

JUPITER CAPITAL PARTNERS

Sri Lanka Private Equity Market Newsletter

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Pic above: Luxury house at one of the housing estates developed by Millennium Housing Developers PLC. Company pioneered large scale housing estates by launching a 1,500 unit housing project in late 1990s.

“Retail businesses with annual turnover more than USD 15.3 million or Rs 2 billion per annum faced erosion of margins after the imposition of Value Added Tax (VAT) from 2013. From 2015 the revenue threshold for VAT has been brought down to USD 3 million or Rs 400 million. This is likely to have impact on large number of mid size retail and whole sale businesses”

PRIVATE EQUITY & OTHER DEAL NEWS

Hemas Power PLC sold 50% interest in Heladhanavi Ltd for USD 4 million to Lakdhanavi Ltd. Heladhanavi owns a 100 MW thermal power plant which is expected to shut down in December as the firm failed to renew contract to sell power to national grid. (Hemas Power had to write off USD 4.4 million from books last year owing to this.) **Lakdhanavi Ltd** is a group company of **LTL Group**, a large independent power producer and is a joint venture between state owned **Ceylon Electricity Board** and Norway's **ABB**).

In a separate, but related deal to above deal, Hemas Holdings PLC said it is exiting power sector. Accordingly a **75% stake of Hemas Power PLC will be sold for USD 13 million**, around 7% discount to NAV, to a consortium of investors including **NDB Bank Group** and **ACL Cables PLC**. Hemas Power will continue to operate three small mini hydro plants with combined 7 MW capacity and benefit from a 30% stake in **Panasian Power PLC**, another listed small hydropower firm with 4 MW capacity. For the first quarter of 2014/15, Hemas Power reported USD 0.7 revenue (down 45%) and operating profit of USD 0.4 million (down 60%) from hydro power segment. Hemas Group is divesting non-core investments to focus on FMCG and leisure sector.

Nation Lanka Finance PLC exited Millennium Housing Developers PLC. The founder of the housing developer sold its 68.1% for USD 3.5 million (9% discount to book value). **Nawaloka Group**, a diversified group with interest in construction bought the control of the company. Millennium Housing, which was listed earlier this year, reported around USD 1 million revenue and USD 0.08 million loss for the first half of FY 2014/15. In another deal Nation Lanka Finance PLC said it sold 75% stake in **Nation Lanka Capital (Pvt) Ltd.**, a small finance company for USD 0.2 million. These two exits are believed to be part of a planned acquisition of Nation Lanka Finance by another financial firm under the consolidation initiative of the financial service providers.

Diversified industrial group Hayleys PLC acquired Alufab PLC and consolidated its leadership position in aluminum fabrication. Swedish promoters of Alufab sold 61% stake for USD 1.3 million, around 9% discount to book value of the small debt free firm. For the FY 2013/14 Alufab made USD 0.7 million revenue and an operating loss of USD 0.3 million.

Malaysia's Parkson Retail has decided to exit from Odel PLC. Subsequent to **Softlogic Group's** purchase of 45% stake in the fashion retailer last month, Parkson Retail has decided to accept Softlogic Group's mandatory offer to buyout other shareholders. Parson Retail entered Sri Lanka in 2012 with a USD 21 million investment in Odel, and the sale reflects a small capital gain for Parkson Retail.

Douglas & Sons Ltd. acquired TVS Auto Parts (Pvt) Ltd. Both companies are in the business of automotive parts distribution. TVS Auto Parts was majority owned by India's **TVS group** and **AP Motha Investments Corp.** a family investment firm, also had a 35% stake in the company.

Asia Capital PLC divested its stock broker business to a consortium led by a local stock market/capital market professionals. Asia Capital, which secured PE funding from Japanese investors few month ago, is concentrating only on the leisure sector investments and also divested its finance business to India's Muhoot Finance last month.

Associated Motor Finance Co PLC said it is acquiring **Arpico Finance PLC** as part of the policy driven financial sector consolidation plan. The deal is closed at an equity valuation of USD 9.4 million - almost 2x the book value of the company, and 13x historical earnings. **Central Finance PLC**, one of largest leasing firms also said they are buying **Isuru Finance Ltd.**, another small finance firm. In another stock market deal, **DFCC Bank** which recently obtained parliament clearance to establish as a company to in order to merge with **NDB Bank**, said it sold a 10% stake in **Nations Trust Bank PLC** to an investor linked to Canada's **Fairfax Financial** for USD 16.6 million, and made 63% capital gain in less than three year holding period.

In debt funding deals, **NDB Bank** has secured a USD 75 million debt finance facility to boost lending to renewable energy, agro-industry and water supply sectors. French Development Financier **Proparco** has provided USD 60 million while Netherlands's **FMO** contributed USD 15 million.

Bimpuh Finance PLC, a small listed microfinance firm said it secured a USD 0.75 million debt funding from **Rural Impulse Fund SA** managed by Belgium's **Incofin Investment Managements**.

Malaysia's EXIM bank has signed a deal to provide a USD 10 million debt funding to a JV by Malaysia's **Hyrax** and **Ceylon Petroleum Corp**. The JV firm is in motor vehicle lubricants business.

In other PE related developments, Sri Lanka's **Ironwood Capital Partners** said it secured USD 30 million commitments mainly from offshore individual investors, and the pledge fund will mainly be focusing on buyout deals. Also **Calamander Capital** which invests in property and buyout deals in Sri Lanka, Bangladesh and in Singapore said it is mulling a possible listing of its investment vehicle in Colombo bourse after building a profit track.

Quarter Holdings LLC, second largest sovereign wealth fund in the Middle East said it is looking for Sri Lankan opportunities in the range of USD 100 – 150 million per deal. **Franklin Templeton Group**, one of active investors in equity and debt markets in Sri Lanka also said they are looking to expand investments in Sri Lanka and will also be looking for PE opportunities.

OTHER BUSINESS & INVESTMENT NEWS

China's **AVIC International Holding Co.** launched a major a 4 tower condominium project consisting 602 apartments. This is the first major residential project undertaken by a foreign firm after **Singapore's Shin Kwan Group's** local subsidiary launched Havelock City project in 2005. (see picture on left).

There were several new property development projects announced or launched during October. **Blue Ocean** property group said they are investing USD 2 million in an 18 storey residential development in Colombo 3, while **Sanken**, a construction company also recently launched a smaller scale upmarket residential development in prime residential area. **Trillium Property Management Co**, a former Ceylinco Group company also said they are investing in two property project in Colombo and suburbs. In a related development **Softlogic Group** which bought **Odel PLC** last month also has secured a 13.5 acre state owned land parcel in Colombo for a property project according to some news reports.

Browns Investments PLC, a listed hotel holding firm said it partnering with two firms to re-develop a property in Male, Maldives into a 4-star 150 room hotel and 100 apartments. Company also said the USD 9.5 million investment will result in company obtaining majority control of the venture.



*Pic above: Artist's impression of **Astoria Residential project** promoted by China's AVIC International Holdings. This is located in Central Colombo. Pic below: Artist's impression of **Havelock City** located in South Colombo. Launched in 2005 as a joint venture between Overseas Realty (Ceylon) PLC and state owned Bank of Ceylon. Several towers of the project have already been completed.*



“Majority of property development projects are targeted at ultra high income segment and overseas buyers. Average price of an apartment in Colombo city is more than USD 200,000 – almost 4 times the affordable price range of the highest income decile in the country”

Impact of new Land Restriction of Alienation Act on foreign Private Equity investors.

New land Act has several implications for foreign PE investors (including locally incorporated investment vehicles with more than 50% foreign interest).

- 1) Buyout investors are likely to find lesser opportunities in Sri Lanka especially relating to businesses which require operational real estate assets and also relating to firms which already have freehold assets (acquired during previous 20 years).
- 2) Both growth and buyout investors will find lesser exit opportunities through trade sale as it will not be feasible to sell majority stake in a large number of firms to foreign financial or strategic investors.
- 3) Although this law impacts all industries, impact is more on service industries which require operational real estate to carry out core business activity (like hospitals, hotels, educational institutions, etc). Even service businesses like IT and BPO which do not rely on operational specific real estate, are likely to face higher entry cost due to upfront taxes on property leases (if the company is majority foreign owned).
- 4) Manufacturing businesses (especially factory based industries) are less likely to be affected as many such businesses are located (and could be relocated) in leased lands within industrial zones.
- 5) Agri business, especially plantations are likely to be closed for majority foreign ownership.
- 6) Foreign property and real estate investors will also be impacted. However the law provides exemptions for large scale development projects.

Leoch International Technology Ltd, a Chinese battery manufacturer said it is entering Sri Lanka with an initial investment of USD 9 million to establish a manufacturing plant in Bata Atta Industrial Zone. Firm said it targets USD 3.2 billion Indian market.

Blue Bay Mineral International (Pvt) Ltd said it is investing US\$ 50 million in a plant to refine and process quartz powder. This project is a collaboration with **Asus Computers** of Taiwan, and **GHL Beratergruppe** of Germany.

TOS Lanka Co (Pvt) Ltd, an electronics components manufacturer and part of Japan's **Tossec Group** has formed a JV with **E-Wis Colombo Ltd**, a local ICT company. The JV will produce PCB boards and is expected to support many local firms engaged electronic components design and assembly businesses.

Ceylon Biscuits Ltd a privately held confectionary manufacturer has invested USD 3 million to open its first overseas factory in Bangladesh and the firm is planning a further USD 10 million to establish two more factories in Bangladesh.

Dhanusha Marine, one of the oldest boat builders said it is teaming up with a Korean firm to expand capacity and also investing around USD 1 million for the expansion. Company also said it is planning to acquire an existing boat building facility in Mauritius to cater to African market.

EAP Films, one of the few film theatre operators said it plans to invest USD 3 million to upgrade its theatre network.

DEVELOPMENT NEWS

Government's road development program is continuing with focus on improving traffic congestion in Colombo as well as improving rural roads. Government has approved a new project to build a **5 km elevated road linking Airport Expressway and City center**. This project is likely to be developed as an extension to the newly built Kelani bridge with Japanese funding. According to news reports, government has also finalized contracts for the proposed Northern Highway linking northern parts of the country. Government also said **Deutsche Bank AG** (London) and the **Bank of Tokyo-Mitsubishi UFG Ltd** has agreed to finance construction and rehabilitation of 537 rural bridges at a cost of USD 162 million

According to reports **Australia's Willard**, a large multinational group has secured a USD 100 million contract to supply 22,000 dairy cattle to Sri Lanka. **Ministry of Economic Development** has initiated this project after the success of a previous pilot project aimed at increasing local dairy production which stands at around 42% of local dairy requirements.

POLICY & REGULATION UPDATES

Land (Restriction on Alienation) Bill prohibiting to alienation of immovable property to foreigners have been presented to Parliament and is expected to be passed within next few weeks. This law prohibits the purchase of lands by foreigners and/or deemed foreigners (i.e. non-citizens, foreign companies and local companies with a shareholding of more than 50% or more foreign shareholders). Proposed law provides certain exemptions for development and condominium properties and permits lease to foreigners (subject to 99 years) on the payment of a 15% Land Lease Tax, which is paid upfront tax for the entire tenure of the lease. Exemptions and concessions are available for leases as well. The propose law comes into effect retro-actively (January 1, 2013) and recognizes inheritance rights of non-citizens in accordance with the law of succession and also renders obsolete the 100% tax on acquisition of property by foreigners. Dual citizens are not considered as foreigners. Further this law recognizes projects approved under Strategic Development Act and for foreign companies wishing to relocate head offices in Sri Lanka exceptions to the restrictions. Further the law does not apply to financial firms. **According to analysts, final amended Act is likely to have more flexibility to accommodate FDI.**

COLOMBO STOCK MARKET HIGHLIGHTS

Stock market was active during the month and main **All Share index gained by 1% for the month** amid a USD 60 million net foreign inflow.

There were no new equity listing during the month, but there were three bond issues by three financial firms - **Pan Asia Bank PLC (USD 23 million)**, **Mercantile Investments Finance PLC (SD 15.3 million)**, and **Merchant Bank of Sri Lanka PLC (USD 15.3 million)**.

ECONOMIC HIGHLIGHTS

Government presented Budget Proposals for 2015 within a medium term budgetary framework spanning 2015 – 2017. Budget proposals included many populist measures such as increase in wages and strengthening of social safety net as well as measures to improve revenue collection, and to support agriculture/plantations. Budget aims to achieve an overall budget deficit of 4.6% of GDP in 2015 compared to estimated 5% deficit in 2014. Budget proposals also included several proposals to **strengthen state owned business enterprises** and also hinted **possible increase in state involvement in some business segments like plantations**. Budget proposals also included a USD 100 fee for entrants to casinos. See Box on right for more specific impact on the budget proposals on SMEs.

Inflation reached record lows in October to 1.6% (YoY). Monthly inflation index dropped by 1.6% in October. Average weighted commercial bank deposit rate was 6.83% in September while average weighted lending rates stood at 12.98%. **Private sector credit growth recovered in August with a growth of 2.6% (YoY)** compared to 0.2% month ago. **Loans by foreign currency banking units accounted for 65% of the increase in loan stock** during August and 45% of increase in the loan stock during previous 12 months.

Exports upto August increased by 14.8% to USD 7.4 billion while imports grew at a slower pace of 4.6% to USD 12.5 billion. Earnings from tourism increased by 32% to USD 1.4 billion while remittances increased by a slower 10% to USD 4.5 billion for the same period. Sri Lankan rupee depreciated by a marginal 0.4% during the month.

Impact on new tax proposals on SMEs

Budget proposals for 2015 have several tax amendments which have direct impact on SMEs. They include:

- 1) Concessionary tax rates applicable for SMEs (in manufacturing and services) with revenue less than USD 3.8 (Rs 500) million has been extended to firms with revenue less than USD 5.8 (Rs 750) million. This is likely to benefit large number of midsized firms and also support high growth SMEs.
- 2) Scope of VAT has been expanded to include retail and wholesale firms with annual revenue more than USD 3 million (Rs 400 million) from USD 15.4 million (Rs 2,000 million). Midsized firms in wholesale and retail businesses will be impacted by this although VAT rate is reduced to 11% from 12%.

In addition to above, there are several industry specific incentives as well as general measures like reduction of electricity tariffs which benefits SMEs.

ENDS

Note: All figures mentioned in this report are converted to USD using the mid month end rate of Rs 130/94, except where figures are provided in USD at source.

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