



Report prepared for the City of London Corporation
by Trusted Sources
Published October 2010

Emerging markets – International capital raising trends



City of London Economic Development
PO Box 270, Guildhall, London, EC2P 2EJ
www.cityoflondon.gov.uk/economicresearch



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October 2010

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Executive Summary

This special interest paper for the City of London Corporation assesses trends in international capital raising by emerging market (EM) companies, specifically those from Russia, Brazil, Mexico, South Africa and India. Separate chapters on each of these countries examine the factors determining where and why firms based there have turned to international capital markets to seek equity finance, with a view to forecasting how such trends will play out. These sections, as well as the Conclusion, highlight the opportunities and threats that such trends present to the City of London and other international financial centres in the short to medium term.

International capital markets are already playing an important role in financing the growth of the EM economies

Companies from the five EMs under study together raised increasing amounts of capital on international equity markets in the five years leading up to the 2008 crisis. Some of the largest offerings on the London Stock Exchange (LSE), the New York Stock Exchange (NYSE) and NASDAQ in particular were from companies from these countries. Notable examples include the US\$8 billion dual listing of Russian VTB in London and Moscow in 2007, the US\$1.8bn IPO of Fresnillo in 2008, the US\$7.5 billion dual listing of Banco Santander (Brazil) in New York and Sao Paulo in 2009 and the US\$1.9 billion Essar Initial Public Offering (IPO) in London in 2010. These demonstrate the growing significance of EMs for the listing and trading businesses of international stock exchanges and for market participants.

Demand for equity capital by EM firms is likely to increase as growth has resumed after the 2008 financial crisis

Robust economic growth in Brazil, India and Russia, in particular, will propel demand from local companies for investment capital. This demand will be increased further by the scale of financing needed for infrastructure development in India and Brazil, the privatisation of state-owned enterprises in Russia and India, and the rapid expansion of consumption in all these countries, as well as foreign M&A activity by Indian firms in particular.

With slower growth in the US, Europe and Japan over the next few years likely to hold back the flow of new issuances from developed market firms, EMs will generate an increasing proportion of global capital raising in the future – a trend from which international capital markets and participant firms should benefit. There can be no better example of this potential business from EMs than the recent US\$67 billion offering for Petrobras, which already had a listing on the NYSE. The international tranche of American Depositary Receipts (ADRs) alone amounted to almost US\$8 billion and overseas investors were able to subscribe to the domestic tranche too.

Domestic capital markets will accommodate many but not all of the needs for new capital raisings

Brazil and India now have large and liquid equity markets that can accommodate most listings of local firms, including "jumbo" listings (exceeding US\$1 billion), without the support of dual or secondary listings in New York or London, as had been necessary in the late 1990s and early 2000s, although Brazil does not have a viable market for Small and medium enterprises (SMEs). Much new capital raising will, as a result, take place domestically, though strategic considerations will drive large companies to look at international listings. For South African firms, controls by the Reserve Bank will stop all but a handful of listings from taking place abroad. The Johannesburg Stock Exchange also has good liquidity. Russia and Mexico have less developed markets and will depend more heavily on offshore listings in the near to medium term.

The scale of EM demand for equity capital means there will nonetheless be many opportunities for international markets

International equity markets like London, New York and Hong Kong retain key advantages over domestic markets which will ensure that increasing numbers of EM companies still go abroad for equity financing. Such advantages include access to a wider pool of investors, inclusion in major indices, strong sectoral expertise, prestige and the provision of foreign capital for overseas acquisitions. These factors will usually ensure that EM firms get better terms of placement and improved after-market support from institutional investors.

London and New York should keep the lead in the EM capital raising business

London and New York stand out as the main international capital centres of choice for all companies from the EMs under study and will maintain this position. Hong Kong is building a powerful presence for itself in Asia, moving beyond Chinese H shares into Mongolian, Russian and potentially Kazakh mining stocks. Despite this, Hong Kong will not challenge London or New York for non-Asian EM listing business except for a handful of China-focused companies, such as Rusal. Russia will continue to depend on London, and Mexico on New York.

As for South African and Indian firms, which in the late 1990s and early 2000s went to New York and London in almost equal measure, most are now more inclined to go to London for new listings (unless they focus on sectors in which the US markets specialise such as technology/internet or business process outsourcing) because of the higher cost and time involved in complying with the Sarbanes-Oxley Act ("Sarbox") in the US. London provides the additional benefits of "premium" listings and access to the FTSE 100 Index for larger companies, which gives exposure to a vast pool of index trackers and passively managed money. London's advantage could be eroded, however, if new financial market regulations or tax policies make it harder or more expensive for foreign companies to list in London.

Opportunities and challenges for the City of London

London faces strong prospects for EM capital raising business. It is already a highly attractive international capital centre, with 326 firms incorporated abroad (and many more with foreign operations) listed on the LSE, and is well-positioned to benefit from higher numbers of EM firms looking to raise equity finance.

London is currently the main offshore listing venue for large-cap Russian firms and looks likely to attract a spate of new listings stemming from the Russian government's resumed privatisation programme; the first of these will be in 2011. Essar Energy's 2010 IPO and entrance onto the FTSE 100 has set a precedent for other Indian firms to get a top-quality London listing and foreign currency for acquisitions. We expect more large Indian firms to come to the London market in the short term. London's expertise in large-cap mining and energy stocks will likely attract more "jumbo" IPOs and secondary public offerings (SPOs) of these types of firms, though London will face increasing competition for small-cap mining firms from Toronto. Brazil, Mexico and other countries in Latin America represent a good hunting ground for City mining finance expertise.

City-based investment banks have already built up significant EM expertise and will continue advising EM firms on London listings and capital raisings. Many City-based investment banks and law and accountancy firms have made successful inroads into the domestic EM capital raising business through their local offices. Apart from India, which has some restrictions on foreign law and accountancy firms practising independently in the local markets, all other countries are open to international participation in all stages of capital raising.

1. Introduction

The City of London commissioned Trusted Sources to produce a special interest paper on the international capital raising trends of EM firms, specifically those from Russia, India, Brazil, Mexico and South Africa.

Project design

The research strategy utilised focused desk research and made extensive use of findings from semi-structured interviews conducted with market participants, policymakers and officials at stock exchanges in Mumbai, Johannesburg, Moscow, Sao Paulo, Mexico City, London, Hong Kong and New York.

Key questions

This special interest paper seeks to answer several questions, including:

- What have been the trends in international capital raising over the past five years, particularly in terms of public equities, by firms from the five countries under study?
- Which international exchanges have benefited from these trends, and how?
- What is the outlook for demand from EM firms for equity capital in future and, with the backdrop of local capital market development, how will this play out in international capital raising?
- Which international capital markets are best positioned to benefit from this, and why?
- What threats and opportunities will this pose to the City of London's IPO/SPO business and advisory work?

Desk research

This part of the research was designed to:

- Provide background analysis of the listing destinations of companies from the five countries over the past five years, with a view to understanding the patterns by sector and location;
- Provide background analysis on the progress made in domestic capital market development in the five countries and how this affects companies' decisions to list abroad. This includes analysis of key regulatory developments recently passed or else in the pipeline that might affect where companies list;
- Assess the main industries and sectors in the five countries that are likely to generate the most international capital raising in the near to medium term.
- Provide background information on strengths and weaknesses of key international capital markets from the perspective of EM firms seeking to raise capital;
- Identify key issues to form the subject material of interviews.

In addition to drawing on material available to Trusted Sources, the researchers analysed information from a range of sources, including:

- Publications and statistical sources from capital markets including the LSE, the NYSE, NASDAQ, the Moscow Interbank Currency Exchange (MICEX), the Russian Trading System (RTS), the Bolsa Mexicana de Valores (BMV), the BM&F BOVESPA, the Bombay Stock Exchange (BSE), the National Stock Exchange (NSE) of India and the Johannesburg Stock Exchange (JSE);
- Statistical databases from Trusted Sources providers such as Bloomberg;
- Legal documents and regulations on South Africa, Russia, Brazil, India and Mexico's securities industries;
- Company prospectuses;
- Speeches made by key government officials, capital market officials and financial market professionals;
- Academic publications.

Interviews

The report made extensive use of findings from semi-structured interviews. The main purposes of the interviews were to:

- Shed light on key trends in international capital raising by companies from the EMs under study and how these are likely to develop in the post-crisis environment;
- Closely examine the motivations for EM companies in seeking equity capital from international markets;
- Understand the competitive advantages of international stock exchanges in attracting listing business from each of the EMs under study;
- Flesh out potential opportunities and threats for both London's capital markets and City-based firms involved in advisory work around listings, as identified by desk research.

In total, 45 interviews were carried out with key capital market representatives, market players (including fund managers and investment bankers), industry leaders, regulators and analysts in Brazil, India, Russia, Mexico, South Africa, New York, Hong Kong and London. Most interview participants hold senior positions within their organisations and are influential in the markets concerned. These interviews helped us to form the opinions expressed in this report and to identify key opportunities for the City of London.

Although some individuals agreed to be quoted, interviews were conducted confidentially in order to allow participants to freely share their views on the markets. The findings from the interviews were synthesised into the report, supporting the main findings of desk research and providing greater on-the-ground insight into opportunities and challenges facing City of London firms.

2. Russia

2.1. Overview of international capital raising trends so far

In the period between the reopening of primary equity markets in 2002 after the dotcom bust and their closing again with the global crash of 2008, London became the international financial centre of choice for companies from Russia (and other former Soviet Bloc countries) raising equity capital. The same applies to a considerable degree to raising debt capital by means of Eurobond issues, but this analysis will focus on equities.

The dominance of London may be gauged from the number of Russian blue chip companies¹ with shares trading there. Of the 63 blue chip companies operating in Russia, 33 have shares traded in London. Some of these are in the form of either a premium or standard listing on the LSE's Main Market. In most cases, however, they are in the form of a Main Market listing of global depository receipts (GDRs), in conjunction with a primary listing on the MICEX or the RTS in Moscow (usually the former). Moreover, several of the relatively few blue chip companies trading only in Russia, most notably Sberbank, seem likely to come to London in the foreseeable future owing to domestic regulation and privatisation.

The underdevelopment of the Russian market has been the most fundamental factor in directing capital raising outside the country. Russia lacks a domestic institutional investor base – pension funds (both state and non-state) and mutual funds represent only 2 and 1 per cent of the total capitalisation of the Russian equity market respectively. The considerable daily trading volumes on the MICEX (well over US\$1 billion, and on most days exceeding the turnover of Russian shares on SETS in London) are instead driven by various pools of wealth, ranging from treasury balances at banks and corporations to individual day-traders. In addition, steadily increasing numbers of international institutional investors are transacting in the local Russian market.

However, even the ability of the domestic market to absorb a typically scaled billion-dollar corporate IPO does not overcome a major drawback of the Moscow market from an issuer's standpoint. The various forms of private wealth that create most of domestic demand do not provide the same liquidity or, above all, the same level of support for share prices in difficult times as can be provided by the dedicated and benchmarked equity funds managed by large institutional asset managers that can be accessed in London and other international financial centres. This is the most important reason why dual domestic-foreign listings play a pre-eminent role despite the desire of Russian companies to get higher valuations by reaching international institutional investors with a broad sectoral (e.g. energy) or geographic (e.g. Europe) focus that are based in London but do not have mandates to buy local shares.

¹ For the purposes of this paper, "blue chip" companies are defined as those whose free-float-adjusted market cap is already, or is soon likely to be, around or above US\$850 million.

2.1.1. Why London?

Russian firms' natural investor base is located in London and/or can be most easily accessed through London. Many EM funds, especially those with a regional mandate for Eastern Europe, are managed in London, and many of those are in turn able to invest in local Russian shares. But London is also a strong centre for pan-European equity investment and for sector specialist investors (notably in energy), all of which are critical for demand and pricing tension. Moreover, incremental demand for Russian equities from funds in the Middle East, Asia and Latin America tend to prefer to invest through a US dollar-denominated, internationally recognised GDR listed in London. Such incremental demand, however, is still insufficient to create an alternative investor base outside Russia, as the January 2010 Rusal IPO in Hong Kong illustrated.

London benefits from precedent and a strong track record. The process of equity issuance in London is a well-trodden track for Russian issuers and market intermediaries. There is a close working relationship between the stock exchanges in London and Moscow. Almost all the major investment banks and Russian securities firms have regulated UK subsidiaries which deal with capital market business in London. One of our sources emphasised that Russia-focused intermediaries are, of course, in London because the investor base is in London, not the other way round. Moreover, there is a comforting familiarity with the legal environment and habitual interaction with the London market authorities. The opinion of a London-based portfolio manager provides further perspective:

"The main market is GDRs clearing through Euroclear. It is simple to use and there is no broker counterparty risk. It will be hard for the Russians to change the gravitation away from London. The market for Russian shares is stuck here. Many investors are still nervous of domestic infrastructure and issues like governance."

2.2. Outlook for capital raising

We expect a rebound in capital raising by Russian firms in the near to medium term, following the widespread postponement of IPO/SPO plans in the post-2008 crash period due to market weakness. According to our sources, there will be two main trends among companies listing in the next few years:

- The stronger survivors of the 2008 storm will seek listings to mobilise the resources necessary to take advantage of market share expansion and M&A opportunities. The metals sector is one of the ripest for consolidation in fundamental terms.
- We expect a spate of new public offerings of minority stakes in major state-owned companies, resulting from the government's plans to revive large-scale privatisation, which is due to get under way in 2011. Sberbank, Russian Railways (RR), VTB (a leading bank), RusHydro, FSK (the national electricity grid), Sovkomflot (the country's largest shipping operator) and the Russian Agricultural Bank are among this group. RR announced in August 2010 that it would spin off its Freight-2 subsidiary in a London IPO in 2011.

Beyond that, the Russian economy is generating thousands of new businesses across dozens of domestically oriented sectors that developed abnormally or were even non-existent under Soviet-era central planning. As these companies grow, more of them will come to the public markets for capital. Examples before the primary markets closed in 2008 included retail, consumer, financial services, media and telecoms companies. Over time these will gradually diversify the sectors represented among listed Russian companies, which are currently focused towards natural resource sectors.

2.2.1. Where will companies go to list?

Many of the smaller offerings, particularly of domestically focused firms, will remain in the Russian market – with the exception of small mining and energy exploration and production (E&P) companies, which are most likely to list in Toronto or on AIM. There is now sufficient liquidity to accommodate primary and secondary equity offerings in the region of US\$100 million, according to market intermediaries we interviewed. (Although one purely domestic IPO this year, Protek (pharmaceuticals), raised US\$400 million this was widely seen as an exception.) Companies seeking capital above this level – including the state-owned enterprises being privatised – will have recourse to international markets to meet their needs, most likely through a London Main Market listing of GDRs in conjunction with a primary listing in Moscow.

2.2.2. Will recent regulatory developments alter this position?

Constraints on Russian firms raising capital abroad

In June 2009 the Federal Service for the Financial Markets (FSFM) – the government agency responsible for the adoption of legal acts, monitoring and supervision in the sphere of financial markets (except insurance, banking and auditing) – announced that new issuers would be required to list at least 50 per cent of their share capital in the domestic market and would be prohibited from listing more than 25 per cent of their share capital outside Russia. The purpose of these measures was to constrain the growth of the offshore segment of Russia's capital market (previously, in 2005, the limits were both set at 30 per cent). Although there is a great deal of confusion in Moscow about the exact status of this regulation, the market intermediaries we spoke to in both Moscow and London suggested that issuers and intermediaries are already abiding by these rules regardless of whether they are currently enforceable.

The regulation crucially states that the limit of 25 per cent limit of a company's share capital being traded outside Russia applies only to companies on the "A" list of stocks (companies that are already listed and have average share trading volumes above a minimum threshold). Companies without any trading history, which by definition include IPO candidates, are automatically placed on the "V" list of stocks, which requires that at the initial listing only 5 per cent of a company's *total* share capital can be listed abroad (as long as at least 50 per cent of the total issue is listed domestically). We understand that this requirement will be waived for exchanges in countries whose national financial market regulators have concluded an agreement to this effect with the FSFM. Such agreements had been signed with regulators in Germany, China and several other countries as of October 2009 but not

yet with the Financial Services Authority (UK) and the US Securities and Exchange Commission (with which discussions are said to be in progress).

The regulation, however, does not appear to place any practical constraint on international tranches of Russian IPOs or SPOs, so will have limited affect on the number of companies coming to London (though according to our sources the constraints have opened quite substantial discounts on some of the larger Russian companies' local share prices relative to the price of the GDRs most often traded in London). First, for the reasons noted above, many Russian issuers will have a natural interest in tapping both the domestic and international markets simultaneously. Second, the new regulation (at least in the draft form publicised by the FSFM in June 2009) states only that half of a new issue must be "offered" in the domestic market. This would not preclude the actual placement of over half or, in theory, the entire issue abroad. Third, some Russian companies choose to use their foreign-domiciled holding company as the formal issuer; and this automatically circumvents FSFM restrictions because foreign companies cannot be listed in Russia. A good recent example is the early 2010 IPO of Rusal in Hong Kong, with a secondary listing on NYSE-Euronext.

Structural reforms making the Russian market more attractive to global investors

The domestic regulator has had greater success in making international investors more comfortable transacting in the Russian markets. It has enacted several reforms designed to establish Moscow over time as an international financial centre – in the first instance a centre to which issuers from "near abroad" countries such as Ukraine, Kazakhstan and Belarus might be attracted to raise debt and equity. These initiatives include Russia's first-ever formal legislation on insider trading (and on countering other forms of market manipulation), the introduction of Russian depositary receipts to attract overseas issuers to Moscow (see below) and the establishment of a single depositary and clearing centre.

This last measure is a key reform that was initiated in 2004 but has since stalled. The track record of many years of share trading in Russia without any serious mishap (such as shares disappearing from companies' share registers) has helped increasing numbers of international investors to feel comfortable about holding local shares. But the existence of many separate share registrars remains perhaps the most important risk deterring mainstream global asset management firms, especially as regards their regulated retail funds, from owning anything other than internationally traded depositary receipts. Until such reforms are credibly implemented, it will be hard to determine whether the consensus view – that tightened restrictions on Russian issuers' use of international markets merely end up penalising Russian companies – is correct.

2.2.3. Will London come under increasing pressure from other competitors for Russian capital raising in the medium-term?

We expect the LSE's Main Market will likely remain what one of our interlocutors described as the "gold standard" for international equity issuance by companies from Russian (and emerging market countries as a whole).

Although Oleg Deripaska, the controlling shareholder in Rusal, in an interview with the media linked his decision last year to choose Hong Kong over London for a Rusal listing to the poor state of bilateral political relations between the UK and Russia, we do not view this as being a substantial factor determining where Russian firms will list. This political angle was likely designed as an eye-catching rationalisation rather than as the primary motivation – especially since the Russian government continued to raise capital in London for some of its most important companies, including VTB and Rosneft (which took over the former assets of Yukos). UK-Russia bilateral relations are gradually warming, and the Russian government continues to pursue listings for major state-controlled companies in London, as evidenced by the choice of venue for the IPO of RR's new freight-forwarding subsidiary.

Although Russia's blue chip firms will continue to list on the LSE, we expect greater competition for Russian international capital raising from several other exchanges:

- **Hong Kong.** Market professionals are quick to point out that less than a quarter of Rusal's share issue was bought by Asian investors (and the Hong Kong regulator made this issue ineligible for retail investors). The poor performance of the shares since their debut in January does not bode well for demand for further Russian share offerings, and in the longer run Hong Kong's high regulatory standards (modelled on those of the UK) preclude competition with London on the basis of lower cost and less complexity. Rusal's suitability for a Hong Kong IPO stemmed in large part from its being an exporter focused on Asian markets. A Russia specialist at a London investment bank gave his prediction:

"You may be able to list in Hong Kong and get a higher valuation if you have a China growth story which will be attractive to Asia Funds and Global Funds. High net worth investors are more important in Asia so this may play a part".

This factor is similarly present in the latest planned IPO of a Russian company on the Hong Kong Stock Exchange (HKEx). Petropavlovsk, Russia's third-largest gold producer, announced on 12 September that its iron ore subsidiary IRC Ltd would raise up to US\$1 billion in Hong Kong in October 2010. The unit is focused on projects in Russia's Far East and north-eastern China. Only a small number of Russian companies, however, are sufficiently Asia-facing to interest investors in Hong Kong IPOs. This rules out domestically oriented Russian companies as listing candidates. The consensus, nevertheless, is that Hong Kong will take some market share in the medium term, though this will be at the sidelines of the Russia listing business.

- **North America.** The first foreign-listed Russian IPOs, such as Vimpelcom (1997), MTS (1999) and Wimm-Bill-Dann (2001) were listed on the NYSE. For telcos, such as Vimplecom, New York was a natural place to go to since it had become the focal point for telecommunications industry as the dotcom boom was getting under way. For other Russian companies in pre-Sarbox days, the attraction was mainly the prestige associated with a US listing. The current competitiveness of New York is perceived to be limited to the specialist investor base for NASDAQ-listed tech stocks. We believe an interesting test in this regard will be the choice of IPO listing venue in the next year or two by Yandex, Russia's leading technology company. It has a proprietary internet search technology that can stand comparison with Google. Toronto is another specialist financial centre in North America, in this case for the metals and mining sector. It has had some success in attracting relatively small companies from the former Soviet Union.
- **Warsaw.** The pool of Polish pension savings that must be invested in domestically listed stocks has attracted several and quite sizeable foreign issuers to the Warsaw exchange. Ukraine is the most notable "customer" from the former Soviet Union (FSU). Russian companies are unlikely to follow suit – not so much for purely political reasons (and in any case Russian-Polish relations have seen a remarkably positive turnaround in 2010) as because of the Russian authorities' project of promoting Moscow as a regional financial centre.
- **NYSE-Euronext.** The secondary listing of Rusal on NYSE-Euronext has not been accompanied by any meaningful trading of its shares on this exchange. For this reason NYSE-Euronext's bid for Russian business remains purely virtual for now. But the competitive potential is there, as the platform is well adapted to issuers' needs. Through its decision to work with UK Listing Authority (UKLA), NYSE-Euronext is skilfully playing to one of the above-mentioned key strengths of London: familiarity with dealing with the market authorities. An equity capital markets professional at a London investment bank explained:

"The question by listing candidates of 'should we consider NYSE-Euronext?' is coming up more frequently. The investment bankers cannot be seen to take sides."
- **Index inclusion for liquidity – exposure to exchange-traded funds [ETFs].** The London market offers the potential for Russian issues to gain inclusion in the FTSE, although this cannot be guaranteed even after overcoming the hurdles to a premium LSE listing. For a company from the FSU, in view of the rules on dominant shareholders and independent directors, this is likely to require incorporating a holding company in the UK, as the Kazakh copper mining company Kazakhmys has done. We believe this route is unlikely to appeal to major Russian companies on grounds of political sensitivity.

On the other hand, there are clear and more easily accessible gains from inclusion in the dominant EM equity benchmark, MSCI Barra's EMF Index, which requires a domestic listing. In general, this requirement points to the continuing complementarity of Moscow and London: the two centres combined meet the

various goals of Russian issuers. In particular, it points to demand for the planned new Russian depository receipt (RDR) programme from Russian companies which are domiciled offshore and whose shares are for now listed in London (for example, X5 [retail], Evraz [steel] and Globaltrans [freight]) or another international centre (Rusal in Hong Kong and CTC Media on NASDAQ).

There is some way to go before the regulatory framework for RDRs will be fully fleshed out. Among the issues still to be resolved are the responsibilities/liabilities of depository banks, the settlement of legal disputes among issuers, depository banks and investors, as well as technical matters related to the supply of stocks for underlying RDRs. But market intermediaries we spoke to expect the first RDR programmes to be launched by the end of 2010 or in early 2011.

2.3. Opportunities for the City of London

2.3.1. Capital raising business

The LSE's Main Market will remain the principal offshore centre for equity capital raising by Russian firms. The local Russian market can absorb issues of a few hundred million dollars, but the cost of capital is likely to be higher and the after-market would be less healthy. Issuers wishing to raise more than US\$100 million will therefore tend to look for a dual foreign listing, mainly in London. There is no credible competitor for the bulk of new business, although Hong Kong, NYSE-Euronext, and Toronto may attract a handful of Russian firms in the medium term. The LSE has developed a sophisticated array of ways for Russian companies to list on London. Jon Edwards from the LSE commented that

"There are at least five ways for a Russian company to list on the LSE from a premium listed UK holding with FTSE membership down to an AIM listing with GDRs on either the Main Board or the Professional Securities Market in the middle."

As the effects of the 2008 crisis recede further, Russian companies that weathered the storm reasonably well will return to the markets in greater numbers to raise capital to support their growth by organic capital expenditures and through acquisitions. This trend will be intensified by the anticipated resumption of the government's privatisation programme in 2011. We expect a stream of large GDR issuances to start early next year; the Russian authorities have already announced that the IPO of Freight-2, a newly incorporated freight forwarding subsidiary of state-owned RR, will take place in London.

2.3.2. Advisory work

Many Russian business opportunities exist for professional services firms with a base in the City. London firms must bear in mind, however, that if they want to take advantage of opportunities they must also have a presence on the ground in Moscow: London and Moscow are in this respect intertwined.

We expect to see continuity in the firms dominating Russian business in London. The big investment banks – Morgan Stanley, UBS, Deutsche Bank, Credit Suisse and JP Morgan – which have all built up large teams of skilled advisers in both Moscow and London, look set to lead the underwriting and book building for London listings in the future. They will continue to be supported by leading Russia-based investment banks with offices in London, including Renaissance Capital and Troika Dialog. An increasingly powerful player in capital markets is VTB Capital, the investment bank division of VTB, which is Russia's second-largest bank and majority owned by the government. VTB Capital has a large office in London and is likely to expand its share of Russian listing business.

At the same time, the law and accountancy firms with offices in both London and Moscow – including Linklaters, Clifford Chance, White & Case, KPMG, PWC and Deloitte – will face a stream of new opportunities stemming from the new wave of offerings coming to London. In addition, firms with sizeable operations in Moscow and Hong Kong will be well positioned to capitalise on the few Russian firms that choose to list in Hong Kong – as Linklaters and Ashurst did when advising Rusal on its HKEx listing.

3. Brazil

3.1. Overview of international capital raising trends so far

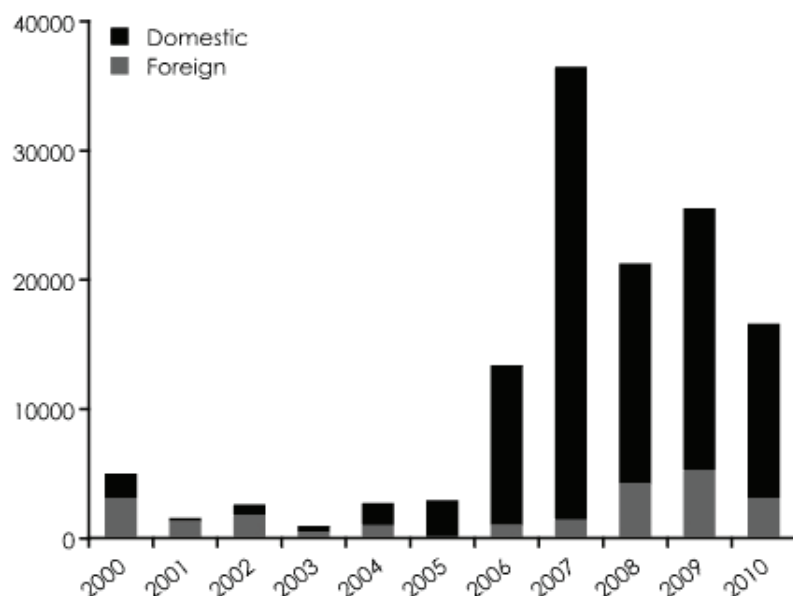
Until 2003, as much as two-thirds of all equity capital raising by Brazilian firms each year was carried out on international capital markets. Brazil's domestic markets were too shallow and illiquid to support the capital needs of local companies, which were forced to go abroad to attract a broader investor base. Larger firms, particularly those with international operations in the commodities sector, carried out dual or follow-on listings of ADRs/GDRs almost exclusively in New York – mainly on the NYSE, though some were on NASDAQ.

The foundations for lessening this reliance on New York were laid in 2002 with the creation of the Novo Mercado, a listing segment of the BOVESPA, Brazil's main stock exchange. This allowed firms to voluntarily adhere to more stringent standards of governance and disclosure, thereby improving the quality of companies listing and bringing an end to large discounts for transparency, governance and liquidity.

The 2003-07 period marked an unparalleled expansion in the size of the domestic equity markets, mirroring and supporting the Brazilian economy's gradual entry into an era of sustainable growth. Domestic listings were initially concentrated in the commodities sector, but beginning in 2005 companies from a broad range of sectors including banking, agriculture, e-commerce and infrastructure went public. Financial services companies, small and medium-sized banks, as well as international investors, who were increasingly comfortable trading on the BOVESPA, poured into the market. A stronger institutional base of domestic pension funds and mutual funds also emerged.

As the chart below illustrates, the turnaround in the BOVESPA resulted in international stock exchanges losing market share in Brazilian capital raising to the domestic exchanges. Absolute growth was nonetheless maintained thanks to the scale of increase in financing needs driven by rapid economic development (although the BOVESPA changed its name to "BM&F BOVESPA" following a merger in 2008, for the purposes of this report it will be referred to as "BOVESPA").

Chart 3-1: Public equity raised by Brazilian firms on domestic and foreign exchanges, 2000-10 (US\$ million)



NOTE: Does not include companies incorporated offshore.

Source: Bloomberg, TS estimates.

From 2006 onwards, improved liquidity on the BOVESPA created greater opportunities for firms to raise capital domestically. This unleashed demand for domestic listings by Brazilian firms, many of which were deterred from going to the US markets after the introduction of the Sarbanes-Oxley Act of 2002 which increased the time and cost involved in regulatory compliance and was a powerful disincentive for companies to list in the US for the first time. As a New York-based equity capital markets specialist told us, “a domestic listing alone these days is often sufficient”. This was of course partly made possible by the sudden increase of foreign investors transacting in the domestic market, resulting from improvements in corporate governance standards in Brazil that made them feel secure about investing on the BOVESPA. International investors currently hold about 30 per cent of local market capitalisation.

Nonetheless, offshore listings have continued. The two main reasons for this are investor demand and conditions of placement: the advent of “jumbo” offerings saw listings that could not be supported by the domestic market alone and/or that were priced at a premium in foreign markets owing to a wider pool of investors. The largest of these offshore listings was the US\$12 billion dual-listed offering for Vale in 2008, followed in size by the US\$7.5 billion Banco Santander Brasil offering in 2009. Both these were listed in New York as well as Sao Paulo. While offerings from Brasil Foods (US\$2.7 billion in 2009) and Itau Unibanco (US\$5.4 billion in 2010) were also listed on the NYSE, both these companies resulted from mergers and had inherited listings from predecessor entities: Brasil Foods from Perdigao (2006) and Itau from Unibanco (more on this overleaf).

Some “jumbo” listings, however, have been carried out solely on the BOVESPA. In 2007 and 2008 BOVESPA (the exchange) itself and OGX, an oil and gas company, had domestic IPOs raising US\$3.7 billion and US\$4.1 billion respectively. Similarly, neither of the “jumbo” issuances from VisaNet (US\$4.2 billion in 2009) and Banco do Brasil (US\$5.4 billion in 2010) did a foreign listing in conjunction with the primary domestic offering.

It therefore appears that while an offering size in excess of US\$2 billion might cause a company to consider a foreign listing alongside a primary listing on BOVESPA, it will most likely only result in a foreign offering either if it is a truly “jumbo” listing (such as the US\$7 billion Vale deal) or if the listing candidate has another good reason to raise capital. This will be primarily cost related or else intended to support overseas sales and trading by “planting the company flag” overseas. In addition to Brazil's global champions in mining and petroleum, the NYSE has attracted petrochemical giant Braskem (2004), banks such as Unibanco (2005) (later Itau-Unibanco), Santander Brasil (2009) and ethanol maker Cosan (2007), as well as smaller offerings from local airline TAM (2006) and aircraft manufacturer Embraer (2007). These companies have been willing to take on the Sarbox compliance burden in return for the benefits that a New York listing has brought to their international strategy.

3.1.1. Why New York?

Brazil is the third-largest country in terms of its number of NYSE-listed non-US companies: 28 firms valued at over US\$700 billion (behind Canada and China), according to NYSE figures. There are a number of reasons why a Brazilian company would consider New York before London or other international markets, including time zone, historic trading relationships, the tradition of debt financing being provided by US banks, and educational links (Brazilian executives studying for their MBAs in the US, for example).

A relative weakness of London would have also played an important role in its ability to compete for foreign listings; most British bankers and fund managers active in the emerging markets, with a few notable exceptions, have historically built their careers in Asia or, since the mid-1990s, in Eastern Europe. Brazil was considered New York's “back yard”. In the absence of a strong reason to go elsewhere, the sheer size of the US capital markets and strong marketing from the NYSE and the US investment banks would have been compelling in the days before Sarbox. The average daily trading value of the NYSE-listed Brazilian companies is larger than the average daily trading value of all companies listed on BOVESPA (the average daily trading value for BOVESPA is US\$1.4 billion, as of 30 June 2010). The NYSE market share (as a percentage of global trading) for 2010 for all Brazilian-listed stocks was 66 per cent.

The tradition of listing on the NYSE will continue, but in view of the demand for financing in Brazil we foresee opportunities for other exchanges, including the LSE. Although listing on the NYSE has helped to increase liquidity for large firms such as Petrobras and Vale, this is not the case for all Brazilian companies listed in New York. This could be because smaller firms do not have the same resources to invest in interaction with portfolio managers or because investors still view Brazil as primarily a commodities producer and do not focus so much on sectors beyond mining and oil.

3.2. Outlook for capital raising

The Brazilian economy has emerged from the crisis in good health, owing to robust domestic consumption and increased spending on infrastructure. After a six-month hiatus issuers returned to the BOVESPA in January 2009. Two truly “jumbo” offerings took place that year: the Brazilian credit card processor VisaNet broke OGX’s record when it raised R\$8.4 billion (US\$4.28 billion) in its June IPO; Banco Santander’s Brazilian unit went even further, raising R\$14.1 billion (US\$8 billion) in September in a joint offering on the NYSE. The 2010 pipeline has been somewhat limited in size and number of offerings so far this year, in part due to anticipation of Petrobras’s secondary offering, which was concluded on 23 September. The company raised US\$67.9 billion in the world’s largest share offering. Nine companies have already filed to list in Q4/10, now that the Petrobras offering is concluded. On 30 September, Brazilian private university manager Estacio raised US\$405.7 million in a secondary offering.

We expect the number of companies going public to increase significantly over the next five years. The main demand for equity capital will be from firms involved in:

- **Infrastructure development.** Brazil must urgently increase its level of investment in infrastructure – a major bottleneck for economic growth – from around 2 per cent of GDP to at least 4 per cent in order to remain competitive, according to Morgan Stanley. This is even more pressing in the light of Brazil’s hosting of the 2014 FIFA World Cup and 2016 Rio Olympics. The sheer scale of infrastructure investment required implies that local capital will be insufficient to finance it, and therefore we expect substantial recourse to international capital markets.
- **Consumer-oriented goods and services.** According to the Getulio Vargas Foundation (FGV), 14.5 million people will leave poverty and 36.1 million people will enter the middle class² between 2010 and 2014. Companies in consumer finance and homebuilding will benefit from these trends and are the most likely listing candidates in this segment.
- The **power sector** will need investment of roughly R\$215 billion (US\$12 billion) until 2019 to meet the government’s ambitious plan to increase Brazil’s generation, distribution and transmission capacity to satisfy total electricity demand of 633 GWh in 2019, up from 415.8 GWh in 2010. Given the strong demand for power sources other than large hydroelectric projects, we expect more alternative energy groups to follow in the footsteps of Renova Energia’s August 2010 BOVESPA listing.
- **Oil and gas firms** (both domestic and international) will seek more growth capital to take advantage of Brazil’s major subsalt hydrocarbon resources discovered in 2008 in the Santos Basin. Despite uncertainty surrounding the future regulatory framework for subsalt reserve development, interest in the

² By FGV standards, for a family to be part of the middle class, its annual household income needs to exceed US\$10,941 per annum.

local oil and gas industry is very strong. Petrobras is the dominant player, but most global oil majors have a presence in Brazil and local firms have begun to emerge. Four companies in the oil and gas sector are expected to offer shares to the public in Brazil in Q3/10. Now that Petrobras has concluded its US\$67.9 billion global secondary offering, local companies HRT Petroleo, Norskan Offshore and the Brazilian subsidiary of Repsol (Spain) will be raising capital via domestic IPOs for investment in their Brazilian operations.

3.2.1. Where will companies go to list?

We believe the BOVESPA will continue to have sufficient capacity and liquidity to meet the majority of incremental demand for equity capital. However, several types of firms will likely find it difficult to attract enough investor demand domestically and/or will see other pricing advantages to foreign listings (as noted above). Alexandre Gartner, the head of research for HSBC Brazil, believes that New York will exert an increasing pull on Brazilian firms as new investors – from global funds, sector-specific funds and new geographical pockets in Asia and the Middle East in particular – become more interested in Brazilian equities as an equity class. Many of these investors will be unable or unwilling to invest in the local exchange, preferring dollar-denominated ADRs in New York.

We expect several trends to emerge in the next five years:

- **Large firms will continue to dual-list some “jumbo” offerings in New York.** The Novo Mercado has already shown that it can handle “jumbo” offerings, including those of Banco do Brasil (US\$5 billion), Visanet, OGX and BOVESPA (US\$4 billion) without support from London or New York. However, unlike India, it lacks the capacity to carry out more than two or three such offerings each year because of the risk of market saturation. For example, in 2009 just two offerings – VisaNet’s R\$8.4 billion (US\$4.28 billion) IPO in June, and Banco Santander’s Brazilian unit’s September IPO of R\$14.1 billion (US\$8 billion) in a joint offering on the NYSE – were responsible for the bulk of the capital raised on the BOVESPA. Similarly, the Petrobras listing virtually dried up the market for other offerings. At such times, the best option for large firms is to tap New York through ADR issuances to attract sufficient investor interest. With more Brazilian firms expanding overseas and requiring foreign capital to do so, we expect a continuation in “jumbo” ADR offerings in New York by those large companies which are either already New York listed or can shoulder the Sarbox compliance burden.
- **Mid-cap firms will look abroad – though not just to New York.** The problem of market saturation and the cost of Sarbox are more acute for mid-cap firms, which have found it increasingly difficult to raise capital on the BOVESPA since the 2008 crisis, according to our sources. Similarly, Brazil’s dynamic private equity firms, many of which have international experience, have found limited opportunities for stock market exit. This has been compounded by the lack of investor appetite for smaller share offerings due to the significant market turbulence that followed the crisis.

Attempts to attract listings by smaller firms via the creation of an over-the-counter market, dubbed the BOVESPA Mais, have also been unsuccessful. According to BOVESPA estimates, there are 60,000 companies in Brazil large enough to enter the market. But so far only one company, the local fertiliser producer Nutriplant, has issued shares on the BOVESPA Mais.

We expect a higher number of mid-cap firms to source capital abroad as a result. One reason that has been cited for the lack of listings in this price range is limited interest from underwriters and book builders in taking on smaller offerings. While New York, as we discussed earlier, is the natural destination for Brazilian firms, many are deterred by earlier movers: medium-sized Brazilian firms already listed there have not seen much trading in their NYSE-listed ADRs, which makes it difficult to justify the cost of overseas listings.

Some companies are eyeing AIM as an alternative, as illustrated by the April 2010 listing of Anglo-Brazilian real estate investor and developer Squarestone Brasil and the possible listing of the Brazilian iron ore firm Ferrous Resources.

- **Currency controls.** Concern in Brazil about the strong Real and its impact on exports could result in further currency controls. The Finance Ministry in October 2009 imposed a 2 per cent financial transactions tax (IOF) on all portfolio capital inflows (foreign direct investment is exempt). The tax was expanded to include depository receipts in November 2009 in an attempt to balance out distortions created by the October tax, and was raised to 4 per cent in October 2010. The IOF has had a limited impact on inflows, but given the expectation of continued inflows, there may be further controls in the future that might reduce portfolio flows (and hence overall liquidity).

3.3. Opportunities for the City of London

3.3.1. Capital raising business

Apart from three small firms listed on AIM, London has limited experience of equity raising by Brazilian firms and is therefore at a natural disadvantage compared to New York because it is not yet a tried-and-tested venue. We nonetheless see several key opportunities for London in terms of Brazilian listing business:

- **Mining, metals, oil and gas.** Market participants agree that the LSE's programme to focus on sectors such as mining has the potential to attract Brazilian companies to the market. The LSE has noteworthy advantages in mining and metals, and it already has a critical mass of listed companies in this sector, including three Latin American firms – Fresnillo (Mexico), Antofagasta (Chile) and Hochschild Mining (Peru). Potential FTSE Indices inclusion is a key additional pull for large mining firms. In addition, London has strong expertise in oil and gas and alternative energy, which is likely to attract more companies to list on AIM and the Main Market of the LSE. According to David Royce at Ernst & Young, London's considerable strength in mining and metals could be extended into other sectors such as agribusiness, which

would provide similar risks and rewards to those offered by other natural resource companies.

- **Specialisation in mid-cap companies.** As mentioned above, mid-cap companies have been displaced on the BOVESPA by “jumbo” listings, which have been favoured by investors since the crisis. It is likely that many mid-cap firms will seek financing internationally in the next few years. Although this is not yet a trend, it could represent an opportunity in the future for the AIM. Currently three Brazilian companies are listed on the AIM (one other firm, ethanol producer Clean Energy Brazil, delisted in 2009).

3.3.2. Advisory work

Brazil is open to international participation in all stages of capital raising. Local and international investment banks, law firms and accounting firms compete directly for business on an equal basis. As a result, Brazil offers myriad opportunities for professional services firms based in the City, though only for those that establish a local presence.

Large international investment banks including Credit Suisse, Morgan Stanley, Goldman Sachs, BoFA Merrill Lynch, HSBC and Citigroup are all active in the underwriting and book-building process for local and international offerings. Local investment banks, including Itau BBA, Bradesco BBI and Banco do Brasil, are also very active in this market. BTG Pactual has become the leading firm in Brazilian capital markets following its acquisition of UBS assets in Brazil in 2009.

International law and accountancy firms have a long history in Brazil. Law firms including Clifford Chance and White & Case have large local offices with teams of experienced Brazilian and international attorneys. Other British firms such as Allen & Overy recently established a local presence but are already seeing strong demand for their services from both international and Brazilian clients. Likewise, international accounting firms like Ernst & Young, KPMG, PWC and Deloitte will continue to benefit from increased local and international capital raising as well as the expansion of global bond issuances.

4. Mexico

4.1. Overview of international capital raising trends so far

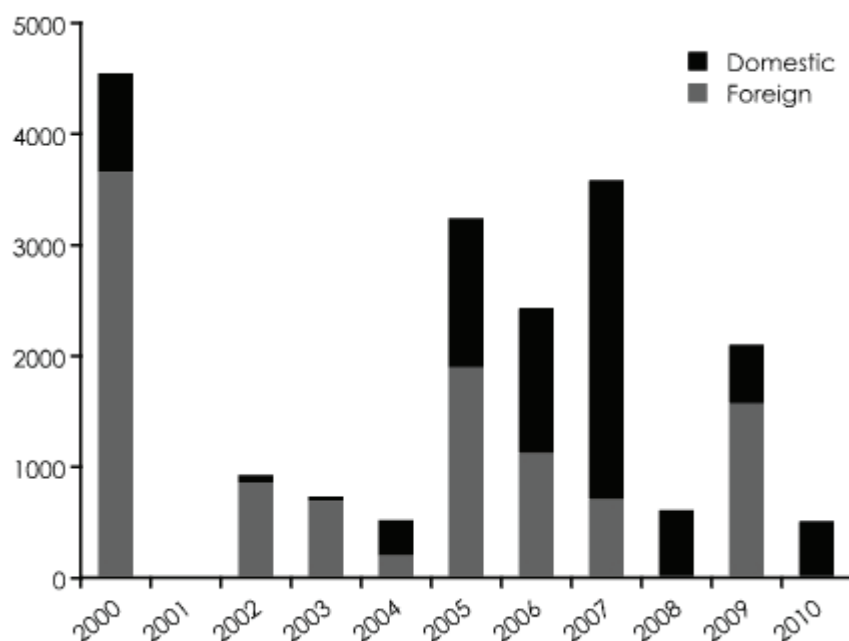
Mexico falls behind the other countries in this study in terms of equity capital raising. Traditionally, equity listings have often been seen as an alternative rather than as a primary capital raising option for most Mexican companies. This is because of the country's culture of family-owned firms whose shareholders generally prefer to sell debt rather than to suffer equity dilution. Capital raising in the past decade has instead been dominated by the country's sophisticated fixed-income and structured-finance markets following important structural reforms in the late 1990s, including the development of a longer-yield sovereign debt curve, an inflation-targeting regime and landmark social security reform. From their inception in 1997 until 2005, local pension funds (known as "Afores") were allowed to invest in fixed-income products (both sovereign and corporate) but not equities, thus helping the growth and liquidity of local corporate debt markets over equity markets.

However, the ongoing capital needs of Mexico's blue chip and mid-cap private sector firms to fund expansion have ensured that a trickle of new equity issuances have nonetheless taken place this decade, although at a considerably slower pace than in other emerging markets such Brazil, India and Russia. Fewer than 150 stocks are listed on the BMV, Mexico's only stock exchange today; 26 IPOs have taken place on the BMV since 2000.

The BMV is a relatively shallow equity market with several important weaknesses, notably a lack of liquidity for all but the top 10-15 listed firms, the absence of major oil and gas and utility stocks in the index and a largely foreign-owned banking sector that does not have actively traded stocks on the BMV. Perhaps the greatest problem of all, however, has been the lack of a sustained domestic institutional base for daily trading in equities.

Because of these factors, as well as the cachet of listing abroad, large Mexican firms needing capital in the past two decades have often turned to international markets – mainly in New York – in order to access a wider pool of investors for their IPOs and SPOs. This is particularly true for listings in excess of US\$500 million such as the IPO of the world's largest primary silver producer Fresnillo on the LSE in 2008.

Chart 4-1: Public equity raised by Mexican companies on domestic and foreign markets, 2000-10 year to date (US\$ million)



NOTE: Does not include companies incorporated offshore.
Source: Bloomberg, TS estimates.

4.1.1. Why New York?

New York has to date dominated the Mexican capital raising business. With the exception of silver producer Fresnillo and two small mining companies that have listed on the LSE Main Market and AIM respectively, nearly all Mexican firms tapping international public equity markets have done so in New York (the majority on the NYSE, with the remaining few on NASDAQ) through ADR issuances in conjunction with a primary offering on the BMV.

Mexico's preference for a New York listing is due to several factors including geographical proximity, strong cultural links, greater analyst expertise, a similar time zone and close economic ties to the US. Approximately 80 per cent of Mexican exports are to the US, and some 10 per cent of Mexico-born Mexicans live in the US. All major US investment banks and brokerages have operations in Mexico City. The enactment of the North American Free Trade Agreement (NAFTA) between Mexico and the US in 1994 also provided a window of opportunity for several of Mexico's top companies to list in New York by bringing Mexico to the attention of US investors, according to Carlos Kretschmer, Managing Director and Head of Capital Markets Mexico for Scotia Capital Mexico.

Mexico provides considerable business to New York: 18 Mexican firms were listed on the NYSE as of 30 June 2010, with a total combined market capitalisation of nearly US\$200 billion. These firms are from diverse sectors, including telecoms (America Movil, Telefonos de Mexico, Telmex), infrastructure/construction (Grupo Aeroportuario del Pacifico, Grupo Aeroportuario del Sureste, Cemex),

food/beverages (Coca-Cola Femsa, Gruma, Bachoco) and real estate (Homex). Nevertheless, a handful of Mexican firms (including Internacional de Ceramica, industrial conglomerate Desc and steel and construction materials firm Imsa) delisted from the NYSE in the mid-2000s, citing rising compliance costs among other reasons. Telmex in July 2010 also raised the possibility of delisting from the NYSE following America Movil's purchase of most of its shares this year.

4.1.2. London lags behind ... but Fresnillo's listing offers hope

Until recently London hosted no listings of Mexican firms. However, 2004 and 2006 saw two Mexican mining firms carry out small offerings on the AIM. These were followed with the GBP905 million (US\$1.77 billion) IPO in 2008 of the world's largest primary silver producer, Fresnillo, a spin-off of Mexican resources group Penoles. Fresnillo carried out a premium listing on the LSE Main Market and, having acquired UK incorporation and satisfied additional entry requirements, gained access to the FTSE 100 Index.

Several sources we interviewed suggested that Fresnillo's listing could mark the beginning of a new trend whereby London attracts Latin American companies to carry out top-quality premium listings. London does have key advantages, the most significant of which is that it provides the opportunity for EM firms to access the FTSE Index. This benefits both valuations and share liquidity: it enables firms to broaden their investment base by gaining access to the index-tracking funds and to many UK active funds that are benchmarked against the index. In addition, inclusion in the FTSE 100 garners greater research coverage and media attention. However, the FTSE does have a requirement that some Mexican firms may be averse to fulfilling. A firm that is not incorporated in the UK will not normally be considered eligible to be included in the FTSE unless it divests itself of a controlling shareholder or a controlling interest held by a group of inter-related shareholders. In Fresnillo's case, Penoles chose to incorporate the unit in London.

We believe that the greater significance of this deal was the inclusion of a Mexican firm in the larger trend of mining companies listing in London. As is evident in the case of South Africa and India (covered in later sections), London's expertise in mining stands out: not only are there sector specialist funds for mining and energy based in London, but the mining world's foremost lobbying group, the International Council on Mining and Metals (ICMM), is London-based, as are the London Bullion Market Association and the London Metals Exchange, the world's largest for non-ferrous metals.

4.2. Outlook for capital raising

After a nearly two-year hiatus that predated the global financial crisis, the BMV had its first IPO of 2010 in April with the listing of supermarket operator Grupo Comercial Chedraui for MX4.57 billion (US\$371 million) – the bourse's largest IPO since 2005. The week after, Mexican brokerage and investment bank Corporacion Actinver SAB raised MX843 million (US\$66 million) in its IPO; and in June mid-sized forestry firm ProTeak Uno listed for MX790 million (US\$61.5 million) – the first company to list under the BMV's new relaxed regulatory requirements for smaller firms (established this

year) to encourage more listings. The BMV estimated in August that there could be another two IPOs this year – perhaps including mid-sized Mexican real estate developer Corporativo Tres Marias (which postponed its share sale in June 2010 due to market volatility) – and six or seven IPOs in 2011.

Despite such indications that the domestic IPO market is finally reviving as Mexico's economy recovers following a deep recession, there are few signs that a step change in the volume of equity capital raised by Mexican firms is likely to take place in the near term. Instead there will be a continuation in a slow stream of companies going to the markets to seek equity finance. According to sources we interviewed, the reason for this is connected more to supply than to demand: there simply are not enough mid-sized companies with compelling investment stories that are either able or willing to go public because:

- **Mexico's top firms are already listed.** The majority of Mexico's largest firms (save for state monopolies such as oil giant Pemex) are already listed on the BMV or are subsidiaries of multinationals. High-growth industries that would normally generate strong demand for equity capital, including telecoms, energy, cement and beverages, are dominated by already listed giants or government monopolies. In addition, NAFTA resulted in foreign multinationals (primarily US-based) carrying out a wave of acquisitions of Mexican manufacturing firms, leaving the country without some of the usual candidates for IPOs.
- **Few mid-sized firms.** Many mid-sized local firms that might otherwise be prime candidates to list on the BMV are family-run companies that suffer from corporate governance or transparency issues. In addition, security concerns also play a part in quelling demand from family-run firms to publicly list their companies. While the BMV's new, relaxed regulatory rules for smaller-sized companies should encourage more listings – the BMV has estimated that there could be 200-300 companies that are eligible to use the programme – these shares could still suffer from low liquidity in daily trading due to, first, a restricted investor base (generally institutional investors) that can purchase them and, second, concerns about corporate governance.
- **Lack of investor interest hurts small-cap firms.** Many small Mexican companies are unlikely to go public owing to a lack of investor appetite. Institutional investors have not often been receptive to IPOs of small-cap firms, particularly because of their generally limited free-float, tiny market share of their specific industries or lack of a compelling story. Valuations are therefore relatively low and share liquidity is weak. It has also been difficult for small and mid-sized firms to get commercial loans from the country's banks to grow their businesses, since banks have focused their attention on consumer credit rather than commercial credit in the past decade.

4. 2.1. Will Mexico follow in Brazil's footsteps over the medium to long term?

Over a longer time horizon, however, we see two reasons for optimism about the development and deepening of Mexico's domestic capital markets and increased private equity deal making, both of which should eventually join several possible sources of new demand for equity offerings.

- **Greater access to domestic equities for local pension funds should create an important domestic base of liquidity in the medium term.** In an important change for the equities market, the government passed new regulations in early 2010 to allow Afores to invest directly in individual stocks listed on the BMV and to increase their permissible allocation of assets to equities by another 5 per cent of total assets under management to a top limit of 35 per cent. Prior to this legislation, Afores from 2005 onwards were allowed to invest in equities only via index trackers.

Fifteen years of macroeconomic stability have helped domestic Mexican pension funds to accumulate MX1.25 trillion (nearly US\$100 billion) in assets under management as of May 2010, equivalent to around 10 per cent of GDP, up from zero in 2007. This change, coupled with the steady growth of domestic pension funds, has not yet significantly boosted liquidity on the BMV but is expected to do so in the medium term. Moreover, as liquidity increases and Afores begin to engage more and more in individual stock picking, more research on individual equities will be produced, which will also help boost trading volumes on the BMV. The BMV in 2009 enacted another key reform when it readjusted its benchmark IPC stock index to emphasise free float rather than market cap. A result of this is that companies are now working on increasing their free floats.

- **The Mexican government's new infrastructure push could encourage more VE/PE investments – and future IPOs.** The Mexican government enacted a regulation in 2009 to allow Afores to invest in mid-sized unlisted companies and infrastructure projects. In particular the launch of new securities, known as capital development certificates, to finance infrastructure projects has attracted investor attention.
- **Potential privatisation of Pemex and other state-run firms?** Under the current constitution, large government-owned companies such as the oil and gas firm Pemex and the state-run power company Comision Federal de Electricidad (CFE) are forbidden to have private capital. The government has looked into ways to list Pemex and other state-run companies on the BMV by structuring the equity sale in such a way as to sidestep constitutional issues, perhaps by securitising cashflow. If this were to take place, it would be likely to have a huge impact on the BMV's trading volumes and liquidity levels, according to Raul Feliz, a consultant at Mexican think tank CIDE. This remains a contentious policy, however, which is a long way from receiving the level of political support needed for its enactment.

In the meantime, we foresee a continuation of the pattern evident since the 1990s: a handful of IPOs on the BMV every year and occasional listings abroad if and when a large Mexican firm needs to raise capital. Potential large-scale IPOs in the pipeline include the real estate and mining units of Mexican billionaire Carlos Slim's holding company Grupo Carso. While Grupo Carso has only talked thus far of listing shares on the BMV, these units could eventually progress to listing internationally. In this event, the mining unit could be a possible candidate to list on the LSE. Mining and transport behemoth Grupo Mexico has also raised the possibility of listing its transport unit following a planned merger of two of its railway companies, pending approval from the country's competition authority (in a decision expected in Q1/11). The group also talked in July of merging mining units Asarco LLC and Southern Copper Corp (which is already listed on the NYSE) in a nearly US\$6 billion deal and listing the new company in New York and Peru.

However, the BMV does not look likely to overcome its chronic lack of liquidity in the next few years. Although the April US\$373 million IPO by the supermarket operator Grupo Comercial Chedraui was completed solely on the domestic exchange, few listings above this size will find sufficient liquidity and pricing tension domestically. The BMV will remain, as one of our interlocutors described it, as a "small and sleepy exchange that suffers from structural issues" in the immediate future. As a result, we foresee large offerings to require support of ADR issuance in New York or elsewhere.

4.3. Opportunities for the City of London

4.3.1. Capital raising business

We believe that Mexico will provide fewer business opportunities for the LSE and the City of London in respect to international capital raising in the near term than the other countries in this study. While there may be companies that can follow in Fresnillo's footsteps, local traders point out that there is not that much demand at present among Mexican companies for global equity capital raising. Moreover, if and when they do choose to list, New York is likely to remain the financial centre of choice, with its stronger base of Latin American investors and market intermediaries and closer cultural, geographical and economic links.

We foresee two main exceptions to New York's dominance, however. First, mining and metals firms, for the reasons outlined above, will be more inclined to consider a London listing than one in New York. Second, Mexican firms looking to carry out "jumbo" offerings will be attracted to London owing to the possibility of accessing the FTSE Indices and, in doing so, acquiring premium valuations and stronger secondary market activity, as occurred with Fresnillo's IPO.

4.3.2. Advisory work

City professional services firms have built up expertise in advising Mexican firms. For example Ernst & Young, Linklaters and Freshfields Bruckhaus Deringer advised on the Fresnillo IPO and are actively marketing in Mexico. According to a source, City firms are seeing considerable interest from potential Mexican listing candidates, particularly those involved in mining, metals and agribusiness. Although the pipeline

for IPOs/SPOs by Mexican firms will be less full than for Russian or Indian firms, we nonetheless expect greater interest in London as a result of the precedent set by Fresnillo and the strong marketing efforts in Mexico by City professionals.

In respect to capital raising on the BMV, Mexico's lead bookrunners on equity capital raising in the past decade have generally been the country's largest (and largely foreign-owned) banks – Citigroup, BBVA and Banco Santander – with Deutsche Bank, JP Morgan, Bank of America Merrill Lynch and occasionally Credit Suisse and UBS playing a role. Local brokerages such as Ixe Casa de Bolsa have also advised on deals. However City-headquartered banks such as Barclays and HSBC have not seen a significant share of equity deal advising or underwriting, even though HSBC is the owner of Mexico's fifth-largest bank (HSBC Mexico).

While top local law firms such as Creel, García-Cuellar, Aiza y Enriquez and Galicia y Robles generally dominate Mexico's league tables for IPO advice, M&A, debt capital markets and project finance, there will be growth opportunities for City firms as the Mexican economy continues to develop. White & Case has advised on past IPO deals (notably the 2006 IPO of Mexican airport operator Grupo Aeroportuario del Centro Norte) with a primary listing on the BMV and ADRs listed on NASDAQ. Baker & McKenzie also has a significant presence in Mexico and, among other deals, has advised Mexican cement giant Cemex on M&A in the past. The Big Four accountancies are all present in Mexico and should benefit as economic activity picks up.

4.3.3. Private equity could offer an opportunity for some City firms

We believe there are interesting opportunities for City private equity companies in Mexico given the fragmented nature of the country's domestic corporate landscape (beyond the traditional near-monopolies such as telecoms, energy, utilities, bread and beverages), particularly in certain retail, infrastructure and service sectors. Moreover, according to Jaime Salinas, Managing Director of Darby Overseas Investments in Mexico, valuations in Mexico are currently more attractive than those in Brazil. However, Salinas points out that the potential for an IPO exit strategy for PE-backed firms in Mexico in the next three or four years is dim. This is because a successful IPO (which would raise at least US\$300 million) implies a company valuation of around US\$700 million, and he notes that there are very few companies of that size that private equity (PE) firms can invest in. A better exit strategy has been finding strategic buyers for PE-backed firms; and this strategy is likely to continue to pay off in the short to medium term.

As private equity investments grow in Mexico, opportunities for providing local accounting and legal services will increase in tandem, in part due to recent tax changes that may complicate PE and secondary offerings. These changes have forced PE investors to become more creative in structuring deals (by seeking out countries of domicile that have the most favourable tax treaties with Mexico), according to Jean Michel Enriquez, a partner with Creel, García-Cuellar, Aiza y Enriquez. In addition, these changes may complicate secondary offerings on equity markets.

5. South Africa

5.1. Overview of international capital raising trends so far

South Africa has generated few listing candidates on international exchanges in the past 10 years, despite there being a sizeable presence of South African (though typically offshore) companies on the LSE Main Market and AIM as well as the NYSE and NASDAQ. Since 2005 there have been no IPOs of South African incorporated firms in London or New York and only one by a foreign-listed South African firm. Although more than 15 SPOs abroad have taken place over this period, the bulk of these (in value terms) have been repeat business by the same firms.

The South African Reserve Bank (SARB), which has responsibility for approving applications by companies to raise capital abroad on a case-by-case basis, allowed multiple firms to do so in the late 1990s but then limited the number of firms permitted to leave in 2002-03. Aside from a small burst of approvals in 2005-06, SARB has not loosened its restrictive hold ever since. The few sizeable companies allowed to raise capital abroad since tightening began include petrochemicals giant Sasol (NYSE, 2003), former state fixed-line monopoly Telkom (NYSE, 2003) and AngloGold Ashanti (several SPOs on the NYSE/LSE). A senior banker at a UK-based investment bank told us:

"South Africa is changing. The Reserve Bank is getting tougher and making dual listings more difficult. They want to support the domestic market and make it less easy for South African companies to keep profits offshore. In the past they allowed companies to raise money overseas for overseas expansion without needing to repatriate the proceeds."

A key reason for this stems from the perceived damage inflicted on domestic markets following the first wave of international listings in the late 1990s and early 2000s. South Africa's largest firms – Anglo American, Billiton (now part of BHP Billiton), South African Breweries (now SABMiller), Old Mutual, Dimension Data and Investec – moved their primary headquarters and primary listings from Johannesburg to London in order to tap into a deeper institutional pool of capital (particularly for the handful that gained access to the FTSE Index), raise their profile and pursue ambitious global expansion strategies. One result of this – also spurred partly by the local bear market in the late 1990s – was that many more firms delisted than listed on the Johannesburg Stock Exchange (now the JSE Limited) during these years: by the end of 2005 there were 373 companies listed, a big fall from 699 companies in 1999. At the peak of the exodus, 85 firms delisted in 2001.

According to our sources, SARB approval of foreign listings is the exception rather than the rule, and tends to be granted only when a company has a persuasive argument for raising capital abroad as well as strong support within the government. In only few situations does SARB seem to consider reasons for going abroad to be good and hence approval is more likely to be forthcoming:

- **Companies that already have an international listing** have been allowed to return to that or another foreign bourse to carry out follow-on offerings. The second-largest global gold mining firm, AngloGold Ashanti, for example, was allowed to carry out SPOs on the LSE and/or the NYSE in 2004, 2006, 2007 and 2009. This is because the Ghanaian Ashanti Goldfields Company, which merged with AngloGold to form AngloGold Ashanti, was already listed in both these centres. A similar situation has occurred for mining companies Gold Fields (NYSE) and Central African Gold (AIM), as well as computer services firm Datatec (AIM).
- **Companies that are pursuing a global strategy** are sometimes given the go-ahead. Sasol, the global petrochemicals company with listings on the NYSE and JSE, and Gold Fields, the global mining company with listings on the NYSE and JSE (and now delisted from LSE), were both allowed to source capital abroad, most likely to fund global expansion and raise their profile in new markets.
- **M&A transactions involving listed companies.** SARB has also approved listings on overseas exchanges following M&A transactions. For example, media company Naspers – after acquiring full control of MIH Holdings in 2002 – gained a secondary listing on NASDAQ via the transaction. In addition, in the recent merger talks (now broken off) between South Africa's MTN and India's Bharti, the South African government insisted on a dual listing as one of its requirements for the transaction to take place; while this requirement might have been an impediment to the merger in this specific case, the reverse scenario is also possible.
- **Relatively small offerings by small- and mid-cap firms for social or strategic reasons.** SARB has appeared willing in the past to allow smaller firms to raise capital internationally to advance social or strategic aims. For example, IT firm Datatec was granted the right in 2006 to list on AIM, and – following the August 2010 approval of a US\$2.3 billion takeover of Dimension Data, South Africa's largest technology service provider, by NTT, a Japanese telecommunications operator – SARB may be persuaded to grant more approvals in this sector for firms that want to raise their profile globally. However, these offerings tend to be considerably smaller than LSE Main Market or NYSE listings.

The other type of firm that has the ability to tap international equity markets is one that is domiciled offshore but has its main operations in South Africa. These are still prime candidates for raising international capital in this way, as are other companies from the African continent. Currently, there are 13 companies listed on AIM with main operations in South Africa. Eleven of these are mining firms, including UK-domiciled Petra Diamonds and Pan African Resources as well as Canada-domiciled Eastern Platinum and Australia-domiciled Sylvania Resources. Several mining firms with South African assets have also listed on the Toronto Stock Exchange (TSX), a new hub for small offerings by mining firms. The only IPO carried out on an international exchange by a South African firm since 2005 – the electronic payment

services firm Net 1 UEPS that listed on NASDAQ that year – was incorporated in the US. However, this method does have its costs, the main one being the tax implications, particularly for those South African firms incorporated in London. Another method that some firms have utilised to retain goodwill among local regulatory authorities while still raising capital abroad has been spin-offs of smaller units, with divisions incorporated in two domiciles. For example, in mid-2007 Anglo American spun off its pulp and paper division Mondi and dual-listed the unit on both the LSE and the JSE.

5.1.1. What determines the choice of listing location?

It is difficult to draw conclusions on trends in foreign listing locations over the past five years, given the limited number of firms that have listed abroad.

According to both local and offshore investment bankers we spoke to, London continues to be the logical destination for South African and other African firms to raise international equity capital, owing largely to the UK's geographical proximity, a similar time zone and already strong ties between UK financial advisory services and Africa. The LSE's position as the global centre of mining finance, despite growing competition from the TSX, is also an important attraction.

Despite this, New York has attracted nearly as much business in value terms as London in the past five years (around US\$3.2 billion for NYSE/NASDAQ vs US\$3.7 billion for the LSE Main Market/AIM, both 2006-10 year to date). New York's obvious advantage is its heavy concentration of technology stocks and technology-focused investors that transact on NASDAQ in particular. This can explain why Net 1 UEPS chose to carry out its primary listing on NASDAQ. In addition, there has been some loss of London's core mining business to New York. Gold Fields delisted from London in 2007 and shortly after listed in New York on finding that a secondary listing in London (with a Johannesburg primary listing) resulted in less liquidity in the secondary market than an ADR listing in New York. The London listing was thus an unnecessary cost. Similarly, AngloGold Ashanti, which has both New York and London listings, has raised more money in the US ADR market than from its London listing in the past three years.

However, the pendulum appears to swing both ways. Since the Sarbanes-Oxley Act in 2002 some firms that initially went to New York have delisted. The South African media company Naspers delisted from NASDAQ in 2007 after five years on the exchange and moved its secondary listing to the LSE Main Market, blaming rising compliance costs and tighter restrictions due to Sarbox as the main cause. Similarly, in 2010, Harmony Gold, which chose to dual-list on NASDAQ in November 2005 despite the Act, chose to delist from the exchange, citing insufficient benefits in relation to costs. But London cannot afford to be complacent, as we have explained, because even in mining the NYSE is a competitor for very large companies which can handle the Sarbox compliance and reporting burden.

The capacity of the domestic market is another major driver of listing location – though at present this figures less in the decision-making process of firms given that

most automatically go to the JSE owing to SARB's restrictions. A London-based hedge fund manager told us:

"The South African market has a strong institutional fabric. There have been life funds in place for many years and a good Anglo-Saxon local brokerage community. Shares traded between the markets are often fungible."

The JSE has more than adequate liquidity at present for the six to 12 IPOs per year that fund managers expect in the near term from sectors that range from construction materials and retailers to casinos. For example, local company Life Healthcare in June this year managed to raise 5.2 billion rand (US\$680 million) in the country's largest domestic IPO since 1998 (though the firm had actually hoped to raise 8 billion rand [US\$1 billion] before adverse market conditions forced it to trim its offer size). In any case, the future expansion and deepening of South Africa's domestic equity markets will ultimately depend on sustained local and global economic growth, as well as on the country's success at curbing its steep unemployment rate and current infrastructure/energy bottlenecks.

The IPO market on the JSE has changed in two ways since the global financial crisis, according to Dale Wood, an equity capital markets investment banker at RMB, a leading South African investment bank (owned by FirstRand). First, due in large part to exchange controls a huge amount of domestic capital is now trapped on the market or on the sidelines. Second, international investors are far more cautious about investing in emerging market IPOs than they have been previously. According to Wood, unless domestic investors first demonstrate initial commitment of 60-70 per cent of the equity capital being raised, foreign investors will remain wary of participating in IPOs. Previously, international investors were far greater drivers of initial demand and pricing.

Current exchange controls imposed on domestic investors, as we have already explained above, have helped to ensure liquidity on the JSE in recent years; and were likely a blessing in disguise for South Africa during the onset of the global financial crisis as it limited excessive capital outflows, according to Deloitte Africa's Director Duane Newman. However, these exchange controls are criticised by domestic and foreign institutional investors, who point out that these are no substitute for organic liquidity generated by robust and functioning domestic markets. According to Riza Moosa, Director of Banking and Finance at a leading South African law firm Deney's Reitz, exchange controls have been relaxed slightly since the mid-2000s. The JSE told us it believed that the trend in the medium term is for slightly more relaxed controls on overseas listings for larger South African multinationals. If this is the case, a prime beneficiary is likely to be the LSE; however, the timing of this is less predictable.

5.2. Opportunities for the City of London

5.2.1. Capital raising business

We do not expect London to derive much business from South African firms in the near term, as a result of SARB's continued restriction on foreign listings. However, there may be additional offerings from firms already listed on AIM or the LSE Main Market. For such business, London will face competition from New York: repeat business for firms already listed in New York will not incur many additional regulatory compliance costs under Sarbox since such firms are already adhering to the regulations. London listing rules are not seen as overly burdensome to South African companies. The head of ECM for EMEA at one leading European investment bank told us that "JSE rules are almost identical to London's."

However, South Africa has not yet succeeded in competing with London for other African listings, which makes the LSE the preferred listing choice for firms from other African countries. The JSE's Africa Board, which was designed to attract companies from the continent, suffers from diminished liquidity levels due to SARB regulations that continue to categorise these companies as foreign-listed rather than domestically listed companies. This means that domestic institutional investors can only invest in these stocks using the 20 per cent of total assets that they are generally allotted to invest in foreign stocks rather than the 80 per cent that they can use to invest in domestic stocks under SARB's current exchange controls. Due to this restriction, domestic investors say that they would prefer to invest in alternative offshore stocks rather than in the current two stocks being traded on the Africa Board.

5.2.2. Advisory work

In view of the above-mentioned limitation on South African companies coming to London, better opportunities for new listings exist in the domestic market. This space is occupied by top-tier local investment banks, including RMB and Stanlib, and leading local law firms such as Deneys Reitz and Bowman Gilfillan. Local banks and brokerages are sophisticated and continue to play a dominant role in the market. However, competition is heating up as global investment banks – including BoA Merrill Lynch, JP Morgan, Deutsche Bank and Citibank – all look to gain market share in South Africa as an entry point into the pan-African market. Some already have successful JVs with local firms such as the one between Morgan Stanley and RMB. In September, Standard Bank ended its local brokerage JV with Credit Suisse and announced that it would set up its own international equities-dealing business.

In international markets, global investment banks including JP Morgan, UBS, Morgan Stanley and Goldman Sachs have generally been the preferred advisers on SPOs and rights offerings for existing foreign-listed South African firms, and will likely be so again in the future. As M&A transactions or spin-offs of global firms continue – particularly in the natural resources sectors – more work for these firms is likely to be generated. There could also be opportunities for City advisory firms stemming from international companies listing on the JSE (in 2008, British American Tobacco obtained a secondary listing on the JSE in a transaction sponsored by JP Morgan

and UBS and advised by Herbert Smith among other firms). The Big Four accountancies are all present in South Africa and will also benefit from these opportunities.

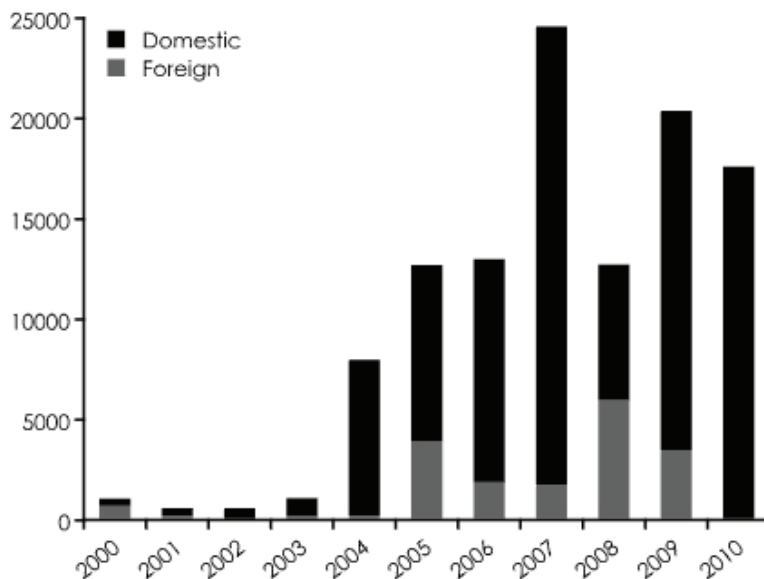
6. India

6.1. Overview of international capital raising trends so far

Although Indian companies can now largely rely on their domestic capital market to fulfil even “jumbo” equity offerings, this was not always the case. The equity issuance market for Indian companies saw rapid growth from 2004 just as India's economic growth rate started to accelerate. Previously, only a handful of Indian firms had tapped overseas capital markets in any size and usually by ADR/GDR issuances in New York and London, typically at around the US\$100-200 million level. These offerings included ADRs listed on the NYSE by Wipro and Satyam in 2000 and HDFC and Dr Reddy's Laboratories in 2001; Infosys listed on NASDAQ in 2003. They tended to be carried out in conjunction with an offering on the BSE and/or the NSE, India's two leading stock exchanges, for the purpose of augmenting the limited amount of funds capable of being raised domestically.

The chart below shows the dramatic increase in overall equity issuance since 2004. This upward trend was temporarily dented during the global crisis in 2008 but resumed again in H2/09.

Chart 6-1: Public equity raised by Indian companies on domestic and foreign markets, 2000-10 year to date (US\$ million)



NOTE: Does not include companies incorporated offshore.
Source: Bloomberg, TS estimates.

Most of the new issues in 2004 were in the domestic market as the government came forward with privatisation offers for energy companies Oil and Natural Gas Corporation (ONGC) (US\$2.3 billion) and, after the election that year, National Thermal Power Corporation (NTPC) (US\$1.1 billion), while Tata Consultancy Services managed a US\$1.2 billion offering. Such large offerings were made possible primarily by the recovery in global investor appetite as memories of the 2000/01 collapse of

the technology bubble faded. In addition, investors were reassured when a Communist-supported coalition led by the Congress Party came to power in May 2004 and signalled broad policy continuity with its right-wing predecessor government; political risk was no longer seen as a major impediment to investment.

This picture started to change in 2005 as the supply of listing candidates increased and was met by growing overseas demand. The most popular mode for Indian firms to raise capital during the first big equity rush of 2005/06 was GDR listings in Luxembourg, owing to the low compliance costs and relatively fast approval process. These were typically small deals in the range of US\$30-100 million issued by mid-cap firms wishing to source quick, cheap capital for domestic operations. But these smaller issues were overshadowed by "jumbo" offerings in 2005 for Infosys (US\$1.1 billion, listed both in Mumbai and on NASDAQ) and ICICI Bank (US\$1.6 billion, listed both in Mumbai and on the NYSE). These companies were joined in 2007 by Sterlite with a US\$2 billion NYSE-listed IPO as well as follow-on offerings from both ICICI and Infosys.

Meanwhile the capacity of the local markets was expanding, and Cairn India raised US\$1.9 billion from a purely domestic IPO in 2006. This was followed by more "jumbo"-sized domestic offerings including large retail tranches for Reliance Power (US\$2.6 billion) and the State Bank of India (US\$4.2 billion) in 2007/08. Subsequently, several state-owned minerals and energy firms made "jumbo" offerings in 2009/10: National Mineral Development Corporation (NMDC) Ltd (US\$2.1 billion), NTPC Ltd (US\$1.8 billion) and National Hydroelectric Power Corporation (NHPC) Ltd (US\$1.2 billion); this trend towards privatisation continues with imminent issuances from ONGC, Indian Oil and Coal India among others. Of the remainder, the bulk of those in the US\$200 million-US\$1 billion range came from banks/financials, infrastructure, energy/power generation and realty. These huge offerings demonstrated that the domestic market, helped by a vibrant retail segment, had come of age.

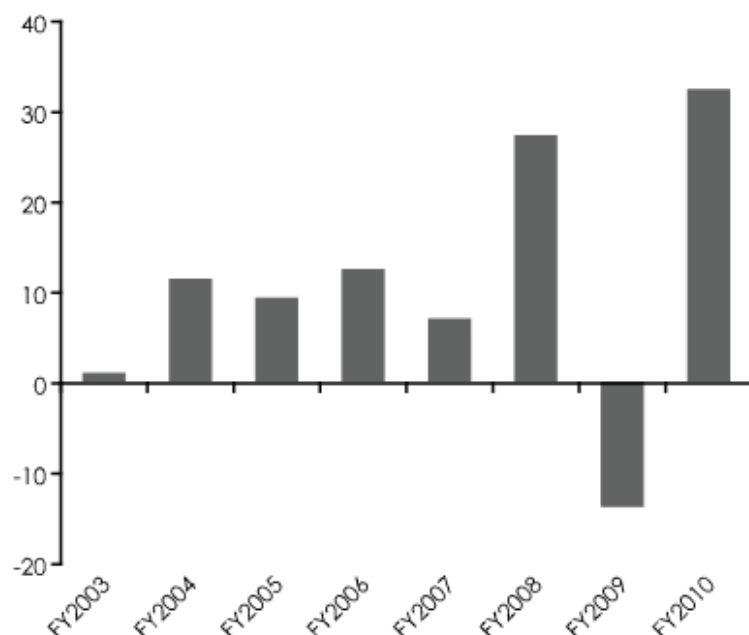
Capital raising efforts in large part relocated to Indian exchanges following the introduction by the Securities and Exchange Board of India (SEBI) of a local qualified institutional placement (QIP) programme in May 2006. This coincided with the gradual easing of the foreign institutional investor (FII) scheme in India and subsequent growth in foreign institutional investors buying and trading shares in the domestic market, thereby enabling Indian firms to tap into a larger pool of institutional capital domestically.

Foreign institutional investors were first allowed access to India's equity markets in 1991 as part of the broader economic liberalisation process. Regulatory sector caps (on percentage of equity owned in a company) restricted FII investment until 2002 when they were lifted in most sectors. FIIs were also allowed into all derivative segments at this point, facilitating a much greater volume of FII trading. This was followed in 2007 by the streamlining of the process for granting FII licences.

By March 2010, there were 1,713 FIIs registered (with 5,378 registered sub-accounts). This expansion helped portfolio flows into India soar from US\$979 million in FY2003 to US\$11.3 billion in FY2004. Except for a dip in FY2009 caused by the global credit crisis,

inflows have stayed strong ever since, hitting a high of US\$32.3 billion in FY2010. Flows remained strong in Q1/FY2011, at US\$4.6 billion.

Chart 6-2: Portfolio flows, FY2003 – FY2010 (US\$ billion)



Source: Reserve Bank of India.

Accordingly the volume of Indian issuances from Luxembourg dropped off sharply in 2007. There were only four listings that year compared to 26 in 2006. A Hong Kong-based hedge fund told us, “Indian GDRs died as more investors got access to the domestic market via FII licences”. Luxembourg has still attracted a handful of Indian firms to list each year since 2006, but these tend to be small issues by mid-cap companies. The exceptions have been larger GDR issues (in the US\$100-400 million range) by Suzlon, Tata Motors and Tata Power. Tata Steel chose to make a US\$500 million GDR issue in London in July 2009 because of the need to raise its profile there following its 2007 acquisition of UK steel company Corus. (One attraction of GDRs for firms concerned about management control is that they can be issued in non-voting form; QIPs always involve the issuance of local voting stock).

The majority of companies now use the QIP route in India. A total of 36 issuers raised Rs255 billion (US\$5.5 billion) in QIPs domestically in FY2008, a figure that plummeted during the credit crisis to just two companies raising a total of Rs2 billion (US\$43 million) in FY2009. This route to raising capital has, however, seen strong growth in FY2010: 62 QIP issues have raised Rs427 billion (US\$9.2 billion).

6.1.1. Where have companies been going?

- **New York has attracted technology, banks and pharmaceuticals.** The August 2010 NASDAQ listing of Makemytrip.com (online travel services) is the latest example of a technology firm sourcing capital in New York. Other examples include Satyam Computer Services (2005, NASDAQ), Rediff.com (2005, NASDAQ) and Infosys Technology (2005/2006, NASDAQ), all of which focus on

software and business process outsourcing. They have been able to tap into the large pools of capital available in the US for investment in the tech sector, and thereby raise their profile among current and potential US clients. As highlighted earlier, two Indian banks (ICICI and HDFC) and a pharmaceutical company (Dr. Reddy's Laboratories) have also listed on the NYSE. Indian banks in particular are attracted to New York by the perception that tighter disclosure norms and greater ADR liquidity will strengthen investor confidence in those firms.

- **London has attracted metals, mining and energy companies.** Back in 2003 the UK-registered holding company of Vedanta Resources raised US\$1 billion in its London offering. A "jumbo" US\$1.9 billion offering for the UK-registered holding company of Essar Energy as well as a modest US\$500 million GDR placement by Tata Steel took place in 2009. Great Eastern Energy, specialising in coal-bed methane, has recently been transferred from AIM to the LSE Main Market. The pattern on AIM is a little different. More than one-third of India-related listings on AIM have come from real estate firms and funds. Other sectors have been clean energy, private equity, media and infrastructure; the most recent listings are in these sectors. Only one Indian-domiciled firm – the Noida Toll Bridge – is presently listed on AIM; most are either funds of companies domiciled in UK tax havens such as the Isle of Man and Guernsey.
- **Singapore is targeting the Indian market.** Singapore has so far not succeeded in attracting a large number of Indian listings. However, an officer of the Singapore Stock Exchange (SGX) announced that it was keen to win Indian business and could offer regional "clusters" in "marine, offshore and energy, real estate investment trusts (REITs) and property trusts, resources and commodities trading". Recent press comment suggests that the much-delayed launch of Indian REITs by DLF and Unitech on the SGX may be back in prospect, potentially the first such issuances since the Ascendas and Indiabulls REITs in 2007 and 2008. If the REITs were launched this would be a major achievement for Singapore. But, as a Hong Kong fund management source told us:

"The Singapore listing of REITs and property companies has been a high-profile disaster. SEBI has not pushed forward a 2008 proposal to facilitate domestic REITs, leaving Singapore as the only outlet for such a vehicle."

Singapore does hold some attraction in the form of geographical proximity to India, cheaper costs and lower taxes than London and New York. Indian firms in real estate, telecoms and financial services could be attracted to a good peer group listed in Singapore. However, most Indian firms remain focused on the advantages of a London or New York listing.

6.2. Outlook for capital raising

We expect several sectors to generate a large proportion of capital raising in the future:

- **Infrastructure.** There is huge demand among energy, construction, power generation and ports sectors for capital. These companies will continue to raise capital to finance their growth plans inside and outside India, both for parent firms and for project-specific entities also known as “special purpose vehicles”. Some of the big issues in the past have come from Adani Enterprises (US\$850 million in July 2010), GMR Infrastructure (US\$1 billion in 2007), Jaypee Infratech, JSW Energy and Videocon.
- **Mining and energy companies.** The successful flotations of Vedanta, Sterlite and Essar Energy may encourage other capital-hungry and acquisitive companies to come to London and NYSE.
- **Banks and other financial services firms.** Banks will need capital to finance their rapid expansion in India's under-penetrated market. ICICI Bank, HDFC Bank and Axis Bank have already raised substantial quantities of capital internationally.
- **Technology, internet and renewable energy companies.** Typically firms in these sectors can obtain better valuations overseas because dedicated investor pools exist in London and New York.
- **Acquisitive multinationals.** Indian multinationals are attracted to foreign listings to raise their profiles among host consumers, suppliers, financiers and investors. However, most have not sought to finance their acquisitions through foreign equity issuances and have relied instead on debt, internal resources and domestic rights issues.
- **REITs.** SEBI has not permitted REITs in India, which leaves a Singapore listing as the only feasible option. Ascendas and Indiabulls listed India-focussed REITs in Singapore in 2007 and 2008. Other property firms are expected to follow suit. These include Fortis Healthcare (with a reported planned deal size of US\$600-700 million), DLF (US\$1.5 billion), Unitech (US\$500 million) and Embassy Property Developments (US\$300-500 million).

6.2.1. The Indian exchanges will dominate new listings

The BSE and NSE in Mumbai will continue to be the primary venues for Indian firms to raise capital and we believe they will take further market share away from international exchanges such as London and New York. According to our sources, the domestic markets can already handle issuances of US\$3-4 billion without the support of dual or follow-on GDR listings in New York or London, as the US\$2.6 billion IPO of Reliance Power in January 2008 illustrated. Market participants are watching the upcoming US\$3-4 billion Coal India IPO to test demand for the largest domestic listing to date. If successful, it will pave the way for more “jumbo” listings that no longer need to be accompanied by a GDR issuance in London or New York.

6.2.2. Will recent government programmes affect this position?

6.2.2.1. Privatisation

In its current second term, the Congress-led coalition has managed to accelerate minority stake sales in state-owned firms, targeting revenues of around US\$8-10 billion per year from issues in the domestic market.

The volume of these issues has the potential to saturate the domestic markets and force some companies to go abroad in search of better valuations. In FY2010, for example, a high-volume stream of overpriced issues by state-owned firms dampened primary market sentiment. Six such issuances accounted for 54 per cent of the total Rs576 billion (US\$12.4 billion) raised on the domestic markets. Aggressive pricing deterred retail investors from subscribing, and state-owned financial institutions such as the Life Insurance Corporation of India and the State Bank of India were forced to step in and support the issuances. The government also missed its revenue targets because it was necessary to hold back further issuances.

The outlook for successful issuances is better in FY2011 because the government appears to have decided to adopt more realistic pricing for its next privatisation round to attract retail investors. The target for the year is Rs400 billion (US\$8.6 billion), and stakes in good-quality firms in energy and minerals are once again up for sale: Coal India, ONGC, Indian Oil, Manganese Ore India and MMTC Ltd. If these issuances prove successful investment bankers expect private firms to get involved and take advantage of primary market momentum.

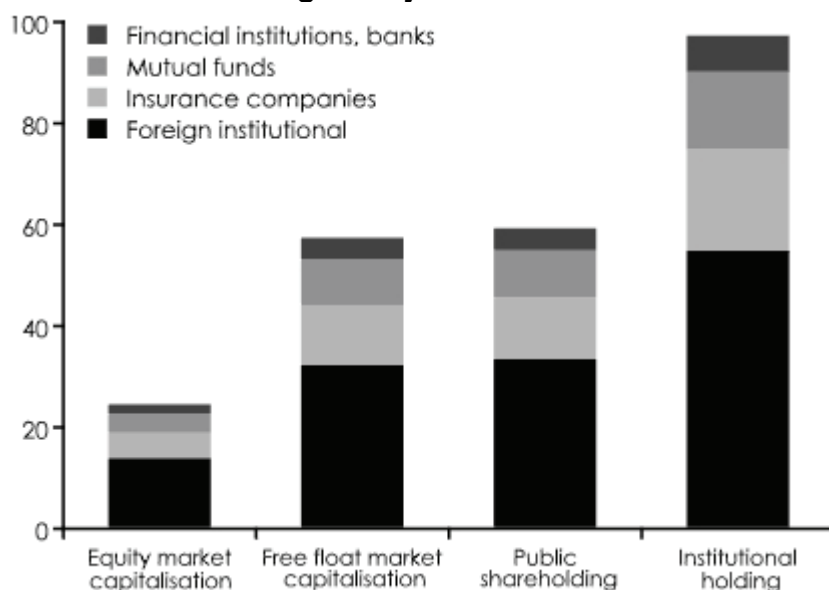
6.2.2.2. The new 25 per cent rule

The government introduced a new rule in June 2010 that required at least 25 per cent of the equity of all listed firms to be made available to the public. Close to 5,000 firms are listed on the BSE, although only about one-third are actively traded. As of March 2010, 41 per cent of the equity of all firms on the NSE was available to the public, but in practice there are many firms in which family ownership groups known as "promoters" hold more than 75 per cent of the equity. Promoters own approximately 49 per cent of the share capital in the market today. The original implementation of this rule would have unleashed a flood of equity into the local market and possibly encouraged some firms to issue shares abroad that would not have done so in the absence of the rule.

The government subsequently relaxed the programme following fears that the domestic market could not handle the supply. State-owned enterprises will now have to dilute only up to 10 per cent of their equity until 2014. This means that whereas under the original requirement a projected Rs1,250 billion (US\$27 billion) was to be issued by 35 state-owned firms, only 15 will now be required to issue Rs200 billion (US\$4.3 billion) of equity. Private companies will still be required to dilute their equity to 25 per cent over the next three years but they will be at liberty to decide both timing and strategy (the original order mandated an annual 5 per cent dilution until the threshold was reached).

The chart below highlights the dominance of international investors compared to domestic institutions.

Chart 6-3: Shareholding of major institutions in BSE-listed companies (per cent)



Source: NSE.

FII have emerged as the biggest market movers in India and currently account for 32 per cent of the free float market capitalisation of the BSE. As the chart above illustrates, they also make up the largest institutional investor base, holding 55 per cent of the total institutional shareholding on the BSE.

FII interest in primary markets remains strong. SEBI data show that in the year to 27 August 2010 FIIs invested a net Rs201 billion (US\$4.3 billion) in primary markets compared with Rs390 billion (US\$8.4 billion) in secondary markets. According to the India Brand Equity Foundation, FIIs invested more in primary markets than in secondary markets in the April-September 2009 period. This is a very substantial commitment of funds to primary markets, demonstrating how foreign investors are increasingly willing to buy equity in local primary markets rather than wait for GDR or ADR issuances.

6.2.3. Where will firms go to carry out international listings?

Despite the likely dominance of the BSE and NSE in attracting future Indian IPOs and SPOs, many Indian firms believe that the benefits from listing abroad outweigh the greater compliance costs and currency risks than are incurred in domestic listings. These benefits fall into the following categories:

Higher valuations (and greater analyst coverage) in specialty stocks. The main international investor bases for several key sectors do not invest directly into India either because of restrictions on EM exposure or because they do not have the research bandwidth to cover local Indian companies. As a result, many Indian firms

will continue to gravitate towards their natural investor base in order to achieve higher valuations. The main trends are:

- **Technology stocks on the NYSE and NASDAQ.** There is a history of Indian outsourcing and technology firms accessing capital on NASDAQ and the NYSE. This trend will continue. The recent IPO of Makemytrip.com on NASDAQ is the latest illustration of this trend.
- **Valuation arbitrage.** Indian stock markets generally offer higher earnings multiples for stocks than international markets. However, in some sectors Indian valuations are lower than global valuations, and there are opportunities to arbitrage this presumed mispricing. For instance, India's largest paper company, Ballarpur Industries, is planning to list its Malaysian subsidiary Sabah Paper Industries in London or Singapore, partly because it hopes that better valuations there will help to improve its Indian stock price.
- **Mining, metals and renewable energy in London.** Indian mining and energy private companies have traditionally listed in London. There is a good possibility that more energy firms will list there, and Indian firms that acquire foreign energy or commodity assets will likely list them separately in London. For instance, it is conceivable that the state-owned Bharat Petroleum will list its Australian shale-gas assets in London or Singapore. An additional incentive for larger firms is to get representation in the FTSE 100 Index, which brings additional prestige and may bring better valuations from buying by index funds. However, there is no evidence that state-owned firms in these sectors will list in London; the recent spate of "jumbo" issuances has been exclusively domestic.

Another sector in which foreign valuations tend to be higher than in India is renewable energy, and a foreign listing in London or elsewhere could make sense for a domestic renewables firm.

Foreign capital for global expansion. Mergers and acquisitions will be the biggest driver favouring foreign listings by Indian companies. Indian firms invested Rs818 billion (US\$17.5 billion) outside India in FY2009 and Rs570 billion (US\$12 billion) in FY2010. This is a long-term process and is likely to gather force over time. The motivation for Indian companies expanding abroad to list in their target markets is to raise their profile and reputation among host consumers, suppliers, financiers and of course investors. A higher local profile can help to increase company sales if consumers gain confidence in the firm. This will also have a positive effect on suppliers. Debt costs will be more manageable if domestic financial institutions reward a higher local profile with better terms. The ability to tap the pool of investors that have traditionally had confidence in the acquired firm, such as British Steel and the Tata-acquired Corus, is useful because it also allows the Indian firm to access foreign currency financing without exposing itself to FX risk if the debt is in the same local currency as the acquired firm.

Our interviews revealed that the sectors considered to have the greatest potential for foreign listings are banks and financial services, automobiles and components,

metals, pharmaceuticals and energy. London has a natural advantage when it comes to metals and energy firms, but firms seeking a foothold in Europe will also gravitate towards a London listing. This dynamic works both ways: Standard Chartered and Cairns have made domestic offerings in India in order to raise their local profile and to tap into the local investor base. Stanchart's IDR was a small percentage of its overall equity, but the Cairns issue was significant (US\$1.9 billion) and involved a productive Indian asset.

London's prestigious premium listing. A full London listing offers access to most global investment groups. A senior banker at a London-based global investment bank told us:

"A London listing allows access to an enormous pool of capital. If you are in the FTSE Index, tracker funds have got to own you and others will follow."

Both Vedanta Resources and Essar Energy are members of the FTSE 100.

London's reputation as a market with high standards of transparency and corporate governance is another draw for Indian companies. Both Vedanta and Essar have faced criticism on corporate governance grounds in India, and a foreign listing is seen as one way to signal to investors that the company does maintain high standards. For example, the marketing of Essar's London listing prominently emphasised how doing so would highlight the company's good corporate governance. At the same time, firms in sectors like infrastructure, mining, energy and property that sometimes face corporate governance issues may perceive that London's governance regime is less onerous than that of the US under Sarbox.

A further advantage of London may be better research coverage. The senior banker quoted above advised,

"There is a global problem in equity research. The secondary equity market alone cannot produce sufficient research coverage. This is a big problem for US-listed firms from the emerging markets where at US\$3 billion you are only a mid-cap. You will be lucky to have a couple of analysts following you."

He pointed out that, at least for the present, companies of this size attract better coverage in London. This research coverage should of course be particularly strong in the mining and energy clusters described above.

Finally, London's track record as a successful and liquid home for companies from Russia, South Africa, Eastern Europe and India offers encouragement to Indian firms considering foreign listings.

6.3. Opportunities for the City of London

6.3.1. Capital raising business

Although the volume of business in the immediate term has been hit by the success of QIPs in domestic Indian markets and the liberalisation of FII access to them,

investment bankers we spoke to said that there is strong interest among Indian firms for a London listing and that several offerings on LSE and AIM are in the pipeline. Although New York remains attractive for banks and technology and outsourcing firms, London will be a draw for Indian multinationals seeking to access European markets, as well as energy, mining and metals companies and, not least, firms that believe that a London listing will help them in strategic or valuation terms.

6.3.2. Advisory work

There is a level playing field in India for financial intermediaries like brokerages, underwriters and merchant banks. Foreign firms are permitted to establish wholly owned subsidiaries that can practise with a SEBI licence. Even state-owned issuances have involved both domestic and foreign-owned firms: book runners and lead managers for Coal India's forthcoming domestic listing are Citi, Deutsche Bank, Morgan Stanley, Enam Financial, Kotak Mahindra and BofA Merrill Lynch. Foreign audit firms such as PwC, Ernst & Young and KPMG are also permitted to offer financial advisory services under the same regulatory umbrella (though their audit functions are more strictly regulated).

Only Indian citizens licensed in India are permitted to practise Indian law. This means that any legal work related to domestic listings must be carried out by local lawyers and partnerships. Indian firms such as Amarchand & Mangaldas & Suresh A. Shroff & Co., AZB & Partners, Dua Associates, Luthra & Luthra, FoxMandal Little and Trilegal will continue to be the main players in the domestic market. However, foreign law firms are permitted to handle external work related to Indian issuances abroad. This has created an opportunity for firms like Linklaters, Freshfields Bruckhaus Deringer, Allen & Overy, Clifford Chance and Jones Day. In practice foreign firms work closely with their Indian counterparts and in many cases have developed longstanding relationships. Larger firms like Linklaters have dozens of Indian lawyers on their staff in locations such as Hong Kong and London.

There are less onerous restrictions on audit-related functions by accounting firms. Global audit firms are not permitted to use their own names while practising in India, and there is a cap of 20 on the number of partners a firm can have and on the number of audits per partner. However, there are no similar restrictions on the Big Four audit firms' advisory functions such as underwriting and consultancy once they have secured SEBI registration.

7. Conclusion

7.1. Continued rapid growth in demand for capital

The impressive growth over the past 10 years in the number of EM firms raising equity capital and the amount of capital raised will continue. Although the 2008 crisis sharply interrupted this trend, we have already witnessed a strong resumption in domestic and international capital raising activities by companies from the larger markets of India and Brazil, including several “jumbo” offerings (NHPC Ltd [India] – 2009, Essar Energy [India] – 2010, VisaNet [Brazil] – 2009, Banco Santander Brasil – 2009). Capital market activity in Russia (which was the most severely affected by the crisis) and South Africa remains subdued. With the exception of two IPOs this year, Mexico's new issue market remains sluggish as it comes out of a deep recession – although, it must be noted, the demand for equity capital by Mexican firms has historically lagged that of other EMs.

Robust economic growth in Brazil, India and Russia over the next few years will propel demand for investment capital from local companies attempting to ramp up domestic operations and expand into new markets. This demand will be intensified by other drivers, including the high levels of investment capital needed for infrastructure development (Brazil and India), the privatisation of state-owned enterprises (Russia and India), the rapid expansion of consumer sectors (Brazil and Russia) and foreign M&A (India).

Capital raising in South Africa and Mexico, in contrast, faces constraints on growth. In particular Mexico's corporate environment, dominated by family-run companies, has a culture of preferring debt financing over equity.

7.2. India, Brazil and South Africa: Demand will be met in large part by domestic markets, unless there are compelling reasons to go abroad

Brazil and India's equity markets are now large and liquid following financial market reforms and rapid growth since 2003. They can and do handle the majority of new offerings by local firms without the support of dual or ADR/GDR listings in New York or London, as had been necessary in the late 1990s and early 2000s. At the top end of the scale, the Reliance Power IPO (US\$2.6 billion in 2008) highlighted the capacity of the Indian market. The upcoming US\$3-4 billion Coal India IPO will be a good test of post-crisis capacity. Brazil's Novo Mercado has shown it can handle even larger amounts, with the Banco do Brasil IPO (US\$5.4 billion in 2010) and the VisaNet IPO (US\$4.2 billion in 2009) being completed without accompanying US listings.

The super-“jumbo” Petrobras global offering, in spite of its ADR listing on the NYSE, challenged the local market due to its sheer size. It has drained liquidity from the system and will likely prevent many smaller offerings by mid-cap firms from taking place for several months.

The depth and liquidity of the BOVESPA and BSE/NSE in India mean that Indian and Brazilian firms will carry out offerings domestically unless there are compelling reasons

to go abroad. The most important of these is the goal of accessing a wider pool of investors, who increase demand and thus the pricing tension for large offerings while also providing greater institutional support in the after-market. “jumbo” offerings of more than US\$3-5 billion in these markets are not the only operations to benefit from twin-track issuance. Some specialty stocks benefit from deep knowledge of their sector in certain international centres. Access for large firms to major global indices, such as the FTSE 100 Index, has been another important driver of going abroad, as have raising foreign capital for global expansion and building profile and reputation among host consumers, particularly for Indian firms. Vedanta Resources, Essar Energy and Tata Steel have all followed this path.

Nearly all new offerings in South Africa will be carried out on the JSE, but for different reasons than in India and Brazil. Government controls prevent all but a handful of companies from going abroad and are unlikely to be relaxed in the near term.

7.3. Russia and Mexico: High dependence on international markets to continue

Russia's domestic market has limited capacity and an undeveloped institutional investor base, neither of which is likely to improve materially in the near term. Companies that want to raise more than US\$100 million will generally need support from London, usually dual-listed in the form of a GDR issuance in conjunction with a primary listing domestically. One of the fund managers we interviewed in London said that “the market for Russian shares is stuck here”. One factor supporting this is the strong presence of FSA-registered Russian investment banks and brokers in London. A second factor is the close working relationship between the London and Moscow exchanges. Finally the strong weighting of energy stocks in the Russian market requires the support of international funds, some of which are not prepared to invest in the local market. While the Russian authorities would like to bring the Russian capital market back onshore, and some measures they are taking underscore this goal, fundamentally they understand that neither the Russian institutional fabric nor the mass of Western investors are ready for this. Financial deepening needs to continue for many more years and confidence needs to be built in the operating infrastructure of the domestic market.

The capacity of Mexico's market is also constrained, though the recent US\$371 million IPO of Grupo Comercial Chedraui showed what strides have been made in developing the BMV. Large offerings by Mexican firms will continue to need the support of a foreign ADR/GDR listing. Historically the problem has not been restricted to the lack of domestic institutional equity funds but more importantly to a weak equity culture leading to a lack of supply. As we expect little change to this supply problem in the near term, few such deals will take place in the next few years.

7.4. Which international capital markets will attract EM firms?

The growth in demand for capital from the five countries under study, and indeed from most emerging markets, has been met by a great increase in demand from developed market investors. It is important to note that India and Brazil can execute their active IPO and follow-on offering pipelines, including offerings in excess of US\$2

billion in size, partly because of the substantial increase in recent years of foreign investors who are ready to deal and settle locally in these domestic markets. Foreign investors now own as much as 30 per cent of the total free-float market capitalisations of the Brazilian and Indian markets by some measures. For the growing pool of emerging market specialist fund managers, a decision as to whether to invest in the local market or to buy a GDR or ADR can be a minor one. Indeed, they may buy one instrument and then swap it for the other if there are tax or other benefits of so doing.

7.4.1. London and New York will keep the lead for now

However, for those companies that wish to tap a broader base of international investors than those investing in their domestic market, London and New York remain the main international capital centres of choice and dominate the market for new equity issuances. Although the Rusal IPO suggested Hong Kong may become a rival for Russian or Indian issues, we believe it is not yet a credible option for any but the most China-facing offerings. Similarly, despite its aggressive pitching for EM business, NYSE-Euronext has a steep hill to climb to compete with the LSE for Russian listings.

7.4.2. Critical mass matters: Regional track record is a driving factor in listing choice

There remains a strong geographical element to choice of listing location: EM companies tend to go to the international centre where there is the strongest presence of their compatriots. This is usually because earlier listings have led to the development of a base of investors focused on their region as well as financial, legal, accounting and tax professionals with expertise in offerings and other corporate finance/M&A transactions emanating from that region. Our research has shown very clearly that Russia will continue to depend on London and Mexico on New York. And the more Russian companies that come to London, the greater will be the peer group against which each new entrant can be assessed. Although a number of blue chip firms from India and South Africa are listed on the NYSE and NASDAQ, the South African authorities actively impede such listings nowadays. We expect Indian firms will continue to be open-minded about tapping international markets but will likely need or want to do so only under very specific circumstances.

7.4.3. But Sarbanes-Oxley and listing flexibility still give London a strong advantage for IPOs; and FTSE index membership is a powerful draw

According to our investment banking sources, the Sarbox burden of governance compliance has reduced the number of IPOs that are carried out in the US from the EMs under study. Unless the Act is amended – or alternatively if the UK's regulatory framework becomes as onerous as that in the US – this situation is likely to continue. There are signs that Sarbox may have been relaxed for smaller companies. According to one of our interviewees, the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was brought into force in the US in July 2010,

includes some exceptions or small corporations that exempt them from some of the Sarbox provisions.

In discussions about Russian, Indian and South African firms with equity capital markets bankers in London, a clear consensus was expressed that for now New York is not a strong competitor to London because of Sarbox except in the technology/internet and business process outsourcing sectors. The situation is slightly different for Brazilian and Mexican firms. Many of their blue chip stocks are already listed in New York and therefore are already in compliance with Sarbox requirements, so it will be easy for them to make follow-on offerings. But the situation is different for Brazilian IPOs: an equity capital markets banker based in New York told us that Sarbox has made Brazilians think twice as to whether they really needed to go outside the domestic market.

London, on the other hand, offers flexibility in listing status. There are at least five ways that a foreign company may list on the LSE, including: creating a UK holding company; gaining a "premium" listing and joining the FTSE Index; a GDR listing on the Main Market or the Professional Securities Market; and an AIM listing.

A further advantage for London over New York, discussed further below in the context of Indian companies, is the ability of foreign companies to obtain a FTSE 100 listing if they meet the tight criteria set by the FTSE Group involving size, compliance with the Combined Code, and lack of a controlling shareholder. Kazakh, Indian and Mexican companies have achieved this goal by creating a UK holding company for their group. However, creating a UK holding company presents considerable tax obstacles, in particular for Russian companies.

7.4.4. Sectoral expertise sometimes drives listing choice

The international centres have built up sectoral expertise "clusters" over the years and this often drives choice of primary or secondary listing venue. For example:

- **London's mining cluster:** Chilean copper miner Antofagasta was listed on the LSE in 1888. South African gold mining shares have been listed on the LSE for decades. Rio Tinto, BHP, Xstrata and Anglo American are global mining industry giants all included in the FTSE 100. They have now been joined in that Index by ENRC and Kazakhmys from Kazakhstan, Fresnillo from Mexico and Vedanta from India. Hochschild Mining from Chile has joined the FTSE 250 Index. The investment banks and fund management houses (with their sector specialist funds for mining and energy) have a deep understanding of the mining industry and a high level of expertise in valuation. Our sources pointed out that mining firms tend to receive premium valuations in London. London-based accounting, consulting and legal firms also employ professionals with a solid understanding of the industry. Furthermore, the mining world's foremost lobbying group, the ICMM, is London-based as are the London Bullion Market Association and the London Metals Exchange, the world's top non-ferrous metals exchange.

- **London's energy cluster:** London plays host not only to BP and Shell but also to a number of energy and power companies on AIM. Cairn Energy and Tullow Oil have been joined by secondary listings from Lukoil and Rosneft from Russia and most recently by Essar Energy from India. However, New York clearly is a competitor in this sector, hosting Petrobras and Cosan (an ethanol producer) from Brazil. London was a pioneer in the privatisation of the power sector and should be able to play to this strength given the demands for power infrastructure in the emerging world.
- **NASDAQ and NYSE telecoms and technology clusters:** New York dominates capital raising business by telecoms firms. Two Russian mobile leaders are listed in New York (VimpelCom and Mobile TeleSystems) as well as Brasil Telecom and two Mexican giants (Telefonos de Mexico and America Movil). In software, business process outsourcing and e-commerce New York and NASDAQ have attracted Wipro and Infosys from India, key players in the field.
- **NYSE's banking cluster:** The NYSE has attracted ICICI Bank and HDFC from India and Itau Unibanco, Banco Bradesco and Santander Brasil from Brazil, among others. For Latin American banks this is mainly because offerings by banks are extremely large, thus requiring support from international investors based in New York. For Indian firms, the reason is more to do with prestige and the perception that tighter disclosure norms and greater ADR liquidity will strengthen investor confidence in those firms.

Other exchanges are attempting to build "expertise clusters" in order to dominate financing for businesses with certain characteristics. Hong Kong's investor base will naturally look at China-focused businesses; Singapore is trying to build a presence in real estate; and finally Toronto is a centre for small-cap mining stocks and a strong competitor to AIM in this respect. One of our sources thought that London had the potential to build a cluster in agribusiness, given the similarities between the risk profile of that sector and mining, in which London already has expertise.

From a company's point of view, listing in a knowledge cluster, surrounded by one's peers, may be beneficial from a valuation perspective, but an even bigger benefit is the presence of a more solid and experienced after-market that can potentially be tapped for more capital in the future

7.5. Opportunities for the City of London

7.5.1. Large-cap Russian firms

Of the EMs under study Russia will continue to generate the most business for London because the state of its domestic markets means that Russian companies go abroad for their financing more frequently. A large percentage of daily trading in Russian blue chips takes place in the GDR market. London will continue to attract this business as it offers a natural investor base and a tried-and-tested listing procedure for Russian firms. With the government resuming its privatisation programme in earnest in 2011, we expect London to see a wave of new GDR issuances on the

Main Market of the LSE – one of the first being the Freight-2 subsidiary of Russian Railways in 2011.

However, as highlighted above, index inclusion at home (MSCI Russia) is becoming increasingly important due to the number of funds that track the index. For example, X5 – the Netherlands-domiciled Russian retailer listed in London – has been excluded from the MSCI Russia Index. Most Russian companies coming to London will therefore wish to be dual-listed.

The majority of smaller offerings, particularly of domestically focused firms, will remain in the Russian market. One exception to this will be smaller E&P and mining firms, which are most likely to list on AIM or the TSX.

7.5.2. India's emerging multinationals

We understand that a number of large Indian firms are looking at a London listing with close interest now that they have observed the ability of both Essar and Vedanta to achieve a premium listing on the London Main Market and even to get a coveted place in the FTSE 100. In addition to the mining and energy sectors, London may find opportunities in financing the power sector, including renewable energy (where it may offer higher valuations), as well as other segments of the infrastructure build-out (ports, airports and roads), as City expertise in these areas is rapidly developing.

It is easy to explain why Indian companies will come to London. Prestige is important, as is access to the FTSE 100 and the possibility of lower debt funding costs as a result of a London listing. An important driver will be the strategic opportunity to raise foreign capital for global expansion, to be represented as a local firm in Europe and to obtain a well-valued and supported acquisition currency (a motive in the Tata and Essar issuances). With Indian outward direct investment likely to continue increasing from its US\$12 billion 2010 year-to-date figure, demand for acquisition capital will mirror this growth, presenting London with more opportunities to attract listing candidates.

7.5.3. Mining and metals companies in Latin America

Although there is not yet a strong trend for Latin American mining firms to raise capital in London, there are successful precedents from the Hochschild Mining and Fresnillo IPOs. The prevalence of large-cap mining firms from other EMs on the LSE, as well as potential access to the FTSE Indices, can only improve London's attraction to Latin American mining companies. London will, however, have to fight against the natural bias of these firms towards New York – though this only applies to large-cap issuances as mid-cap mining and metals firms are increasingly favouring Toronto (as we discuss below).

7.6. Challenges for the City of London

7.6.1. Fast-growing EM domestic capital markets

The gradual deepening and increased sophistication of EM domestic capital markets are the biggest long-term threat to London's EM listing business. Greater numbers of firms can source capital domestically and, owing to regulatory improvements, no longer have to accept a local discount for poor transparency, questionable governance or liquidity. In future the development of local markets will continue as local institutional bases grow (particularly in Brazil and India) and as the volumes of portfolio inflows swell. Although the global crisis disrupted the upward trend of portfolio inflows into EMs, net inflows have returned. As EMs continue their robust growth – in direct contrast to the economies of Europe, the US and Japan – we expect a gradual but nonetheless enormous migration of investment capital to emerging economies over the medium to long term as investors follow the growth.

It is not just London's EM capital raising business that is challenged by domestic markets: several EMs, including India, Brazil and Russia, have launched local depository receipt programmes to attract foreign companies with a local presence. Recently the BOVESPA authorised the Brazilian units of Deutsche Bank and Citibank to sell Brazilian Depository Receipts (BDRs), and in May 2010 Standard Chartered raised US\$530 million by launching the first-ever Indian Depository Receipt offer.

Finally, the development of domestic markets is also a challenge to London's investment banking and broking businesses. Large new players from the BRICs in particular are playing a more prominent role in global business. VTB Capital of Russia and BTG Pactual of Brazil stand out as stating publicly that they have international ambitions. Industrial and Commercial Bank of China has been named as a lead manager of the Petrobras super-"jumbo" offering. Others will follow in their wake. As this trend develops further, City firms will face increased competition to secure advisory and new issue work.

7.6.2. Other regional centres

New York will continue to be London's main competitor. Despite the development of large pools of capital in Asia, we do not expect any major competitors for non-Asian EM listing and capital raising business to appear in the short to medium term. The simple fact is that institutional money run out of Asia tends to have its mandate limited to investment in Asian securities. Some Asian retail money will be attracted to foreign luxury stocks with a brand presence in Asia, as evidenced by the success of the HK\$5.5 billion IPO of the French skincare and personal care retail chain L'Occitane International that is making inroads into Asia in April 2010. This will likely also be true of mining stocks with a strong Asian focus (like Rusal) but this will be limited in size. Hong Kong, however, should nonetheless be watched given its active marketing push into EMs, particularly Russia.

Toronto has built up a strong reputation as a hub for small-cap mining firms and will dominate these smaller listings in future, according to several of our sources. In 2009 alone, more than C\$19.4 billion (US\$17 billion) of equity finance was raised by 395 mining companies on the TSX, compared to around only US\$1.4 billion by 13 new

issues on AIM, according to the TSX. In addition, the TSX Venture Exchange has more mining companies listed on it than any other exchange, although it typically attracts only very small deals. There is a strong presence of mining firms from all countries under study. London will remain the favourite venue for large mining firms and, as a result, will see more equity raising by value (though not number) in future. However, Toronto is expected to take much of the business for small mining stocks that AIM has historically been targeting.

7.6.3. Regulation and tax

In the aftermath of the 2008 global crisis there is a real risk of new regulations weakening the UK's flexibility in capital raising compared to the US. We were warned in one interview that the progress of a July 2010 financial services consultation paper – CM7874 – should be watched in this regard. A similar risk to flexible structuring lies in possible changes to the overall tax regime by the new government.

List of Abbreviations

General

ADR	American Depositary Receipt
C\$	Canadian dollar
ECM	Equity capital markets
EM	Emerging market
EMEA	Europe, the Middle East and Africa
E&P	Exploration and production
ETF	Exchange-traded funds
FDI	Foreign direct investment
FII	Foreign institutional investor
FSU	Former Soviet Union
FX	Foreign exchange
GBP	Pound sterling
GDP	Gross Domestic Product
GDR	Global Depositary Receipt
H2	Second half of year
HK\$	Hong Kong dollar
IPO	Initial public offering
JV	Joint venture
M&A	Mergers and acquisitions
MOU	Memorandum of understanding
MX	Mexican Peso
PE	Private equity
R\$	Brazilian Real
REIT	Real estate investment trusts
Rs	Indian rupee
QIP	Qualified institutional placement
RDR	Russian Depositary Receipt
SPO	Secondary public offering
US\$	US dollar
VC	Venture capital

Capital markets

AIM	Alternative Investment Market
BMV	Bolsa Mexicana de Valores
BSE	Bombay Stock Exchange
HKEx	Hong Kong Exchanges and Clearing
JSE	Johannesburg Stock Exchange
LSE	London Stock Exchange
MICEX	Moscow Interbank Currency Exchange
NSE	National Stock Exchange of India
NYSE	New York Stock Exchange
RTS	Russian Trading System
SGX	Singapore Stock Exchange

TSX Toronto Stock Exchange

Government authorities

FSA Financial Services Authority (UK)
FSFM Federal Service for the Financial Markets (Russia)
SARB South African Reserve Bank
SEBI Securities and Exchange Board of India
SEC US Securities and Exchange Commission
UKLA UK Listing Authority

Legislation/ agreements

NAFTA North American Free Trade Agreement
Sarbox Sarbanes-Oxley Act, 2002

