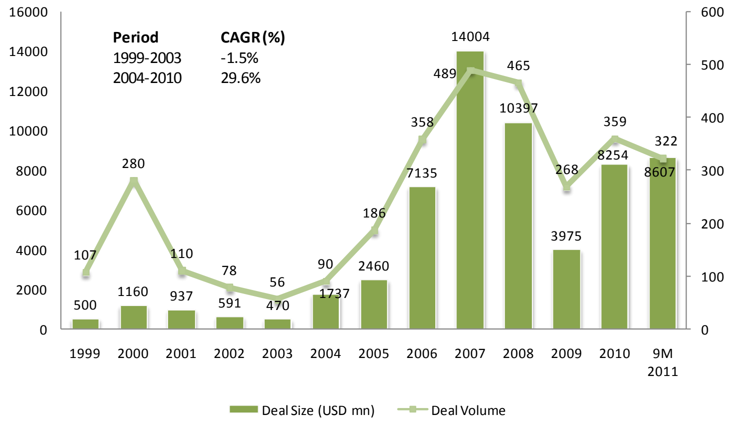
2011: private equity in India – a perspective

In the first nine months of CY11, private equity (PE) investments at US$8.6 billion have already surpassed the US$8.2 billion recorded for the whole of CY10. In CY07, India received US$14 billion from PE investors across 489 transactions, and, in CY08, PE investors completed 465 transactions and invested US$10.4 billion. PE investments decelerated to US$3.9 billion in CY09 largely due to the global sub-prime crisis and its aftermath.. Over the past three years, the average deal value fell from a high of US$28 million per transaction in CY07 to US$14 million per transaction in CY09 only to recover to US$26 million in CY10 reflecting the risk appetite of investors. In terms of deal value, India ranks sixth after the US, the UK, Spain, France and China.

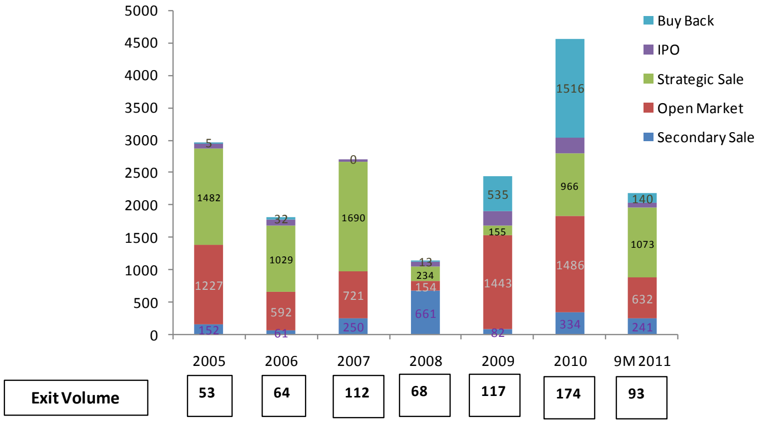
private equity investments in India



CY09 and CY10 were years of exit for PE investors in India. Private equity investors made 117 exits in CY09 and 174 exits in CY10 worth US$2.4 billion and US$4.5 billion respectively. In comparison, PE exits in CY11 have been less encouraging due to volatility in the domestic capital markets and other economic challenges like high interest rates and inflation and a slowing GDP growth. Exit value for CY11 (up to September 2011) was less than half of the exit value witnessed in CY10.

As per a recent KPMG report, private equity in India returned a gross IRR of 17.9%, which is slightly above 14.4% investors would have earned if they had made the same investments in the Sensex. Net of manager fees and other costs, the IRR earned by limited partners (LPs) fell below the 14.4% return for the Sensex. This return is well below the benchmark of 25% gross IRR targeted by most LPs and funds.

private equity exit volume and value



Big ticket PE exits in CY11

Exit	PE Investor(s)	Acquirer	Deal Size (US$ millions)
Paras Pharma	Actis, Sequoia	Reckitt Benckiser	726
Intelenet Global Services	Blackstone	Serco	630
SKS Mircofinance	Sequoia & Others	IPO	354
Intelligroup	SAIF Partners	NTT Data	199
Aamby Valley	Siva Ventures	Buyback	323
Kotak Mahindra Bank	Warburg Pincus	Open Market	171
Honda Motors	Bain Capital, GIC	Hero Group	~ 1,000

Key developments of CY11 in the domestic private equity industry

Internet and e-commerce make a strong comeback: The NASDAQ listing of the travel site *MakeMyTrip.com* spurred the interest of PE investors, and, in 2011, a number of early and growth capital investors made significant investments in internet and e-commerce businesses in India. In addition to online travel portals, CY11 saw the emergence of various e-commerce business models, such as group buying, fashion, shoes, baby products, classifieds, auto sales and luxury brands. We believe valuations continue to be aggressive for India internet plays; however, this time valuations are based on revenue and profitability rather on eye balls or hits or clicks. Until 30 September 2011, technology companies received US$619 million from PE/VC funds through 70 deals. We believe in 2012, the e-commerce industry will see some shakeout and could lead to consolidation, especially in group buying portals.

The food & beverage industry attracts special attention: CY09 and CY10 were the years when the agriculture sector received special attention from PE investors. In 2011, PE investors made significant investments in the domestic F&B industry. Devyani International (which operates *KFC, Pizza Hut* and *Costa Coffee* chains in various parts of India), *Sagar Ratna* (restaurant chain in North India that serves South Indian cuisine) and *Prakash Snacks* (a maker of potato chips) received sizeable growth capital from well-known PE funds. These investments indicate players in the F&B industry are achieving scale rapidly and are benefiting from high disposable income of the growing Indian consumer. *In CY12, watch out for companies that target the F&B exports market, selling ready-to-cook ethnic and global foods.*

More global food brands to enter India: Over the past few years, we have witnessed a gradual influx of a large number of coffee chains and a few global quick service restaurants (QSR) chains (*Dominos, McDonalds, KFC*). We believe the Indian palate is now getting more global and will welcome more global food brands. However, these global food brands will have to adapt to Indian tastes, and, at the same time, face competition from domestic QSR formats, which have emerged in CY11.

Private investing vs public markets: Four founding partners of Sequoia Capital in India quit to restart their investment firm Westbridge Capital, but this time with a focus on investing only in publicly listed companies. This has triggered an interesting and relevant debate on the challenges faced by private equity firms focused on making investments in private markets. Private markets have some level of opacity and the space is crowded, with a large number of firms chasing too few deals. With 6,000 small- and mid-cap listed companies, we believe that the listed market presents interesting opportunities to PE investors

PE managers continue to go solo: Domestic PE managers continue to leave their jobs and jump on to the entrepreneurial bandwagon by starting their own funds. Some managers were able to successfully close their first funds and also make their first investments. We believe this trend is encouraging for long-term growth of the India PE industry.

PIPE deals remain sluggish: Over the past few years, PIPE deals have been an integral part of the overall PE space. The annual PIPE deal activity has varied from 10% to about 25% of annual deals during 2006-11. Currently, there are multiple factors that make a strong case for PE, even for listed entities, as an alternative source of growth capital compared to traditional means of fund-raising, particularly public markets and availability of bank finance. However, due to lackluster public markets, PIPE deals remain sluggish.

Mezzanine and debt financing: Considering risk-weighted returns, global PE players realized the need to offer mezzanine/debt instruments to domestic infrastructure and real estate companies, and, in 2011, this led to the emergence on PE-backed NBFCs, such as Indostar (Not Rated) and Magma Financials (Not Rated). We believe that is a positive step as it will help bridge the funding gap for companies that prefer to raise capital via quasi-debt instruments, and will help in the development of the corporate debt market in India.

CY12 could be year of secondary PE transactions: With a volatile stock market (due to persistent global uncertainties) and the drying up of primary markets, we could see the emergence of secondary PE transactions. About US$31 billion was invested by PE funds in India from CY06-08. Assuming a five-year holding period and an IRR expectation of 25%, nearly US$91 billion of exit value has to be realized over the next three years. The total exit value realised during CY09-11 (until Sep 2011) was only US$9.1 billion.

Some developments of CY11 that will shape the investing climate in CY12 are as follows:

- Anti-corruption movement
- Robust growth in internet usage and rapid adoption of e-commerce
- India's debut in the *Grand Prix* and introduction of other sporting franchisees such as *World Series Boxing* and *World Series Hockey*
- Rapid adoption of tablets in India
- *Twitter* and *Facebook* as a household phenomenon
- Intensified competition in the small car market

- Bottoming out of the mobile telephony call rates