

# JUPITER CAPITAL PARTNERS

## Sri Lanka Private Equity Market Newsletter

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AUGUST 2013

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**Vellai Oya Estate and Tea Factory** (picture above), one of 17 tea estates owned by **Watawala Plantations**.

Vellai Oya is a medium elevation estate (2,000 – 4,000 feet from sea level). This month they bettered their previous record for all time best price for BOPF teas at Colombo Tea Auction.

*Increase in secondary (minority/PIPE) deals by family run investment firms/vehicles, as market prices remain low and volatile.*

## DEAL ACTIVITY IN AUGUST

**Aureos South Asia Fund LLC (managed by The Abraaj Group) shed its stake in Sunshine Holdings PLC to 10% from 20.1%** and realized US\$ 3.5 million. Aureos paid US\$ 4.7 million for a 25% stake in Sunshine in 2008, and divested close to 5% during stock market bull run in 2010. The buyer was **Mouldex Ltd.**, a company linked to stock market investor **M. M. Udeshi**. For the 1Q 2013/14 Sunshine Holdings' earnings were down by 64% to US\$ 0.5 million

In another related deal, Sunshine Holding's associate company - **Estate Management Services (Pvt) Ltd. upped its stake in Watawala Plantations PLC to 74.6% from 53.75% for US\$ 5.2 million. Main seller was Mouldex Ltd., which held 19% stake in Watawala Plantations.** In June, Singapore's **Piramid Wimlar** bought a 35% stake in Estate Management Services thus diluting Sri Lanka's **Sunshine Holdings** to 33.2% and India's **Tata Group** to 31.6%. **Aureos South Asia Fund LLC** also hold 3% in Watawala Plantations. For the 1Q 2013/14, Watawala Plantations' profits were down sharply to US\$ 0.083 million from US\$ 1.1 million last year.

**Expolanka PLC divested its 60% stake in HelloCorp to Senok Group for US\$ 0.4 million.** Hellocorp commenced operations in 1999 as the pioneer call-center in Sri Lanka. According to PE backed Expolanka's annual report, Hellocorp mainly serves local airlines and returned to profits in FY 2012/13. Expolanka is exiting non-core businesses to concentrate on its core travel and logistics businesses, and acquired 50% stake in Indian travel services company - **Akquasum** for US\$ 0.9 million in May 2013.

**Perpetual Capital, a family run investment firm sold 11.6% stake in HDFC Bank PLC for US\$ 2.25 million** and reportedly made a gain close to US\$ 0.5 million. The buyer was **Thurston Investments**, another family run investment firm. HDFC bank is a specialized housing loan lender controlled by National Housing Development Authority (a state agency). HDFC reported US\$ 0.37 million earnings for 1H 2013 – up 391%. Last year Perpetual Capital bought 80% of **W. M. Mendis Co.**, a pioneering alcoholic beverages manufacturer in the country, for an undisclosed price.

**Ideal Finance Ltd.**, a new privately held small finance company promoted by a group of local and Japanese investors said they are negotiating an investment from a US based investment fund to boost its capital. Two other finance companies previously owned by **Ceylinco Group** are also looking for investors to bridge capital shortfall in their books. **The Finance PLC**, is reportedly negotiating US\$ 30 million capital infusion from a group of Malaysian investors, and **Nation Lanka Finance PLC**, also said they are looking for funds from Middle East investors.

**Navara Capital, a local financial advisory and investment firm has agreed to buy NWS Securities**, a stock broking firm for an undisclosed price (deal pending regulatory clearance). In April, 51% stake of NWS Securities was acquired by a consortium led by stock market investor Nimal Perera for approx US\$ 0.26 million.

Contd.

There were two deals in companies in troubled PC House Group: Adam Investments, a local family investment company, purchased a 20.8% in PC Holdings PLC for US\$ 0.32 million. British American Technologies Ltd another local company active in the stock market, bought a 24% stake on PC Pharma PLC for US\$ 0.27 million. PC House PLC, also says that they are open for a bail-out deal as company's share price tumbled further to less than one Rupee (from highs of Rs 30s). Last month (July), Sri Lankan stock market investors T. Senthiverl bought a 10% stake in PC House for US\$ 0.32 million betting on a possible restructuring. PC House, PCH Holdings and PC Pharma are controlled by S. H. M. Rishan, a self made entrepreneur and their main business lines include IT equipment retailing, garments manufacturing and pharmaceutical distribution (respectively). Share prices of all three companies have fallen sharply due to heavy losses amid allegations of poor corporate governance.

## OTHER INVESTMENT HEADLINES

Archer Daniel Midlands Europe BV has injected US\$ 14.2 million for Chemcel (Pvt) Ltd and acquired a 66% stake. As a result Chemmanex PLC, the promoter, has reduced its stake from 70% to 23.8%, and CIC Holdings PLC has cut its stake from 30% to 10.2%. Funds raised will be utilized to expand factory which manufactures bio-based super absorbent polymers (used in food and personal care industries). Chemmanex is a company engaged in manufacturing specialty chemicals and industrial intermediaries, and is a subsidiary of CIC Holdings PLC - one of Sri Lanka's largest agri-business firms.

China's AVIC closed a deal to buy a land in Colombo to build a hotel. The seller - Lee Hedges PLC has sold a 4,595 sq.m. from their prime city property for US\$ 9.3 million. In a separate deal, Lee Hedges PLC also bought a state land (1,340 sq.m.) adjoining its own property on a 99 year lease for US\$ 3.5 million last month. Lee Hedges, which is an investment trust, is also developing a commercial property.

State owned Sri Lankan Airlines announced a joint venture with Lufthansa to maintain and service aircrafts at newly opened Mattala International Airport in Southern Sri Lanka. The US\$ 14 million venture is expected to earn around US\$ 100 million revenue annually.

In another similar deal, PE backed Access Engineering PLC announced a joint venture with Chinese port equipment manufacturer Shanghai Zhenhua Industries Co. Ltd to service and maintain port equipment at newly opened Colombo International Container Terminals at newly opened Colombo South harbor. Access will own 30% in the venture.

Government has approved six port related ventures worth US\$ 1.6 billion under the Sri Lanka Port Authority's development plan for the new Hambantota Harbour. These ventures will be offered land in the new Industrial zone linked to the port:

- Advance Surfactants India will invest US\$ 261 million in petroleum, petrochemicals and chemicals manufacturing plant.
- Sri Lankan firm Laughs Group will invest in US\$ 20 million in a LPG storage and distribution facility and a further US\$ 1.1 million in a lubricants blending plant.
- Another local company Rank Holdings will build a US\$26 million petro-chemical storage and transshipment facility.
- Hong Kong based Energy World International is expected to invest US\$ 1.35 billion in a LNG hub terminal.

John Keells Holdings PLC announced a plan to raise US\$ 173 million through a rights issue. The diversified conglomerate will use funds for its planned US\$ 650 million city resort. Company is also issuing warrants to raise further US\$ 125 million in two tranches in 24 and 36 months. John Keells' share price has been declining in recent months and during August Company's share price declined by 17.5%.

### Mega Real Estate project delays and cancellations on the rise.

Despite many foreign investors acquiring land for property projects at high prices a, recent research highlights that many proposed mega projects have not yet commenced constructions, and some projects appear to be abandoned. Among the projects appear to be abandoned are Singapore's Mustaphas's planned US\$ 115 million mixed development and India's L&T's US\$ 135 million residential project. Even US\$ 408 million Shangri La mixed development project has faced unexpected delays while Indian Krrish Group's US\$ 450 million mixed development has also faced delays with controversies relating to delays in payment for land and alleged payoffs for officials.



Hambantota Port has seen increase in ship arrivals, especially Automobile carriers. Pictured above the Automobile Carrier MV "Istra Ace" owned by Mitsui OSK Line, arrived at the Port mid August as the 100<sup>th</sup> ship to call on the port.

According to news reports, **India's Bharathi Airtel is negotiating with UAE's Etisalat to sell its loss-making Sri Lanka unit** which has only around 8-9% market share. According to same news report, Airtel's Sri Lanka unit is valued around US\$ 110 – 130 million compared to investment of US\$ 300 million.



Historic **Mount Lavinia Hotel**, originally built during 1805 – 1811, is located in Mount Lavinia (beach front). Two pictures above show how the hotel looked during late 1800s and how it looks today.

## DEVELOPMENT NEWS

**World Bank has provided US\$ 200 million funding to develop Galle and Kandy cities** – two main provincial cities. Earlier World Bank provided US\$ 320 million to **Metro Colombo Urban Development Project**. Metro Colombo development project has already uplifted the facilities and environment of Colombo city.

**Government launched a US\$ 280 million coast conservation and sea reclamation project**. A Dutch company has been awarded the project to develop the sea-beach in Colombo city and reclaim sea off **Mount Lavinia** – a popular tourist and entertainment suburb located South of Colombo (See picture on left).

**National Enterprise Development Authority is planning to establish a Technology Transfer and Development Fund** with the aid of Germany's **GIZ** and UK's **SQW** (consultants). The proposed fund will provide finance to firms experiencing difficulties entering and/or expanding into export markets due to lack of appropriate technologies and /or product and process innovations. The fund will also look at funding research institutes and technology providers in Sri Lanka.

## LEGAL AND REGULATION UPDATES

**Securities and Exchange Commission revised lock-in rules for new listings/IPOs**. This is the second revision of lock-in rules since first introduced in 2011. Key features of the new rules relevant for PE investors are highlighted below:

- Investors who acquired shares prior to 12 months (from the date of listing application) and holding more than 5% are subject to 6 month lock-in.
- Investors who bought shares in a secondary transaction, within 12 months of listing application, are subject to 12 month lock in from the date of purchase, or minimum 6 months from listing (whichever longer).
- Lock-in period for investors who bought new shares within 12 months of listing application will be determined by the Commission.
- Minimum 18-month holding period to qualify for offer for sale (through an IPO).

## FINANCIAL MARKETS

**Rating Agency Standard & Poor's has assigned a risk rating of 8 to the Sri Lankan Banking sector (out of 10 being the highest risk category)**. S&P highlights that despite high loan growth seen during post 2009 period, credit to GDP ratio is still low in Sri Lanka. Defaults are expected to rise in coming months, partly caused by inefficient use of credit and excessive exposure to gold. S&P has highlighted that **Sri Lanka Banking sector has the world's highest exposure to gold backed loans** (gold pawning) with gold loans accounting for estimated 15% of total loan book of commercial banks. (The second highest exposure is in India with just 4-5% of loans accounting for gold loans). Defaults are expected to rise as gold prices remain bearish.

**Fitch Ratings has also noted that Sri Lankan banks do not account gold backed loans and lending to government in calculating capital adequacy** leading to distortions of capital adequacy.

*Gold pawning has increased by an average 50% during last three years compared to average loan growth of 25% during same period.*

Three of the four commercial banks which have high exposure (more than 20% of their loan book in gold backed loans) to gold loans are government owned banks. **People's Bank**, country's second largest government owned commercial bank has the highest gold loan portfolio amounting for 36% of the total loan book. In a separate development government announced in August that it is taking necessary steps to increase the capital of Peoples Bank to keep up with the business volume growth.

Month end 3-month Treasury bill rate was 8.61%. Commercial bank's prime lending dropped marginally to 15.93% from 16.14% last month. Commercial Bank's average fixed deposit rate was 12.82% - which is drop of 0.54% from last month. Private sector credit showed a growth in July reversing declining trend in recent months.

Several debt issues were completed during August (which were announced earlier). **Singer Finance PLC**, a consumer durable financier announced plans to raise US\$ 9.4 million bond issue

**Sri Lankan rupee depreciated by 1.4% during the month** to close at 131/69 and 135/01. In a bid to curtail potential volatility in the exchange rate, **Central Bank imposed measure to discourage vehicle imports** by requiring 100% margin deposit requirement to import non-commercial vehicles.

Colombo Stock market's main **All Share Index lost 3.4% for the month** although for the year, the index remains positive with 3.4% gain. Average daily turnover was US\$ 5.2 million and there was US\$ 16.8 million foreign inflow to the market. Market cap as at end of the month stood at US\$ 18 billion.

## ECONOMY HIGHLIGHTS

**Inflation picked up to 6.3% in August (YoY)** from 6.1% in July. 12-month average inflation dropped to 8% from 8.3% recorded in July.

Government revenue (and grants) for the five months up to April was down by 4.2% to US\$ 3.4 billion, while expenditure were up by 7.1% to US\$ 4.9 billion. **Government debt increase by 5.9% to US\$ 47.6 billion** compared to beginning of the year. Government secured further US\$ 400 million budgetary support from ADB and World Bank.

According to latest data released by the Central Bank, country's **gross official reserves dropped to US\$ 6.28 billion in June** – a 8.5% drop since beginning of the year. Exports for the first half of the year were down by 4.5% to US\$ 4.66 billion. However in June, exports grew by 15.3% reversing 15 month declining trend in exports. Imports also declined by 5.8% to US\$ 9.21 billion during first half of 2013. **Earnings from tourism for the first half of 2013 was up by 22.9% to US\$ 459.9 million on a 13.1% growth in tourist arrivals.**

Note: All figures mentioned in this report are converted to US\$ using the mid month end rate of Rs 133/35, except where figures are provided in US\$ at source.

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Newsletter No. 7

Issued on 2 September 2013

*Sri Lanka rupee has depreciated by 4.8% against US\$ since beginning of the year.*

*Earnings from tourism shows continued growth with earnings growing faster than arrival numbers.*