HARGREAVEHALE

INVESTMENT BULLETIN

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How's That?

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This month Sid Lall, one of our investment managers recounts his experiences of a recent trip to research investment opportunities in India.

Being driven all the way at 80km per hour, in an air-conditioned, nearly new, black Toyota, on a pot-hole free road may not sound fancy in the West but when it is to Asansol, for four hours from Calcutta (or Kolkata as it is now known), it sounds like a dream from over ten years ago. Gone are the days when even the Maharaja of Burdawan, would have to consider the train or be restricted to travelling in an ambassador car with the windows down, at a snail's pace hoping to be home before dark. The Maharaja is no longer restricted and this new improved road accessibility to his district will have a significant impact for asset revaluation in general, not just for land. Beyond recovery from the 2008 global crisis, it is likely to go to new highs. If there were any white elephants, he is no longer surrounded by them.

In Asansol, lies the coal bed methane site of **Great Eastern Energy** and the route to it is now beautifully balanced between a thriving industrial base and lush green fields as far as the eye can see. I actually stopped taking photos of the steel belt in and around Durgapur when I realised that it was more than just one or two plants in that area and many of them would be functioning throughout the night as was evident on my way back that evening. Everything from auto parts distributors to biscuit factories have also located near here and they all demand cheaper fuel for electricity. Great Eastern has a pipeline stretching over 70 km with yellow sign posts to warn of their presence 2 metres below the ground. Having completed this in a semi rural area is an achievement in itself and must have generated considerable local opposition despite government support. It was not long ago that even Tata Motors could not succeed in this area just outside Calcutta, with their vision of a Nano factory. Yet Great Eastern Energy has managed to secure itself an infrastructure that will allow it to provide a fuel source that is 40-50% cheaper [than petrol and LPG], whether it be used in a truck that has been converted to use CNG (compressed natural gas) or in an industrial plant. They have more demand than they can satisfy.

On approaching the tinted windows of the Halliburton trailer at one of the wells I had to wonder, could it really be that there were world class experts willing to sit here in the heat and dust, on a 90 day rotation, away from families altogether, with no social life and just concentrate on 'fracking'? Wikipedia describes hydraulic fracturing as a 'process that results in the creation of fractures in rocks' It is used to 'increase or restore the rate at which fluids, such as oil, gas or water can be produced from a reservoir, including unconventional reservoirs such as shale rock or coal beds.' Indeed, these were senior engineers with regional knowledge of coal bed methane in America and Australia but also other oil and gas blocks in places like Mongolia, where one of them had done a stint for SOCO International plc! 100% was the rate of recovery from the reservoir just fractured, minutes before my arrival. The digital charts of pressure and flow were being reviewed with a sort of silent joy, yet the sense of adrenaline pumping was so clear that it could not have been staged. Still, the analysts (Arden) use 50-55% as a recovery rate in their models for the stock valuation and this conservative approach has its merits; as they still get an NAV of £10 for the stock when it is trading at c.£5.00.

The local press reports suggested sales of Land Rover and Jaguar have recovered sharply. Plenty were spotted in Mumbai. Mercedes is no longer worth turning your head for as you should expect to see an SUV by Porsche or Audi (and not the old models either) ahead of it. Service at the hotels (branded Taj) owned by the Tata Group is possibly second to none and may well require another news bulletin altogether. The message here is that demand is strong and people have money to spend- lots of it as if they are not backed by land they have enterprise!

Reading Kamal Nath's (ex Minister of Commerce) book on my Jet Airways economy flight (as good as Economy Plus on British Airways except on newer plane with better service)*, India's Century*, describes how more than half the GDP is now accounted for by the services sector. The IPL (Indian Premiere League), run by Lalit Modi, coincidentally the nephew of Y K Modi (Chairman of Great Eastern Energy) certainly stole the show for every media channel and is watched religiously both at home and at work by anyone vaguely interested in cricket. It has cleverly involved the biggest stars of Bollywood. Even Shah Rukh Khan or 'King Khan' as he is known, has a share in a team called Kolkata Knight Riders (KKR) and turns up to promote it with full dedication. One has to wonder if this can be the equivalent and eventually bigger than the English Premiere League. Perhaps Shilpa Shetty is better known in the UK for winning Big Brother; she too is involved with IPL. Cheer leaders were being flown in with Jet Airways for the IPL specifically, all expenses paid – how could they afford it? Prior to this there must have been the entourage that goes with international cricket stars, again all expenses paid. Is it sustainable or just a fad? Some numbers might help – franchisee fee $75-100m, income in 2008 was $7.7m, but by 2009 KKR doubled it to over $15m. That is just the income from its central pool. From sponsorships it trebled the income stream from $5m to over $15m. So that is over c.$30m of income for just one team in one year! Hotels and tourism aside, this is good for cricket, good for Kolkata and certainly very good for the airlines.

On one of my flights, I was sitting next to a lady who wanted to complain because her empty juice Tetra Pak carton had not been cleared after twenty minutes of asking. So she did and then decided to write a complaint form as well after being rude; exaggerating the amount of time she had been made to wait. Essentially, this was making sure that the air steward was either going to be given a warning or be sacked. India still works on class system to a large extent; it is all about who you know. Unfair, but I saw her writing her name and realised that she was in fact involved with a big, real estate company. That would carry weight and Jet Airways would react strongly to please her even though it was her that was wrong in this situation. The stewards were clearing up anyway but it was just that they were not doing it when she wanted. This same real estate company has also been suspected of packaging some of the family owned assets into another company, to be sold at inflated prices via related party transactions. A sense of duty required me to fill out a separate form to praise the same air steward at handling the situation so well, apologising when there was no need to and taking the humiliation gracefully. So I did, and the lady next to me did not know it. Jet Airways should treat both its *Jet Privilege* members' comments with equal weight. India is the world's largest democracy.

Hopefully, the air steward has not been sacked as I write this piece. Invest in India but do so carefully as what looks good on paper, may not be backed by sincere individuals at the top. Get to know the management, we do this in the UK but it is even more useful in India.

When the Minister of Road Transport & Highways, Kamal Nath, publicly announces a target to build 20km of new roads in India per day it is something for all to see! Even if he achieves 6km per day that will be an impressive feat and if anyone can do it, he will. This will have consequences not only for the infrastructure sector but also autos and real estate amongst others.

A small company called **West Pioneer Properties**, aims to benefit from the completion of a 6 lane highway that will connect Bombay to Nashik. This will reduce the journey time from 4 hours to 1.5 hours. It should be completed in 6- 8 months but ahead of that West Pioneer has a deal with Intercontinental Hotels Group to build a Holiday Inn 200 room hotel. It focuses on the ‘long tail’ or middle income market in India for residential and retail real estate. It is a two phase project with a mix of 150,000 square feet for residential as well. The residential build is based on a pre-funded model essentially financed by the end buyer or his mortgage provider. Visibility is strong here and having started at c.2000 INR (Indian Rupees) per square feet during the financial crisis of 2008 they are now selling at over 3000 INR per square foot and still seeing high demand. They have a monopoly (for now) in Kalyan, a suburb outside Mumbai, and the shopping mall there is seeing increased footfall as per their latest interims. The quality of that footfall is also higher as judged by the number of families coming out to shop together, effectively making it a social event. Unlike some other real estate companies listed on AIM, this does not have a fancy office address; in fact it does not even have an elevator. Instead, it shares meeting rooms with the McDonald’s corporate offices, who happen to be tenants in their Mall. Unlike many other real estate companies this is not highly geared and most importantly, it delivered an interim profit of over $1m. The analysts forecast a loss of $0.6m for the year 2010 but this looks more than likely to be beaten. With a market cap of £20m it is possible that this little company can achieve $20m of PBT by 2012e putting it on a prospective P/E of c.2x for that year. Although some discount should be given for it being an illiquid emerging market exposed stock, one has to wonder if it won’t start to re-rate when the full year numbers are out in a few months.

Sitting at the Taj Lands End Hotel, as industry captains and Bollywood stars walk by casually, I looked at two analysts from Religare Hitchens Harrison, thinking there would not be much overlap between us. I was wrong again. Not only did we have **Cairn** in common, as this is listed in both the UK and India, the assumptions we made in valuing these stocks were also similar. The CFO of **Great Eastern Energy** was coincidentally at Cairn previously. However, returning to Cairn, it aims to provide India with 20% of its oil and gas requirements at peak production. Some say India is importing as much as 70% of its energy requirements today. From this perspective, Rajasthan is real and Greenland will decide its fate. Drilling is expensive and for it to go into virgin territory, this is a big risk. However, should it be successful, it will probably catapult the stock valuation to take it a few rungs higher in the FTSE 100 board.

Cove Energy, was another one that made me think. Having successfully made an offshore gas discovery in Mozambique, they have Anadarko as operators and two Indian companies as partners in the block with similar stakes. Bharat Petroleum and Videocon are both household names in India but most in the UK would not know who they are. Once again, the assumptions made by them on the reserves found were similar to ours in London – initially indicated as 2tcf, the accuracy of 3D mapping leads management to believe it could be 4 tcf but as much as 10 tcf if the sands really do have such good interconnectivity all through. Further drilling will confirm it and they are on an accelerated programme for now but the analysts I met are assuming 5tcf. A crude measure of value (rule of thumb being $1bn per tcf of gas) would suggest the fair value for Cove's c.8.5% stake is $425m or £281m. Post fund raisings this works out to c. 85p per shares based on 337m shares outstanding The current market cap of Cove is c. £164m. This does not ascribe any value for its other assets in Tanzania that are operational.

The same analysts said Reliance is still interested in the D9 block even though the first drill there was dry. In a 90:10 split with UK listed **Hardy Oil & Gas**, the market now pays no attention to its find at the D3 block. Having met the management recently, it seems that even though the two blocks are of decent size (c.7-10 tcf each), D3 alone could be worth $500m (c.100% upside from current share price). If a new report suggests that there is some value in D9 left rather than zero as the market has ascribed to it, this would be a big catalyst. It is therefore possible that Hardy Oil &Gas could double but remains speculative and burdened by negative sentiment for now. As such, it is a special situation, speculative, requires patience and should only have an appropriately small weighting, if at all.

Expectations from my trip were low; how much could it have changed since December, when I was last in India? I was certainly caught out. Budget hysteria has passed and most sectors have come out well from it, but still the buzz continues. Driving to the airport from Alipore to Kolkata airport, the journey time has increased as new roads are being completed and the 'new town' is being developed fast. I knew that last time. What was apparent just months later, was the quickened rate of completion and radical change in landscape - beyond recognition. People have started moving into the new town. There will be a natural demand for residential apartments from corporate offices like IBM, who have one of the largest offices in that area. That is the sort of building that can't be 'flipped' over night. They are here to stay and by taking hold of a site like that on the main road it also makes a bold statement to anyone who comes into or leaves the city. Outsourcing and IT services look to be growing themes in this region.

India is still behind China, but catching up and could win the marathon, as Nath says in his book. It has fewer language barriers with the West and good political leadership under Prime Minister Manmohan Singh. With all the right ingredients in place, if they can contain inflation, which is a concern (c.9.9%) and manage currency and their deficit prudently, GDP growth will continue. India has many state assets that going to be gradually privatised and this will help control any deficit issues. S&P has recently lifted its outlook rating on India from 'negative' to 'stable'. That should help flows of foreign institutional investment (FII), which essentially drives the SENSEX higher still. M&A is also on the rise and India is not holding back on acquiring foreign companies for their knowledge base or brand.

The recent announcement by Fortis Healthcare for Singapore's Parkway is yet another large cross border transaction. India's Fortis Healthcare is controlled by brothers Malvinder & Shivinder Singh, formerly of Ranbaxy (the generics global giant previously sold to Japanese company Daichi Sankyo) and is reflective of how these powerful families can evolve internationally and still secure financing to do so.

For those who have not invested in India, one has to ask whether they actually have a choice. Buy or get bought seems to be the mantra. Directly or indirectly we are all investing in India – whether it be the Land Rover you sit in or the leather in your Louis Vuitton hand bag, it is all Indian, so don't get caught out!

Buy recommendations as a result of the visit:- All Higher Risk Companies

Cairn Energy
Cove Energy
General Eastern Energy
Hardy Oil & Gas – Speculative buy
West Pioneer Properties

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Conflicts Disclosure: Siddarth Chand Lall personally owns shares in General Eastern Energy

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