising their right to dissent, especially when financial goals are not achieved. This is particularly true with respect to resolutions that propose increased compensation when financial performance has been stagnant or below par. For example, shareholders rejected a proposed increase in executive compensation at Tata Motors. In another instance, shareholders rejected several resolutions connected with United Spirits Limited entities, including some which purported to benefit the company's chairman. These developments were virtually unprecedented in corporate India.

The 2013 Companies Act has empowered minority shareholders through the introduction of several mandatory requirements. For example, the concept of class action lawsuits was introduced and minority shareholders can now file them against companies.

Shareholder activism in developed economies

These reforms are starting to bring India closer in line with developed economies, such as the US and UK, where shareholder activism is well-established. The US Securities Exchange Commission's (SEC) 'say on pay' rules have generated tremendous support and opposition in equal measure, while the cancellation of golden parachutes and the roll-back of bonuses and performance incentives have become common at listed companies. A number of merger and acquisition (M&A) transactions have been affected by hostile takeovers and forced divestments of non-profitable or core businesses, while the use of the 'poison pill' has been vociferously criticised. Similarly, in the UK, shareholders have vetoed several executive pay packages and M&A transactions. The eurozone has also seen instances of shareholder activism regarding executive pay and auditor appointments.

Summary

We should welcome the arrival of shareholder activism in India, with experience around the world showing us that it is here to stay. The ability of minority shareholders to take control of board resolutions to protect their interests rather than those of a few shareholders and management, and veto actions they deem detrimental to the long-term interests of the company and themselves, is set to play a major role in improving corporate governance.

Vidya Rajarao
Partner
Grant Thornton India LLP
T +91 80 4243 0803
E vidya.rajarao@in.gt.com

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 in India is one of the largest assurance, tax, and advisory firms in India. With over 2,000 professional staff across 13 offices, the firm provides robust compliance services and growth navigation solutions on complex business and financial matters through focused practice groups. The firm has extensive experience across a range of industries, market segments, and geographical corridors. It is on a fast-track to becoming the best growth adviser to dynamic Indian businesses with global ambitions. With shorter decision-making chains, more senior personnel involvement, and empowered client service teams, the firm is able to operate in a coordinated way and respond with agility.

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

Grant Thornton
An instinct for growth™

grant-thornton.co.uk

GRT100678