10 ways to buy into India's latest growth spurt Page 35

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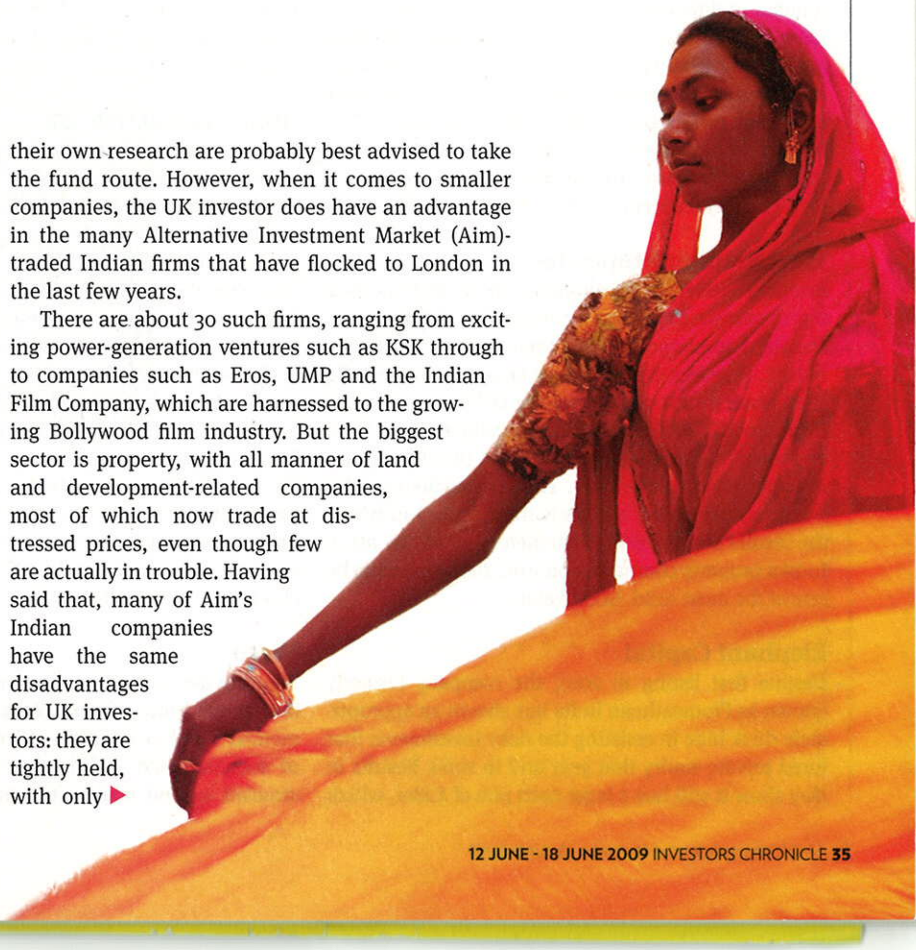
A TASTE OF INDIA

The enormous changes in India are creating unique investment opportunities. **Nick Louth** finds 10 UK-listed companies with Indian exposure that look well-placed to benefit

India offers some excellent share opportunities



Investing in India can be as complex and frustrating as dealing with the country's notorious bureaucracy. But, for those with an eye for detail and some patience, there are some excellent share opportunities. With the return of a Congress Party-led government in the recent election and economic growth likely to be second only to China among the BRIC (Brazil, Russia, India & China) economies this year – see sidebar, on page 36 – India has an awful lot going for it. Not least is its large, self-confident middle class, which numbers 200m well-educated consumers. A new study by management consulting firm McKinsey suggests that if India continues its recent growth, average household incomes will triple over the next two decades and it will become the world's fifth-largest consumer economy by 2025.

While the country has numerous large and well-known domestic companies, it isn't easy for UK investors to access them. Firms such as Reliance, Bhati Airtel and Infosys, for example, are listed primarily in Mumbai. Where foreign listings exist, they are more likely to be in New York than in the UK. Those who want a broad exposure to India without doing their own research are probably best advised to take the fund route. However, when it comes to smaller companies, the UK investor does have an advantage in the many Alternative Investment Market (Aim)-traded Indian firms that have flocked to London in the last few years.

There are about 30 such firms, ranging from exciting power-generation ventures such as KSK through to companies such as Eros, UMP and the Indian Film Company, which are harnessed to the growing Bollywood film industry. But the biggest sector is property, with all manner of land and development-related companies, most of which now trade at distressed prices, even though few are actually in trouble. Having said that, many of Aim's Indian companies have the same disadvantages for UK investors: they are tightly held, with only ▶

a small free float; and they are often thinly traded, so you have to put up with large bid-offer spreads.

For all their cheapness in PE ratio terms, very few pay any kind of dividend. Above all, there are murky governance issues in many stocks in which news is too infrequently issued, where there are numerous cross-holdings, where related-party transactions can be hard to fathom and where the interests of the small investor might occasionally be forgotten. After all, it's one thing to be a sleeping partner as Aim-based investors are in many of these companies, but you do want to be woken up occasionally and told what is going on.

The biggest Mumbai share index, the Bombay Sensex 30 Index, had its worst annual performance since 1991 last year. However, it has soared 80 per cent so far in 2009, adding almost 20 per cent overnight on the election news. After years of parliamentary logjam, the hope is that an overall majority for the moderate government of Manmohan Singh will lead to the economic reforms and infrastructure development that India so badly needs. So here are 10 interesting companies that we think will benefit.

KSK Power Ventur

India is chronically short of power stations and generation capacity, and KSK Power Ventur believes that whatever happens to Indian economic growth, large industrial companies are still likely to need 15 per cent more power than is available. Output is just 184 megawatts (MW) now, but it has financed and fuel-sourced another 675 MW for delivery by 2010, plus 1,973 MW under development. The company is spread over a number of different niches within the industry, some more cyclical than others, which provides resilience against uncertainty. These include project management, resources, green energy and fund management as well as power generation itself. A fabulous stock, but heftily priced with a PE ratio of 45, this is one for the long term. More patient investors may want to wait for a cheaper moment to get in. Fairly priced.

West Pioneer Properties

Bringing western-style shopping malls to India is a big departure in a country where the logistics and transport to support such developments are patchy at best. However, by cautiously targeting only middle class areas near those second-tier cities not paralysed by gridlock, West Pioneer is doing comparatively well, as shown by the small premium that the shares have over net asset value (NAV). The last results were hit by the strong dollar, as this is the currency in which the results are reported. Nonetheless, of all the many Indian property companies on Aim, this appears to be one of the most solid. Good value.

Elephant Capital

Despite first listing in 2007, the company formerly known as Promeathean India has shown an appropriately thick hide in resisting the risky investments that lured private equity that year and in 2008. Results in May show it still has a large cash pile of £28m, which accounts for the majority of its £48m market capitalisation. Of the big investments already made, Elephant has made a loss on slump-hit car firm Mahindra, although a 3 per cent stake in Obopay looks more enticing. Obopay is a California-based company specialising in mobile-phone payment technology which Elephant hopes to bring to India. Obopay has deals in place with Mastercard, Fidelity and Bancorp. With opportunities more reasonably priced in 2009, and plenty of financial firepower, the fund is well-placed to find the out-of-favour sectors and distressed situations it is looking for. The shares are thinly traded, but may have speculative appeal. Good value.

'India is a more reassuringly familiar territory for the British investor than China. The widespread use of English, the good education system and the sheer hard work of the middle classes are well understood assets'

Greenko

Renewable energy producer Greenko is sitting pretty. With India short of generating capacity, the company has almost 100 MW of hydro-electric and biomass generating capacity onstream and another 146 MW under development towards its 400 MW target. To do this, Greenko has secured an Indian interstate trading licence which will allow it to sell electricity on the open market at a better premium. Ultimately, the company plans to develop from an owner operator to a developer of projects. News earlier this month that Greenko has managed dramatically higher tariffs at several plants, and will meet expectations for the year, has powered the shares, but there is more to go. Good value.

India Capital Growth

The year 2008 was an awful one for domestically-orientated closed-end fund Indian Capital Growth. Net assets shrank from £123m to £32m, a staggering fall which reflects the company's holdings of small- and medium-sized companies. The fund underperformed the main BSE Sensex, which halved in value, by a further 23 points, having made the fateful decision to remain almost fully invested throughout.

However, the performance pretty much matched the Bombay small-cap index and there is potential for a substantial rebound in 2009 and 2010, some of which is already under way following the post-election rally. The average PE ratio of the fund's holdings was only five at the year-end, so for those who want a cheap play on recovery among individual stocks too small to research or not listed in the UK, this might be worth a closer look. Good value.

Hirco

Property developer Hirco is a peculiar beast. It is an investment vehicle for India's largest residential/commercial developer builder, Hiranandani, in a series of self-contained middle-class enclaves being constructed around major cities in the subcontinent.

India's economy

India is turning out to be one of the world's most resilient economies during the downturn. India's GDP growth rebounded to 5.8 per cent in the first quarter, double the government's own target, though still below the heady 9 per cent recorded in the previous fiscal year. While China may grow faster, at 6.3 per cent, India's expansion will still leave Brazil and Russia well behind. These two countries are expected to suffer a contraction of GDP of 0.3 per cent and 5.6 per cent, respectively, this year. Foreign investors have poured into India since the election result, pushing up the rupee by 4 per cent since then and 13 per cent since the low hit in March.

The biggest worry is government debt which has doubled to 12.2 per cent of GDP since 2006, helped by big pay rises to public servants and government funding of banks' write-offs of overdue debt owed by small farmers. India is in some ways like France, in hock to special interest groups, such as agriculture, but with the added complications of caste and religious schisms.

However, India is a much more reassuringly familiar territory for the British investor than China. The widespread use of English, the good education system and the sheer hard work of the middle classes are well understood assets.

While export growth has evaporated, domestic demand is still strong, which will allow the country to bounce back into strong growth in 2010. Unlike many other nations, India still has room for further monetary easing if required, and the largely domestic-facing banks have mostly been spared the terror that the world's financial system has endured.

The Bollywood film industry has a worldwide fan base

Staged construction and gradual payments means that Hirco has net cash rather than debt.

However, like most such ventures, Hirco trades at a drastic discount of 85 per cent to NAV of 672p at 31 March, despite good property sales so far by Hiranandani, whose controlling family holds a substantial minority in Hirco itself. A half-year loss of £30.88m, which was driven by a 5.7 per cent NAV write-down, compares with profits of £52.5m a year ago. While activist investor Laxey Partners was rebuffed in an attempt to turf out three directors and appoint a chairman independent of the Hiranandani family, the good news for investors is that a maiden dividend is due this year. Good value.

Top 10 Indian plays

Company	Epic code	Sector	PE ratio	Dividend yield
Eros	EROS	Media	3.1	nil
Eredene	ERE	Property	na	nil
Elephant Capital	ECAP	Private equity	na	nil
Greenko	GKO	Energy	13.7	nil
Hirco	HRCO	Property	na	nil
India Capital Growth	IGC	Fund	na	nil
KSK Power	KSK	Energy	45.8	nil
Trikona Capital	TRC	Property	5.1	nil
West Pioneer Properties	WPR	Property	6.5	nil
UMP	UMP	Media	9.1	nil

Trikona Trinity Capital

Activist investor QVT triggered a break-up of Trikona Trinity in March, which will lead to the sale of its property assets and a return of cash to investors, through either a tender or share buyback. Although the motion was passed against the wishes of management, the shares continue to trade at a 40 per cent discount to the stated NAV of 138p. Assuming this figure can be relied upon to be reflected at liquidation, the fact that the shares still trade below 60p represents a huge potential value for those prepared to delve into the intricacies of the Indian governance system. Speculative good value.

'Many of Aim's Indian companies have the same disadvantages for UK investors: they are tightly held, with only a small free float; and they are often thinly traded, so you have to put up with large bid-offer spreads'

Eros

An Investor Chronicle 2009 Tip of the Year, Eros represents one of the two best plays on the burgeoning Bollywood film industry, especially now that the price is far below the 138p it stood at in January. A profit warning in March included a two-month delay to four films, partly prompted by the Mumbai terrorist siege, plus a currency hit.

This resulted from the weakness of the rupee, in which most sales are made, against the dollar in which results are reported. At that time the shares plumbed a low of 40p, which put them on an absurdly low PE ratio of less than one, both historically and prospectively. This was something of an overreaction given the company's long film release schedule, the strong partnership deals with Sony and Lionsgate, the large film back catalogue and TV activities, and its previously good record of beating analysts' expectations. The company has now bounced back with three strongly received films launched at Cannes. Buy.

UMP Group

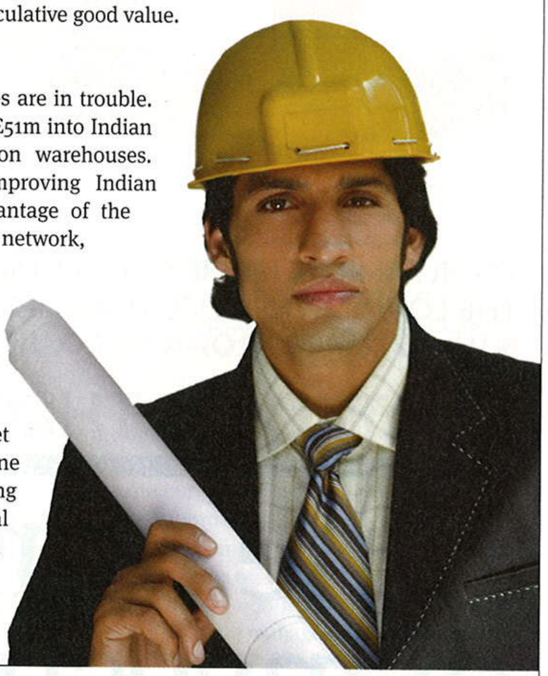
Another Indian film company, this time with good links with Hollywood, where Disney has a 32 per cent stake in UMP's parent company UTV Group. UMP was formerly UTV Motion Pictures, and has a long release history plus a significant distribution presence in the US. It has connections with some high-profile US-based Indians, including writer Jhumpa Lahiri, and directors Miar Nair and M Night Shyamalan.

However, it is currently in dispute with Indian cinemas over commercial release terms and is holding back its film. There are also some hard-to-fathom intra-company transactions and confirmation of takeover talks with 75 per cent parent UTV Software. For those that can live with such typically Indian complexities, the company does look to offer some excellent growth opportunities at a low cost. Speculative good value.

Eredene Capital

Not all Indian property ventures are in trouble. Eredene Capital has ploughed £51m into Indian ports, logistics and distribution warehouses. Its facilities are aimed at improving Indian infrastructure and taking advantage of the improved internal transport network, with an exit target of five to 10 years.

The company is in the process of raising an additional $400m (£250m) and, although this is taking some time given the current market conditions, the fact that Eredene has cash on its balance sheet along with well-known international investors such as Caledonia and Henderson should give confidence that it will continue to get the backing it needs. Buy.



Middle-class enclaves are being constructed around major cities