

# AVCJ Private Equity and Venture Capital Report **INDIA 2010**



## OVERVIEW – A steep learning curve

Over the past year in India, fundraising was down, investments were down, IPOs were nearly non-existent and panic levels were up. 2009 was a sobering year for private equity investors and fund managers in India, but not necessarily for the reasons that the rest of the world experienced.

2006 and 2007 saw a rash of new entrants, many unprepared for the realities of the Indian market.

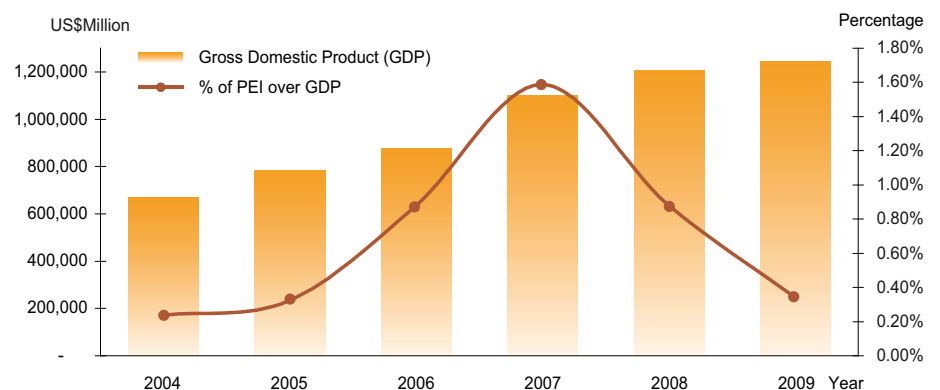
India has a decidedly positive GDP growth projection of 5.4% in 2009.

After the height of the ‘fools rush in’ seen in 2006 and 2007, the past 18 months have highlighted the unique dynamics of the Indian market and the need for considerable time, effort and research – not just turning up ready to play ball. Touting a big, foreign name and bringing in a billion dollars does not necessarily translate into success, as many have learned the hard way. But even those with extensive networks, proprietary deal flows and the good sense not to enter into hastily arranged deals had a tough time of it.

As the rest of the world witnessed crumbling economies and worried about ever breaking even again, India’s economy chugged on, driven by organic, domestic consumption and growth. The IMF projects a 4% growth rate for 2009, down from 7.3% in 2008 but certainly much higher than the decidedly negative numbers forecasted for advanced economies around the globe.

In the second half of the year, the public markets took off, and promoters turned to higher valuations – not necessarily higher value-add – for capital raising. As a result, far fewer deals were done. In 2008 \$10.6 billion was invested in India; this year, that number dropped to just over \$4 billion. As a percentage of private equity investment growth over GDP, last year’s 0.87% was already a departure from the 2007 high of 1.58%. This year, however, saw an even more dramatic slump to 0.33%.

FIG 1.1  
INDIA - GROSS DOMESTIC  
PRODUCT VS. PRIVATE EQUITY  
INVESTMENT



\* GDP data refers to fiscal year (April 1-March 31) and Private Equity Investment data refers to year-ended on December 31

Source: International Monetary Fund  
AVCJ Research

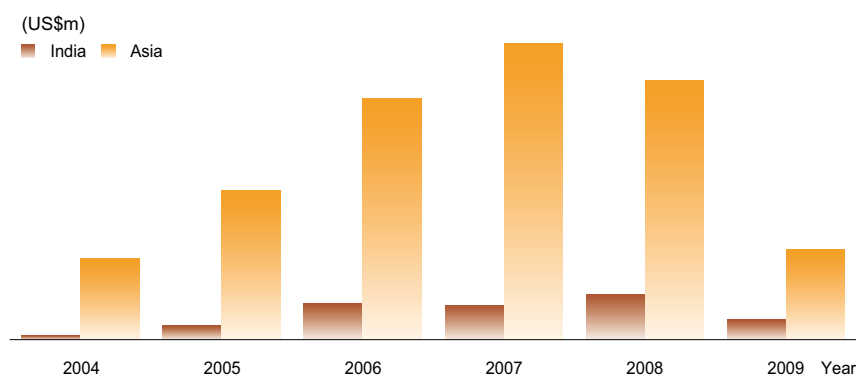
Likewise, foreign direct investment hit a plateau after three years of considerable growth. Unsurprisingly, with a significantly lower number of investments made in 2009,

## FUNDRAISING – Down, but not out

Fundraising was lower in 2009, but appetite still exists.

With a global economic crisis on, capital markets trumping private equity as the preferred method of capital raising, and a considerable amount of dry powder sitting around unable to be deployed, fundraising in India fell dramatically in 2009. Having hit a six-year peak of \$8.8 billion in 2008, fundraising dropped off by 60% and only around \$3.5 billion was raised. India fared better than Asia as a whole however, with the region seeing a 66% slump year-on-year from \$51 billion raised in 2008 to \$17.3 billion in 2009.

FIG 2.1  
TOTAL FUNDS RAISED  
(2004 - 2009)



Last year, Gulpreet Kohli, managing director at Chris Capital, predicted that many first time funds that went to market in 2007 and 2008 would not be able to raise more for follow-on chapters. This indeed turned out to be true. What became clear this year was that new firms were only too eager to join the India gravy train. Some of the resulting disasters and sobering lessons have left a bad impression on the market as a whole, and particularly on LPs who are more discerning in their approach to Indian firms.

LPs are raising the bar for GP expectations.

LPs have been very open and blunt about what they want out of GPs here. Chihsung Lam, Managing Director of Axiom Asia Private Capital explained, "India is a more complex market than others, so one's ability to create value-add – real value-add – is for us one of the determining factors."

### TOTAL PRIVATE EQUITY FUNDS RAISED

(US\$ million)	2004	2005	2006	2007	2008	2009	% Change 2008-2009
India	XXX	XXX	XXX	XXX	XXX	XXX	XXX
Asia	XXX	XXX	XXX	XXX	XXX	XXX	XXX
% India over Asia	XXX	XXX	XXX	XXX	XXX	XXX	XXX

\*Excluding real estate & global funds  
Source: AVCJ Research

# INVESTMENT CLIMATE – Private equity vs public markets

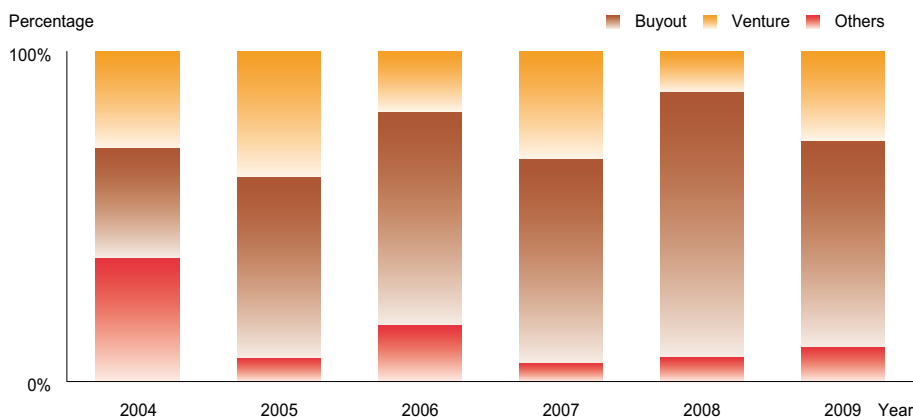
Public markets drove up valuations, slowing investment activity.

Private equity is competing with all types of capital.

Investment in India dropped off nearly 61% in 2009 to \$4.2 billion, a slump attributable not so much to the global economic downturn per se, but to the strength of the public markets, which were hotter than hot in the second half of 2009, attracting promoters in search of capital at valuations far higher than private equity firms were willing to pay.

As Sandeep Naik, Co-Head of Apax Partners India Advisers Pvt Ltd explained, “Right now, our competitors are other forms of capital, like sovereign wealth funds, QIPs, PIPEs, banks and even other so-called ‘alternative investors.’”

**FIG 4.1**  
**INDIA - PRIVATE EQUITY INVESTMENT SPLIT BY STAGE**



Source: AVCJ Research

Whilst views vary on the sustainability of this trend, there is no doubt that the flexibility of options inherent to QIPs and PIPEs make them attractive to promoters looking for quick, dumb capital, without all the legal contracts. But Rajeev Gupta, Managing Director & CEO, WL Ross India articulated it well in the headline: “This is just a sign of the times.”

2010 may see a correction in promoters’ desire just for money.

Mahesh Chhabria, partner at Fund 3i India Pvt. Ltd noted that coming to the end of the year, “there is an increasing appreciation by promoters after the downturn – after last year – that they may not be able to get as much as they think.”

## TOTAL PRIVATE EQUITY INVESTMENTS MADE

(US\$ million)	2004	2005	2006	2007	2008	2009	% Change 2008-2009
India	XXX	XXX	XXX	XXX	XXX	XXX	XXX
Asia	XXX	XXX	XXX	XXX	XXX	XXX	XXX
% India over Asia	XXX	XXX	XXX	XXX	XXX	XXX	XXX

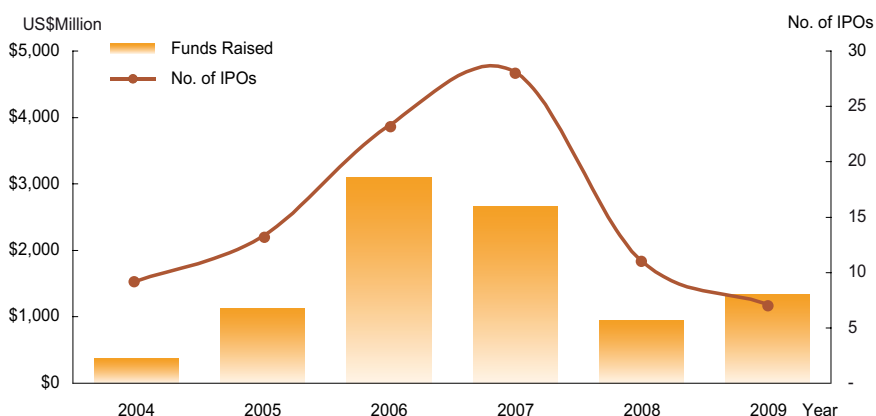
Source: AVCJ Research

# EXIT ENVIRONMENT – At a standstill

Managing companies through the downturn took top priority.

With the equities markets in the toilet at the start of the year, fund managers spent more time managing their portfolio companies than preparing for IPOs. Even into the second quarter, recovery of the Sensex remained choppy. And, with few investors looking to shell out cash for investments, trade sales were nowhere near 2008 values.

**FIG 5.1**  
**INDIA - PRIVATE EQUITY-BACKED IPOs**

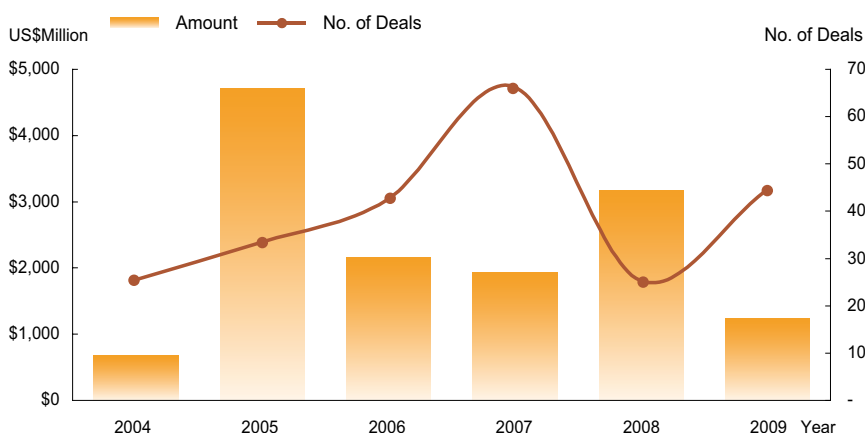


Source: AVCJ Research

The mentality of the Indian entrepreneur can make sales difficult.

Adding to the pressure, sales are sometimes difficult as a general rule simply because Indian entrepreneurs desperately believe in their companies and don't want to let them go. Munesh Khanna, Managing Director, Investment Banking, Centrum Capital Limited, "Selling is a very emotional decision for them. They usually fall into two categories: one is that they believe in the company and so they don't understand why they should go public and sell part of this dear business; the other is, 'Okay, I want to sell it, but what will I do then?' which can really stall the process."

**FIG 5.2**  
**INDIA - TRADE SALE EXITS IN PRIVATE EQUITY**



Source: AVCJ Research