YEN CAPITAL
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YEN NEWSLETTER

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I need your PAN No.
It's a high value transaction

Watch Out

India	
1-Jun	Indian Trade Balance
1-Jun	HSBC Markit Manufacturing PMI
1-Jun	Indian FX Reserves, USD
1-Jun	Indian Bank Loan Growth
5-Jun	Indian HSBC Services PMI
12-Jun	Industrial Output – May
14-Jun	WPI – May
18-Jun	Mid Quarter Review of Monetary Policy
29-Jun	CPI – May
US	
1-Jun	ISM Manufacturing Index
1-Jun	Unemployment Rate
1-Jun	Core PCE Price Index (MoM)
13-Jun	PPI – May
14-Jun	CPI – May
28-Jun	GDP – Q1
Europe	
1-Jun	Manufacturing PMI
1-Jun	Unemployment Rate
4-Jun	PPI (MoM)
6-Jun	Interest Rate Decision
13-Jun	Industrial Production (MoM)
14-Jun	CPI (YoY)
China	
4-Jun	HSBC Services PMI
8-Jun	CPI (YoY)
8-Jun	PPI (YoY)
10-Jun	Industrial Output – May
10-Jun	Trade Balance
13-Jun	Money Supply – May
Japan	
7-Jun	GDP (QoQ)
7-Jun	Bank Lending (YoY)
8-Jun	Economy Watchers Current Index
11-Jun	Household Confidence
12-Jun	Core Machinery Orders (MoM)
14-Jun	Industrial Production (MoM)

Swaps in India: evolution and the trend today

Currency and interest rate swaps have been in India for about 15 years now. By swaps we are referring to the broad genre of products that have the Rupee as one leg as opposed to a cross currency swap. A cross currency swap is one in which one G-7 currency (say the USD) is swapped against another(e.g. Yen). Currency swaps came into India in 1996 and interest rate swaps were introduced for the first time in 1999. These are onshore instruments and can only be offered by the Authorized Dealers(ADs). The early 2000s witnessed the advent of the quanto and leveraged quanto swaps. These were popular with clients since being interest rate swaps they were perceived to be less risky than currency swaps, yet the large volatility in USD interest rates in 2001-02, allowed corporates to make money and become more adventurous.

As it happens with most products in the "introductory stage" of marketing, the market was illiquid in the late 1990s, had few market makers and was perceived as an esoteric product. Profit margins for the banks was high. By the year 2002, the market had grown a fair bit. It was still dominated by a few select foreign banks and margins for the market makers continued to be high. The regulatory guidelines back then, permitted the embedding of currency options within a structured swap. By this time USD-INR currency options had come into the market but corporates were not allowed to receive premia by selling options. The market makers made corporates sell options and have them embedded in the swaps, this served the twin objectives of larger positive carry for the clients and also offered protection in the event of the market moving in the opposite direction.

Let us delve a little deeper in this. Notwithstanding the fact that interest rates in India have by and large declined over the last 15 years, the Rupee always had higher implied rates over most G-7 currencies, more particularly, the USD, JPY and CHF. Hence it made sense for Indian corporate and institutions to look at reducing the cost of their rupee borrowing by synthetically moving into a currency that had a lower rate of interest. This made sense as long as the product was selectively marketed to appropriate clients, since the clients needed to have balance sheets that were strong enough to withstand unforeseen losses.

By 2003-04, the private sector banks in India realized that they were losing out on making fee income since they had never seriously looked at marketing these products. Being local banks, they had greater access to a larger cross-section of clients. Mass marketing became commonplace and resultantly, the products began to be sold indiscriminately. Meanwhile, the MNC banks, had by this time found the Indian FIs and banks as lucrative counterparties. Being larger entities, they could do much bigger trades. Greed had suddenly become the key driver and indiscriminate selling combined with unprecedented market volatility saw huge losses by Indian corporates and Institutions between 2005 and 2008.

The central bank swiftly acted to tighten the guidelines , penal measures were imposed wherever warranted. The media flashed stories of corporate and banks fighting protracted legal battles. One good step that the RBI took, has ensured that most commercial banks today have a policy on suitability of such products on their clients. A number of positive regulatory changes have been announced some of which are listed below:

- Options are no longer permitted to be embedded in a swap.
- Once a swap is cancelled, a new transaction cannot be undertaken on the same underlying rupee exposure.
- Only listed clients can do swaps, unlisted clients need to have a minimum NW of Rs 200 crore, in case they do not have a natural hedge.
- Indian banks now attribute higher PFE (potential future exposure) numbers compared to the earlier days. This is a more realistic assessment of the risk associated with the product as compared to the past.
- More structured processes for client adoption.
- Complete bar on exotic structures.

The market is very deep and liquid today for the vanilla products. Indian clients are increasingly cognizant of the key role that the advisor plays and are rightly looking at banks more as counter-parties and less as advisors. To our mind, this is a step in the right direction.

Swaps remain an important and critical risk management tool . They need to be used with caution and with the strength of deep market knowledge both for hedging as well as for executing certain market views. The world over, they are a necessity for vibrant and deep financial markets.

Yen Capital has the relevant resources to advise clients appropriately in this area.

— Sandip Basu
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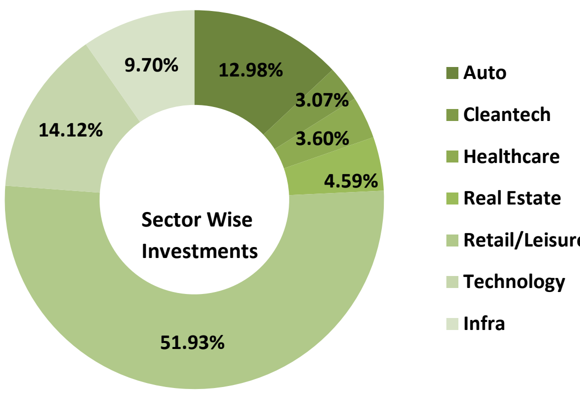
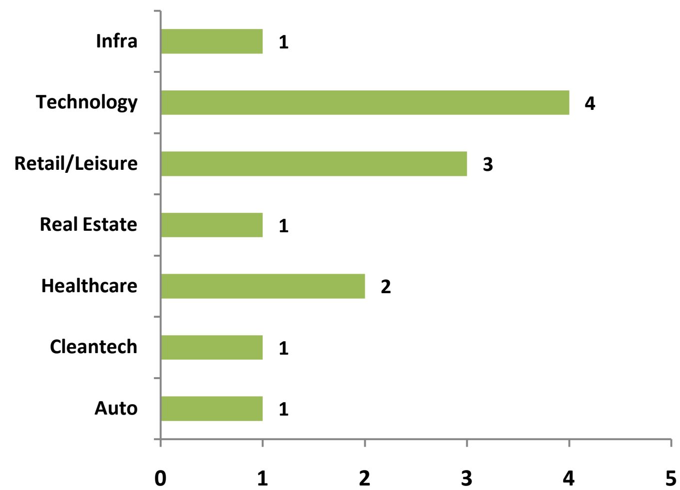
Private Equity

- In the month of May, there were 14 PE deals which have been completed with an approximate investment of US$ 320 million
- Retail/Leisure and Technology sector saw maximum no. of deals with total investment of US$ 165 million and US$ 45 million respectively.



Number of Deals in May, 2012



Key Deals

- APG, Netherland based pension fund manager invested US$ 123 million in Delhi based Lemon Tree Hotels. The deal includes 6% stake in Lemon Tree and an investment in a 47:53 Joint Venture. The JV is formed to set up 35 hotels across country. Lemon Tree currently owns 18 hotels with an inventory of 1,571 rooms.
- Quikr Mauritius, the holding company of Quikr India has raised US$32 million from Warburg Pincus and its existing investors Matrix Partners India, Norwest Venture Partners and eBay Inc in its fifth round of funding. Quikr is a classifieds site used by individuals & small businesses across 83 Indian cities. Currently, it has presence in over 40 cities, and Quikr plans to launch in 30 more shortly.

Source: Press releases, Yen analysis

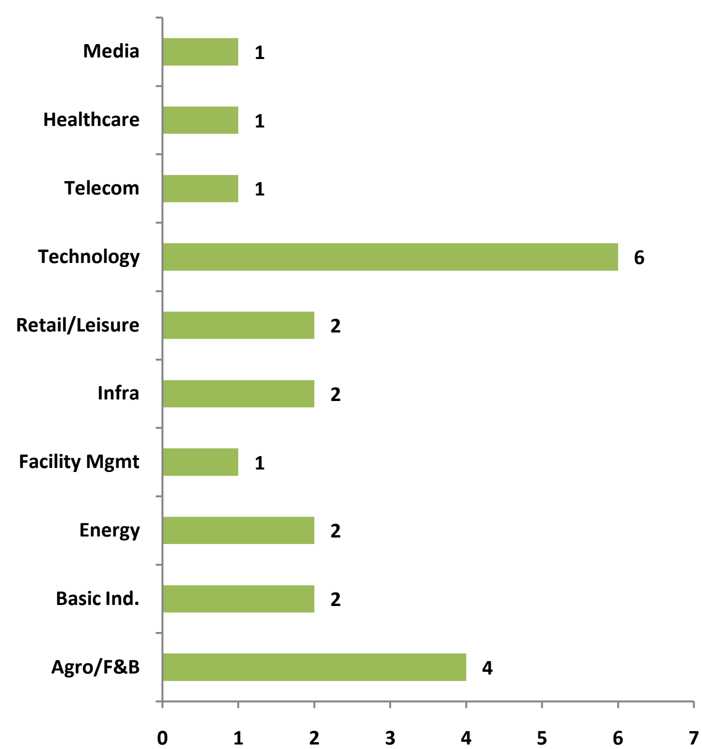
Mergers & Acquisitions

During the month of May, there were a total of 22 M&A deals. Technology was the most popular sector completing 6 deals followed by Agro/ Food products during the

Key Deals

- ICRA Techno Analytics Limited, is a Kolkata based global business consulting and software technology services firm. ICRA Techno acquired majority stake in California based BPA Technologies Inc. The valuation of BPA is approx US$16 million. BPA offers strategy consulting, implementation and application management services in its area of specialization.
- ValueFirst Messaging, is a Hyderabad based IT company that runs person to person (P2P) messaging portal. The co. has acquired Way2Online Interactive, an IT Company that runs person to person messaging portal for US$ 36 million in an all cash deal. The deal has been funded through internal accruals & investment from New Enterprise Associates & Headland Asian Ventures Fund.
- Bharti Airtel Limited, is a leading telecom company based out of Mumbai. Bharti has acquired 49% stake in Qualcomm Asia Pacific's Indian BWA entities for US$ 165 million. With this deal, Bharti's BWA spectrum will increase to eight circles from the current four circles. Qualcomm is known for pioneering in the CDMA technology.
- IRB Infrastructure Developers undertakes construction and operation of major road and highway projects in India and is based out of Mumbai. IRB acquired MVR Infrastructure & Tollways Pvt Ltd. for approx. US$ 24 million. MVR Infrastructure is the concessionaire for Omallur - Salem - Nammakkal BOT road project in Tamil Nadu.

Number of Deals in May, 2012



Source: Press releases, Yen analysis

Key Indices: May 2012 Review

	31th May 2012	30th April 2012	MoM Change (%)	29th May 2011	YoY Change (%)
Sensex	16,218.53	17,318.81	*-6.35%*	18,503.28	*-12.35%*
Nifty	4,924.25	5,248.15	*-6.17%*	5,560.15	*-11.44%*
Dow Jones	12,393.45	13,213.63	*-6.21%*	12,569.79	*-1.40%*
Nasdaq	2,827.34	3,046.36	*-7.19%*	2,835.30	*-0.28%*
Hang Seng	18,617.66	21,094.21	*-11.74%*	23,684.13	*-21.39%*
Nikkei	8,542.73	9,520.89	*-10.27%*	9,693.73	*-11.87%*

India: The years-old stock market adage, 'sell in May and go away', seems to be holding true for the third year in a row, as Dalal Street has lost close to Rs 4,00,000 crore of wealth with the benchmark Sensex falling by over 1,100 points. The FMCG index lost 4.1%, while high beta sectors like realty and capital goods fell 4.1% and 6.3% respectively.

May saw net sellers from foreign investors of Rs. 347 Cr. in equities, for a slew of reasons including India's economy growing at 5.3% in the quarter to March, the slowest pace in nine years. For 2011-12, the economy expanded by 6.5% as against the Government's provisional forecast of 6.9%. Sticky inflation, aggressive monetary tightening by the RBI, policy stalemate and a global slowdown have crimped corporate investments and consumer spending over the course of FY12.

On the bright side, the PMI survey showed new export orders continued to grow at a strong pace in May.

U.S.: The U.S. markets also posted their biggest monthly decline since May 2010. The Labor Department reported that the U.S. economy added just 69,000 jobs in May compared to estimates for about 150,000 jobs. The weaker than expected job growth contributed to a modest increase in the unemployment rate, which edged up to 8.2%, marking the first increase since last June. Generating additional selling pressure, the Institute for Supply Management reported that its index of activity in the manufacturing sector fell by more than expected. The ISM's purchasing managers index fell to 53.5 in May from 54.8 in April. Economists had been expecting the index to edge down to a reading of 54.0. The economy grew at an annual rate of 1.9% in the first three months of the year, below its earlier estimate of 2.2%.

Moreover, failure to reach a consensus over how to solve Europe's debt crisis weighed down the markets through the month.

Asia: Asian markets finished the month bruised after concerns over the health of the Spanish banking system pushed stocks down across the region, with Australia and Japan recording their worst month in two years. Spain's 10-year bonds reached as high as 6.65%, close to the levels that drove Greece, Portugal and Ireland to bailouts. There was a broad flight to safety as investors ditched risk assets for safer options. In economic news, China's official purchasing managers' index fell to 50.4 in May from 53.3 in April. Economists had expected the reading to fall to 52. The HSBC purchasing managers' index fell to 48.4 in May from 49.3 in April, scoring below the neutral mark for a seventh successive month.

Asia's worst performer for the month was the Hang Seng Index, which dropped **11.7%** to 18629.52. Hounded by short sellers, the benchmark fell in 16 of the month's 22 trading sessions. It was the Hang Seng's worst May since 1998.

Currencies

Currency Market	31st May	30th April	MoM Change (%)
USD/INR	56.300	52.730	*6.77%*
EUR/INR	70.040	69.810	*0.33%*
EUR/USD	1.244	1.3245	*-6.08%*
GBP/USD	1.5576	1.6235	*-4.06%*
USD/JPY	79.25	79.92	*-0.84%*

Key Economic Indicators

	May-2012	Apr-2012
FOREX Reserves (USD Bn)	290.00	294.60
REPO rate	8.00%	8.00%
Reverse REPO	7.00%	7.00%
CRR	4.75%	4.75%
SLR	24.00%	24.00%
Bank Rate	9.00%	9.00%

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