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India AIM Report

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Strong Relative Outperformance – Shrugging Off The World's Problems

Subject Areas in This Issue

London AIM Listed Indian Companies

Companies Mentioned

DQ Entertainment
Elephant Capital
Eredene
Eros International
Greenko
Ienergizer
India Hospitality
Indian Energy
Infrastructure India
Noida Toll Bridge
Skil Ports & Logistics
Unitech Corporate Parks
Photon Kathaas

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Indian companies quoted on London's AIM market strongly outperformed their local market, and came very close to shrugging off the world's broader problems during 2011.

The Indian AIM companies fell 8.4% in value during 2011. This compares to a 25.8% drop in the AIM All-Share Index, and a fall of 24.5% in the Mumbai Sensex Index. The Indian Rupee also nosedived. A UK based investor "buying the Sensex" would have finished the year with a real loss, in UK£, of 35.4%.

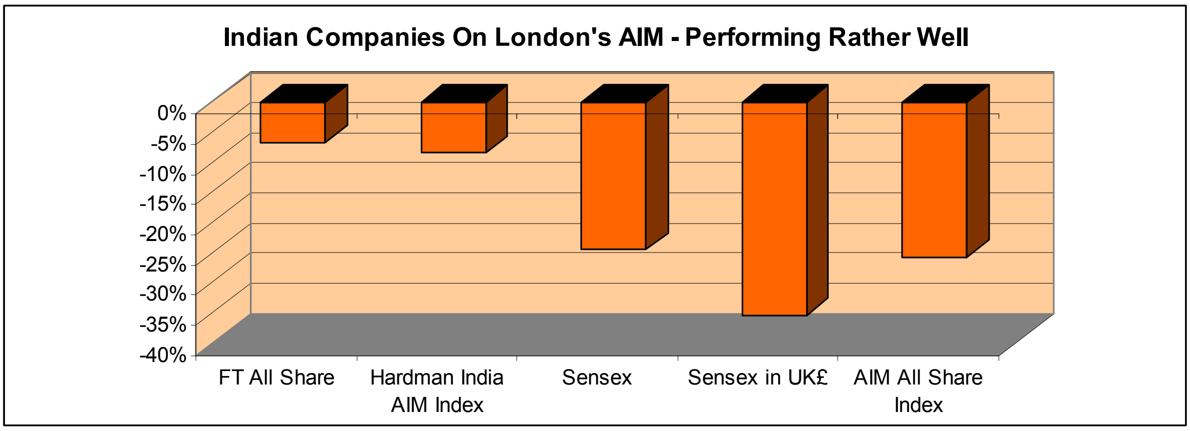
By comparison, the FTSE All Share Index declined 6.7%.

The best performer on both a six month and twelve month view was **ienergizer**, the outsourcing specialist, which now has a market cap of £400m and is clearly institutional size. Its shares gained 40% in the second half of the year and 54% over the full twelve months of 2011. **Indian Energy**, which was taken over by the London AIM quoted infrastructure fund **IIP** during the year, has given a 22% gain to investors who held on to their IIP shares.

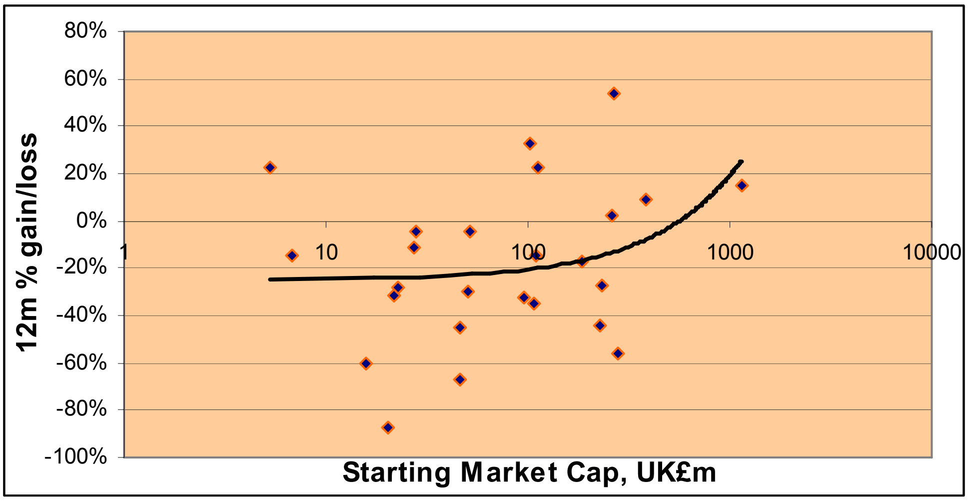
In H2, after ienergizer, the top performer was **Unitech Corporate Park**s, with a gain of 19.9%. This company lets commercial properties to IT and outsourcing companies, and has been performing strongly on the back of new corporate lettings that have very much boosted its earnings visibility. Its shares have also been trading at an exceptionally large discount to their net asset value.

The total value of the Indian companies quoted on the London AIM market is £3.2bn. Some of these companies are very significant in terms of size. 8 of them have a market cap in excess of £100m, and one has a market cap of over £1bn.

Many of these companies have been corporately active, showing that the Indian managements understand the ways in which a share quote can be used to benefit a company, and are assertive enough to do so. There were well over a dozen significant corporate actions during 2011, including one takeover and seven share placings for new equity capital. Several companies also proved adept at handing money back to shareholders when it was right – one company, Trinity Capital has made capital repayments in the past twelve months that are equal to its January 2011 share price.



Big vs. Small



This scattergraph shows that the trend evident in H1 2011, of the larger Indian companies on AIM outperforming the smaller ones, continued into H2. For the year as a whole, Indiian companies with a market cap of over UK£100m were the place to be.

The relationship was by no means total, however. It was still possible to beat the trend at the smaller end of the marketplace. The pattern was very much influenced by three of the four companies to have halved in value or more being at the sub-£100m end of the market capitalisation range.

The Economy – Growing Less Rapidly

The latest GDP figures from India show growth of 6.9%. While still impressive on a world scale, it is some way short of the 9% - 10% expected by both local commentators and the international investment community at the start of the year. The last Industrial Production figures to be released were poor, the current account deficit has been worsening, and the domestic inflation rate is still a matter for concern. The weakness of the Rupee vs. the US Dollar, and indeed almost every other major currency, will feed further inflation during 2012.

Availability of Information

Managements were active travellers during 2011, and were frequently in London to update investors. This trend was evident in H2 as much as in H1. We believe that this is an important factor in the sound performance of the Indian companies on AIM. Some companies keep, in effect, a permanent IR presence in London even though there is no operational necessity beyond ensuring continued easy access to the debt and equity markets. Examples are **Greenko** and film company **Eros International**. Both have market capitalisations of approaching UK£300m, so are of a size that can justify the cost. This is particularly important at a time when the London stockbroking/investment banking market has been shedding staff, meaning that some of the traditional stockbrokers are less able to give the necessary support to their quoted company clients.

Dealing levels in some of the quoted Indian companies on AIM is very low. There is a very noticeable lack of research available for potential investors on some of these companies.

The Individual Companies

Company	Sector	Ticker	Cap £m	31.12.2011 p.	% change 1.1.2011 - 31.12.2011
Dhir India Investments	Investment Company	DHIR	6.3	37.5	-60.5%
DQ Entertainment	Film/Entertainment	DQE	14.9	41.5	-67.3%
EIH Plc (in US$)	Investment Company	EIH	24.3	0.58	-11.5%
Elephant Capital Plc	Investment Company	ECAP	16.3	32.5	-28.4%
Eredene Capital	Port Development	ERE	56.4	12.625	-29.9%
Eros International	Film/Entertainment	EROS	266.2	229	2.1%
Greenko Group	Energy	GKO	167.8	118.5	-27.3%
Hirco Plc	Real Estate	HRCO	49.8	49.5	-4.3%
Ienergizer	Outsourcing	IBPO	408.8	272.5	54.0%
India Capital Growth Fund	Investment Company	IGC	25.3	33.75	-44.7%
India Hospitality Grp (in US$)	Hotels/Restaurants	IHC	2.5	0.115	-38.6%
Indian Energy	Energy	IEL	6.4	25.1	22.4%
Indus Gas	Energy	INDI	1309.6	716	15.3%
Infrastructure India	Investment Company	IIP	112	65.25	22.1%
Ishaan Real Estate Plc	Real Estate	ISH	64.3	44.125	-32.6%
Jubilant Energy	Energy	JUB	120.7	29	-56.4%
Mortice Ltd	Facilities management	MORT	27.0	56.5	-4.2%
Mytrah Energy (ex Caparo)	Energy	MYT	152.2	93	-17.0%
Noida Toll Bridge (in US$)	Infrastructure	NTBC	420.2	3.5	9.2%
OPG Power Ventures	Energy	OPG	128.3	36.5	-44.1%
Photon Kathaas (in US$)	Film/Entertainment	PKP	5.8	0.42	-14.6%
Skil Ports & Logistics	Port Development	SPL	70.0	159	-35.2%
Trinity Capital	Investment Company	TRC	31.6	15	32.3%
Unitech Corporate Parks	Real Estate	UCP	95.0	26.375	-14.2%
West Pioneer Properties	Real Estate	WPR	14.8	18.5	-31.5%

Losers outnumber winners by almost 4:1. This is not surprising in a year that was notable for its bear market.

Real Estate

Once again the star performer was **Trinity Capital**, which made three capital repayments during the course of the year. We have added back these capital repayments to the end-December 2011 share price to arrive at the capital gain in the table. By the magic of mathematics, if instead the returned "stake" money is deducted from the original cost – and many investors will look at their Trinity Capital shareholding in this way – then investors are in for a free ride, because the shares were 48.5p each at the start of the year, and 49.5p has now been returned to shareholders. **Unitech Corporate Parks** suffered with the pack in H1 but had a strong H2 as management took time to address critics who had requisitioned an egm. None of the dissenters' points were passed.

Energy Companies

The tiny **Indian Energy** led the way, at least partly because it was taken over by the larger **Infrastructure India** (IIP) during the course of the year. The bid was all paper, so for the purposes of Index calculation we have included the equivalent value in IIP shares from the date of the deal. Indus Gas, the largest of the Indian companies on the London AIM stock market, was also a very strong performer.

The shares of the operators of wind farms and power stations performed less well, although the underlying progress made by the companies was, in the main, satisfactory. **Greenko**, see page 6.

Broadcasting, Entertainment and Leisure

Eros International was the best performer in this sector, registering a small capital gain for its investors. The very much smaller **Photon Kathaas** showed a small drop in its share price, as the release of its Hindi re-make of the film Vinnai Thandi Varuvaaya was delayed into 2012. This led management to lead down earnings expectations. However, management has stressed that the pipeline for 2012 is strong.

India Hospitality paid back 42c/share to investors during the course of the year, so its share price performance is rather better than appears from a quick read of the investment statistics. Adding back the capital repayment, the shares lost 38.6% of their value over the course of the year.

Elephant Capital bought back shares from investors at 35p each, via a tender offer, during the year. The shares have almost held the tender offer price since then. Elephant Capital owns 1% of the company that controls the Trident and Oberoi hotel brands.

Hyderabad based animation specialist **DQ Entertainment** was the sector's worst performer in share price terms, in spite of a sound operating performance.

Outsourcing

The only quoted Indian outsourcing company, **ienergizer**, happened also to be the best stock market performer.

Infrastructure and Port Development

Shares in both the AIM quoted port developers, **Eredene Capital** and **Skil Ports & Logistics**, were down over the course of the year. The sector's best performer was the rarely traded **Noida Toll Bridge**, which is one of the four Indian companies on AIM whose shares are priced in US Dollars.

India as a world player – investing in India based global company compared to a domestic power producer.

One of our key messages is that 2011 demonstrated that successful investment in Indian quoted stocks benefitted a great deal from backing India as a global force. Investors should back good exposure to the Indian expansion theme but in 2011 it was better to back companies which are playing India internationally. One example is Eros International, which has been greatly helped by having 40% of its operations in international (non Indian) operations, but with clients looking to an Indian product. As ever this is not a hard and fast exclusive rule. H2 the best Indian price performer on AIM was UCP a 100% Indian business (even though nearly all tenants are international companies). But that was after a weak H1 2011 share price performance. This does mean some local companies (we assess Greenko) have been less favoured in share price terms. Either way, most UK quoted companies have had more resilient share prices than the local market (especially adjusting for the currency weakness).

Eros International **226p £264m market cap**. *Share price unchanged over 12 months*

Eros has impressive top line growth but small EPS growth. This is solely because of the costs of growth (particularly the accounting amortisation of money invested in product). Cash generation is good. Shares have performed well compared to most peer groups, but especially for Indian midcap companies. A major saving grace is the international position of Eros – not for nothing is it called "International".

The product is strong. India equates to 60.1% of revenue (rising from 56%), Eros selling film content through cinema theatres, television and digital including music and applications. Whilst India is growing strongly, North America and Rest of the World (Middle East and elsewhere) are also rising: up over 20% annually in the half year to September 2011, reported in November. Digital content positioning is strong, for example Eros is the seventh most watched Youtube provider globally in the entertainment segment. The product is broadly based, not being "hit" reliant, though the current half year should benefit from two "hit" releases. This is a good business in a strong market segment supplying Indian consumers with a popular product in a very large market.

The financials show both the benefits but also the costs of growth. Revenue rose 35% in US$ terms H1 2011/12 vs H1 2010/11. The margins are stable (EBITDA margins were 76.4% H1 2011/12 up from 75.5%) but growth is impacting and cost of sales rose at 54% H1 vs 43%. H1 registered PBT up only 4% (in US$, the reporting currency). This was as a result of the amortisation charge rising from 32% revenue to 43% revenue H1 2011/12. This results from the accounting treatment of expenditure on films. EPS fell 7.5% to 18.6 cents (H1 2010: 20.2 cents), a fall resulting from dilution.

So performance in H1 to September 2011 was profoundly affected by the underlying growth in the business. Cash generated from operations remained strong, at US$67.5m (H1 2010: US$65.8m), with debt at US$114m. So in the period to September, all was growing as expected and the costs of growth were under control. H2 should grow strongly with the pipeline being delivered but the headwind from currency could amount to 10% at current rates. This could trim F/Y EPS to the range 45 to 50 cents, still up from the previous year's 38.6, which was 6% up on 2010. These are growth rates well below the top line growth, and consensus estimates for 2012/13E growth range around 10%. We note that were the business to slow its investment in future expansion, the amortisation would tail off potentially boosting profits by over 50%. Also noteworthy is that the PE rating on the current 226p share price is some 8x or less 2011/12E consensus earnings.

After a 30% share price rise in 2010, the shares remained exactly unchanged in 2011 – not a bad performance given the global stockmarkets and the Indian political and currency negatives. Eros shares are not on the face of it highly rated and whilst much of the growth is dissipated before it reaches the bottom line, there is every reason to believe that a significant franchise has been built up and that the EPS growth will not be dented by the problems the Indian domestic political and current account situation is bringing.

In contrast to Eros International's global approach, Greenko typifies one of the better power generation companies. Its shares had a difficult 2011, ending the year at 118p. Since then a bit more perspective has returned and there has been a small bounce. Some of the concerns over local politics may be being put into context and investors looking a bit further out at what Greenko is successfully creating.

Greenko 133p £189m market cap. *Share price - 8% over 12 months*

Greenko has to manage growth and also the political and regulatory issues from supplying local Indian electricity distribution businesses. Growth remains intact and well managed, but 2011 faced problems with currency and the price rises for its energy, which are likely to come, have been delayed again. The rollout remains on track, with financing available and Greenko's ability to remain profitable, despite the costs of expansion, is encouraging.

Investors who in 2009 showed faith in the successful ongoing Greenko rollout programme were amply rewarded by the shares rising five fold by 2011. At that stage (year to March 2009), revenue was €14m, EBITDA €6.1m, PBT €3.2m. To March 2011, EBITDA was at €25.2m, PBT €11.4m. In the H1 to September 2011, there was good news on rising margins (39% at the operating level, up from 25%), but the 10% of previous year revenue from sale of carbon certificates was missing as CERs were retained, the worldwide prices having fallen sharply. Gas prices being high, there was a reining back in the offtake in the gas generation business (where Greenko sells at a fixed margin but variable volumes). These are marginal issues – the business remains on track.

Were Greenko to achieve the rollout as anticipated, the prospect is for 2015 €350m sales; €190m EBITDA; €145m EBITA; €90m PBT; 44c EPS, a 3.6x PE. To allow for possible slippage we consider that 2015/16E will be the year full capacity will be online and possibly carbon credit markets will still be impacted negatively by politics so assume nil there. This core estimate would be €65m PBT; 32c EPS. This income stream derives from, effectively, 15+ year annuity style visibility, with rising prices and with the profits of course allowing fully for depreciation, but with new plant.

So this is clearly high growth and it is a good outcome that the business remains profitable in the rollout of new generating capacity. Helped by a £50m fundraising in May, the capex is anticipated at €200m this year and nearly doubling in 2012/13E. End September €93m debt was held before taking the €40m cash into account. 2011/12E debt levels may rise by €150m and by over €300m 2012/13E. Debt is very much available, with Standard Chartered providing a fresh tranche, as announced by Greenko. Projects are typically 30/70 equity/debt, with debt costing up to 12%. The 15th December investment by Standard Chartered includes a convertible tranche which entitles Standard Chartered to participate in the IPO of any of Greenko's subsidiaries, and under certain conditions provides Standard Chartered with the right to convert this tranche into the Group's main holding company shares at a mutually agreed internal rate of return. So far, very little debt has been taken on pre commissioning of plant, as Greenko has cash.

The group as planned is refocusing to wind and also adding to its hydro capacity, with the biomass remaining but more as basic baseload. A total of 183MW is operational, 400MW being built and a medium term (2015) 1000MW target, now raised longer term to 1600MW. Whilst $70m funding was agreed recently with Standard Chartered, it is likely there will be more debt required at project level and Indian rates are high (c12%). Greenko is borrowing at modestly above base rate levels.

The basic driver is the shortage of power in India and ongoing economic growth (albeit growth having moderated), but there is a high political influence and recently confidence here has taken a knock (affecting share prices across the sector eg OPG Power). Inflation is a problem in India but this does mean that long term assets generate long term income streams at inflating prices. We note there is financing pressure for both Greenko and its customers the local electricity Boards, but both are manageable and, stepping back for the larger picture, this is a priority area to support economic development. State utilities have held prices virtually static in the last several years notwithstanding cost and supply pressures. This has had the effect of affecting margins for all producers but in 2011, the central regulator has directed state regulators to ensure that tariffs are reviewed annually. Several state utilities have already in Q3 or Q4 2011 filed applications with their state regulators for significant tariff increases. For example in Tamil Nadu the SEB has accumulated losses and has filed an application with the state regulator for a minimum tariff increase of 25 % over current levels for industry.

Nothing in the current margins or the financing of Greenko suggests this is not a leader in performance and delivery of new projects (13 operational now, 40 by 2016). By March 2013, debt may reach just over 100% the estimated €280m shareholders' funds (stated including €55m intangibles).

Recent results disappointed only in one small way, regarding the absence of income from the sale of CERs: in jittery stockmarkets, and with the recent significant weakness in INR and in the perceived outlook for Indian politics, there was a temporary spike down in the price. This has partially reversed as Greenko remains firmly on track as a growth story. Financing issues we would expect will see a successful outcome and eventually the generation of over 4000 GWh by 2015/16 (assuming € prices 20% higher, though core estimates would be more like a 40% rise) €350m.

Projecting some way out to 2015/16E on a mature portfolio, this is €120m EBITA and €45m PAT; 32c EPS on 35% EBITA margin. We believe that under realistic scenarios EBITA margins could be 40-45%. From that level, cash generation alone (without further generation volume growth) would enhance profits 10% pa and price growth we would anticipate to continue, leaving investors with well over 15% pa EPS growth even at this mature stage. These figures ignore carbon Credit sales, which come through at effectively 100% margins.

In summary, the sector has decent sized companies, established and generating profits whilst in the midst of a significant costly investment phase financed in part with debt, costing over 10%. Product prices are virtually guaranteed to rise after years of under-pricing for political reasons. This is a regulated and politically sensitive area. So, whilst these projections we believe conservative would place the shares on a PE only just over 5x, this is four years away and there is an element of funding risk as well as economic constraints to the clients. This may well be why 2011 was not the year for investors in Greenko, but operationally and financially the case would appear to remain intact. There is a strong technology link with GE, licences, land and power purchase agreements are all in place. A momentum building on power price rises (which has to be high on the agenda in 2012) would be a positive trigger.

This has been a difficult year across the board for the Indian power generators' share prices. NHPC, the largest, floated two years ago, hit a year low of INR 18 end 2011, down from 25 in early November and 28 at the start of the year. The fall in the INR H2 2011 has left these shares significantly down in sterling terms. Many have similar price trends including the UK quoted OPG Power. Primarily this seems a symptom of concern over the Indian political situation, which was exacerbated by actions and changes of plans in November: paying more attention to this than the medium term fundamentals.

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