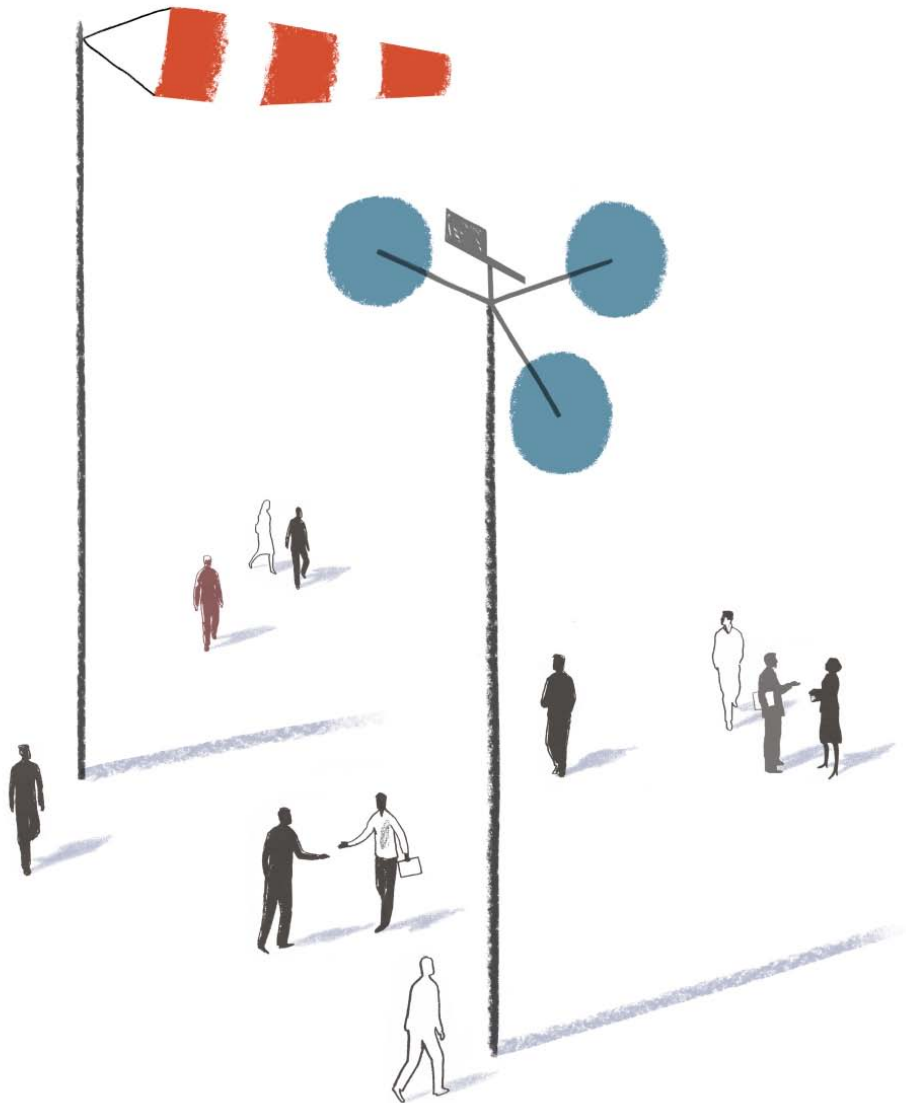


The Fourth Wheel

Private Equity in the Indian Corporate Landscape

June 2011



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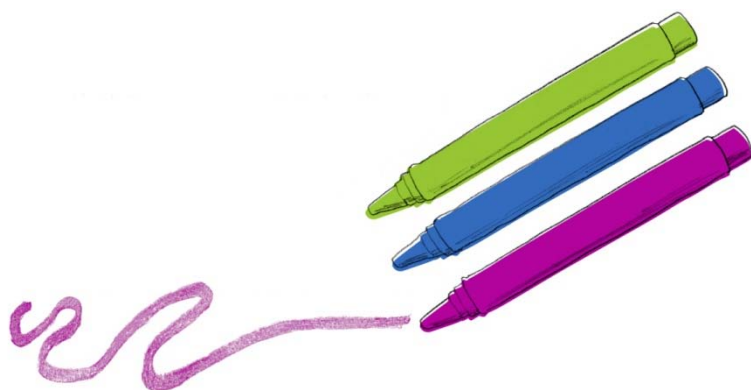
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Foreword by IVCA



It has always been our endeavour at IVCA to provide timely insight for the Indian Venture Capital (VC) and Private Equity (PE) Industry. Thus, it is with great pleasure, we, along with our Knowledge Partners, Grant Thornton, present the report titled “Fourth Wheel” at a time when VC/PE industry is coming of age in India. The report will be very useful for understanding the role of VC/PE in India’s growth and has significant amount of data on investments by VC/PE and the growth of the industry across sectors and sizes based on the Grant Thornton Dealtracker which has been a pioneer in tracking M&A and VC/PE deals over the past seven years. There are also very useful analysis of the industry based on the experience of Grant Thornton Professionals on Structuring PEs, Due Diligence, Corporate Governance and related issues.

IVCA has been actively working with Grant Thornton which has been tracking the pulse of the industry and has emerged as an authority, to put in place systems and monitoring processes to ensure the report provides one of the most accurate and incisive analysis of trends that matter.

We believe the report is a must-have and puts the current challenges and opportunities presented to the industry in perspective, along with a detailed analysis of investment trends according to stage, sector and players.

This is just one of the many measures IVCA is taking along with Grant Thornton to promote the industry within India and throughout the world and encourage investment. We look forward to your feedback and continued support.

- **Sudhir Sethi**

**Member
IVCA Executive Committee & Research &
Data Sub Com**

Foreword



The Indian Corporate Landscape has been dominated by three different types of companies for a long period of time; the Public Sector (Government or Public Owned and in that sense including Cooperatives), the Private Sector and the Multinational. Each of these operate with their unique style of business operations, focus and objectives of the business, relationship with stakeholders, management and board etc. Over the past decade and a half we are seeing the emergence of companies which is owned or supported by PE. We call it the Fourth Wheel using the metaphor of an automobile which was till now a 3 wheeler but is now gaining stability with a Fourth Wheel.

Some of the characteristics of the Fourth Wheel or PE backed companies:

- a. strong growth orientation
- b. focus on shareholder value creation
- c. active board with PE directors taking high interest in management
- d. connectivity on local and global basis with other companies in the PE family to leverage and benefit from (almost akin to a group company concept)
- e. business focused on medium term driven by the need for a liquidity event.

Why do we believe that the PE backed companies are now capable of being classified as a separate group?

- PE investments over the past six years have touched about US\$50 bn which is a significant proportion of the total investment into India Inc. In comparison, capital raised through Initial Public Offering (IPO) in this period is US\$31 bn.
- Total Foreign Direct Investment (FDI) flows into India over the past six years were about US\$116 bn and we believe a good proportion of this would be PE since a large proportion of PE investment is through FDI. It may be useful for India to lure more PE as it pitches for more FDI.
- Presently we have about 7700 companies listed in BSE and 1470 companies in NSE. BSE states that of the 7700, 3106 stocks traded and possibly about 2000 are actively traded between both the exchanges. In the past six years that we have been tracking PEs we have estimated that there are about 1500 companies which received PE investment. Even if a third of these were to get listed over the next few years they will form a significant share of the total no of companies going for IPO.
- The total investment by PEs over the last six years is about US\$ 50 bn. Even assuming that all this is at par and assuming an average stake of 25%, the total market value of PE investee companies would be atleast US\$ 200 bn. The market cap of BSE is about US\$ 1400 bn. So on a conservative basis, PEs already are about 15% of the market. there are multiple assumptions as some of these are unlisted but this gives a good sense of the scale of PE investment).

Foreword

We believe that the entry of PE into India has given a further impetus to entrepreneurship and wealth creation. In the decades before liberalisation we had Development Banking as the Mantra where Public Financial Institutions helped entrepreneurs who lacked the capital to invest or grow by providing low cost debt and liberal financing. However, they had rigid criteria and the assessment was predominantly about ability to repay.

If the company were a success, the institution got back its loans and if it failed, it had to write it off. Naturally, this was not a sustainable model for the institution. Once, development banking ceased to operate, there was a gap and no support was available for entrepreneurship and PE stepped in to create a new breed of entrepreneur who has the vision, is ambitious, has a unique proposition and is able to scale up rapidly if provided with capital support. The entrepreneur is also aggressive and seeks rapid growth and actively pursues M&A as a strategy. PEs through their network of investment within the country and internationally are also able to provide support to the business.

We, therefore believe that PE backed companies have now reached a scale and presence in India Inc and deserve to be called the Fourth Wheel and will make the existing three wheeler better balanced as each of the four will compete and improve their performance in the years to come.

VC is one of the key and the first pillar of creating new businesses especially in the technology sector. Whilst a lot of the report has focused mainly on PE, we detail below the main Venture Investors and the deals they have done. In the tech sector over the past 6 years we have seen 262 deals and a total investment of US\$ 3.70 bn. Some very key initiatives have been funded in these sectors and we believe several of them will reach good scale and some may reach international scale. It is also great to see some very focused investors in this sector eg IDG, Helion, Intel, NEA, Canaan. KPCB, DFJ etc, who are not just responding to proposals from entrepreneurs to fund but also thinking of potential opportunity sectors, developing the concept and then finding entrepreneurs to drive them.

We also have some poster boys who have made it big like K Ganesh of Tutorvista who set a great example for entrepreneurs through their ability to build multiple businesses over the years leveraging on the VCs and creating wealth for themselves, the VCs and value for the economy.

Conclusion and outlook

It is clear from our report and the trends in the market that the Fourth Wheel is moving steadily and has been a big contributor to the Indian economy and wealth creation. We believe that this will increase over a period of time and within the funds there will be more segmentation both in

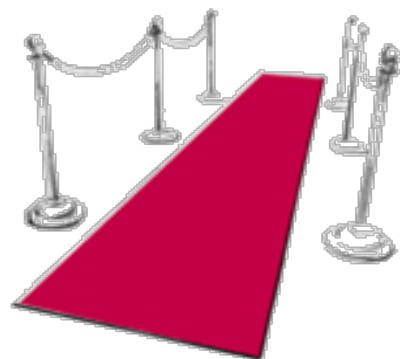
Foreword

terms of themes of investment, source of funds and size focus.

We hope this report will attract the attention of regulators and government and create awareness in their mind about the industry and need for regulatory support and clarity to grow and help the industry and portfolio companies to grow. We believe the stronger and deeper this industry grows we will see more wealth creation. This would further create a new class of entrepreneurs and drive economic growth.

- Harish HV

Partner, India Leadership Team



Introduction

This is a document we aim to bring out annually. It is focused on PE to understand the key aspects of PE investment in India and is aimed at the PE industry as well as companies where PEs are already invested and those seeking investment from PEs.

We have been following the growth of PE formally since 2005 through our Grant Thornton Dealtracker. The first set of PE funds started investing in Indian Corporates since about early 90s. We have seen the entry of several funds excited by the opportunity offered by the Indian Economy and today can count close to 500 funds operating in the Indian market.

We first start with what is PE. There is a broad distinction between what is considered PE internationally and in India. Internationally, PE is all about acquiring a company usually public, taking it private (hence the word PE) and working on improving its performance through a mix of operational and financial reengineering and then selling it to another investor or back to the public. In India, the word PE is typically associated with Growth Capital which is provided to emerging companies to enable them to build scale using the capital and other management inputs and exit by going public or by a strategic sale.

Internationally, PE takes significant majority stake whilst the Indian investors are usually minority investors. Ideally in India, we should call them GE or Growth Equity but we will stay with what is commonly used, which is PE. We have also included VC within the definition of PE for this report.

The Indian PE Industry is evolving and is putting together a complete ecosystem of trained people with experience in investing, service providers (I-Bankers, Accountants, Tax Consultants, Advisors etc).

The Indian entrepreneur has seen PE as a source of capital and value add to enable them to grow based on several success stories born with support of PE. There is also a perception that it is not cheap as it comes with strings and management inputs or interference and several times seen as necessary evil to be endured since the other funding options are closed.

The PE industry has also realised this and is working hard to put together models whereby they add significant value to businesses and help businesses scale up through positive interventions. We are now seeing the industry employing people with operational experience in the industry as opposed to pure financial experts alone to have a better mix of talent.

For the entrepreneur who has built up a business to some minimum scale where using seed or venture capital or capital from friends and family, there are two broad options for raising equity to fund growth, going the IPO route or the PE route.

Based on experience we would argue that the PE route has several benefits if the right PE is chosen for the value addition and the chemistry between the entrepreneur and the investor works well. We have seen several cases of companies where PE investors work hard at creating value for the businesses, spend time to understand the company, provide the right connect to various publics e.g. customers, suppliers, technology,

Introduction

people etc., guide them and help them put together corporate governance practices which help prepare for a listing and have equally seen cases where the investor operates like a portfolio investor who after investing is busy with the next deal, comes once a quarter and asks difficult questions and challenges the management rather than work with them to resolve issues.

We would argue that like choosing the right partner in life or business, it is important for entrepreneurs to look at all these issues, not just valuation, while choosing a PE investor.

The industry had predominantly relied on international sources of funding but now has also developed domestic fund sources and several funds have raised funds either completely or partially in India. We see increasing specialisation among PE funds who are VCs, sector focused, size focused or theme focused which helps in bringing together the appropriate skills to help build businesses.

We believe that this will help both the investor and the investee and reduce competition among PEs for deals.

Overall we see the PE industry becoming a key force in India Inc and this report seeks to educate the reader on the shape and dimensions of PE in India.





Private Equity in India

Private Equity in India

India today is among the more attractive investment destinations globally, driven by a combination of strong economic growth, an improving regulatory environment and favorable demographics. As India continues on its rapid-growth path, several large potential investment sectors such as financial services, infrastructure and domestic consumption offer significant opportunities for PE investor. India is generally considered a 'must have' destination for foreign institutional and PE funds, who recognise the potential of Indian Companies to generate high returns leveraging on the country's economic growth.

India's GDP grew from US\$3.76 trillion in 2009 to US\$4.05 trillion in 2010 (adjusted for Purchasing Power Parity) while real GDP grew at 8.3% in 2010 which is an increase from 7.4% in 2009. GDP per capita has increased from US\$3,200 in 2009 to US\$3,400 in 2010. Even though the global economy as a whole experienced several corrections in its recovery from the recession, India was able to continue its growth trajectory.

India now has a sizeable middle class and the percentage of its population below the poverty line is gradually reducing. At the same time, disposable income among its middle class is growing and there is a great deal of cash circulation in the economy. The country has the second largest population in the world of 1.173 bn, with 65% of the population between 15-64 years in age.

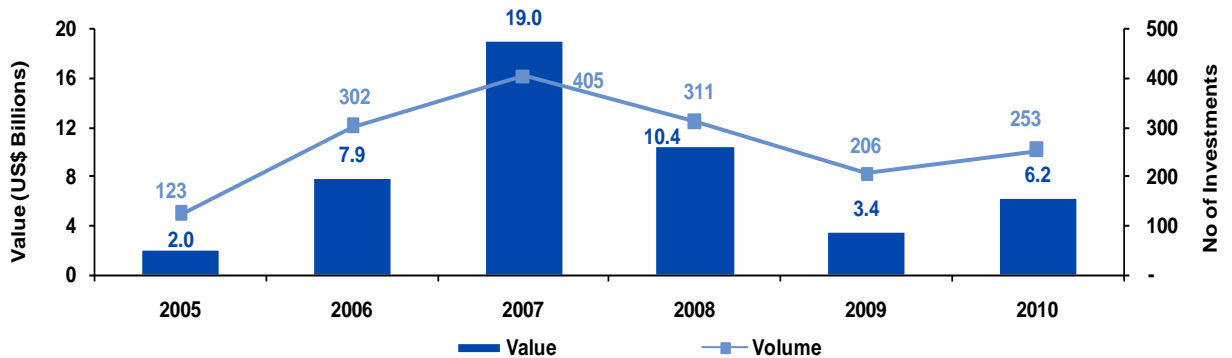
Expanding urban wealth and increased domestic consumption has resulted in the industrial production growth rate increasing to 9.7%. There is an increase in urbanisation and Tier II and Tier III cities which have fewer amenities than Tier I are becoming hot targets for investors looking to generate multi-bagger returns several years into the future. Fast moving consumer goods (FMCG) are being pushed by the increase in disposable income. With a growing middle class, retail sales are growing and with 30.5% of India's population being under the age of 14, there is a large demand for schooling and all other tertiary industries associated with schooling and higher learning.

Several sectors of the economy are growing rapidly such as Real Estate, FMCG, Retail and Education and there is a growing creation of organised large scale businesses with better systems, processes and cost advantages out of traditional small businesses be it retail, real estate, beauty saloons, restaurants etc.

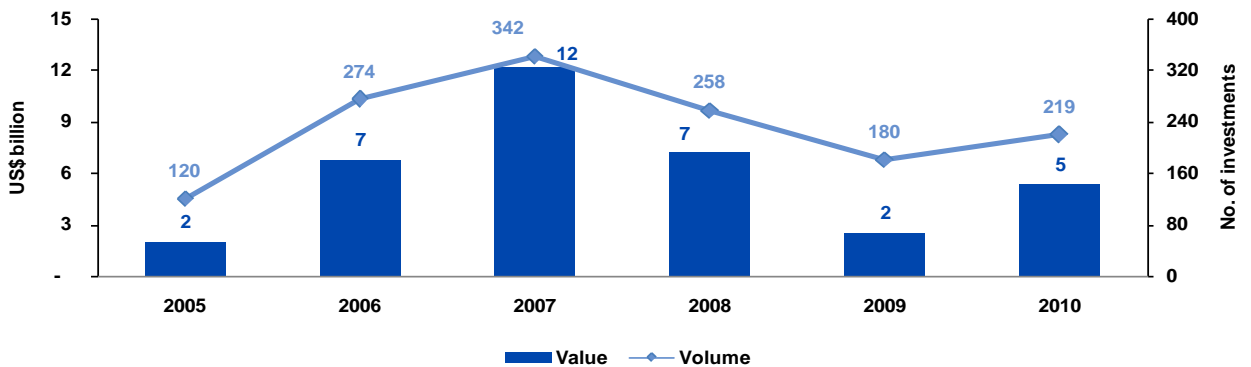
PE investors have played a significant role in the development of several sectors in India over the past decade eg Telecom, Healthcare, Technology, Retail, Education etc. PE investments have grown from US\$ 2.0 bn in 2005 to US\$ 19 bn in 2007. Thereafter, investment value fell to around US\$ 6.2 bn in 2010 registering a CAGR of 25% over the last six years.

Private Equity: Investment Trends

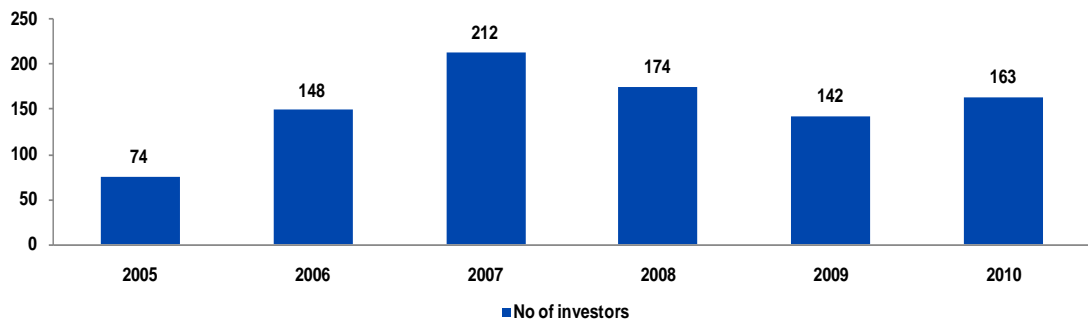
Total PE Investments (2005 - 2010)



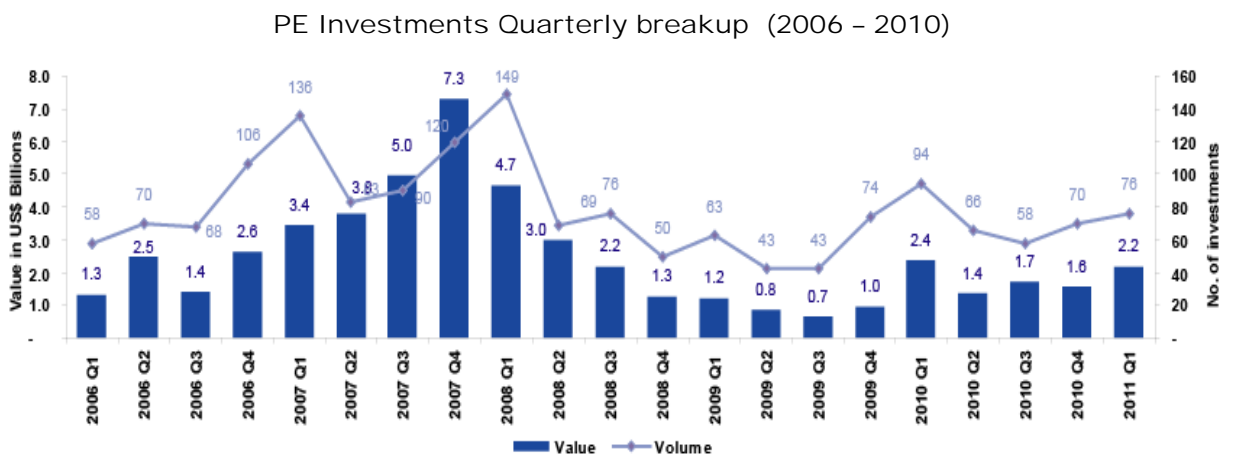
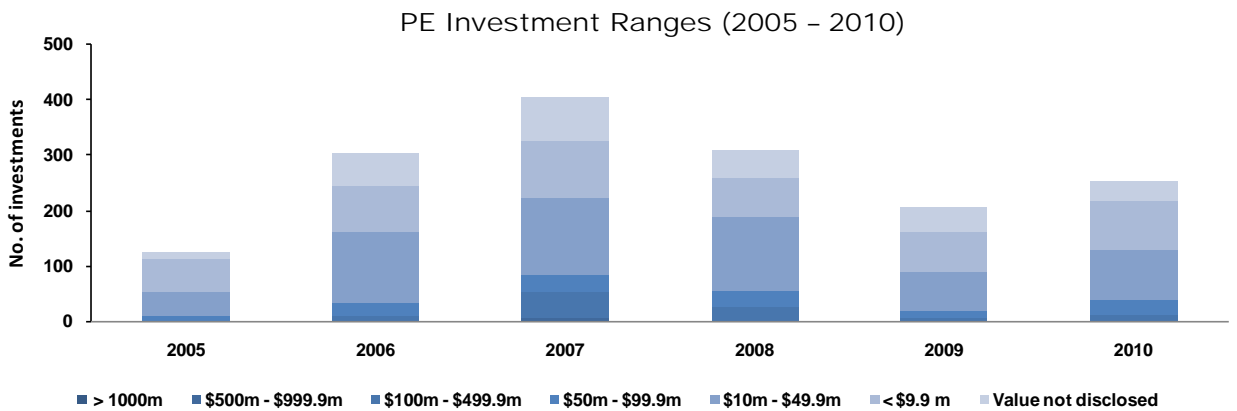
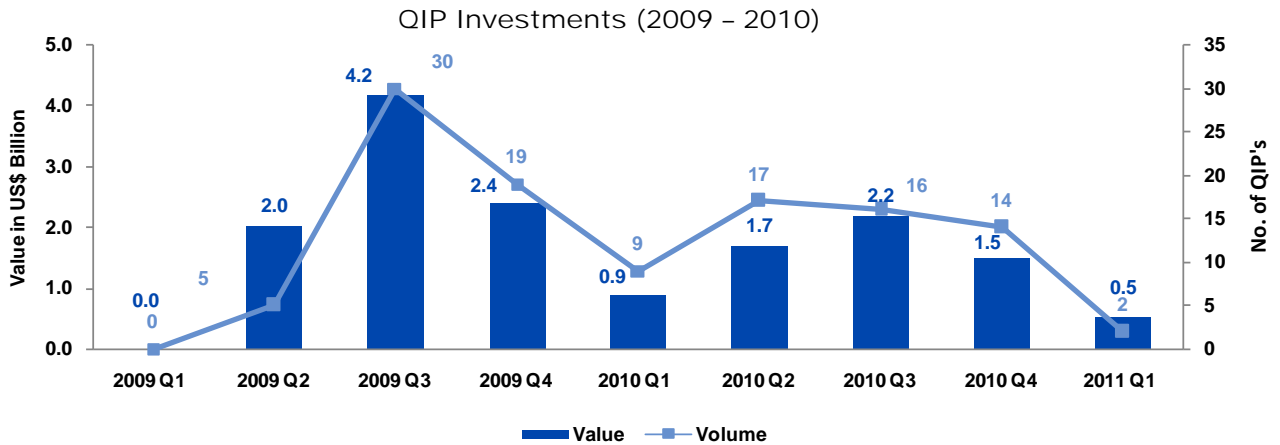
PE Investments (non Real Estate)(2005 - 2010)



Number of PE Funds who invested in that year



Private Equity: Investment Trends



Private Equity: Investment Trends

Top Deals (2005 – 2010)

(Value in US\$ mn)

Year	Investor	Investee	Sector	%	Value
2007	Temasek Holdings	Bharti Airtel	Telecom	5%	1,907
	Kohlberg Kravis Roberts & Co	Flextronics Software Systems	IT & ITeS	85%	1,035
2006	Temasek Holdings, Investment Corp of Dubai, GS, IEP, Macquarie, AIF Capital, Citigroup	Bharti Infratel (subsidiary of Bharti Airtel Ltd)	Telecom	10%	1,000
2007	ICICI Venture Funds Mgmt Co	Jaypee Infratech	Real Estate & Infrastructure Management	N.A.	800
2007	George Soros, Eton Park Capital, Deutsche Asset Mgmt, Capital International, Citigroup, T Rowe Price, Credit Agricole, UBS & Kotak Mahindra	GMR Infrastructure	Real Estate & Infrastructure Management	N.A.	767
2007	Carlyle Group	HDFC	Banking & Financial Services	6%	650
2008	Providence Equity Partners	Aditya Birla Telecom	Telecom	20%	640
2007	Avenue Capital Group	SKIL Infrastructure	Real Estate & Infrastructure Management	26%	500
2006	Providence Equity Partners	Idea Cellular	Telecom	15%	460
2008	Symphony Capital	DLF Assets	Real Estate & Infrastructure Management	N.A.	450

Top 10 Investors (2005 – 2010)

Investor	Volume
Sequoia Capital India	57
International Finance Corporation	53
Bennett Coleman & Company Ltd	52
Citigroup Venture Capital	39
ICICI Venture	32
IDFC Private Equity	31
Goldman Sachs Investment Partners	27
IL&FS Investment Managers Ltd	23
Intel Capital	22
Reliance Capital	22

Largest Recipients of PE Funding (2005 – 2010)

Investee	Volume	Value
Bharti Airtel	4	3,166
GMR Infrastructure	8	1,152
DLF Ltd	3	1,050
Idea Cellular	8	951
HDFC	2	767
NSE	6	697
Lodha Group	5	680
Nitesh Estates	6	621
Moser Baer India	4	528
GVK Energy	3	404

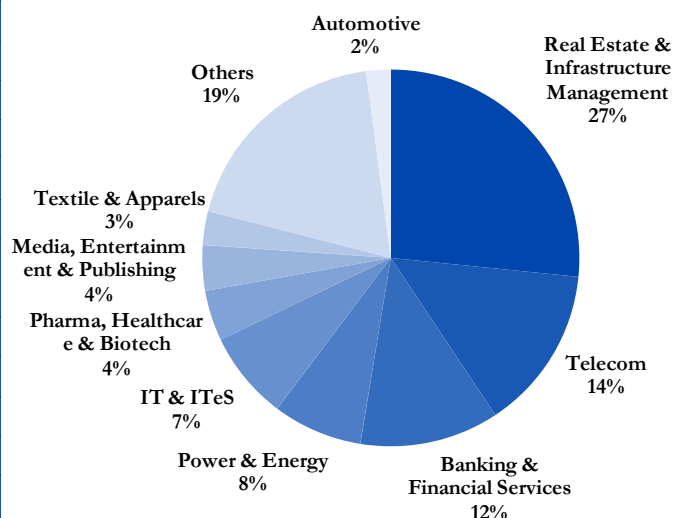
Private Equity: Investment Trends

Sector Investment Break-up (2005 – 2010)

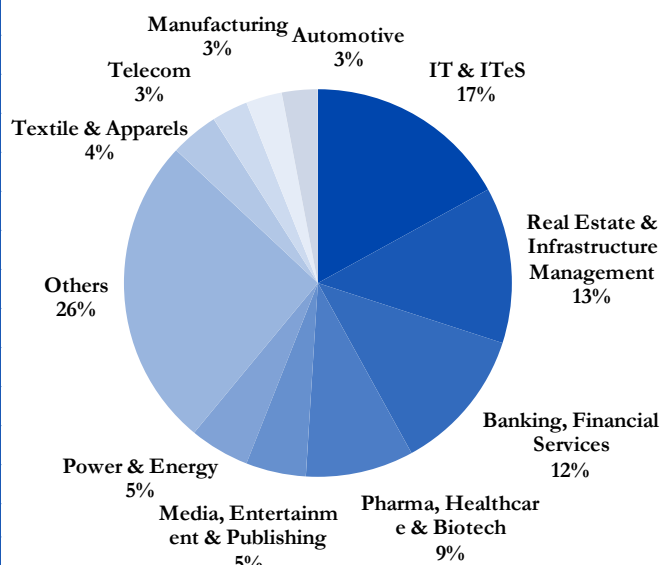
PE Sector Break-up (By Value) (2005 – 2010)

(Value in US\$ mn)

Sector	Value	Volume
Real Estate & Infra Mgmt	13,043	203
Telecom	6,886	53
Banking & Financial Services	5,850	186
Power & Energy	3,772	78
IT & ITeS	3,708	277
Pharma, Healthcare & Biotech	2,124	141
Media, Entertainment & Publishing	1,922	86
Textile & Apparels	1,423	59
Others	1,085	75
Automotive	1,030	45
Manufacturing	988	49
Shipping & Ports	722	13
Engineering	710	32
Hospitality	661	35
FMCG, Food & Beverages	635	34
Electrical & Electronics	634	19
Cement	567	13
Retail	471	31
Logistics	463	31
Oil & Gas	437	16
Agriculture & Agro Products	366	24
Aviation	291	19
Education	286	29
Metals & Ores	265	11
Plastic & Chemicals	259	19
Travel & Travel Services	196	12
Mining	164	4
Breweries & Distilleries	27	2
Printing & Stationary	18	3
Gems & Jewellery	17	1
Grand Total	49,018	1600



PE Sector Break-up (By Volume) (2005 – 2010)



Private Equity: Sector Trends

Sector Break-up (By Volume) (2005 – 2010)

Year wise Top Sectors

(Value in US\$ mn)

Sector	Value	Volume	TOP 5 - 2007	Value	Volume
IT & ITeS	3,708	277	Real Estate & Infrastructure Mgmt	6,764	61
Real Estate & Infra Mgmt	13,043	203	Telecom	3,421	10
Banking & Financial Services	5,850	186	Banking & Financial Services	3,231	59
Pharma, Healthcare & Biotech	2,124	141	Media, Entertainment & Publishing	999	31
Media, Entertainment & Publishing	1,922	86	IT & ITeS	744	67
Power & Energy	3,772	78	TOP 5 - 2008	Value	Volume
Others	1,085	75	Real Estate & Infrastructure Mgmt	3,138	51
Textile & Apparels	1,423	59	Telecom	1,397	15
Telecom	6,886	53	Power & Energy	900	16
Manufacturing	988	49	Banking & Financial Services	819	32
Automotive	1,030	45	IT & ITeS	488	55
Hospitality	661	35	TOP 5 - 2009	Value	Volume
FMCG, Food & Beverages	635	34	Real Estate & Infrastructure Mgmt	882	25
Engineering	710	32	Power & Energy	413	13
Retail	471	31	Banking & Financial Services	364	26
Logistics	463	31	Logistics	216	11
Education	286	29	IT & ITeS	215	36
Agriculture & Agro Products	366	24	TOP 5 - 2010	Value	Volume
Electrical & Electronics	634	19	Power & Energy	1,537	24
Aviation	291	19	Real Estate & Infrastructure Mgmt	945	33
Plastic & Chemicals	259	19	Services	594	33
Oil & Gas	437	16	Telecom	515	6
Shipping & Ports	722	13	IT & ITeS	398	41
Cement	567	13			
Travel & Travel Services	196	12			
Metals & Ores	265	11			
Mining	164	4			
Printing & Stationary	18	3			
Breweries & Distilleries	27	2			
Gems & Jewellery	17	1			
Grand Total	49,018	1600			

Private Equity: Investment Trends

Range-wise Top Deals (2005 – 2010)

Top investors >1000mn (Value in US\$ mn)

Investor	Volume	Value
Kohlberg Kravis Roberts	1	1,035
Temasek Holdings	1	1,907

Top investors - \$500mn - \$999.9mn

Investor	Volume	Value
Carlyle Group	1	650
Providence Equity Partners	1	640

Top investors - \$100mn - \$499.9mn

Investor	Volume	Value
Citigroup Venture Capital	5	623
3i	4	744
Blackstone Group	4	885
Goldman Sachs Investments	4	548
Temasek Holdings	3	722

Top investors - \$50mn - \$99.9mn

Investor	Volume	Value
Blackstone Group	8	464
Warburg Pincus	6	449
IDFC	5	321
3i	4	249
ICICI Ventures	4	252

Top investors -49.9mn - \$10mn

Investor	Volume	Value
International Finance Corp	24	464
ICICI Ventures	20	424
Sequoia Capital India	19	362
Citigroup Venture Capital	17	502
IDFC Private Equity	15	361
Goldman Sachs Investment	15	333



“Private Equity in India needs to operate in the space where public markets are unable to calibrate/map or price a business. Most of the success stories (both from an investor and an investee perspective) have been around new sectors, business models or sometimes entrepreneurs themselves. It is also important to recognise that extraordinary returns will only come from solving difficult problems for such companies/ businessmen. The era of riding the wave of rising markets is well behind us.”

- Nainesh Jaisingh MD, Standard Chartered Private Equity Advisory Ltd

Top investors - < \$9.99 mn

Investor	Volume	Value
Sequoia Capital India	34	195.25
International Finance Corp	23	108.45
Intel Capital	17	68.27
Helion Venture Partners	13	54.14
SIDBI Venture Capital	13	44.44
Ascent Capital	12	72.64
IDG Ventures	12	25.01

Private Equity: Investment Trends

Sector-wise Top Deals (2005 – 2010)

(Value in US\$ mn)

Real Estate & Infrastructure Management

Year	Investor	Investee	% Stake	Value
2007	ICICI Venture Funds Management Co	Jaypee Infratech	N.A.	800
2007	George Soros, Eton Park Capital, Deutsche Asset, Capital International, Citigroup, T Rowe Price, Credit Agricole, UBS and Kotak	GMR Infrastructure	N.A.	767
2007	Avenue Capital Group	SKIL Infrastructure	26.00%	500
2008	Symphony Capital	DLF Assets	N.A.	450
2007	Deutsche Bank	Lodha Group (25 per cent stake in a special purpose vehicle)	N.A.	425

Telecom

Year	Investor	Investee	% Stake	Value
2007	Temasek Holdings	Bharti Airtel	4.99%	1,907
2007	Temasek Holdings, Investment Corporation of Dubai, Goldman Sachs, Macquarie, AIF, Citigroup and IEP	Bharti Infratel (subsidiary of Bharti Airtel Ltd)	10.00%	1,000
2008	Providence Equity Partners	Aditya Birla Telecom	20.00%	640
2006	Providence Equity Partners	Idea Cellular Limited	15.00%	460
2006	Temasek Holdings	Tata Teleservices Limited	9.90%	380

Banking & Financial Services

Year	Investor	Investee	% Stake	Value
2007	Carlyle Group	HDFC	5.60%	650
2007	BNP Paribas	SREI Infrastructure Finance	50.00%	180
2007	Khazanah Nasional Berhad	IDFC	9.95%	180
2006	Farallon Capital	Indiabulls Financial Services	N.A.	165
2007	Merrill Lynch	Multi Commodity Exchange	5.00%	160

Power & Energy

Year	Investor	Investee	% Stake	Value
2010	Blackstone	Moser Baer Projects Pvt Ltd	N.A.	300
2008	Orient Global Tamarind Fund Pte Ltd	Cairn India Ltd	2.60%	279
2010	3i India Infrastructure Fund	GVK Energy Limited	21.10%	255
2008	Farallon Capital	Indiabulls Power Services	23.40%	247
2007	3i India Infrastructure Fund Ltd	Adani Power Ltd	N.A.	227

Private Equity: Investment Trends

Private Equity investors have not restricted their investments to a handful of sectors, but have in fact diversified their investments over the years into sectors like Hospitality, Education, Consumer Goods and the like. Real Estate, though has always been a favoured sector with PE funds and has received 26% of total PE investments over the last six years. Other sectors that have received substantial PE investment include Telecom, Banking and Power & Energy.

(Value in US\$ mn)

IT & ITeS

Year	Investor	Investee	% Stake	Value
2006	Kohlberg Kravis Roberts & Co	Flextronics Software Systems	85.00%	1,035
2007	Blackstone Group	Intelenet Global Services Pvt Ltd	80.00%	200
2006	Olympus Capital	Quattro BPO Solutions	N.A	115
2010	Goldman Sachs, Indivision and Oak	Tikona Digital Networks	70.00%	106
2006	General Atlantic Partners	Hexaware Technologies	14.99%	77

Pharma, Healthcare & Biotech

Year	Investor	Investee	% Stake	Value
2007	Apax Partners	Apollo Hospitals Enterprise Ltd	11.00%	104
2011	Integrated Healthcare Holdings	Apollo Hospitals Enterprise Ltd	8.82%	102
2008	AIG and JPMorgan	Narayana Hrudayalaya Pvt. Ltd	25.00%	100
2010	Warburg Pincus LLC	Metropolis Healthcare Services	N.A.	85
2006	HSBC Global Investment Fund	Glenmark Pharmaceuticals	6.70%	78

Top Investors by Sector (2005 - 2010)

IT & ITeS

Investor	Volume
Sequoia Capital India	20
Intel Capital	17
Bennett Coleman & Co Ltd	14
Canaan Partners	10
New Enterprise Associates	10
IDG Ventures India	9
Nexus Venture Partners	9

Pharma, Healthcare & Biotech

Investor	Volume
ICICI Venture	15
International Finance Corp	9
Sequoia Capital India	7
Citigroup Venture Capital	6
Bennett Coleman & Co Ltd	4
Evolve Capital	4

Banking & Financial Services

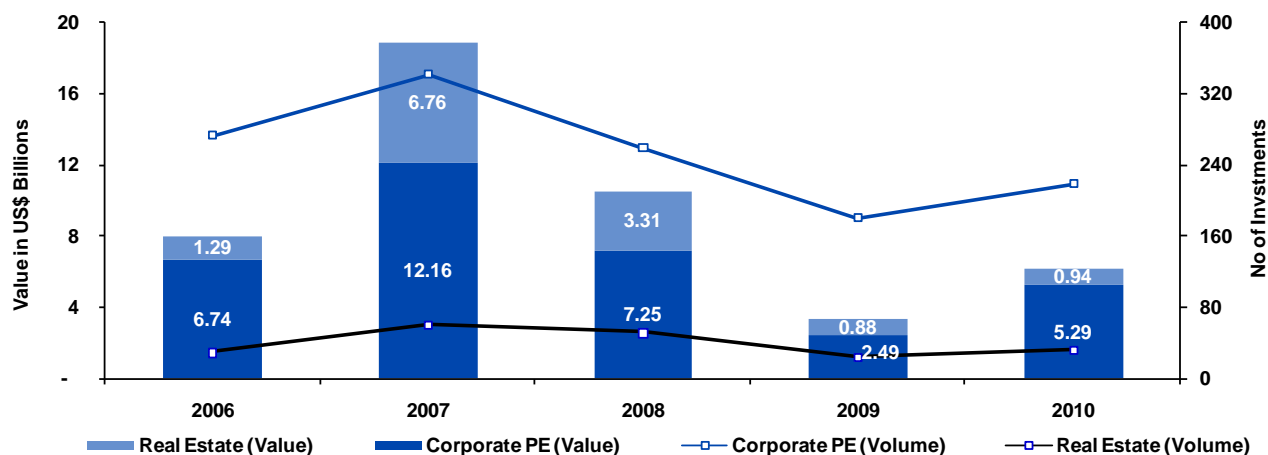
Investor	Volume
International Finance Corp	12
Lok Capital	8
Sequoia Capital India	7
Aavishkaar Goodwell	6
ChryCapital Partners	6
Goldman Sachs Investment	6

Power & Energy

Investor	Volume
International Finance Corp	7
IDFC Private Equity	6
3i	4
Reliance Capital	4
Acumen Fund	3

Private Equity: Real Estate Focus

Total Real Estate PE Investments (2006 – 2010)



Top 10 Real Estate Investments (2005 – 2010)

(Value in US\$ mn)

Year	Investors	Investee	%	Value
2007	ICICI Venture Funds	Jaypee Infratech	N.A.	800
	George Soros, hedge fund Eton Park Capital, Deutsche Asset Management, Capital International, Citigroup, T Rowe Price, Credit Agricole, UBS and			
2007	Kotak Mahindra	GMR Infrastructure	N.A.	767
2007	Avenue Capital Group	SKIL Infrastructure	26%	500
2008	Symphony Capital	DLF Assets	N.A.	450
	Deutsche Bank and a group of private equity firms	Lodha Group (25 per cent stake in a special purpose vehicle)	N.A.	425
2007	D.E. Shaw	DLF Limited	N.A.	400
	Merrill Lynch & Co	7 Residential Housing Projects of DLF Ltd	49%	377
2008	MPC Synergy	Phoenix Mills	N.A.	325
2007	Goldmansachs	Century Group	N.A.	300
	GIC and Citigroup Venture Capital	Shapoorji Pallonji's real estate business SPV	15%	290

Private Equity: Real Estate Focus

Top Real Estate Investors - 2006

Investor	Volume	Value
IDFC	3	76.59
Citigroup	2	89.65
Morgan Stanley	2	154.87
Quantum Group of Funds	2	38.33
Trikona Capital	2	46.54

(Value in US\$ mn)

Top Real Estate Investors - 2007

Investor	Volume	Value
Citigroup	7	634.24
IL&FS Investment	4	165.75
IDFC	3	42.17
Morgan Stanley	3	191.00
Trinity Capital	3	39.52

Top Real Estate Investors - 2008

Investor	Volume	Value
Citigroup	4	160.00
AMP Capital Finance Mauritius Ltd.	2	50.00
Axis Private Equity Ltd	2	77.50
Deutsche Bank	2	150.00
ICICI Ventures	2	56.75

Top Real Estate Investors - 2009

Investor	Volume	Value
Red Fort Capital	3	58.89
IL&FS Investment	2	111.11
Indiareit Fund Advisors	2	13.10
Standard Chartered Private Equity	2	44.44
Sun Apollo Real Estate Fund	2	50.00



“Restrictive regulations are becoming the biggest hurdle for PE investors operating in India and more specifically domestic funds. The industry needs serious cohesive reforms from the decade old regulations (last set of SEBI guidelines on Venture Capital came into force in 2000). In particular, we need to look at tax policy on clear tax-pass through sector restrictions, prohibitions on purchasing secondary shares and convertible instruments and investments in non banking finance companies for SEBI registered funds. Further, with frequent changes in foreign investment regulations, PE investors are tending to spend more time with lawyers and accountants than their investee companies just to enable even long term FDI investments.

- Nitin Deshmukh, CEO , Kotak PE

Top Real Estate Investors - 2010

Investor	Volume	Value
Kotak India Private Equity Fund	5	142.55
IL&FS Investment	3	46.70
ASK Property Investment Advisors	2	122.34
HDFC	2	118.09
ICICI Bank	2	57.45

Venture Capital Making a Strong Beginning

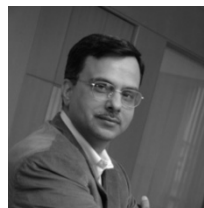
Top IT & ITeS Venture Capital investments

Investor	Volume	Value
IDG Ventures India	9	17.11
Intel Capital	9	17.83
Kleiner Perkins Caufield & Byers	8	17.19
Canaan Partners	7	15.95
Helion Venture Partners	7	10.26
Matrix Partners India	7	11.50
Nexus Venture Partners	7	17.12
Sherpalo Ventures	7	13.74
Draper Fisher Jurvetson	6	14.83

(Value in US\$ mn)

Top Non-IT & ITeS Venture Capital investments

Investor	Volume	Value
Citigroup Venture Capital	10	10.54
Reliance Capital Partners	10	19.91
Sequoia Capital	10	22.18
Helion Venture Partners	9	24.76
International Finance Corporation	9	16.20
Lok Capital	8	17.10
Aavishkaar India Micro Venture	7	2.42
Draper Fisher Jurvetson	7	10.67
Mumbai Angels	7	1.93
SIDBI Venture Capital Ltd	7	19.37



“We expect US\$ 70-75 bn of PE and VC Investments in India during 2010-2015. To understand the break-up of this, about US\$ 22 bn is expected to be required for follow-up funding of 660 current PE-funded companies. Then, about 2000 companies in IT/ ITES, Manufacturing, Engineering and Construction and Healthcare, are expected to attract close to US\$ 30 bn in new PE and VC investments during 2010-15. Further, we see new investments in sunrise sectors such as Telecom (US\$8bn+ potential driven by developments such as 3G rollout etc.), BFSI (US\$ 6bn+ potential driven by grant of new banking licenses), energy (US\$5bn+ potential as supply-demand gap widens), education (\$2bn+ potential as regulations become more favorable) and retail (US\$2bn+ potential driven by favorable government policies and increasing foreign participation).”

- **Sudhir Sethi, Founder, Chairman & MD, IDG Ventures India**

Private Equity Dealmakers

Dealboard			TOP PE INVESTORS
Rank	Last Year	Move	TOP INVESTORS 2010 (Deal Value - Deal Volume)
1	2	↑	International Finance Corporation (US\$ 223.43 Mn - 14 Deals)
2	1	↓	Sequoia Capital India (US\$ 161.95 Mn - 12 Deals)
3	4	↑	Matrix Partners (US\$ 52.03 Mn - 6 Deals)
4	★	↑	Mumbai Angels (US\$ 2.23 Mn - 6 Deals)
5	8	↑	Helion Venture Partners (US\$ 13.91 Mn - 5 Deals)
6	3	↓	IDFC Group (US\$ 124.71 Mn - 5 Deals)
7	★	↑	Intel Capital (US\$ 4.83 Mn - 5 Deals)
8	★	↑	Blackstone Group (US\$ 427.66 Mn - 4 Deals)
9	★	↑	Fidelity International (US\$ 17.02 - 4 Deals)
10	★	↑	IL&FS Investment Managers Ltd. (US\$ 75.53 - 4 Deals)



"PE in India has so far largely been a growth capital market where investors take minority stakes and depend on the Promoters to scale the business. In growth capital investing, the entrepreneur is at the centre of a PE investor's strategy. Having aligned our interests completely with the Promoter, PE funds are ancillary beneficiaries of a Promoters' success. Hence it is imperative that the Promoters and Investors have a good working relationship".

- Raja Kumar, Ascent Capital

Dealboard			TOP PE INVESTORS
Rank	Last Year	Move	TOP INVESTORS 2008 (Deal Value - Deal Volume)
1	9	↑	ICICI Ventures (US\$ 135.00 Mn - 8 Deals)
2	3	↑	International Finance Corporation (US\$ 247.13 Mn - 8 Deals)
3	★	↑	NEA Indo US Ventures (US\$ 31.07 Mn - 8 Deals)
4	4	↔	Sequoia Capital (US\$ 102.84 Mn - 8 Deals)
5	10	↑	IDFC Private Equity (US\$ 223.81 Mn - 6 Deals)
6	★	↑	Nexus Capital (US\$ 16.58 Mn - 6 Deals)
7	8	↑	Blackstone Group (US\$ 186.61 Mn - 5 Deals)
8	★	↑	DE Shaw Group (US\$ 172.50.88 Mn - 5 Deals)
9	★	↑	Draper Fisher Jurvetson (US\$ 19.48 - 5 Deals)
10	2	↓	Goldman Sachs Group (US\$ 320.00 - 5 Deals)

Dealboard			TOP PE INVESTORS
Rank	Last Year	Move	TOP INVESTORS 2009 (Deal Value - Deal Volume)
1	4	↑	Sequoia Capital (US\$ 51.92 Mn - 7 Deals)
2	2	↔	International Finance Corporation (US\$ 61.52 Mn - 6 Deals)
3	5	↑	IDFC (US\$ 139.26 Mn - 5 Deals)
4	★	↑	Matrix Partners India (US\$ 42.59 Mn - 5 Deals)
5	★	↑	Aavishkaar Goodwell India Microfinance Development Company (US\$ 6.69 Mn - 4 Deals)
6	★	↑	Aavishkaar India Micro Venture Capital Fund (US\$ 0.67 Mn - 4 Deals)
7	★	↑	Banyan Tree Growth Capital (US\$ 35.97 Mn - 4 Deals)
8	★	↑	Helion Venture Partners (US\$ 12.44 Mn - 4 Deals)
9	★	↑	IFCI Venture Capital Funds Limited (US\$ 14.81 - 4 Deals)
10	★	↑	Rabo Equity Advisors (through India Agri Business Fund) (US\$ 20.82 - 4 Deals)

Private Equity Dealmakers

Dealboard			TOP PE INVESTORS
Rank	Last Year	Move	TOP INVESTORS 2006 (Deal Value - Deal Volume)
1	4	↑	Sequoia Capital India (US\$ 168.11 Mn - 14 Deals)
2	★	↑	Ascent Capital (US\$ 86.73 Mn - 9 Deals)
3	★	↑	ChrysCapital Partners (US\$ 270.14 Mn - 9 Deals)
4	8	↑	International Finance Corporation (IFC) (US\$ 76.60 Mn - 8 Deals)
5	7	↑	Actis Capital LLP (US\$ 214.04 Mn - 6 Deals)
6	★	↑	Baring Private Equity Partners Limited (US\$ 58.23 Mn - 6 Deals)
7	2	↓	Citigroup (US\$ 64.34 Mn - 6 Deals)
8	3	↓	IL&FS Investment Managers Ltd (US\$ 60.82 Mn - 6 Deals)
9	★	↑	New Vernon (US\$ 69.36 - 6 Deals)
10	5	↓	Reliance Capital Partners (US\$ 65.82 - 6 Deals)

Dealboard			TOP PE INVESTORS
Rank	Last Year	Move	TOP INVESTORS 2007 (Deal Value - Deal Volume)
1	7	↑	Citigroup (US\$ 957.86 Mn - 20 Deals)
2	★	↑	Goldman Sachs Investments (US\$ 400.80 Mn - 12 Deals)
3	4	↑	International Finance Corporation (US\$ 182.56 Mn - 10 Deals)
4	1	↓	Sequoia Capital India (US\$ 83.21 Mn - 9 Deals)
5	★	↑	Fidelity International (US\$ 90.87 Mn - 8 Deals)
6	★	↑	Lehman Brothers (US\$ 123.05 Mn - 8 Deals)
7	★	↑	Merill Lynch & Co (US\$ 111.18 Mn - 8 Deals)
8	★	↑	Blackstone Group (US\$ 727.88 Mn - 7 Deals)
9	★	↑	ICICI Ventures (US\$ 140.01 - 7 Deals)
10	★	↑	IDFC Private Limited (US\$ 168.95 - 7 Deals)





Fear over
Private
Equity...

Fear over Private Equity...

India Inc concerns about Private Equity

We capture below some concerns/ fears expressed by Indian Businessmen on PE and try to analyse them.

“PE investors don’t really understand my business”

One of the biggest fears entrepreneurs have about the involvement of a financial sponsor is that PE players don’t understand their companies or their industries. This is even more true in high-technology sectors such as telecom, mobile communications, information technology and biotechnology. Very often, this perceived lack of understanding creates a lot of uncertainty about how effective the relationship will be post transaction.

However, over the last five years, by and large PE investors have played a large role in transforming small businesses in technology driven sectors through continued financial support. In fact, PE investors have displayed considerable knowledge of specific sectors and niche markets in carving out business plans and charting out strategies for their portfolio companies paving the way for their success.

We have also seen examples where there is a disconnect between the entrepreneur and the investor and sometimes this comes because some of the PE investors act like Portfolio Investors and focus on deal making and after that on the next deal. On existing investments they pay less attention and if things don’t move as per plan

then they start interfering and cause disruption and many of them do not have the experience in operations or business to contribute positively and hence interfere than value add.

We believe that PEs who invest carefully and spend time and effort in guiding and growing their investments are more likely to be successful. It is akin to growing a plant. If you spend time nurturing the plant with water, fertiliser and where necessary pesticide, it will give out a lot of fruit. If it starts withering then overdoses of any of these ingredients may not help.

“PEs are bankers who expect high interest rates”

Many entrepreneurs see PEs only as a source of capital and when they see the terms which may include alternate structures to provide security and return to the investors, they come to the conclusion that the PEs are usurious bankers and not risk takers.

This is sometimes true based on the structures PE create for their investments. However, entrepreneurs need to understand that PEs are taking equal risk with their money being given to the entrepreneur to build and manage. They are clearly medium to long term investors and are accountable to their investors. The clauses are meant to protect downsides and also put pressure on the entrepreneur to deliver.

Fear over Private Equity...

India Inc concerns about Private Equity

“PE investors give too little and ask too much”

Most entrepreneurs are wary of relinquishing control, particularly over a business they have built over a long period of time. They fear that PE investors tend to force prerogative over specific operations despite owning a smaller share of the company. Entrepreneurial concerns usually start with the realisation that for the first time in a long time, their actions would be accountable to someone and have to have the discipline to think through their actions and justify it rather than be unquestioned kings in their domain. That is the price they need to pay for getting capital in and manage the business professionally.

"PE investors are only in it for the exit"

Most entrepreneurs perceive an investor's enthusiasm with certain reservations believing that a financial sponsor already has an exit in mind early on in the post-transaction experience and will look to only short-term performance and wants to exit quickly in months and not years.

The average exit period in India by a PE is about 4-6 years which is a reasonable period. It is important for Entrepreneurs to realise that the PE is structured for exit and clearly they will drive for value generation within their timeframe and if value is created it benefits both the sides.





Investor
views on
Private
Equity
Industry

Investor Views



Impact of PE investment on Indian Corporates

- Support an ambitious aspiration
- Greater professionalisation
- Set high quality governance standards

How have PEs managed the relationship with the Indian Promoters? What are the challenges?

- Cannot comment on other PEs
- At Sequoia Capital – we have been fortunate to have backed exciting, ambitious entrepreneurs and have built deep enduring relationships
- The challenges have always been on the business side - strategy, competitive dynamics and growth and in crafting the right response as a business. In our experience, by working with the entrepreneur and the management team in the true spirit of a partnership, we are able to overcome these challenges.

What are the biggest challenges for PE investors operating in India eg. Opportunities, Fund Raising, People etc?

- Biggest challenge is in finding the right opportunities

PEs are going to be the fourth dimension of Indian corporate (PSU, Indian Companies, MNC being the other three). Do you agree and why?

- It is still early days for Private Capital in India.
- The private capital industry has to contribute a lot more in supporting many entrepreneurs in building lasting companies and demonstrate success at scale many times over, before been called the fourth dimension of Indian corporate

The relationship between PE and Entrepreneur is one of Love or Hate...

- I would definitely not characterize it that way.
- At Sequoia we see ourselves as entrepreneurs behind entrepreneurs. We like to be on the same page as the entrepreneur, 100% before we invest; and once we invest, our motivation and working style is to partner with the entrepreneur, back his/her judgment and business instinct, and provide every possible help and support.

- **VT Bharadwaj**
Managing Director
Sequoia Capital

Investor Views



Restrictive regulations are becoming the biggest hurdle for PE investors operating in India and more specifically domestic funds. The industry needs serious cohesive reforms from the decade old regulations (last set of SEBI guidelines on Venture Capital came into force in Yr 2000). In particular, we need to look at tax policy on clear tax-pass through, sector restrictions, prohibitions on purchasing secondary shares and convertible instruments and investments in non banking finance companies for SEBI registered funds. Further with frequent changes in foreign investment regulations, PE investors are tending to spend more time with lawyers and accountants than their investee companies just to enable even long-term FDI investments. There is a need for creation of a stable and level playing field for VC/PE investors vis-a-vis other categories of investors with respect to regulations regarding market participation as well as issues of “permanent establishment” and incentivising the development of investment management skills on Indian soil. There is also a need for reforms regarding regulations involving institutional investors, particularly rules regarding investments by pension and insurance funds in Domestic PE funds.

- **Nitin Deshmukh**
CEO
Kotak PE



Investor Views



Impact of PE investment on Indian Corporates

PE investors are generally a positive force for Indian corporations. Indian entrepreneurs are energetic, ambitious, creative and intelligent. However, many of these entrepreneurs are inexperienced in scaling up an organisation. Scaling up requires systems and processes, and most importantly in organisation and people development. These are areas where PE investors can be the most helpful. PE investors can also assist in corporate governance and business development. Governance is critical at the time of exit, either a sale to a strategic buyer or an IPO.

How have PEs managed the relationship with the Indian Promoters? What are the challenges ?

There are challenges with some 'traditional' Indian promoters who promise to professionalise the firm and improve governance but underestimate what it takes. On the other hand, we (PE managers) need to do a better job educating the promoters prior to the investment and act as true partners post the investment. Showing up at a board meeting once a quarter is not sufficient. PE funds have to work closely and interact frequently with the management teams.

What are the biggest challenges for PE investors operating in India eg. Opportunities, Fund Raising, People etc?

PE investors need to demonstrate stronger value addition abilities to their portfolio companies.

PEs are going to be the fourth dimension of Indian corporate (PSU, Indian Companies, MNC being the other three). Do you agree and why ?

I do not agree. PE firms exist to support the growth of the Companies. The Corporations and their management teams are the real players in our economy.

The relationship between PE and Entrepreneur is one of Love or Hate...

I disagree. These relationships are based on trust and partnership.

- **Mukul Gulati**
Managing Director
Zephyr Peacock India

Investor Views



Impact of PE investment on Indian Corporates

In my experience, Indian corporates have benefited substantially from getting a PE player on board in the following ways:

- better Board practices leading to a more disciplined approach to decision making rather than relying purely on entrepreneurial gut
- attracting higher quality talent by conveying a positive message on governance and business ambition
- improving ability to pursue strategic acquisitions and making a stronger international foray.

How have PEs managed the relationship with the Indian Promoters? What are the challenges?

I think it has been a learning process on both sides. For promoters, in some cases, especially those who haven't had nominee directors or equity partners in the past, there is a style change where they need to carry new stakeholders with them on major decisions. For some PE players, there is a process of discovering that the real source of influence comes from the ability to add real value rather than from the definitive docs. By and large, I would say that the relationship is working.

What are the biggest challenges for PE investors operating in India, eg., Opportunities, Fund Raising, People etc?

High levels of competition for quality deals and non-availability of experienced people are the two biggest challenges facing Indian PE.

The relationship between PE and Entrepreneur is one of Love or Hate...

I would disagree. I think the role of a PE fund is to be a constructive partner who strengthens the hands of the Entrepreneur, while the Entrepreneur needs to be conscious of his obligations and watch out for the interest of the PE fund. As long as this equation gets established, there is no reason for the relationship to be rocky.

- **Dhiraj Poddar**
Director
TA Associates

Investor Views



Impact of PE investment on Indian Corporates

Investment in a company by PE investor is in a sense an acknowledgement of the company's strong value proposition and confidence reposed on the entrepreneur's or management team's abilities.

In small and medium businesses in India that we target for investment, a dearth of in-house business support infrastructure in the form of experienced managers and strategic planners form considerable barriers as innovative entrepreneurs attempt to scale up. We are now seeing that entrepreneurs seek the support of PE investors and expect them to play a meaningful role in addressing some of these gaps.

Apart from providing the much needed equity funds, the role of PE investors now includes helping companies to become more professional, inculcating higher corporate governance standards, helping install more resilient systems and processes to enhance operational performance, assisting in raising new rounds of capital and providing access to their own business networks. PE investors also at times play a role in helping companies bring in senior management personnel at the key operational levels to manage growth.

In Aureos we call this the PE+ approach and in addition, since we are a global firm with 29 offices serving 50 emerging markets worldwide, we are able to leverage these relationships to enable

businesses expand across borders. Aureos has found that great value comes from building on leadership values and leveraging the responsible approach towards business, to deliver more than just investor returns.

How have PEs managed the relationship with the Indian Promoters? What are the challenges? Is the relationship between PE and Entrepreneur Love or Hate...?

Over the years Indian entrepreneurs have begun to see PE as a credible source of capital with a distinct value proposition rather than as a funder of last resort. A key question that entrepreneurs are now focusing on is whether the PE partner can bring any other tangible or intangible value apart from funds.

The relationship between an entrepreneur and investors is in many ways like a marriage - rapport, patience and transparency are key. Investors are now increasingly playing the role of a sounding board to the management team and providing positive enhancements which are appreciated by the promoters. We at Aureos try to ensure that interests are aligned and entrepreneurs are able to achieve their full potential.

Building relationships both at professional as well as personal levels requires hard work by all parties. The same can be achieved early when all parties look beyond the immediate transaction and try to support each other to get to their respective goals and create a win-win situation. It is therefore

Investor Views

important for both parties to spend enough time with each other prior to the transaction and set their expectations clearly. We at Aureos have had a very positive experience with all the entrepreneurs we have worked with.

What are the biggest challenges for PE investors operating in India eg. Opportunities, Fund Raising, People etc?

The biggest challenges for PE investors in today's environment are people and opportunities.

People: PE investment is a people business. As in all growing businesses, finding and retaining quality people with the appropriate expertise coupled with right cultural fit is a constant challenge.

Opportunities: Riding on the back of strong underlying fundamentals, India remains an attractive investment destination. Not surprisingly therefore, the competitive landscape for PE Investors in India has been intense in the last few years. Finding the right opportunities at the right price and closing transactions within reasonable timeframes remain continuing challenges. Going forward, profit or earnings growth and not multiple expansion is likely to drive value creation for investors.

Active involvement by PE investor would be required for creating significant additional value in Companies.

We at Aureos seek opportunities in small and medium sized businesses in underfunded sectors with growth potential. In our experience, transactions in that segment are substantially relationship driven. We therefore commit extensive resources to building and maintaining personal relationships with key deal providers and entrepreneurs in order to seek appropriate opportunities for the Fund.

- **G. V. Kumar**
Partner
Aureos India Advisers Pvt. Ltd.

Investor Views



PE in India has so far largely been a growth capital market where investors take minority stakes and depend on the Promoters to scale the business. In growth capital investing, the entrepreneur is at the centre of a PE investor's strategy. Having aligned our interests completely with the Promoter, PE funds are ancillary beneficiaries of a Promoters' success. Hence, it is imperative that the Promoters and Investors have a good working relationship.

Investors bank on the Promoter's domain capabilities while playing a role in strengthening the senior management team, improving systems, processes, governance, fund raising and IPO. Since there is a clear demarcation of responsibilities, the Promoters are able to focus on their core competencies of driving growth while leaving capital raising and other aspects to the investors. However, promoters have to display keenness to make best use of the expertise that PE funds bring to the table to enhance the profile of their companies and gain traction in the business.

Indian promoters are excessively focused on valuations. They should realise that valuations are notional; growth, execution and choosing the right PE partner are keys to success in the long term. Also, only if PE funds make the expected returns will there be a sustained flow of long-term PE capital into Indian enterprises and next generation entrepreneurs.

Good corporate governance has become an essential ingredient to attract quality investors. Indian public markets have also become discerning about this and are willing to pay a premium for companies with good corporate governance while at the same time punishing companies that are suspect. Promoters should therefore display enthusiasm embracing good corporate governance practices and take the assistance of their more experienced PE partners to adopt best practices throughout the company.

- **Raja Kumar**
CEO & Managing Director
Ascent Capital

Investor Views



Impact of PE investment on Indian Corporates

The full impact of PE investments on Indian corporate, particularly companies that would be classified in the midcap size is yet to play out. Indian companies have utilised PE for only their capital requirements. However, PE investment from the right firms is much more than just capital – it involves the entire spectrum from inputs on strategy & business model, improvement in operations (both of the prior achieved through PE firm's network) enhancement of governance, HR and compliance standards, increased discipline in capital allocation and financials through focus on right metrics, amongst others. Actis's work at companies such as Paras, Glenmark etc. are examples.

How have PEs managed the relationship with the Indian Promoters? What are the challenges ?

PE firms in India have very differing business models. Whilst some are pure capital providers, others take varying levels of interest in their portfolio companies. Nature of relationships therefore also vary. In general we have not heard of too many public discords between PE firms and promoters, but I am certain there are bound to be some. Managing a PE investor is no different from managing a new partner in the business, hence challenges in a PE-Promoter relationship relate to difference in opinion about strategy, execution, time and method of liquidity etc.

However, in a well diligenced investment (where both the promoter and the PE firm gain a good understanding of each other), these differences of opinion can be rationally ironed out.

What are the biggest challenges for PE investors operating in India eg. Opportunities, Fund Raising, People etc?

It would be people – management in other words. It not only requires a great leader (promoter / CEO) but also a strong team to firstly create differentiated business that attracts a PE firm, and secondly (and more importantly) continue to execute on the differentiated platform to build value for both the parties. There has been a marked change for the better in the past decade with promoters realising the importance of a first class team. In parallel three decades of liberalisation has spawned managerial talent across all levels. The challenge for PE firms is to find a well developed team that can be backed to create value in an increasingly dynamic market.

PEs are going to be the fourth dimension of Indian corporate (PSU, Indian Companies, MNC being the other three). Do you agree and why ?

PE firms seldom own companies in perpetuity given the constraints of the PE model. Hence I would disagree that there will be a permanent addition to the three categories listed above.

Investor Views

However, I entirely see, if one were to trace the history of a company, a formerly PE owned/ invested Indian company or an MNC. There are several examples of companies in the more developed PE markets of the US and the EU where many professionally managed companies (that is no single controlling shareholder) originated from PE portfolio. KKR used to own Gillette before it was listed and eventually taken over by P&G.

The relationship between PE and Entrepreneur is one of Love or Hate...

This needs to be put in perspective. Historically, Indian PE funds were perceived as passive financial investors. The entrepreneurs expected them to provide capital for growth, valued their contribution to improvements in financial management and governance but did not consider them capable of adding value on the operational side. Hence any attempt to add value to the business was seen as interference.

Over the last few years many India companies have realised and acknowledged that some PEs can add value to the operational areas. PEs which are able to add value on operational side have high-quality operational capabilities in their team and on their advisory panel. Paras is a classic example where Actis helped the company with improvements in distribution and brand management.

**- Homer Paneri
Principal
Actis Private Equity**

Investor Views



In light of recent economic and policy developments in key areas such as telecom and banking, what are your expectations from the Indian PE and VC space in the coming years?

We expect US\$ 70-75 bn of PE and VC investments in India during 2010-2015. To understand the break-up of this, about US\$ 22 bn is expected to be required for follow-up funding of 660 current PE-funded companies. Then, about 2000 companies in IT/ ITES, manufacturing, engineering & construction and healthcare are expected to attract close to US\$ 30 bn in new PE and VC investments during 2010-15. Further, we see new investments in sunrise sectors such as Telecom (US\$8bn+ potential driven by developments such as 3G rollout etc.), BFSI (US\$ 6bn+ potential driven by grant of new banking licenses), energy (US\$5bn+ potential as supply-demand gap widens), education (US\$2bn+ potential as regulations become more favorable) and retail (US\$2bn+ potential driven by favorable government policies and increasing foreign participation).

In light of recent initiatives such as launch of 3G services, what can be expected from the Technology VC space in the coming years?

India is expected to witness close to US\$ 7.5 bn of technology VC investments during 2010-15. With positive trends in telecom (3G rollout), Internet (rise of data cards and Internet dongles, affordable smartphones) and other technology sectors such as cleantech, technology will continue to act as a medium through which VC investors can benefit from India's economic growth.

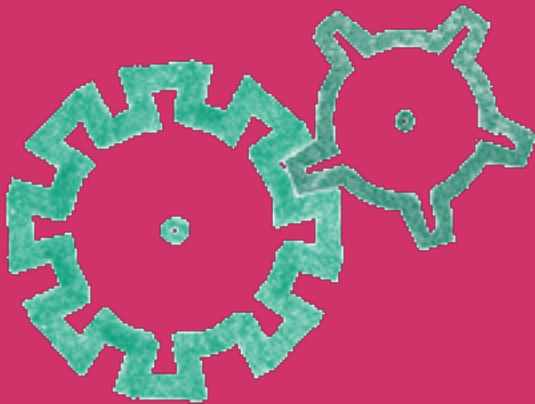
With several global technology VC funds present in India, what makes IDG Ventures' investment approach unique compared to these other funds?

IDG Ventures India invests in companies that have a disruptive technology or a differentiated business model with a strong domestic market and potential to grow global, backed by a sound management team.

We have nurtured innovation over the years through a combination of innovative engaging mediums. We provided seed funding to our portfolio company 3DSoc, while we invested in Aujas through our Entrepreneur-in-Residence model. IDG Ventures is also the only Venture fund in India to sign a Cooperation MOU with a multi-national corporate. Partnering with global firms allows IDG Ventures India's portfolio companies to leverage their expertise in global markets in scaling up their own businesses. Partnering also opens up new channels to reach out to entrepreneurial ventures with a good potential.

IDG Ventures India has a strong focus on building a knowledge repository on various sectors of potential high growth. Investment professionals at IDG Ventures India engage in deep research on high growth sectors to build a knowledge base and gain insights on fundamental drivers of growth. Extensive research has been conducted over the years, both in-house and through academic interns from top B-schools of the country.

**- Sudhir K Sethi
Founder, Chairman & MD
IDG Ventures India**



Private Equity Process

Private Equity Fund Raising

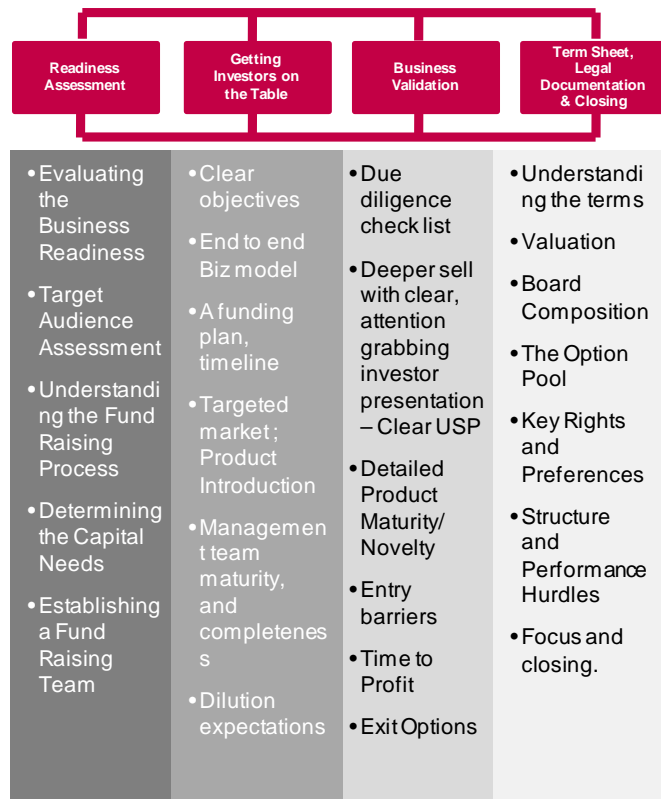
Many entrepreneurs see the capital raise process as a litmus test for the firm. PE players are sophisticated investors and are expected to bring in professional insights into the business, prepare for the quantum jump and suggest the road ahead. It is therefore equally important for the entrepreneurs to market the company as much as it is to market its products. The process is intense and therefore needs committed time, energy and resources on the part of the entrepreneur.

On its part, the PE player values the Company on a variety of parameters, which include the business model, growth strategy, management team, product maturity, market potential, customer confirmation, dilution expectations and exit options to conclude the capital needs assessment.

“I think the role of a PE fund is to be a constructive partner who strengthens the hands of the Entrepreneur, while the Entrepreneur needs to be conscious of his obligations and watch out for the interest of the PE fund. As long as this equation gets established, there is no reason for the relationship to be rocky.”

Dhiraj Poddar
Director, TA Associates

Entrepreneur Process



Investor Process



Private Equity Deal Structuring

Deal Structuring – Even when there is a broad agreement on valuation, an improper deal structure can act as a deal breaker. PE players in India, in many cases, have had to adapt their strategies to accommodate the Indian promoter. In the choice of securities for investment – the use of non voting preferred over a longer horizon, the use of Mezzanine debt, etc. are being considered. Similarly, the legal documents are far less tighter than in the more developed countries with pay to play provisions for anti dilution, loose covenants etc., being given careful thought.

Staged Financing – Phased financing is essentially investment at different stages and if the company meets certain milestones, a strategy to protect investors who target growth companies. This acts as a win-win for both the PE players and the entrepreneurs with the investor cutting the risk and the company getting access to capital. This kind of financing is especially useful in some sunshine sectors like early stage cutting edge technology companies, pharma R&D companies to name a few.

Syndicated Deals – With rising valuation expectations, on the back of the recent economic downturn, private-equity firms in India are diluting the risk of investing in assets by clubbing together. Syndicated Investing, wherein a set of PE players collaborate to invest in companies, combine a credit view with equity upside. The lead investor sources the deals and takes a portion of the transaction, giving an added comfort level to the other investors. These structures help the PE players reduce the risk and take exposure in certain key sectors like Infrastructure, Power etc.



Private Equity Deal Structuring

Private Investment in Public Equity (PIPE) deals - A private investment in public equity, often called a PIPE deal, involves the selling of publicly traded common shares or some form of preferred stock or convertible security to private investors. For PE investors, PIPEs tend to become increasingly attractive in markets where control investments are harder to execute. Generally, companies are forced to pursue PIPEs when capital markets are unwilling to provide financing and traditional equity market alternatives do not exist for that particular issuer.

Following the new rule of minimum 25 per cent public float for listed companies, PIPE deals should be back in vogue. While promoters could dilute stake without unsettling the market price, PE funds will benefit as they can buy stake in some quality companies at good value as promoters are also under some pressure to dilute stakes.. It will also ease the ability of the PE investor to exit since the company is already listed.

Corporate Debt – Difficult economic conditions are often a good time to seek out opportunistic investments as prices decline. PE funds make use of distressed debt and restructuring funds which may do well in the short term and also in longer term opportunities such as mezzanine funds and middle market buy out funds with an operating focus to start extending their footage in the companies and thereby the sector of their interest. The advantage is that PE funds can follow this up with an equity funding. By then, they can raise the company's valuation and build a better relationship with the promoters.

Is your business ready to partner with PE?

- Have you determined the objectives for your business and you personally?
- Have you researched advisors that can critique your plans?
- Is your transaction team in place?
- Do you have experienced, knowledgeable management teams?
- Are your customer relationships strong?
- Are your suppliers' contracts in order?
- Is your balance sheet clean and accurate?
- Is the company tax compliant?
- Are all of your financial statements in order?
- Have you had an audit?
- Have you rectified and lawsuits or pending legal obligations?
- Does the company have adequate insurance?
- Have you addressed any issues with accounts receivable or inventory?

“Any fool can buy a company. You should be congratulated when you sell.”

Henry Kravis, Founder, KKR

Due Diligence – The New Paradigm

Robust Diligence in these times to make deals successful

The recent events of Satyam and Subiksha have clearly raised concerns in the minds of the investor community on the reliability of financial information and the integrity of management. Hence, robust due diligence is the need of the hour and private equity investors are clearly focused to enhance quality of due diligence.

PE investors typically sit on Boards of their investee companies and hence, they become liable for the various acts of the investee companies and get bound by the Indian Regulations starting from India Companies Act, FEMA, Income Tax Act as well as Foreign Corrupt Practices Act (FCPA).

Due diligence should focus on the various risks and opportunities of the business of the potential investee companies. Due diligence should focus on the various risks ranging from commercial and market risks, legal and regulatory risks, financial risks and most importantly, reputation risks.

Hence, a robust due diligence process would typically cover the following areas of due diligence:

- integrity due diligence on the promoter
- commercial and operational due diligence
- financial, Tax and Legal due diligence
- environmental due diligence (particularly important for investments in Infrastructure and chemical sector)

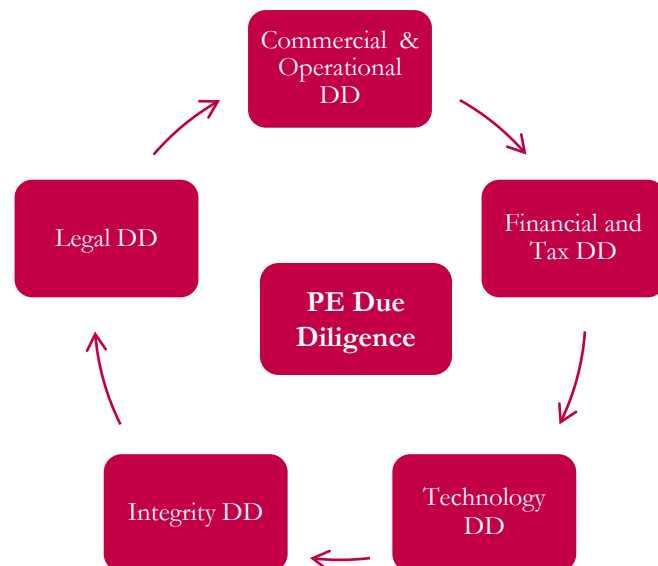
The paradigm is of course not to get completely carried away by focusing only on the risks but also the ability to identify the opportunities and strengths of the potential investee companies.

Identification of risks and opportunities and the strategy for risk mitigation and capturing the market opportunities would be key for successful deal making in 2011.

Diligence for Private Equity

Post the financial crisis and the demand for value creation from investee companies, PE buyers have increased the focus on effective due diligence. Increased level of certainty is being demanded before putting in money. The due diligence process is critical in a successful business transaction to ensure that the buyer is getting the most for its money and that there are not any major surprises after the documents have been signed. A thorough review of what is being bought is the best insurance against any unwanted surprises down the road. Although the overall procedure has not necessarily been affected by the financial crisis, the due diligence has become broader in scope. PE buyers look to financial, tax, integrity, commercial & operational and legal due diligence services to support the financial investment case.

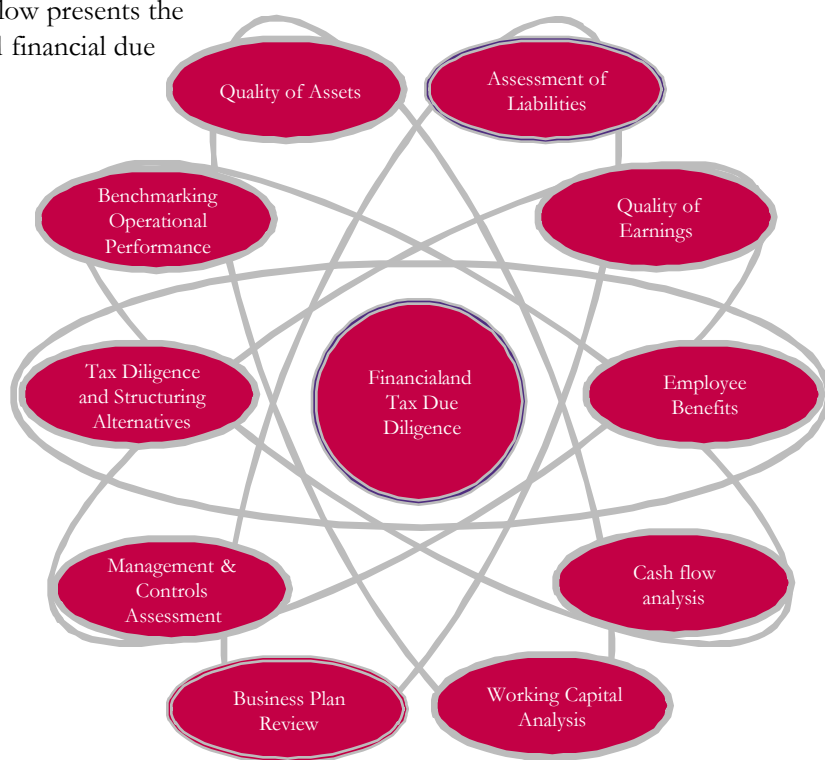
An effective due diligence requires understanding the investment objectives, involving a sector specialist team, defining the diligence scope, pre-planning the diligence methodology, identifying sector specific issues, defining the timelines and agreeing the communication protocols. Non-communication of investment objectives, adopting an undefined methodology, involving inexperienced resources, lack of sector knowledge and diligence execution with undefined scope will result in time consuming ineffective diligence without producing information needed for effective decision making.



Diligence for Private Equity

Financial & Tax Due Diligence

Financial Due Diligence is an important aspect of the entire transaction. Financial due diligence assessment traditionally emphasised only on financial aspects through measures such as inventory turn, variability of sales, differences between sales forecasts and actual, levels of WIP, etc. However, in the current times financial due diligence also focuses on certain matters covered in commercial and operational due diligence as well. Different advisors focus on different issues; some analyse every aspect of the Target Company capital structure; others want to focus on profitability, while others are especially concerned with employee relations. Often the areas of concern reflect problems which the advisors have faced in past deals. The chart below presents the scope covered in a well executed financial due diligence.



Diligence for Private Equity

Commercial & Operational Due Diligence

Commercial due diligence is playing a much more significant role in PE as investors get back into investing mode, with a far greater focus on planning for downside scenarios. Although financial due diligence specialists review certain aspects covered by commercial and operational due diligence, the financial due diligence team is highly unlikely to have sufficient time to delve deeply into the operational and commercial reasons behind the numbers included in the financial records. PE investors are increasingly being recommended to focus more effort on commercial and operational due diligence to reduce investment risk. The chart below presents the key areas to be covered in a commercial due diligence.



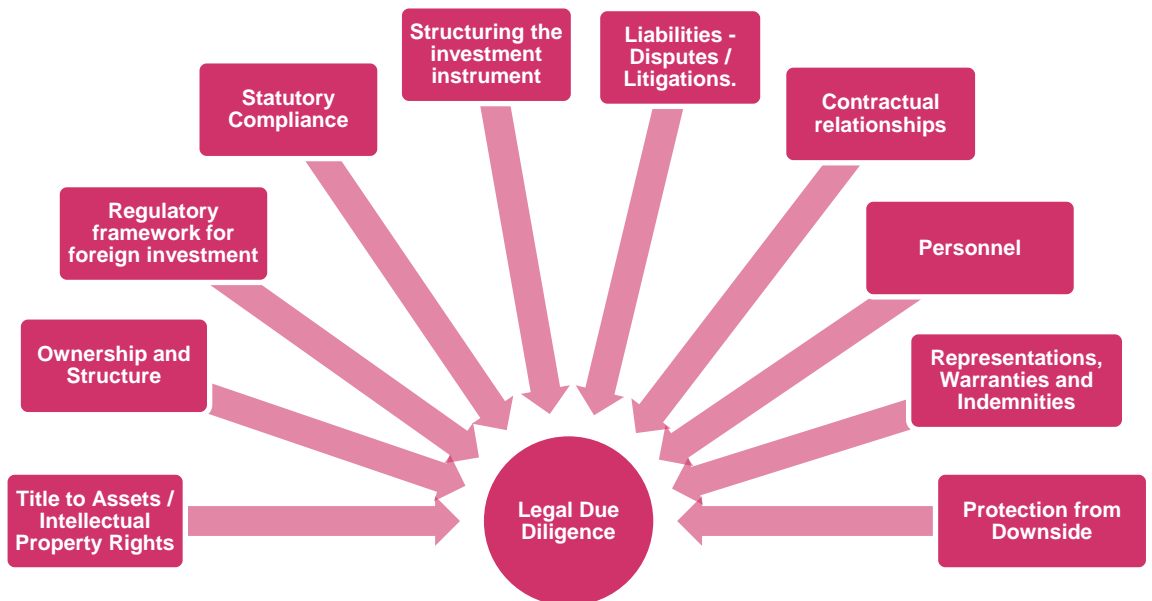
Diligence for Private Equity

Legal Due Diligence

Integration of India into the global economy, increasing foreign equity participation in all sectors and rise in the number of laws that are applicable to any business has increased the importance of legal due diligence in a corporate transaction. The legal due diligence process is very critical to determine whether the company concerned presents a good investment opportunity to the investor, and also to determine the other important aspects of the deal such as valuation of the company, the nature of representations and indemnities to be taken from the company and its founders, etc.

Moreover, given the complex corporate, securities, exchange control and taxation laws, conducting thorough due diligence of the investee company is very crucial. The main areas to be covered in a legal due diligence are covered below:

Major issues uncovered in legal due diligence will often echo other concerns the investors have discovered in their financial and commercial due diligence, and the combination can kill a deal.



Key Due Diligence Questions to address in a Private Equity Transaction

Key deal question	Key questions	Indicative Analysis / Steps to address the key questions
Are we comfortable with the reputation of the promoter and are there any integrity and ethical issues?	<ul style="list-style-type: none"> • What is the reputation of the promoter / entrepreneur in the market – is the person seen in the market with low business ethics? • Does the promoter have any pending litigations against him and what could be the potential risks to business in the future ? 	<ul style="list-style-type: none"> • Carry out an Integrity Due Diligence on the promoter is very important to the deal
How good is the quality of customer base in terms of customer retention, customer losses, pricing as compared to competition and customer satisfaction?	<ul style="list-style-type: none"> • How is the quality of customer base – does it have the top clients which would contribute to future growth or does it have clients which are facing growth challenges? • Has the company lost clients in the recent past and if so, what are the key reasons? • What is the quality of the product/ service and quality control mechanisms which are in place? 	<ul style="list-style-type: none"> • Analyse the revenue growth in the past 3-5 years and understand the quality of growth and quality of the customer base • Understand the impact of customer losses on the business and reasons for such losses • Analyse the quality of sales pipeline in terms of new client additions, probability of client conversions • Analyse the pricing trends and profitability by customers • Carry out a customer due diligence by speaking independently to customers to assess the business potential, customer satisfaction levels
What are the key growth drivers in the market and key challenges?	<ul style="list-style-type: none"> • What are the key drivers in the market in which the Company is operating – challenges and opportunities? • Who are the key competitors and what are the strengths and weakness of the Company ? 	<ul style="list-style-type: none"> • Carry out a Market Due Diligence to assess the market dynamics, opportunities and challenges, competitor analysis – financial and operational
Quality of corporate governance	<ul style="list-style-type: none"> • Are there significant related party transactions ? • Is the Group structure complex and does the Company have aggressive tax and regulatory practices? 	<ul style="list-style-type: none"> • Evaluate the corporate governance framework in the Company • Analyse the related party transactions and impact on revenue and earnings

Key Due Diligence Questions to address in a Private Equity Transaction

Key deal question	Key questions	Indicative Analysis / Steps to address the key questions
What is the sustainable / normalised level of earnings of the business ?	<ul style="list-style-type: none"> • What are the key business drivers impacting earnings? • Are there any one-off items impacting historical reported earnings such as one-time revenues, one-time costs ? 	<ul style="list-style-type: none"> • Analyse the historical reported earnings and identify one-off items such as one-off revenues, one-time costs etc
How reliable and achievable is the business plan ?	<ul style="list-style-type: none"> • Are the assumptions used in the projections in-line with historical trends? • What are the key assumptions/ sensitivities to the business/valuation model? 	<ul style="list-style-type: none"> • Analyse the business plan with respect to the key assumptions and how has management performed in the past against the budget ? • Benchmark the earnings of the company with comparable industry players and evaluate the sustainability of such earnings
What is the quality of cash flows and working capital levels ?	<ul style="list-style-type: none"> • How do earnings translate into cash flows and what is the level of free cash flows generated in the business? • What is the level of dependence on external financing and promoter/related party financing? • What are the normal levels of working capital requirements of the business? • Are there any sticky debts due from customers? 	<ul style="list-style-type: none"> • Analyse historical cash flows to assess the level of cash generated from operations and strain, if any, on cash availability post capex requirements • Analyse borrowings and the key financial covenants, repayment obligations and security offered • Evaluate the ageing of trade receivables and potential recovery issues
What is the quantum of net debt ?	<ul style="list-style-type: none"> • What are the debt like items which are included as part of current liabilities and off-balance sheet items • What are the key tax exposures? 	<ul style="list-style-type: none"> • Analyse borrowings and the key financial covenants, repayment obligations and security offered • Identify the debt like items such as overdue creditors, contingent liabilities, tax exposures

Key Due Diligence Questions to address in a Private Equity Transaction

Key deal question	Key questions	Indicative Analysis / Steps to address the key questions
Quality of senior management and compensation levels	<ul style="list-style-type: none"> • What are the trends in compensation (fixed and variable) ? • What have been the trends in attrition over the historical period and the key reasons for the same? • What are the key terms of the management employment contracts? Are there any onerous terms contained in such contracts? • Does the Company have ESOP's? What is the impact of the transaction on the ESOP's issued by the Company? 	<ul style="list-style-type: none"> • Analyse head count and compensation levels as at latest period end, by function and grade • Analyse attrition rates and reasons for attrition • Inquire into and comment on arrangements with senior management in relation to employment terms, golden parachutes, non-compete, interest free loans etc
What are the key tax exposures ?	<ul style="list-style-type: none"> • Is the company availing of any tax holidays that may expire in the near term? • Has the Company been compliant with Direct and Indirect tax laws in India? • Are there any significant contingencies against the Company? • Has the Company made adequate provisions against outstanding liabilities? 	<ul style="list-style-type: none"> • Carry out a full fledged tax due diligence focused on the direct and indirect tax issues • Evaluate the effective future tax rates that would need to be built in the business/ valuation model

Portfolio Valuation

The global financial crisis brought with it a number of changes in the way financial sector operates. One of these changes is that LPs have started demanding more clarity in reporting and we are seeing an increasing demand for portfolio Valuation from PE funds. There is demand for regular and independent assessment of Fair value of investments by independent Valuers. We detail below some of the typical frameworks that are used for Valuing Portfolios and considerations and implications in determining Fair Value.

Valuation frameworks

The increasing importance placed by international accounting authorities upon transparency over fair value reporting in the PE industry has reinforced the need for the consistent use of valuation standards worldwide. Despite the arrival of fair value as the guiding principle of valuation, valuation of PE and VC investments remains challenging given the growing complexity of PE transactions and volatile market conditions.

The reporting guidelines set out by industry bodies only provide recommendations on best practices in the valuation of PE and VC investment. The framework of guidelines and Standards that are currently applicable to the valuation of PE investments, which can be chosen by the PE Fund's reporting requirement include:-

International Private Equity and Venture Capital Guidelines (IPEVC)

The IPEVC valuation guidelines were developed by the Association Française des Investisseurs en

Capital (AFIC), the British Venture Capital Association (BVCA), European PE and Venture Capital Association (EVCA), and find endorsement by over 37 regional and national associations. The IPEVC valuation guidelines, which superseded in 2005 the erstwhile EVCA guidelines, were revised in September 2009 and are based on the overall principle of 'fair value' in order to be broadly consistent with IFRS and US GAAP accounting requirements.

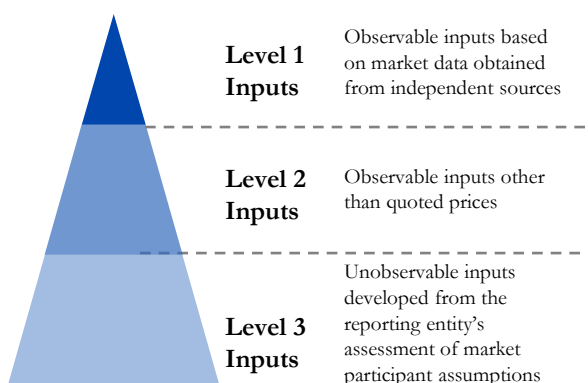
The IPEVC valuation guidelines can be applied to PE funds, financial instruments commonly held by such PE funds, as well as to investments held by other entities in such PE fund, providing the framework for consistently determining valuations for the different investments held by them. The underlying principles of valuation as per IPEVC guidelines are to assess the fair value of each investment at each Reporting Date, and apply a methodology that is appropriate in light of the nature, facts, circumstances of investment and its materiality in context of total investment portfolio and use reasonable data and market inputs, assumptions and estimates. Also, the definition of 'Fair value' as per IPEVC guidelines is broadly consistent with US GAAP as well as IFRS.

Adoption of IPEVC guidelines is gaining favor in the PE industry, given that it aids international financial reporting compliance through convergence with US GAAP and IFRS on fair value, and provides a consistent yardstick for measurement of investment performance across funds.

Portfolio Valuation

PE Industry Guidelines Group (PEIGG)

Formed in February 2002, the PE Industry Guidelines Group is comprised of a volunteer group of industry wide representatives who have come together to debate and establish a set of reporting guidelines for the industry. PEIGG is a broad-based alliance of general partners, limited partners and service providers participating in PE industry in the US. PEIGG Guidelines are followed mainly by PE funds where the financial statements are prepared under US GAAP, which require reporting of its investments mainly to US Investors. The PEIGG Guidelines assist PE participants in complying with the US GAAP which requires fair value reporting under FAS 157. As per the guidelines, all investments should be valued at the fair value.



Fair value Measurements under USGAAP-ASC 820/SFAS 157 and IFRS

The point of convergence, therefore, in the above two widely used standards, is the concept of fair value, which is fast becoming the yardstick for all PE fund valuations. fair value, at its core, is the rational and unbiased, potential market price for a good or service.

SFAS 157 requires portfolio companies to be reported at fair value and provides a fair value hierarchy for financial reporting that prioritises the inputs to valuation techniques used to measure the fair value, but not the valuation techniques themselves. By creating a single, comprehensive definition of fair value, the FASB hoped to improve the transparency of corporate accounting practices and provide a standard framework for valuation. IFRS also prescribes application guidance on specific considerations in ascertaining the fair value of an asset/liability.

However, it is relevant to note that though the fair value concept is supported as a whole, the value estimated for a financial asset is only as reliable as the valuation techniques used. Even though sophisticated valuation models continue to be developed, judgment is a critical part of the valuation process; competent persons will arrive at different estimates of fair value for identical instruments. IFRS address this by periodically requiring a calibration of the valuation technique and testing for its validity using prices from any observable current market transactions in the same instrument or based on any available observable market data.

Portfolio Valuation

Valuation of PE Funds: Special Considerations

Since PE funds often enter companies at various stages of development, they structure their investments in ways commensurate with the circumstances. PE firms typically use a variety of clauses such as preferred returns' clause, anti-dilution clauses, ratchet clauses, commitments on follow-up investment and non-compete clauses, in making their investments. Investment may also be in the nature of mandatory or optionally convertible preferred stock arrangements, stock options and warrants, convertible instruments, floating conversion price, resets and instruments with similar characteristics, and mezzanine financing. Most of these arrangements are designed with a view to ensuring a minimum guaranteed return to the Fund. In addition to the effect on control exercised by these clauses, current/future rights of investors and investment risk could also trigger events contingent upon future parameters. Further, most of the investments would be typically in unquoted companies and to estimate the fair value of the investment one may require application of discounts for lack of marketability and illiquidity in addition to some of the discounts or premiums commonly applied in valuations.

From a Valuer's perspective, the investment instrument, terms of funding and contingent trigger events have a significant impact on the valuation of the investment and the fund portfolio, and must be duly considered.

“Since PE funds often enter companies at various stages of development, they structure their investments in ways commensurate with the circumstances. PE firms typically use a variety of clauses such as preferred returns' clause, anti-dilution clauses, ratchet clauses, commitments on follow-up investment and non-compete clauses, in making their investments.”

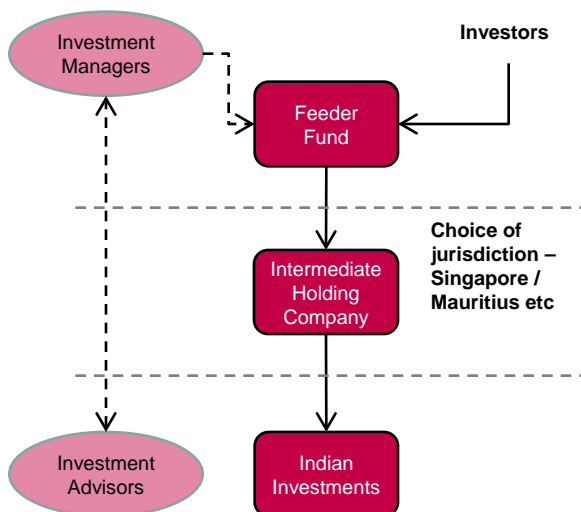
Private Equity Fund Structuring

India, as one of most stable and fastest growing emerging markets, is an attractive destination for PE fund investments. In spite of the global economic slowdown, PE deal value in India doubled in 2010 as compared to 2009. Structuring a Foreign PE fund for investment into Indian companies is a complex exercise as it involves interplay between the investors, a fund and the actual investment target situated in different tax jurisdictions. Each of these persons has a special role to play in an investment activity and careful tax planning is essential to protect the income flows and prevent taxation in multiple tax jurisdictions. Further, India is on the threshold of a significant change in its direct tax laws with the Direct Taxes Code ("DTC") Bill tabled in the Parliament on August 31, 2010.

Mauritius has generally been a preferred jurisdiction for routing investments into India primarily because of the favourable tax treaty between India and Mauritius which provides beneficial tax treatment to capital gains. As per the tax treaty, capital gains generated by a Mauritius resident on sale of shares would be liable to tax only in Mauritius and not in India. Mauritius does not however tax capital gains under its domestic law.

The popularity of Mauritius as an investment jurisdiction also stems from the fact that the Indian tax authorities have clarified, via issue of a circular, that a tax residency certificate issued by the Mauritian Revenue Authorities would constitute sufficient evidence for accepting the status of residency and beneficial ownership of the Mauritius entity. The Supreme Court has also in the case of *Azadi Bachao Andolan* confirmed the availability of tax treaty benefits to a Mauritius resident subject to tax residency certificate provided by the Mauritian Revenue Authorities. There have however been instances in the past in the case of *NatWest Bank Plc* where the tax authorities have disregarded conduit /shell intermediate holding companies and consequently denied tax treaty benefits.

The clarificatory circular and ruling of the Supreme Court does not seem to have settled the dust as various authorities (especially at the lower levels) are challenging the validity of tax residency certificate and the consequent substance in Mauritius entity to claim the benefit under the tax treaty.



Private Equity Fund Structuring

The authorities have been holding that the criteria required to be fulfilled to claim the benefit under the India-Mauritius tax treaty was that of "effective management" and the tax residency certificate does not substantiate the same in Mauritius.

Certain other jurisdictions (depending on the nature of income) such as Singapore, Cyprus, Netherlands etc, can be considered as holding company jurisdictions for investing in India. The protocol to the India-Singapore tax treaty provides that the Singapore tax resident would enjoy the same capital gains tax exemption as a Mauritius resident subject to satisfying the "limitation of benefit/substance" provisions. As per the protocol, a shell / conduit company in Singapore would not be eligible for the beneficial tax treatment of capital gains even if it is a tax resident of Singapore. Based on the guidelines provided in the protocol, a Singapore resident entity would not be considered as a shell / conduit entity provided:

- it engages in real and continuous business activities in Singapore; and
- it is listed on the recognised stock exchange of Singapore or its total annual expenditure on operations in Singapore is equal to or more than S\$ 200,000 in immediately preceding period of 24 months from the date the capital gains arise.

Similarly, the India-Netherlands tax treaty provides that capital gains on sale of shares by a Dutch tax resident to a person (not being resident in India) would be liable to tax only in Netherlands and not India. However, the Dutch tax law provides for a full participation exemption (on both dividends and capital gains) for domestic and foreign shareholdings held by Dutch holding companies under the participation exemption regime.

The conditions for qualifying for the participation exemption include the requirement for the Dutch holding company to hold an interest of at least 5% in the nominal paid up capital of the subsidiary and the participation in the subsidiary to be held for business reasons (motive test) and not mere portfolio investment. Various factors are considered (active management in subsidiary, assets test) while analysing the motive test.

Cyprus residents are also eligible for beneficial tax treatment on sale of shares under the Cyprus-India tax treaty with the tax treaty requiring only the resident country of the seller (ie, Cyprus) to tax the gains. Cyprus, under its domestic tax legislation, does not tax capital gains on sale of shares (except where shares sold are of a company whose assets include immovable property in Cyprus and is not listed in a recognised stock exchange). The Indian government has in the past been in discussions to make amendments in the beneficial capital gains tax provisions under the Cyprus-India tax treaty via insertion of "limitation of benefit" provisions, however these amendments are still to come into effect.

Private Equity Fund Structuring

Considering the above, building substance into the intermediate holding company would be an important part of the entity set up. In order to simplify substance building at a legal entity level, PE funds proposing to set up multiple holding companies in one jurisdiction for various investments could consider Protected Cell Company structures (permitted in certain countries including Mauritius) which allow holding of various investment vehicles as cells (each cell with control of its own assets and liabilities) within the same legal entity.

Apart from the substance consideration, PE funds also need to contend with uncertainty regarding tax treatment of capital gains as certain jurisdictions, notably Singapore, look to treat the income from sale of shares as trading income in some situations. The Approved Holding Company regime in Singapore which provided certainty on the capital gains tax treatment on sale of shares has expired and there is uncertainty with respect to tax treatment in Singapore on sale of shares, especially with respect to investment funds. However, notwithstanding this, Singapore provides various tax incentives for fund management (including for fund managers) and financial sector industries which could be a key criteria in selecting an appropriate jurisdiction.

In light of this, key criteria for PE funds in selecting an appropriate jurisdiction should be the availability of clear substance rules / guidelines in such jurisdiction and clarity on treatment (i.e., trading income or capital gains) of the share sale transactions.

In addition to structuring the investment through an appropriate jurisdiction, it is important to ensure that the PE fund/investment advisor (from an exchange control perspective, if the investment advisor firm has been set up in India with foreign direct investment, it needs to comply with certain minimum capitalisation norms as applicable to a non-banking financial companies) to the PE fund does not create a permanent establishment in India. Where a permanent establishment is created, the income earned by the PE fund attributable to such permanent establishment could be subject to tax. A permanent establishment is generally created if the foreign entity is carrying on business in India either through fixed places of business (branch, office etc), employees/other controlled personnel or dependant agents who secure/conclude contracts in India on behalf of the foreign entity.

The concept of permanent establishment is wide enough to not only apply in situations where contacts are in the name of the foreign entity but also to apply in situations where agents have the authority to conclude contracts on behalf of the foreign entity even if the contracts are not actually in the name of the entity. The lack of active involvement of the foreign entity in transactions is generally indicative of the grant of authority to the agent.

Private Equity Fund Structuring

Therefore, where the investment advisor does more than identification of an investment opportunity such as carrying out due-diligence, negotiating the term sheet, maintain documentation relating to a particular transaction, being signatories to the shareholder agreement etc on behalf of the PE fund, then the fund could potentially be exposed to tax in India on its India business income. Given the lack of adequate guidance under the India tax law regarding the characterisation of gains arising from transfer of shares (especially in case of funds), it is possible that the purchase and sale of shares are treated as the ordinary business activities of the fund on account of which the consequent gain/loss on sale of shares by the fund could be treated as business income and be considered as attributable to the permanent establishment.

Given these developments in the tax law, PE funds need to tread the uncertain waters carefully and review each aspect of their transaction structure immediately. Taking cognizance of the above factors and putting in place necessary safeguards would help to avoid future surprises and ensure a healthy rate of return for investors.



Leveraging Governance for Value Maximisation

As India continues to be recognised for her high growth potential and offers both a huge market as well as a supply base, several or rather most of the cross-border and local PE Funds are wooing the emerging companies, aiming to be a part of their growth. Besides, mergers and acquisitions both domestic and international, amongst the mid-size and emerging companies are picking up speed since a lot of these have access to PE funding. But will the new capital-led technological innovation, product portfolio expansion and increased geographical outreach suffice to achieve and manage profitable growth of the funded PE portfolio companies? Or will brilliant business ideas, strategies and scaling need the support of strong internal management and accountability?

During a PE investment, significant effort is focused on pre-deal structuring and valuation. However, a lot of value remains to be realised out of a portfolio even when the right price has been paid; some value is leaked out of most deals. This arises because the assumptions in cost reductions, growth drivers or synergy benefits may not be fully achieved. Significant efforts go into market strategies and technological improvements but internal management robustness or so to say the 'governance' is often lost sight of as a matter of importance and priority.

Planning for growth with numbers, assumptions and forecasts is crucial when injecting growth capital. However, its implementation and building the organisation to scale can be the difference between realising potential and not.

Certain key issues need to be factored in, such as – sound operational & financial management, managerial capability development, speed of decision, delegating yet retaining control, improved reporting system etc.

How well the investee company is prepared for scale and sustainability is the key factor that most often determines whether the full potential is realised. It's time to give greater attention to the governance aspects of PE portfolio companies.

Governance requires a fine balance of the interests of the owners on the one hand and of the other stakeholders (lenders, employees, business associates, government etc) on the other. Since PE portfolio companies are largely family owned and managed businesses, safeguarding the interests of the owners is hardly a challenge. However, going forward, these organisations will need to increasingly manage the interests of other stakeholders if they have to scale up profitably and sustainably. To achieve and sustain profitable growth, they will increasingly need to attract and retain talented human resource. Today's business managers don't look for just a financial reward; they need an organised and transparent method of working and an environment that offers challenging roles with enough room to apply their knowledge and wisdom, and they look for an organisational culture that promotes ideation and initiative.

PE funded businesses will have to create all this to be an attractive employer brand. However, such an employee empowering environment comes with its own escalated needs of risk management.

Leveraging Governance for Value Maximisation

As they scale, companies will also need to keep their good vendors engaged for the long term through effective and transparent purchase practices in order to be able to run uninterrupted and efficient supply chains for their customers in turn. Besides, as they move to newer and bigger markets, it will become increasingly important to be ethical in the eyes of the customers, and highly compliant with various regulatory norms.

Above all, they will need to be increasingly seen as well-managed and thus attractive organisations to the investors, both current and future. The need to create and nurture a good ‘corporate’ brand in the market cannot be over-emphasised for those of the medium enterprise that aim to move to the next higher level by entering the capital market or facilitate a profitable exit of their strategic investors.

Good governance undoubtedly has a linkage to competitiveness, profitability and sustainability. Setting up a strong governance framework involves the design and implementation of an effective organisation and authority structure, high performing business processes, a motivational performance management system, sound risk assessment and risk mitigation plan, self-monitoring mechanism and a reporting system that provides the right and adequate information on a timely basis.

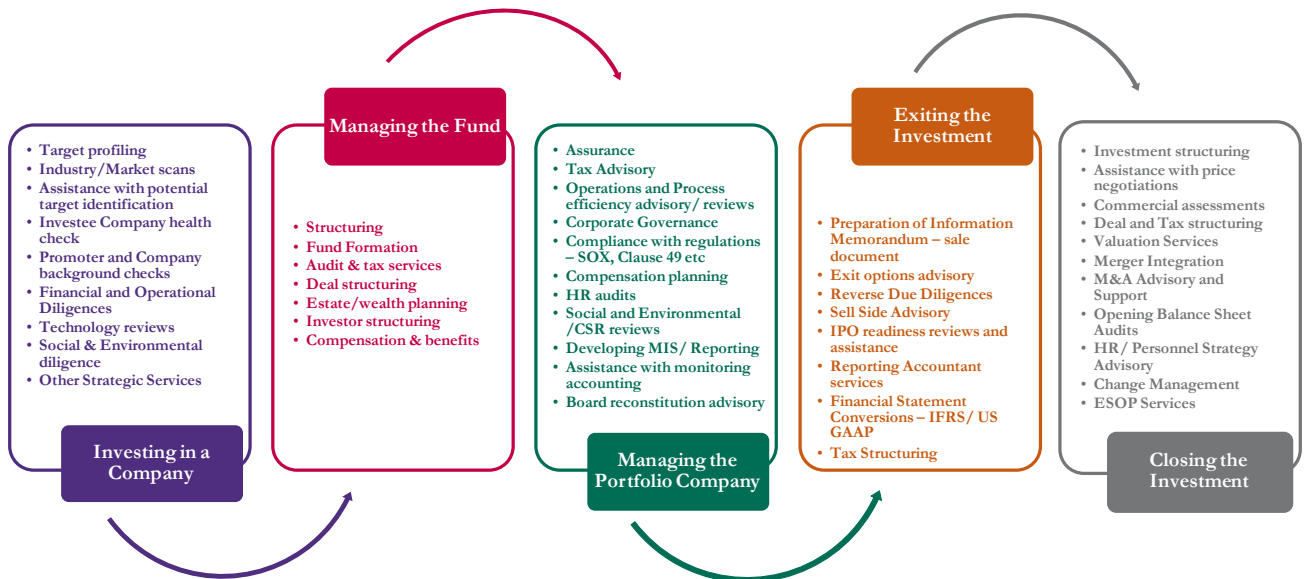
It’s initially a bit challenging to cope with the new organisational environment where entrepreneurs transition from a role of ‘managing’ to ‘strategising’ and their teams transition from an ‘executing’ to a ‘creating’ mode. However, a well-planned and informed transformational exercise minimises stress and surprise.

Finally, it is good to realise that good governance alone doesn’t guarantee success, but the lack of it is very often the cause for business failure. Is the fast-growing community of PE portfolio companies doing enough about it?



Fund and Investee Company Services

Technical excellence and distinctive client service



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The firm's mission is to be the advisers of choice to Indian businesses who have global ambitions- raise global capital, expand into global markets, adopt global standards or acquire global businesses. The firm specialises in providing compliance and advisory services to growth oriented, entrepreneurial companies, and adopts best in class international tools, methodologies and independence/ risk management standards for all its services.

As a member firm within Grant Thornton International, the firm has access to member and correspondent firms in over 100 countries, offering our clients specialist local knowledge supported by international expertise and methodologies.

Grant Thornton India has done over 700 due diligences and 750 valuations in the past 7 years and has provided assurance, business risk, valuation, consulting and business transformation services to Private Equity Funds, their investee companies and other clients. Listed below are select Funds that we work with

From identifying the right strategic fit to structuring and closing the deal, we can support you in all aspects of your transaction to maximise value.

 <p>Sale of majority stake to</p>  <p>USD 310,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>Invested in</p>  <p>USD 15,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>Invested in</p>  <p>USD 43,500,000</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>Invested in</p>  <p>USD 7,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>
  <p>Invested in</p>  <p>USD 43,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>	<p>HNI</p> <p>invested in</p>  <p>USD 7,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>acquired</p>  <p>CAD 35,000,000</p> <p>Grant Thornton acted as sole financial and acquisition financing advisor</p>	 <p>acquired</p>  <p>USD 22,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>
 <p>Invested in</p> <p>Travel Services Company</p> <p>USD 38,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>acquired</p>  <p>USD 14,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>acquired</p>  <p>Undisclosed</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>acquired</p>  <p>Undisclosed</p> <p>Grant Thornton acted as sole financial advisor</p>
 <p>acquired</p>  <p>USD 21,740,000</p> <p>Grant Thornton acted as sole financial advisor</p>	<p>True Pack India</p> <p>acquired by</p>  <p>US\$ 10,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>acquired</p>  <p>USD 75,000,000</p> <p>Grant Thornton acted as sole financial advisor</p>	 <p>acquired</p>  <p>USD 3,500,000</p>  <p>USD 3,300,000</p> <p>Grant Thornton acted as sole financial advisor</p>

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