Elephant Capital

INVESTING IN INDIA

     

Quarterly Update

November 2009

Highlights

- Our NAV (unaudited) stands at 87p at the end of November 2009
- During the quarter, Elephant Capital announced that it had been obliged to write down a loan that had been advanced to Krammer Holdings Pvt. Ltd.. The principal of the loan was £3.7m and the write-down could be up to £2.8m. As part of this exercise, Elephant Capital will assume effective control of c.1.3m shares held in Mahindra Forgings Limited, which were given as security to this loan. There have been no material developments since our announcement in November, but we will keep investors updated as appropriate
- In November, we announced a US$10m investment in Global Cricket Ventures, an online media and broadcast company, which is the exclusive licensee of key digital and mobile rights to the Indian Premier League and key digital rights to the Champion's League Twenty20 cricket tournaments and which owns the domain name cricket.com
- In December Obopay was selected as 2010 Technology Pioneer by the World Economic Forum in recognition of its innovation, transformational technology, leadership and substantial long-term impact on businesses and society . Again in December, Obopay announced that its mobile payments application was now available on Apple iPhones for use in the US
- Shortly after the period end, we were pleased to announce the appointment of Pramath Raj Sinha as Chairman. Pramath spent 12 years at McKinsey, where he was a partner, and led McKinsey India's telecoms, IT and media practices. He is the founder and MD of media company 9.9 Mediaworx Pvt. Ltd., and a Non-Executive Director of BILT, India's largest paper products company, DLF-Pramerica, an insurance company, and Kaleidoscope Entertainment Pvt. Ltd., a prominent film and TV production business
- The team is working on a number of transactions in the engineering, media, financial services, ancillary services and pharma sectors. Few of these are majority control situations but all are in privately held, unlisted businesses
- We are confident that we will make significant progress on these transactions in the coming quarter, and will update the market accordingly

Economic Update

- GDP growth for the second quarter (Jul – Sept) was the strongest for 18 months at 7.9%, well ahead of consensus estimates of 6.3%. Manufacturing came in at 9.2%, up from just 3.4% in the previous quarter, whilst the Index of Industrial Production has registered growth of 9%-plus for the past three consecutive months
- However, Q2 data also shows a 27% increase in Government Final Consumption Expenditure, demonstrating the significant contribution that the exceptional stimulus spending is making to economic performance
- In its Second Quarter Review of Monetary Policy, the Reserve Bank of India ("RBI") placed its projection of GDP growth at 6.0% "with an upside bias", unchanged from its July projection; however, with Q2 GDP growth surprising on the upside, most analysts agree that this is likely to be raised in the third quarterly review
- The RBI significantly increased its projection for WPI inflation at end-March 2010, to 6.5% "with an upside bias", against 5.0% projected at the time of the July review. In addition, it has removed some of the unconventional liquidity support measures which were introduced in the wake of the credit crisis. These developments come as price inflation, which was negative for 14 consecutive weeks turned positive in September, and now stands at 4.8%
- The export sector continues to lag other economic indicators, with October data showing year-on-year decline of 6.6%. However, the magnitude of this decline has narrowed from c.30% reported for the four consecutive months from April to July
- In November, the Government announced a mandatory sell down of profit-making public sector firms, which do not already have a minimum 10% public shareholding and amended the rules on how the proceeds can be used, to allow for enhanced spending on social sector programmes. This move has been widely welcomed, as it both provides comfort that the Government will address its burgeoning fiscal deficit, estimated at 6.8% of GDP in 2009/10 and confirms that reform and liberalisation remain firmly on the agenda

Economic Update

- The past six months have seen appetite for Indian risk return very substantially, enabling over US$10bn in new equity issues to be raised on the Indian markets from April – October. Almost 80% have come from four sectors – banks, oil & gas, real estate and power, with real estate and power contributing almost 50% of total new equity. Analysts expect a further US$7bn in new equity issues could be in the pipeline before the end of the financial year (to Apr 2010), and including the mandatory sell down of public sector businesses, this figure could be even higher

- Foreign institutional investors continued to be net buyers of Indian equities, with net purchases totaling over Rs 300bn (US$ 7.1bn) from September – November. The Sensex rallied 8% over this period, reaching a high of 17,326 in mid-October, but, in line with markets globally, experienced a pullback at the end of November, on news that Dubai World with US$60bn in debt liabilities had sought to delay payments

- Activity within the Indian private equity space remains subdued. A total of 93 PE deals were announced in H109, with a combined value of US$2.89bn, compared to 185 deals valued at US$6.93bn in H108

Portfolio Update

EIH

- Year-on-year drop of 22% in sales and 46% in EBITDA at the H1 stage
- The 440-room Trident at Bandra Kurla, Mumbai opened in Dec 09, and an Oberoi in Gurgaon, Delhi, is targeted for 2010
- In August, the group announced a partnership with Max India Chairman Analjit Singh, to set up a 5 star, 100 room hotel in Dehradun, India, under the Trident brand. Mr Singh, who has a stake of c.4.4% in EIH, will own the property, whilst EIH will manage it. In September, the Indian press speculated that the Oberoi family was in discussions to sell Mr Singh a little over 17% in the company, but EIH have not commented on the news. Similarly, speculation has also arisen that ITC, a 14.9% shareholder might be considering a hostile approach to EIH
- On the catering side, the company announced in August that Delhi International Airport Limited had signed a 25 year agreement with EIH to finance, design, develop and manage the provision of in-flight catering facilities and services at Indira Gandhi International Airport (IGI Airport) in Delhi

Mahindra Forgings

- Total income for the consolidated business was down 57% at the end of H1 2010 vs. H1 2009, with EBITDA margins reduced to less than 1% from c.11% the previous year
- An upturn in passenger cars and light commercial vehicles was reported for India (c.10% sales) in Q1 2010, which was sustained into Q2 and the company is optimistic that it is seeing the start of the upturn. It believes that the situation in Europe may have stabilised
- Current strategy is focused on i) cash conservation through inventory and capex control, ii) cost reduction through operational improvements in India and "rightsizing" in Europe, and iii) greater co-operation and utilisation of the synergies between the Indian and European operations. In Europe, personnel and fixed costs have been reduced by c.40%; inventories have also been cut by 40% and capex curbed
- In October, the Board of Directors gave its approval, in principle for a Rs 2.26 bn equity issue to fund ongoing capital requirements, and strengthen the company's debt covenants. Terms of the issue have yet to be disclosed

Portfolio Update

NIIT

- In its Q2 update in October, NIIT said the period was characterised by "greenshoots optimism", meaning that sentiment had returned, but had yet to impact upon business
- The company reported sales growth of 16% with a 22% increase in EBITDA, representing margin improvement of 67bps
- Individual Learning Solutions (58% sales) saw sales growth of 7% and margin improvement of 149 bps to 27%; Corporate Learning Solutions (24% sales) saw sales fall 7%, reflecting difficulties in the corporate market, particularly in the US, but margin gain of 492 bps to 8%, as the division successfully reduced costs and improved product mix. The Schools business (16% sales) turned in the strongest performance, with sales growth of 175% reflecting large Government orders, which is lower margin, and hence the EBITDA margin in the business fell to 9%, from 14% last year
- NIIT also announced that its Board had approved a raising of Rs 2.3bn (nearly US$50m) by way of a qualified institutional placement of equity ("QIP"); or a Rs 2bn QIP and issue of convertible warrants of up to Rs 300m. The funding is to enable the company to take advantage of the growth of opportunities in the education and training sector which are arising as a result of Government policy. The company recently announced that the QIP would take place in Q1 2010

Nitco

- On 22 September, Nitco announced that the Directorate of Revenue Intelligence ("DRI") had investigated its premises in connection with an investigation into customs duty payable on imported marble slabs. Goods worth Rs 97m were retained in the raid, and several members of the management team were placed in custody. No further update has been provided, but Elephant Capital has made its own announcement in respect of these investigations and will update the market as appropriate
- In its announcement, Nitco reassured the market that these events would not have a material effect on its operations. However, H1 results were adversely affected, as the sale of vitrified and marble slabs was suspended for two months. As a result, sales were down 29% at the interim stage, and the EBITDA margin fell from 14.2% last year to 8.8%. Nitco is expected to loose a further two months trading in Q310
- The wider real estate sector seems to have stabilised in recent months. The residential vertical, especially in tier I and II cities is most advanced, encouraged by the lower interest rate environment, and rising consumer confidence, reflecting the strength of the economic recovery

Portfolio Update

Obopay

- In its Q309 results Obopay reported revenues of US$217,227 for the 9 months to Sept 09 vs. US$ 1,041,390 for the year to Dec 08. However, 2008 figures include US$ 785,303 in development and customisation fees, which are more exceptional in nature. Transaction and monthly fees for the 9 months to Sept 09 were US$ 42,523 vs. US$ 49,936 for the 12 months to Dec 08. Loss from operations stood at US$ 20m over the 9 month period vs. US $ 27m for FY08
- Following its investment in Obopay in March, in August, Nokia announced the launch of "Nokia Money", a mobile financial service offering, which provides consumers with access to basic financial services; the service will be rolled out gradually to selected markets, beginning early 2010; Nokia is expected to invest c.$33m in a further fund raising this month
- From December, the Obopay mobile payments application will be available on Apple iPhones in the US
- In December, Obopay was selected as 2010 Technology Pioneer by the World Economic Forum, for its innovation, transformational technology, leadership and substantial long term impact on businesses and society. It was one of 26 companies globally to receive the award

Global Cricket Ventures

- On 19 November, Elephant Capital announced that it had entered into a definitive agreement to invest US$10m in the "Series A" funding of Global Cricket Ventures Limited ("GCV"). This investment has now been made
- Elephant Capital's stake in the business is c. 50% and it is represented on the Board; however, GCV has plans to raise a further US$5m in a "Series B" funding, which will dilute Elephant Capital's holding
- GCV is an online media and broadcast company, which is the exclusive licensee of key digital and mobile rights to the Indian Premier League ("IPL") and key digital rights to the Champion's League Twenty20 ("CL") cricket tournaments and which owns the domain name cricket.com
- The IPL is the world's most successful club cricket T20 competition, attracting 90 million viewers in its second season, despite being held outside of India. Ten year broadcasting rights were sold for US$1billion to World Sports Group ("WSG") in 2008, which was subsequently revised upwards to US$1.6billion for nine years
- The inaugural CL tournament was held in India this year, and ESPN Star Sports acquired the broadcasting rights for US$975million in a ten year deal. In both cases, GCV's agreements with the BCCI / WSG have eight years to run

Investment Summary

Valuation			
(£m) Company	Investment at Cost	Market Value 30-Nov-09	Gain / Loss
EIH Ltd	5.4	7.3	1.9
Mahindra Forgings Ltd	7.3 (1)	4.1 (2)	(3.2)
NIIT Ltd	1.9	2.3	0.5
Nitco Ltd	5.5	1.3	(4.2)
Obopay [3]	1.2	1.7	0.5
Global Cricket Ventures [4]	5.9	5.9	-
Total	27.2	22.7	(4.5)
Cash Balance [5]		21.0	
Total		43.7	
NAV per share (£) (unaudited)		0.87	

*Mkt. Value = No. of shares held as on 30 11 09 * Closing Price as on 30 11 09 on NSE * Exchange rate of INR 76.92 Rs / 1 GBP as on 30 11 09 (Source: Oanda)*

(1) Includes Elephant Capital's investment at cost of £3.5m and £3.7m loan to Krammer Holdings Pte. Ltd (the principal amount)

(2) In November 2009, Elephant Capital was required to write down the loan to Krammer Holdings Pte Ltd; the loan was secured on c.1.3m shares in Mahindra Forgings; the market value is therefore represented by the market value of Elephant Capital's investment, plus the market value of the security shares adjusted for accrued interest of £333,690 which has not been received

(3) Post Nokia's investment (E1 financing round) Obopay's investment has been re-valued as per the International Private Equity and Venture Capital Valuation Guidelines

(4) Valued at cost

(5) Does not account for income and expense accruals

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