Crowe Horwath

April 2014

The Global Corporate Advisor

The Corporate Finance newsletter of Crowe Horwath International

Welcome to the April issue of The Global Corporate Advisor. This month we look at theory, law and practice, in view of the still-evolving economic climate around the world.

The opening article by Vijay Thacker in India is about the newly implemented Companies Act, 2013. It examines select provisions of the new law that may be of interest to cross-border businesses.

Derek Mair from Aberdeen analyzes how shipping industry capital providers view the future. His article delves into market dynamics of the shipping industry in Scotland, keeping in mind the continued buoyancy the sector is witnessing in the North Sea, despite the global outlook not being so positive.

The final article in this issue finds Miguel Moreno Tripp from Mexico bringing theory into practice, discussing traditional valuation methodologies and concluding with the simple effectiveness of the P/E ratio.

Don’t hesitate to get in touch with your local advisor if there is any topic you’d like us to include in a future issue of The Global Corporate Advsior.

Marc Shaffer
Regional Leader, North America
+1 312 857 7512
marc.shaffer@crowehorwath.com

Inside This Issue:

Contact Us

The GCA team is here to respond to your needs relating to M&A transaction support, valuations and advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don’t hesitate to contact Peter Varley, Chairman of GCA, at *peter.varley@crowecw.co.uk.* Alternatively, please contact your local GCA team member to discuss your ideas.

A Spotlight on Relevant Provisions in the Companies Act, 2013

By Vijay Thacker, India

The Companies Act, 2013 has finally been passed and is being implemented from April 1, 2014, replacing all but some provisions of the previous Companies Act, 1956. The law is supported by several rules stipulated in furtherance of the provisions of the Companies Act.

In this article, I am briefly outlining select provisions of the new law that may be of interest to cross-border businesses.

Readers are advised to examine the entire provisions more closely and get advice on the matters outlined below and other provisions.

1. Constitution of a Board of Directors: Every company, including private companies, must have one director who is resident in India (182 days in a financial year). Each person to be appointed as director must have a Director's Identification Number. While the provision to appoint alternate directors (for overseas directors) continues to be available, a person cannot be appointed as an alternate director for more than one director in a company; a person can be appointed as an alternate director for an independent director only if the former is otherwise qualified to be appointed as an independent director. Specific provisions for appointment of certain categories of directors have been made:

2. A company is not permitted to make an investment through more than two layers of investment companies, except if:

(a) the company is acquiring a foreign company, which has investment subsidiaries through more than two layers under the laws of the foreign country or

(b) a subsidiary is required to have an investment subsidiary in accordance with the provisions of any other law.

This restriction may have implications on investment structuring for real estate and other transactions, although it will not have an implication on structuring of an international investment into India through more than two layers of overseas investment entities.

3. Rules have been prescribed for the issue of Indian Depository Receipts (IDR) by companies incorporated outside India. Besides complying with regulations prescribed by the Securities Exchange Board of India (SEBI) and Reserve Bank of India, the issuer company must:

(a) have pre-issue paid-up capital and free reserves of at least $50 million and minimum average market capitalization, in its parent country, of at least $100 million for the last three years,

(b) be continuously trading on the stock exchange in its parent or home country for at least the three immediately preceding years,

(c) have a track record of distributable profit for at least three of the five immediately preceding years,

(d) file a due diligence report in the prescribed form along with its application to SEBI for approval of the issue.

In addition to these points,

(e) the prospectus must be signed by a whole-time director and the CFO,

(f) the number of underlying equity shares offered shall not exceed 25% of the post issue number of equity shares of the company,

(g) the IDR must be denominated in Indian Rupees

(h) an auditors' report with audited accounts for the prescribed period must be filed, and in case the accounts are not subject to statutory audit in the parent country, then specified financial information audited by a Chartered Accountant in India must be filed.

Criteria	Woman Director	Independent directors	Director elected by small shareholders
Listed company	Yes	1/3rd of board, if chairman is non executive; 1/2 of board if executive chairman	If requisitioned by 1000 small shareholders or 1/10 of total small shareholders, whichever is lower
Other public company with		At least 2, unless larger number otherwise required	
Paid-up share capital ≥	Rs.1 billion	Rs.100 million	
Turnover ≥	Rs.3 billion	Rs.1 billion	
Outstanding debt		Rs.500 million	

4. Several restrictions have been introduced for acceptance of deposits by companies, including from members. The term “deposits” covers all borrowings other than specified borrowings. The regulations require prior shareholder approval, credit rating, deposit insurance and the provision of security. They also require application of rules to delayed refund of application moneys for securities that could not be allotted, and to trade advances from customers that are not appropriated to the supply/service billing within 180 days. While an inter-corporate loan is excluded from the ambit of these provisions, loans from non-corporate shareholders are covered – this can impact debt provision requirements under shareholder agreements. Loans can be taken from directors, with certain limited reporting compliances.

5. A company which has a default relating to any public deposits accepted by it shall not make any acquisitions or loans while the default subsists.

6. A newly incorporated company cannot commence business, or make any borrowings, unless all subscribers to the memorandum of association have contributed their entire committed subscription amounts to the company, within 180 days of incorporation. Consequently, new companies need to be capitalized in time.

7. Articles of Association of companies may contain entrenchment provisions, requiring stricter provisions for approval of changes, compared to the requirements for a special resolution under the Act. These are typically relevant for joint ventures and care must be taken that the Articles are amended in the manner stipulated, for inclusion of the entrenchment provisions.

8. A company cannot vary the terms of any contract referred to in a prospectus, or the objects of the issue, without a special resolution by shareholders and other reporting compliances. Dissenting shareholders must get an exit option as per the specified rules.

9. Companies cannot issue shares at a discount, except as sweat equity shares, which can only be issued after one year of commencement of business.

10. Preference shares must be redeemed within 20 years, except those issued for infrastructure projects, which can carry a longer redemption period.

11. Each listed company and all other public companies that meet or exceed the specified thresholds – (a) paid up share capital of Rs.100 million, (b) turnover of Rs.1 billion, (c) aggregate debt of Rs.500 million – must have an Audit Committee and a Nominations and Remuneration Committee.

12. Compulsory Corporate Social Responsibility (CSR) spend: Companies that achieve or exceed the specified thresholds – net worth of Rs.5 billion, turnover of Rs.10 billion or net profit of Rs.50 million in any financial year – must constitute a CSR Committee of the Board and must spend at least 2% of its net profits on CSR activities, which cannot include activities solely beneficial to the company’s employees and their families. Provisions are made for monitoring of the spends by the CSR Committee, disclosure of CSR policy and reporting in the directors report to shareholders. Companies will need to act promptly to set up the CSR Committee and outline the CSR policy.

13. Board meetings can be held through participation by video conference or other audio visual facility, subject to several procedural aspects stipulated in the Rules. However, a video conference based meeting cannot approve the annual financial statements, annual board report, a prospectus or a proposal for merger and acquisition, amalgamation, demerger, and takeover. Moreover, an audit committee meeting for approval of accounts cannot be held through video conference. This enabling feature for board meetings is beneficial.

14. Several restrictions have been placed on companies entering into related party transactions, with prescribed approval provisions under various circumstances.

15. A director shall not receive any compensation for loss of office or retirement from office, in connection with a share transfer involving offer to other shareholders or purchase of the company’s shares unless such compensation arrangement is disclosed to, and approved by, the members. Such compensation cannot be paid to the managing director or whole-time director of a company, which is in default on payment/repayment of:

(a) principal amounts or interest on public deposits, debentures, debts to banks or financial institutions,

(b) employee statutory liabilities,

(c) income tax and various indirect taxes specified,

(d) dividends on preference shares or redemption of preference shares.

16. Compulsory rotation of auditors is mandated for

(a) all listed companies,

(b) unlisted public companies with paid up share capital exceeding Rs.100 million or public borrowings exceeding Rs.500 million,

(c) private companies with paid up share capital exceeding Rs.200 million or public borrowings exceeding Rs.500 million.

No audit firm can be appointed for more than two consecutive terms of five years and must then have a break of five years. Common partners between the previous and new audit firms and firms from the same international network are not permitted. The applicability of this change is effective three years forward and may undergo changes in the interim.

17. There are heightened reporting responsibilities around fraud on the company auditors and the management.

18. All companies must adopt April-March accounting year, for shareholder reporting purposes. International companies needing to adopt a different year, due to international reporting needs, must obtain specific approval. The April-March year synchronizes the company reporting financial year and the financial year for tax reporting purposes.

19. Each company must now prepare a cash flow statement as part of its financial statements. Even private companies are required to provide consolidated accounts of the holding, subsidiary and associate companies.

20. A natural person who is an Indian citizen and resident in India can form a One Person Company. This entity must convert to a private limited company if its paid-up share capital exceeds Rs.5 million or its average annual turnover for the three immediately preceding financial years exceeds Rs.20 million.

21. The declaration of a new company's registered office must carry a verification which includes either the ownership title or a notarized rent or lease agreement, which means that it may no longer be possible for a foreign business to "borrow" an address at a professional's office or a business center unless this is accompanied by a lease or rent agreement.

For more information:
Vijay Thacker is a Director of Crowe Horwath Advisory Services Pvt. Ltd. in India.
He can be reached at +91 22 66311471 or vijay.thacker@crowehorwath.in

How Shipping Industry Capital Providers View the Future

By Derek Mair, Scotland

Against the backdrop of a struggling economy, with minimal growth in the UK and Europe, sources of finance remain challenging for all sectors across Europe, including shipping. Global ship financing has been hit hard by the turmoil in the financial markets and, in particular, by the European debt crisis. Combined with low freight rates, higher prices and declining asset values, this makes it seem inevitable that many less credit-worthy owners will struggle to raise new debt. Ship owners' ability to take delivery of their new builds or to place new orders will be constrained if their access to the debt markets is limited further. Therefore, the expectation globally for 2014 is that owners will continue to struggle and postpone or even cancel new build orders. That said, cash-rich and well established owners may be able to make deals that could prove to be attractive in the long run.

In contrast, the demand in Northwest Europe for vessel tonnage is significantly higher due to the presence of the North Sea oil and gas industry. Vessel tonnage is required for the provision of offshore support, dive support, subsea construction, emergency response and rescue. The oil and gas sector continues to demonstrate its resilience and the outlook for the North Sea in 2014 is positive.

The shipping industry in the North Sea remains buoyant and is being serviced by large numbers of new builds entering the market in 2013 and 2014. The new builds are being acquired by companies with strong balance sheets utilizing various sources of finance.

Since the high demand for vessel tonnage in the North Sea is being driven by activity in the oil and gas industry, capital providers view shipping companies operating in the North Sea as oil and gas service companies when evaluating funding proposals.

Recent examples of funding to shipping companies that we have seen in the market are the provision of mezzanine debt to an independently owned shipping company and senior debt facilities to a listed entity.

Market dynamics of the shipping industry in Scotland

The main focus of the shipping industry in Scotland is towards supporting the oil and gas industry in the North Sea. The market approaches this in three ways:

Longer term charters: There is an ongoing requirement to support subsea construction operations in the North Sea, which is typically achieved by subsea construction contractors securing long-term charters from vessel owners. This gives the contractor all the operational benefits of owning a vessel without the capital expenditure funding requirement. We find that debt providers are willing to support these contractors with ongoing working capital requirements by classifying these companies as an oil and gas service company.

Service contracts: Oil and gas exploration and production companies (E&Ps) secure the use of vessels through multiyear service contracts with vessel owners. Vessel owners are able to secure funding with the visibility of income that these support contracts bring. This is typically how smaller independent companies enter the market.

Spot market: There is a very active spot market for vessels to support short-term drilling campaigns offshore. The day rates are far greater compared to the returns from long-term charters. However, this brings the risk of lower utilization rates.

Capital providers tend to look at the mix of income derived by shipping companies when assessing the opportunity and risk profile of the business. Smaller companies may rely on term charters while larger companies typically have a stronger balance sheet to cope with the associated risks and rewards of the spot market.

What are capital providers looking for?

When making lending decisions, capital providers assess the whole business. However, there are certain key requirements that must be met by all shipping companies to be successful in raising finance.

Strong balance sheet: Capital acquirers will want to ensure that businesses are adequately financed by equity backers so that there is an appropriate contribution by current shareholders.

Visibility of earnings: Visibility of earnings through charters or commercial contracts is key for companies to demonstrate quality of earnings and debt serviceability. Large companies can rely on the strength of their balance sheets to service the debt without maximum utilization of vessels.

Strong management team: Capital providers normally take the view that they are backing the management team and not the company, therefore a team with a strong track record is key. This is required when a business is going through harder times, especially since a strong team at the helm will be prepared to make tough decisions.

Strength of business plan: Demonstrating the sustainability of your current business, coupled with visibility on future activity, within a strategic business plan will decrease the risks associated with forecasting future earnings. In turn, the probability of securing investment will improve with investors willing to fund more visible earnings.

Risk profile: The North Sea shipping market is typically made up of a mix of long-term contracts and spot rate work. The spot rate market can command far higher returns for companies. Therefore, the company should appropriately diversify between spot and contract work to manage its risk profile.

Age of vessels: Whether the vessels to be purchased are new builds or older models will have an impact on the security position for lenders.

Specification of vessels: The specification of vessels, with an assessment of versatility in operations, will assist capital providers in assessing the risk profile of the business.

Finding the correct capital partner

In our experience, businesses should partner with capital providers who specialize in the sector that their company operates in. Such providers are well-placed to invest for growth since they are likely to have a unique insight into your business. A specialist shipping capital provider may also have the ability to add genuine value through access to experienced individuals who have a track record in the industry.

As well as understanding the current business, a capital provider must also understand and buy in to where the business is going with its growth strategy. To achieve this, you must ensure that any prospective capital provider shares your investment philosophy, attitude to risk and future market outlook.

Before approaching a capital provider, management teams need to undertake a rigorous and honest appraisal of the risks in their business and ensure that their strategic and tactical plans are robust and, more importantly, executable. This is critical to maintain the confidence of prospective capital providers. They will want management to have a cohesive strategy and realistic financial projections with plans in place to respond and adapt to unexpected changes in the market.

What does the future hold?

2014 is shaping up to be a strong year for the shipping industry in the North Sea. There are a number of new vessels to be delivered in 2014 but increasing activity in Northwest Europe and competition from alternative markets should utilize this additional supply.

The year has commenced strongly in the North Sea. As a result of limited availability of vessels, the usual slowdown during the winter months was not as much in evidence as in the previous years. This is illustrated by published vessel utilization rates with average day rates for both smaller and larger Platform Supply vessels increasing compared to the same period in 2013. This is set to continue in the coming months as we enter the subsea construction season.

In 2013, the capital investment in UK Continental Shelf projects totaled £14.4bn, the highest level of capital expenditure for over three decades. This is projected to continue at similar levels for 2014 and 2015 due to a significant number of large projects being sanctioned.

The medium to long-term outlook for the shipping industry in the North Sea remains extremely positive. There will continue to be demand to support the oil and gas industry with a longer term demand for decommissioning support. The shipping industry will also play a key role in the construction and maintenance support in the delivery of infrastructure for the offshore renewables market.

The stability of demand for vessel tonnage in the North Sea gives capital providers the confidence to take a long-term view in their investment appraisal to provide investment to shipping companies for the medium to long-term.

For more information:
Derek Mair is Partner & Head of Shipping, Anderson Anderson & Brown LLP in Aberdeen.
He can be reached at +44 1224 625111 or derek.mair@aab.co.uk.
Anderson Anderson & Brown is a member of HCWA, an association of independent accountancy practices in the United Kingdom. HCWA is a business alliance member of Crowe Horwath International

Traditional Valuation Methodologies

By Miguel Moreno Tripp, PhD, Mexico

As we know, two of the most popular valuation methodologies are the Discounted Cash Flow (DCF) and Relative Valuation (RV). Most of the time they are used as a confirmation of each other's values, which we would expect to be in a ballpark range, at the very least. But did you know that both methodologies are relatives of each other? Let's take a look.

The DCF is based on the Gordon Growth Model, developed in the late 1950s. This model states that the value of a stock is given by the present value of future dividends paid by the company (d1, d2, d3, etc.). In other words, this model implies that capital gains, which are arrived at by calculating the difference between the price paid and the price sold of a stock, will be nada given a lengthy period of time. The reason is that, when time tends to infinity, the present value factor (i.e. $(1+r)^{\infty}$) converts anything into a very low value.

When the dividends are of the same value (d1= d2, =d3, etc.) then the time series becomes a perpetuity $p=\frac{d}{r}$. But nobody wants the dividends to be of the same value; we want them to grow over time. If we assign the letter 'g' as the constant growth rate then we will find the well-known valuation formula:

$$p=\frac{d}{r-g}$$

On the other hand, one of the most used relative valuation ratios is the well-known price to earnings or P/E ratio. It is part of the relative valuation family of ratios, such as price to book value, price to sales, price to EBITDA, etc.

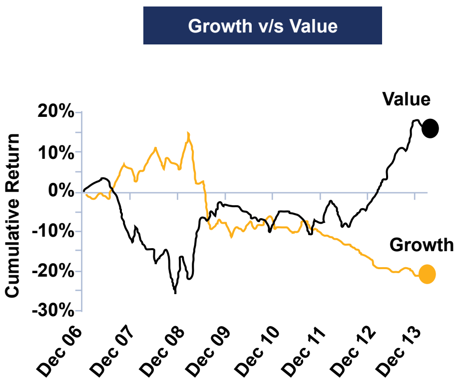
This relatively simple ratio, which represents the relationship of the market price to the earnings of the company, has an impressive pedigree. It is used not only by investors but is also well-documented in financial academic literature. Renowned theorists of financial economics, French and Fama, in their classical paper of 1993, dethrone the beta as a proxy for explaining the stock premium over risk-free rate of return. They used in their analysis the P/E, the Price to Book Value and the beta of the stocks sampled; both the P/E and the P/BV did a better job at explaining the returns of the stocks analyzed than the beta did.

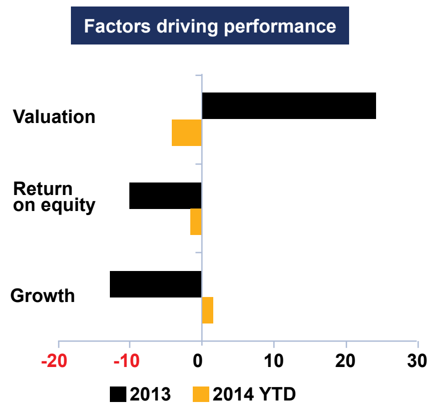
If we divide both sides of the aforenoted formula by e, we end up with this:

$$p/e=\frac{\frac{d}{e}}{r-g}$$

The ratio d/e is none other than the dividend payout ratio. It represents the amount of dividends paid to shareholders out of the earnings of the company.

Another classification of the P/E ratio is: Growth or Value. This criterion is used to choose between two approaches to invest and is widely used by investors and money managers.





Source: Fidelity https://www.fidelity.com/viewpoints/investing-ideas/growth-cheap. FMRCo quantitative research. Stock performance from December 2006 through February 28, 2013. Growth and value stocks from S&P 500® Index based on proprietary FMRCo model. Factor-based investing compares the outperformance of the top quintile of S&P 500® Index stocks with the bottom quintile, for valuation—based on P/E next 12 months, return on equity, and growth—earning per share for the trailing 12 months.

We can have a sense of the P/E and P/BV levels by analyzing the attached sample of Mexican companies.

As of April 11, 2014	Company	P/BV	P/E	YtoY Stock Return
ALSEA*	ALSEA, S.A.B. DE C.V.	7.48	46.92	25.8
AMXL	AMERICA MOVIL, S.A.B DE C.V.	4.51	12.16	2.6
ASURB	GRUPO AEROPORTUARIO DEL SURESTE, S.A.B DE C.V.	2.97	21.04	(2.5)
AZTECACPO	TV AZTECA, S.A.B. DE C.V.	1.93	19.95	(11.7)
BIMBOA	GRUPO BIMBO, S.A.B. DE C.V.	3.71	38.60	(7.6)
BOLSAA	BOLSA MEXICANA DE VALORES, S.A.B DE C.V.	2.79	20.19	(27.9)
CEMEXCPO	CEMEX, S.A.B DE C.V.	1.42		17.8
CHDRAUB	GRUPO COMMERCIAL CHEDRAUI, S.A.B. DE C.V.	1.81	23.52	(10.3)
ELEKTRA*	GRUPO ELEKTRA, S.A. DE C.V.	1.96		(25.8)
FEMSAUBD	FOMENTO ECONOMICO MEXICANO, S.A.B DE C.V.	2.71	27.10	(20.2)
GAPB	GRUPO AEROPORTUARIO DEL PACIFICO, S.A. DE C.V.	1.92	18.95	(1.5)
GMEXICOB	GRUPO MEXICO, S.A.B. DE C.V.	2.56	13.87	(15.8)
GMODELOC	GRUPO MODELO, S.A.B. DE C.V.	3.43	11.40	13.5
GRUMAB	GRUMA, S.A.B. DE C.V.	3.60	14.78	101.9
ICA*	EMPRESAS ICA, S.A.B. DE C.V.	0.69	22.34	(46.1)
ICHB	INDUSTRIAS CH, S.A.B. DE C.V.	1.16	18.95	(29.2)
KIMBERA	KIMBERLY - CLARK DE MEXICO, S.A.B. DE C.V.	13.13	24.42	(13.8)
KOFL	COCA- COLA FEMSA, S.A.B. DE C.V.	2.57	25.20	(33.5)
LABB	GENOMMA LAB INTERNACIONAL, S.A.B. DE C.V.	3.88	19.28	6.9
LIVEPOLC-1	EL PUERTO DE LIVERPOOL, S.A.B DE C.V.	3.50	24.88	(8.6)
MEXCHEM*	MEXICHEM, S.A.B. DE C.V.	2.26	89.11	(24.6)
MFRISCOA-1	MINERA FRISCO, S.A.B. DE C.V.	4.16		(51.4)
OHLMEX*	OHL MEXICO, S.A.B. DE C.V.	1.18	8.48	(8.9)
PE&OLES*	INDUSTRIAS PEDOLES, S.A.B. DE C.V.	3.10	27.44	(40.6)
TLEVISACPO	GRUPO TELEVISA, S.A.	3.83	33.97	28.0
WALMEXV	WAL - MART DE MEXICO, S.A.B. DE C.V.	3.95	24.87	(18.7)
		3.32	**25.54**	

Source: INFOSEL

Technically speaking, the P/E ratio uses the market price of the stock relative to the earnings of the company and the p in the noted formula represents the intrinsic value of the company. In other words, analysts will compare one with the other and make a recommendation as to buy, sell or hold the stock.

If we believe that markets are efficient, then both values will be aligned and thus become essentially the same. So they are close relatives after all.

For more information:
Miguel Moreno Tripp, PhD is the GCA Director at Gossler, S.C in Mexico.
He can be reached at +521 81 8020 2344 or miguel.moreno@crowehorwath.com.mx

Regional GCA Leadership

China
Antony Lam
antony.lam@horwathcapital.com.cn

Indian Subcontinent / Middle East
Vijay Thacker
vijay.thacker@crowehorwath.in

Southeast Asia
Alfred Cheong
alfred.cheong@crowehorwath.com.sg

East Asia
Mok Yuen Lok
yuenlok.mok@crowehorwath.net

Latin America
Fabio Farina
fabio.farina@crowehorwath.com.br

USA / Canada
Marc Shaffer
marc.shaffer@crowehorwath.com

Central and Eastern Europe
Igor Mesenský
igor.mesensky@tpa-horwath.cz

Oceania
Andrew Fressl
andrew.fressl@crowehorwath.com.au

Western Europe
Peter Varley
peter.varley@crowecw.co.uk