2008 Reloaded: Ten Trends

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More Controlled Transactions in Future

There were 13 buyout transactions in 2008 as compared to 11 in 2007. The average deal size in India has also increased sharply by 125% to US$36 million in 2008, from about US$16 million in 2005. The prominent buyouts include New Silk Route Advisors acquiring Dawanay Day AV; Future Capital Holdings acquiring Centrum Direct and Centrum Wealth Managers; ILabs Capital picking up a 60% stake in Lehren Entertainment Pvt Ltd; Navis picking up a 60% stake in Sah Petroleum Ltd; and RFCL (an ICICI Venture company) buying out completely Alved Pharma and Foods Pvt Ltd, and the medical diagnostic business of Godrej Industries Ltd.

As the credit crisis surfaces, a lot of family houses or entrepreneurs in India will shed their non-core assets and focus on their core strengths. "I see a huge potential and possibility for private equity in India to get to the next level – which is to get controlled transactions," said Archana Hingorani, executive director of IIML.

Money behind the Money Dries Up

Institutional investors like endowment funds or pension funds in the US, which are typically the limited partners to venture capital and private equity funds in India, are rationalising their allocations to private equity funds. Of about 84 funds from India which are out in the market to raise capital, only about 16 of them have been able to raise a total of US$4.56 billion in the first ten months of 2008. This is in contrast to 37 funds closed in 2007 that raised a total of US$9.68 billion. In 2006, 36 funds raised US$9.76 billion. Those out on the road for fundraising believe that even having a niche franchise like infrastructure or real estate does not help. Investors realise that the era of free flow of cheap capital is over and sources of capital would now want an increase in returns.

Venture Funds Look at Growth, PIPEs

Indian venture investing has turned growth in 2008. Silicon Valley's blue chip venture capital firms such as Draper Fisher Jurvetson (DFJ) have moved beyond their pure early-stage venture investing in India. Tech-focused venture fund Norwest Venture Partners announced they would go sector agnostic in India, and would do growth and private investment in public equity (PIPE) deals. The fund hired a banker from Goldman Sachs to invest in sectors like financial services and infrastructure. Mayfield Fund raised a US$110 million India-dedicated fund earlier this month, which would also look at doing private equity type growth investments. Earlier, funds like Sequoia Capital India, Matrix Partners, Lightspeed Venture Partners and Sandalwood Partners had diversified into late-stage and growth.

The Japanese Invasion

2008 saw Japanese giants making inroads into the Indian deal space. Japanese pharmaceutical giant Daiichi Sankyo snapped up India's largest pharmaceutical company Ranbaxy Laboratories for US$4.6 billion. The deal was the biggest inbound acquisition in India. In another large deal, Japan's telco NTT DoCoMo acquired 26% in Tata Teleservices (TTSL) for US$2.7 billion.

Also the year has seen the rise of Japanese financial services firms, both globally and in India. While Japanese banking giant Mitsubishi UFJ Financial Group acquired up to a 20% stake in the then troubled Morgan Stanley, Nomura group picked up bankrupt Lehman Brothers' Europe and Asia units, including India. Mitsubishi UFJ, Nomura, Mizuho Corporate Bank and Daiwa Securities have also now established a ground presence in India.

Cleantech Investments Take Off

The sector has attracted investments from both private equity and venture capital funds. Most of the investment in this sector was in segments like photovoltaic (PV) and renewable energy service providers. IDFC PE has invested in three cleantech deals – co-investing US$92.5 million in Moser Baer PhotoVoltaic, a fully-owned subsidiary of Moser Baer; US$100 million in SE Forge Ltd, a components manufacturing subsidiary of Suzlon; and US$10 million in carbon credit advisory firm Emergent Ventures. Renewable energy company Orient Green Power Ltd also raised US$55 million in a private equity funding round led by Olympus Capital.

The year also saw the debut of Silicon Valley's leading venture fund KPCB in this sector in India. KPCB, with Sherpalo Ventures, invested US$8 million in Bangalore-based renewable energy firm Kotak Urja. KPCB is betting big on cleantech as it partnered with Al Gore for a US$500 million Green Growth Fund. The companies like Attero Recycling Pvt Ltd (DFJ and NEA IndoUS) and waste management equipment manufacturer, Kam-Avida Enviro Engineers (Peepul Capital).

Private Equity Biggies Catch the India Bus

2008 saw the remaining global private equity biggies setting up shop in the country. While Blackstone and Carlyle had entered India in the previous years, others like Kohlberg Kravis Roberts & Co and Bain Capital (KKR) only entered India in 2008. In November 2008, KKR hired Citigroup veteran Sanjay Nayar as India chief executive. Bain Capital, which has assets under management of more than US$80 billion, hired ex-DSP Merrill Lynch banker Amit Chandra as India head. Another private equity biggie to set up shop in India is Apollo Management. Candover, a leading European private equity house, set up an India office and has hired Harsha Raghavan from Goldman Sachs. UK-based, mid-market focused private equity fund, Englefield Capital, hired Dinesh Vaswani from Temasek to establish its India operations. Some venture funds like Walden International and Charles River Ventures have also set up offices in India.

There are others like Permira, Advent International, Lloyds TSB Development Capital and Cinven, who also have India on their plans. Will that happen in 2009?

Private Equity Funds Turn to Block Deals

PIPE deals through fresh issue of shares may have lost flavour, but private equity funds are now acquiring shares from the open markets through bulk or block deals. This method appears to be much more lucrative for funds as they get stake in companies at lower valuations, and they do not have to go through a lengthy process of negotiations with the management. But they may be deprived of the rights such as a say in the management and a board seat. The private equity funds who are most active in this game are Ashish Dhawan's ChrysCapital and Pulak Prasad's Nalanda Capital. These two funds have picked up stakes between 1-10% in more than a dozen companies, and have pumped more than Rs 2,700 crore into the Indian stock markets. There are other private equity firms like SAIF Partners and ICICI Venture who have also done similar deals, not mentioning hedge funds.

Surge in Infrastructure Funds

2008 saw a rush of funds looking at investing in the infrastructure sector. Morgan Stanley Global Infrastructure Partners appointed Gautam Bhandari as a managing director in India. He will make investments across the infrastructure value chain in India. JPMorgan & Chase Co set up a US$2 billion fund to invest in Indian infrastructure projects such as roads, ports and power. Global buyout fund KKR said it is considering investing in infrastructure sector in India and China. Goldman Sachs is raising a US$7.5 billion fund, which will look at investing in India. Macquarie Capital Group Ltd and State Bank of India are co-raising a US$2 billion infrastructure fund, while 3i Group of UK has already raised a US$1.2 billion fund. ICICI Venture is following suit with a US$1 billion fund. Anubha Shrivastava, portfolio director, South Asia, CDC Group, said: "There is a compelling story for infrastructure in India and we are interested in exploring this asset class a little further."

Exit Options Drying Up

The exits made by private equity firms are directly linked to the fortunes of the capital market. In 2007, private equity firms exited in 65 companies, of which 16 were through IPOs. In 2008, the capital markets were not conducive, and barring a few ones like Resurgere Mines, there were hardly any liquidity events via IPO. However we did see exits via secondary private equity transactions and trade sales. UTI Ventures exited Excelsoft by selling its stake to DE Shaw at 50 times returns, Chrys Capital exited Shriram Transport by selling to JP Morgan, e4e India exited Aztecsoft to Mind Tree Consulting. Private equity investors believe that there will be more exits in the near future via M&A.

Limited Partners Become More Demanding, More Hands On

Limited partners or the institutional investors, who are suffering from a shortage of capital and stretching allocations themselves, are negotiating with GPs on share of profits and the fee that the fund can take back home. The institutional investors' attitude towards private equity is also changing. Limited partners are demanding more rights and are also subjecting those raising funds to intense scrutiny.

"They are closely monitoring what is going on in the market, which was not the case earlier. Earlier, they would get their investor report, and they would come back if they had any questions. Now it is a little more hands on, as every four or five weeks, one or the other LP will call to ask what the progress on the projects is, and if they are on track," says a private equity investor.

This article first appeared in VCCircle.com on 1 January 2008 at http://www.vccircle.com/500/news/2008-reloaded-10-trends.