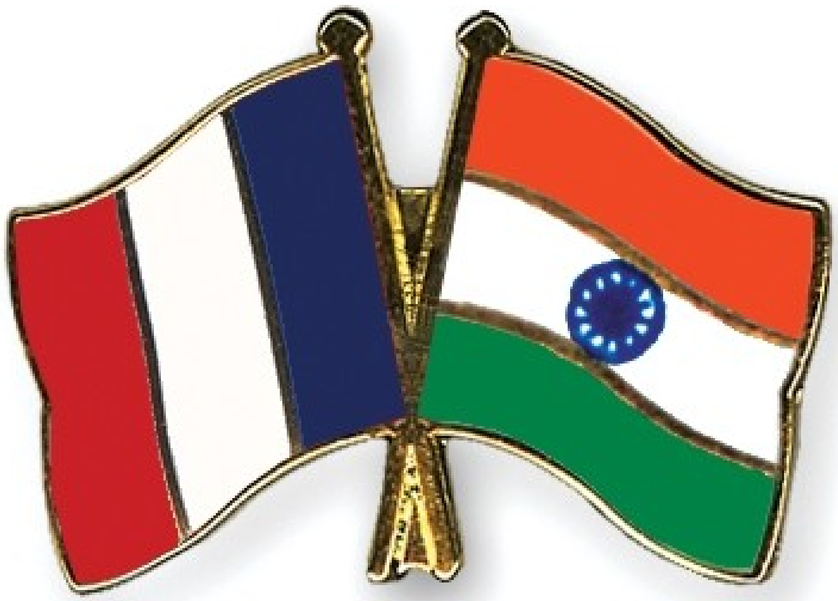

# Private Equity Investments in India

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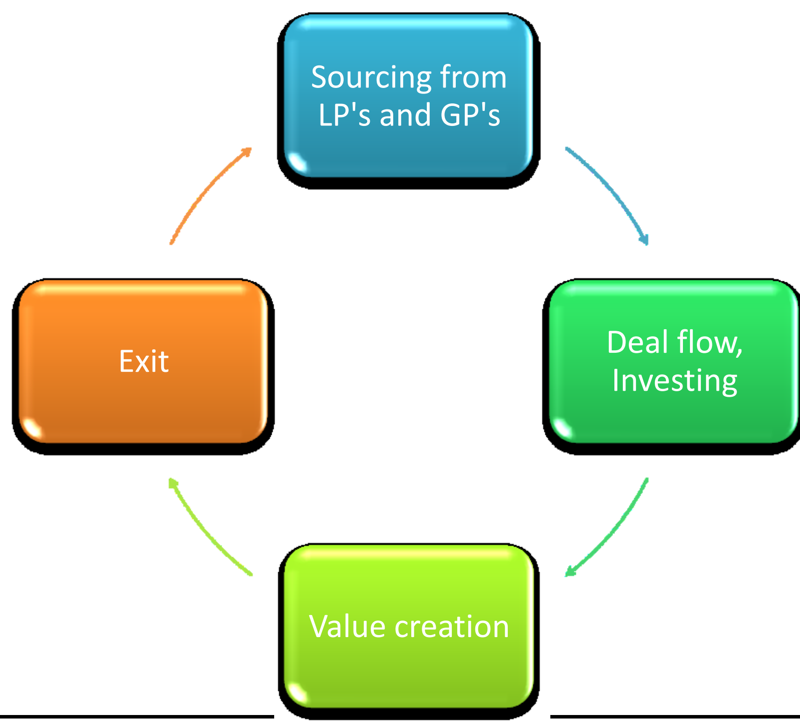
# Introduction

The PE Report gives an overview of the PE investments in India. The report presents the past investments, highlights the upcoming industry for future investments, tax efficiency for foreign investments, etc. The research team has also done SWOT analysis and 5 forces analysis in the report. This will give a reader an idea for market positioning and USP for Private Equity Company in India.

# Matrix of PE cycle



# Executive Summary

1. After a setback in PE investment in 2008, 2010 rebounded with big investments of Euro 6.5 billon compared to Euro 2.90 billion in 2009. First quarter of 2011 has already reported investments of Euro 2.25 billion.
2. Non-financial services, infrastructure, telecom etc. has been the favorite PE investment avenues till date.
3. India remains an attractive market for international investors because of its fast economic development, political factors, large numbers of English speaking population, large talent pool, etc.
4. PE firms seeking to raise approximately Euro 24 billion in 2011. The bulk of new capital will continue to come from offshore investors that face fewer restrictions and are freer from complex tax and legal burdens
5. DTAA (double taxation avoidance agreement) helps international investors to remit their funds out of India without paying any tax. Please find the details on the KPMG report enclosed.
6. Infrastructure and Manufacturing sector holds lot of promises for PE investment followed by upcoming sectors like Education, food processing etc.
7. According to industry experts the real action and the biggest need of capital for capital in India is for companies under Euro 40 million in revenue.
8. International PE firm's biggest challenge while working with Indian companies is that the majority are family run businesses and generally there is a lack of corporate governance. To overcome this, industry experts suggest the Investment manager should know family dynamics well.
9. Other than the capital, PE firms should bring the expertise of technology, governance, etc. as well, which has direct implications on the efficiency of the Investee Company.

10. The opportunities of the SWOT analysis can be the USP for Private Equity Company in India. There can be the value creation by giving investee companies exposure to the European market, Chinese market/sourcing, global strategies (strategic alliances with European companies for value addition and may be at time of exit) and corporate governance.
11. One of the threats can be the introduction of a new Tax law in India in April 2012 called DTC (Direct Tax Code); which could apply tax on capital gains on foreign investment. However industry experts suggest that the international tax treaty will be respected.
12. For exit opportunities Private Equity Company has an upper hand. At the time of exit they can have strategic alliance with a European company, IPO overseas or selling it to an international PE.
13. In order to create something valuable between India, France and China cross learning, transfer of knowledge and close cooperation will play a key role.

## The Indian PE History:

In India, private equity is reasonably young, dating back to the mid-1990s. Indian companies received almost no Private Equity (PE) or Venture Capital (VC) funding prior to mid-90's. The environment heated up in the end of the '90s with the IT boom, with companies in IT. This scenario began to change in the late 1990s with the growth of India's IT companies and with the simultaneous dot-com boom in India. VC's started making large investments in these sectors; however, the bust that followed led to huge losses for the PE and VC community, especially for those who had invested heavily in start-ups and early-stage companies. After almost three years of downturn in 2001-2003, the PE market began to recover towards the end of 2004. PE investors began investing in India again, except this time they began investing in other sectors as well (although the IT and BPO sectors still continued to receive a significant portion of these investments) and most investments were in late-stage companies. Early-stage investments have been dwindling or have, at best, remained stagnant right through mid-2007. In recent years, there has been a resurgence of these firms, with India's stock markets booming and sectors like the life sciences, infrastructure and most recently real estate being growth stories for the future. Global firms such as Warburg Pincus, Blackstone, Sequoia Capital and the Carlyle Group have a presence in India, while Indian players like ICICI Venture and ChrysCapital are vital players in the industry.

PE-VC investments in India have witnessed a phenomenal growth both in terms of amount invested (from Euro 1.2 billion in 2004 to EURO 15 billion in 2007 before tapering off to EURO 5.5 billion in 2008) as well as the number of deals (from 80 in 2004 to 481 in 2007 and then slowing down to 297 in 2008).

# Key findings from our analysis of PE-VC investments (2004-08):

1. The PE-VC investment activity in India is becoming more matured and broad based. It has undergone a complete overhaul during the 5 year period ending 2008. While 4 out of 10 industry classes accounted for more than 80% of PE investments in 2004, investments are much more evenly distributed across the 10 industry classes in 2008. The figure below gives the snapshot of the deals, their value across the ten industries in the India from 2004 to 2008.

**Table 3- Industry wise split-up of investment activities for each year (2004-2008)**

| INDUSTRY | YEAR WISE INVESTMENT IN Euros | | | YEAR WISE NO. OF DEALS | | | AVERAGE AMOUNT PER DEAL IN EURO | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2006 | 2007 | 2008 | 2006 | 2007 | 2008 |
| | | | | | | | | | |
| IT&ITES | 1638(26%) | 973(6.5%) | 644(11.7%) | 71(18.5%) | 77(16.0%) | 68(22.9%) | 23.1 | 23.1 | 9.5 |
| Computer-Hardware | 46(0.75%) | 170(1.1%) | 90(1.6%) | 5(1.3%) | 13(2.7%) | 8(2.7%) | 9.2 | 9.2 | 11.21 |
| Healthcare | 400(6.5%) | 509(3.4%) | 332(6.0%) | 40(10.4%) | 36(7.5%) | 28(9.4%) | 10 | 10 | 11.9 |
| Manufacturing | 124(11.7%) | 1131(7.6%) | 507(9.2%) | 80(20.8%) | 75(15.6%) | 35(11.8%) | 10.1 | 10.1 | 14.5 |
| Engineering and Construction | 827(13.4%) | 2001(13.4%) | 1519(27.5%) | 48(12.5%) | 59(12.3%) | 49(16.5%) | 17.2 | 17.2 | 31 |
| Telecom&Media | 1019(16.5%) | 3195(21.3%) | 826(14.9%) | 14(3.6%) | 37(7.7%) | 21(7.07%) | 72.8 | 72.8 | 39.3 |
| Transportation & Logistics | 352(5.7%) | 633(4.2%) | 271(4.9%) | 27(7.0%) | 29(6.0%) | 12(4.0%) | 13.1 | 13.1 | 22.6 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Financial services | 1129(18.3%) | 5250(35.1%) | 606(11%) | 44(11.4%) | 87(18.1%) | 31(10.4%) | 25.7 | 60.3 | 19.5 |
| Non-Financial services | 414(6.7%) | 810(5.4%) | 421(7.6%) | 30(7.8%) | 49(10.2%) | 32(10.8%) | 13.8 | 16.5 | 13.2 |
| Others | 234(3.8%) | 297(1.9%) | 304(5.5%) | 25(6.5%) | 19(3.9%) | 13(4.4%) | 9.36 | 15.6 | 23.4 |

**Table 4- Financing Stage wise split- up of investment activities for each year ( 2004-2008)**

| FINANCING STAGE | YEAR WISE INVESTMENTS in Euro | | | YEAR WISE NUMBER OF DEALS | | | AVERAGE AMOUNT PER DEAL IN EURO | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2006** | **2007** | **2008** | **2006** | **2007** | **2008** | **2006** | **2007** | **2008** |
| Early | 521(7.6%) | 1867(12.5%) | 167(3%) | 70(18.2%) | 74(15.4%) | 47(15.8%) | 7.5 | 25.2 | 3.6 |
| Growth | 1155(16.8%) | 3055(20.4%) | 667(12.1%) | 96(25%) | 120(25%) | 55(18.5%) | 12 | 25.5 | 12.1 |
| Late | 2184(31.8%) | 3715(24.8%) | 3481(62.5%) | 98(25.5%) | 139(28.9%) | 133(44.8%) | 22.3 | 26.7 | 26 |
| Pre-IPO | 137(2%) | 543(3.6%) | 255(6.6%) | 14(3.7%) | 30(6.2%) | 8(2.7%) | 9.8 | 18.1 | 31.9 |
| PIPE | 1449(21.1%) | 5031(33.6%) | 889(16.1%) | 91(23.7%) | 104(21.6%) | 49(16.5%) | 16 | 48.4 | 18.1 |
| Buyout | 1419(20.7%) | 759(5.1%) | 90(1.6%) | 15(3.9%) | 14(2.9%) | 5(1.7%) | 94.6 | 54.2 | 18.1 |
| GRAND TOTAL | 6865 | 14970 | 5549 | 384 | 481 | 297 | 27.03 | 33.02 | 18.3 |

2. There are huge PE investments in technology led, capital investment sectors like Telecom, Power and Infrastructure in addition to the sectors that were traditionally preferred by PE-VC investors like IT & ITES, Healthcare, etc.

3. The rate of growth in number of deals is consistently lower than the growth rate of amount invested.

4. The overall inclination in PE-VC investment is towards having lesser number of high quality deals of larger size and hence average amount per deal is rising steadily. Quite a few investments, mostly at late stage in industries like telecom and financial services have recently witnessed deal sizes unprecedented in Indian PE arena.

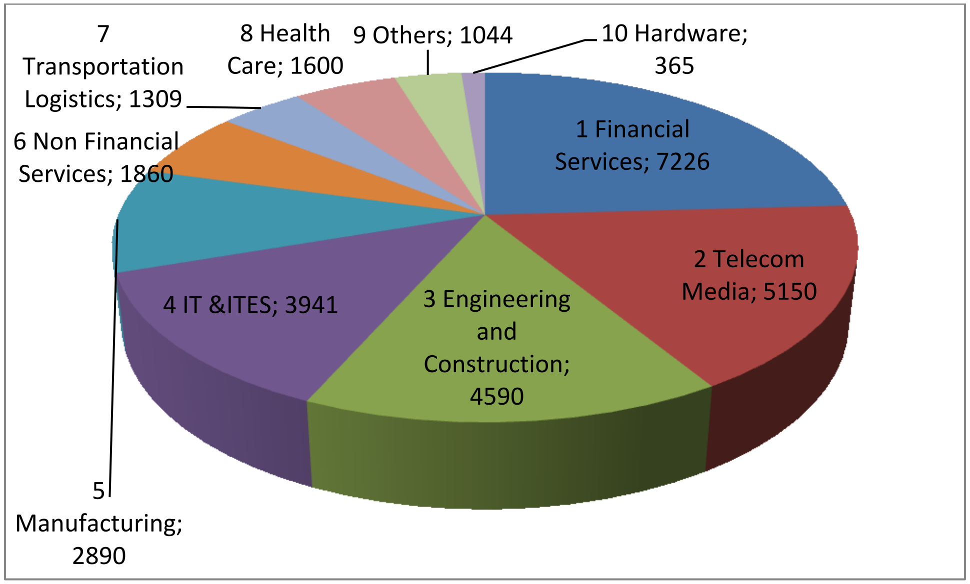
5. Late stage and PIPE (Private Investment in Public Equity) deals are consistently bagging major share of PE-VC investments over the five year period, with late stage deals being the least affected even in the period of economic downturn, while early stage deals have suffered the most.

6. Huge proportion of investments in late and PIPE stages, coupled with very low share of early stage investments, highlights increasingly risk aversion nature of PE-VC investors, as well as the pressure on the fund managers to quickly exit from their investments.

7. Buyout investments are comparatively very few in India and constitute only 3% of total number of PE investments deals. The trend is also consistent across the industry classes except for IT & ITES.

8. Majority of early stage investments are contributed by domestic investors, while a large share of PIPE and buyout investments is funded by foreign investors, probably suggesting the tendency by foreign investors to invest in established businesses.

# Sector wise past trend Analysis from 2004 to 2008



# Sector wise Investments and Analysis from 2004 to 2008

| Table 1 - Industry Classification Details | | |
|---|---|---|
| Sl. No. | Industry class | Sectors included |
| 1 | IT & ITES | IT & ITES / Software / Internet |
| 2 | Computers-Hardware | Computer Hardware / Semiconductors / Electronics |
| 3 | Healthcare | Healthcare / Pharmaceuticals / Medical services / Life sciences / Biotechnology |
| 4 | Manufacturing | Light & Heavy manufacturing / FMCG / Foods & Beverages / Consumer & Business products |
| 5 | Engineering & Construction | Engineering / Capital goods / Construction / Real estate / Energy / Oil & Gas / Infrastructure |
| 6 | Telecom & Media | Telecommunications & ISPs / Print & Electronic Media / Entertainment |
| 7 | Transportation & Logistics | Shipping & Logistics / Distribution / Transportation |
| 8 | Financial services | Banking / Financial Services / Insurance |
| 9 | Non-Financial Services | Advertising & Marketing / Education / Hotels & Resorts (Hospitality) / Travel & Tourism / Leisure / Sports & Fitness |
| 10 | Others | Agriculture / Retail & Wholesale / Mining & Metals / Textiles & Garments / Chemicals |

From the table above, it is evident that financial services were the favorite sector for PE from 2004 to 2008. Credit crunch for early startups in India has also lead to growth in financial services.

Telecom media being the second most preferred area for PE has experienced some big money making exits. The most talked exits of PE are from BhartiAirtel followed by Engineering & Construction sector has changed the face of India. Since 2006, PE funds have invested approximately Euro13-billion, equivalent to one-fourth of the total capital flows to India in the infrastructure sector. Over the past three years, the power sector has attracted the most interest from PE investors, increasing to 45 per cent of total PE infrastructure investment between 2008 and 2010.

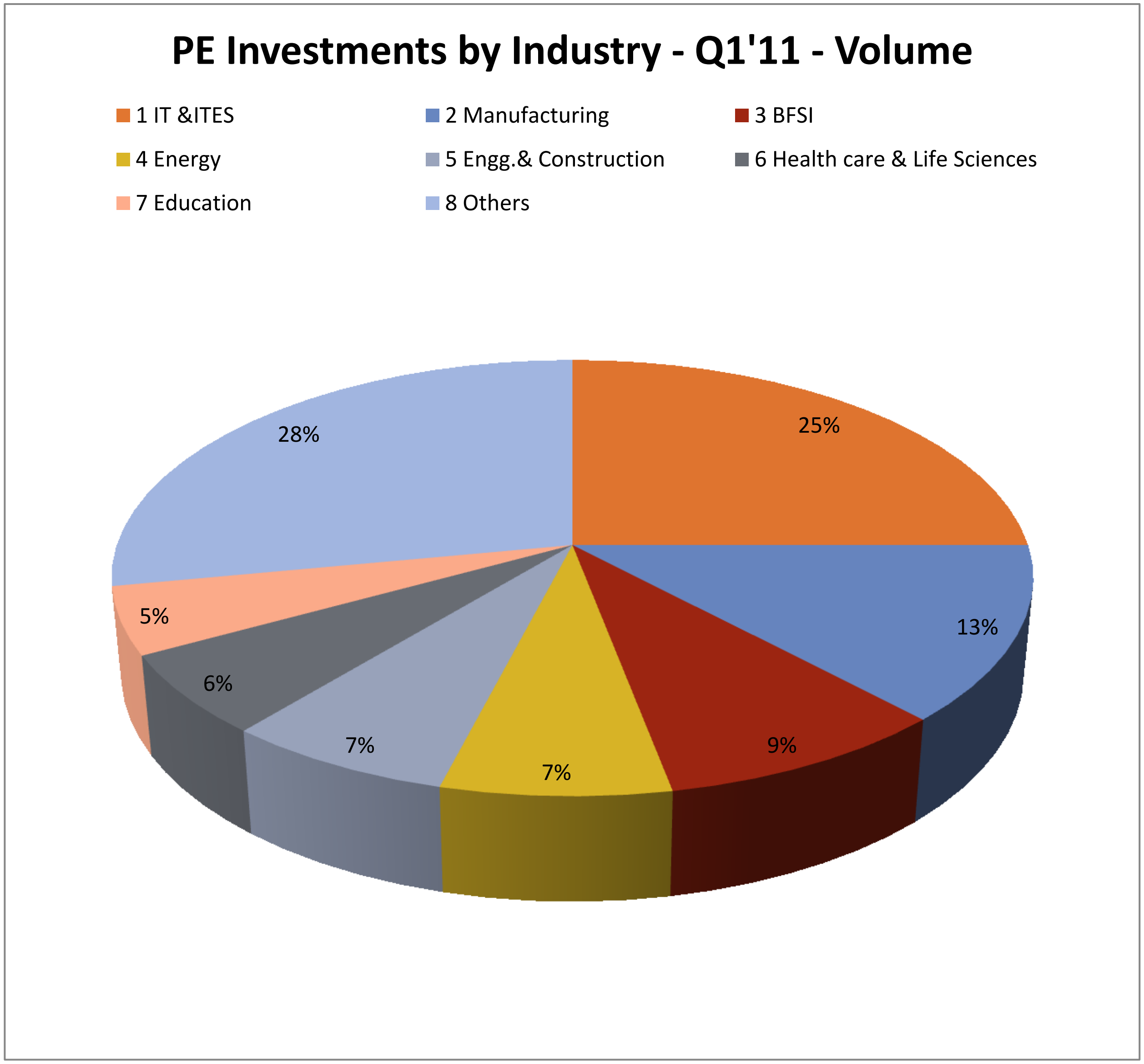
The investments led to the construction of the 6th largest airport of the world in New Delhi, road construction projects, support of metro projects by private players, etc. A growing middle class and their thrust to have their own house has fueled the growth in this sector; this drive has a direct implication on financial services - in terms of project and housing finance as well.

IT &ITES has changed the industry outlook of India. Bangalore the second silicon valley of the world is helping India in topping the charts in exports of software. Lot of research and development is being done in this area, as industry wants to transform from mere service providers to innovators. Manufacturing has not seen much investment. As the Government is changing reforms and pushing their exports, we can expect to see lot of changes in this area in the near future.

# Present Scenario of PE in India

Year 2010 saw Private Equity investments in India turn the corner, recovering to reach Euro 6.5 billion across 328 disclosed transactions from the low of Euro2.9 billion across 250 deals made in 2009 - a healthy rise of 124%.

Year 2011 kicks off with the soaring numbers. First quarter saw private equity investments worth Euro 2.2 billion in the first three months of 2011 – most of which went in the infrastructure, IT and manufacturing sectors. In all, 96 deals were made in the quarter with private equity deals worth about EURO 510 million confirmed in March, an increase of nearly 120 percent from the month before.




Private equity investments in the January-March quarter were about 57 percent higher than the Euro 1.43 billion worth of PE investment recorded over the same period in 2010 and more than double the Euro 1 billion accrued over last three months of 2010.

During the quarter, PE firms obtained exit routes for their investments in 14 Indian companies, including one IPO (of PTC Financial Services). In comparison, there were 34 exits (including seven IPOs) in the first quarter of calendar year 2010.

***"Conditions in place for the year ahead bode well for private equity in India to embark on that journey. Based on extensive interviews with industry experts and our own analysis, the Confederation of Indian Industry estimates that if India meets the challenges of creating a more hospitable environment for PE investment, private equity has the potential to fund up to Euro100 billion over the next three years."*** (Report of Bain and Company 2010)

Appendix 1 presents the investments of 5 most active PE fund in India in 2010

# Key findings from our analysis of PE-VC in the current scenario

1. India saw the largest increase in deal activity among the big Asia-Pacific markets in 2010. Although still far below the 2007 peak of Euro 15 billion, last year's total deal value more than doubled from that of 2009 to Euro 6.5 billion, including venture capital, infrastructure PE investments and real estate investments.

2. The fundamentals look auspicious for PE in India to continue to grow and evolve in 2011 and beyond. Short-term nervousness in the capital markets in 2011 and high priced corporate debt are expected to keep valuations down. That is likely to help

open up interesting deal-making opportunities for PE investors. Healthy macroeconomic conditions continue to support India's status as a preferred destination for investors.

3. India's fundamentals will continue to attract eager PE investors and bolster the confidence of limited partners. The pace and strength of the industry's future growth would be accelerated if valuations in India become more attractive and exits continue to build on the momentum established in 2010.
4. Indian promoters are gradually coming to recognize PE as a patient source of active capital that can help build their businesses. The PE industry will need to work closely with their investee companies and invest in further educating other Indian promoters about the PE and VC value proposition.
5. India's PE and VC industry is far from reaching its full potential. The biggest barrier holding it back is lack of regulatory support. Indian policymakers still do not regard PE and VC as a distinct asset class, nor have they given sufficient attention to creating a regulatory environment more conducive to the industry's growth.
6. Investors' appetite for exposure to India's PE market remains strong. Some 120 PE funds are seeking to raise approximately Euro 23 billion in 2011. The bulk of new capital will continue to come from offshore investors that face fewer restrictions investing across sectors and are freer from complex tax and legal burdens.

# Present opportunity for PE firms in India

- **Education:**

Highly attractive with an estimated Euro27.2 billion market for private institutions. Over Euro204 million has been invested in Education ventures since 2006, and more than Euro544 million investments is being planned over the next 12 months. Presently we are witnessing PE investment flowing to the Education sector.

### • Healthcare:

Significant capabilities in India for clinical research are need of the hour. Low average number of hospital beds will bring in massive investment to build more hospitals throughout the country. Over Euro 466 million investments has taken place in this area since 2004.

### • Clean tech or renewable energy:

There is a growing need for more reliable power supply throughout the country. Supportive regulations are providing a boost to clean tech/renewable energy. About Euro3.5 billion PE investments is expected over the next few years.

### • Food processing:

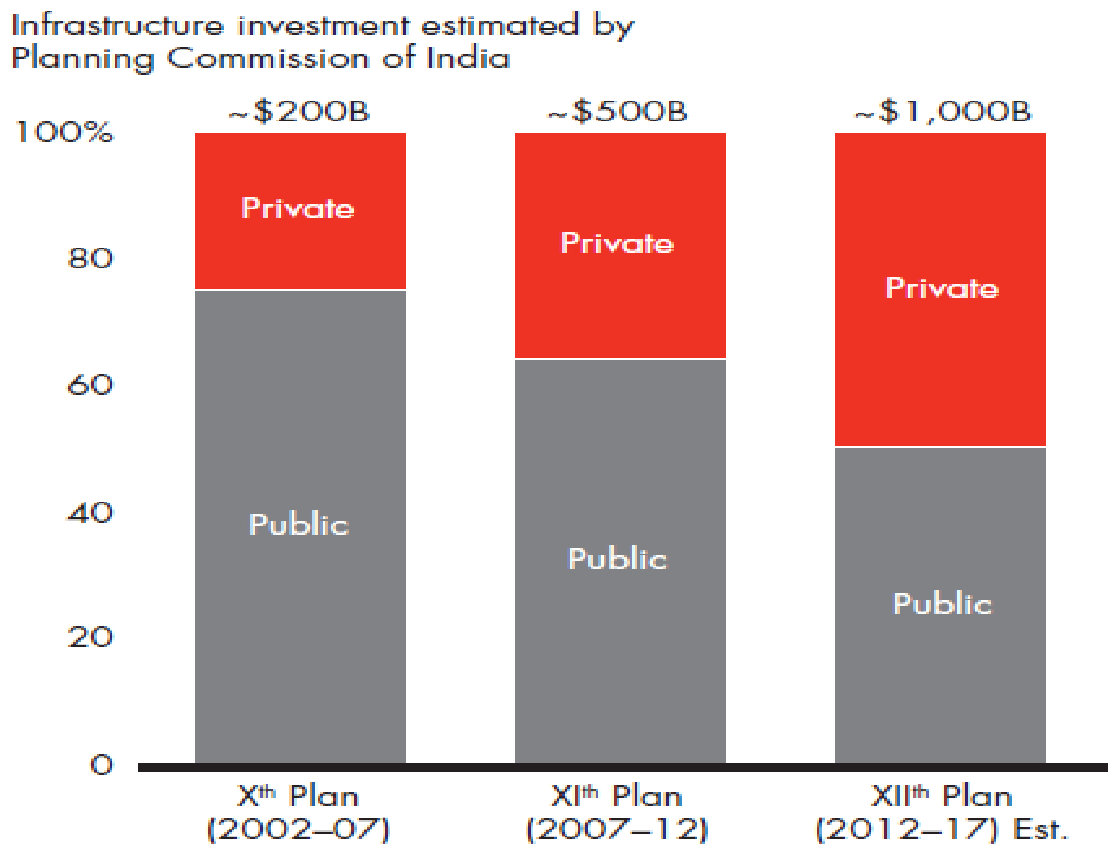
PE investors tend to like food companies as they grow fast and the business tends to be steady once a brand name has been established. Food is a secular business; it does not get affected by financial downturns. With their growth potential and profits, these companies are considered safe investments. Generally PE players have a lot of interest in the food businesses, but not many investable companies are available, as they are often cash-positive and do not need institutional capital.

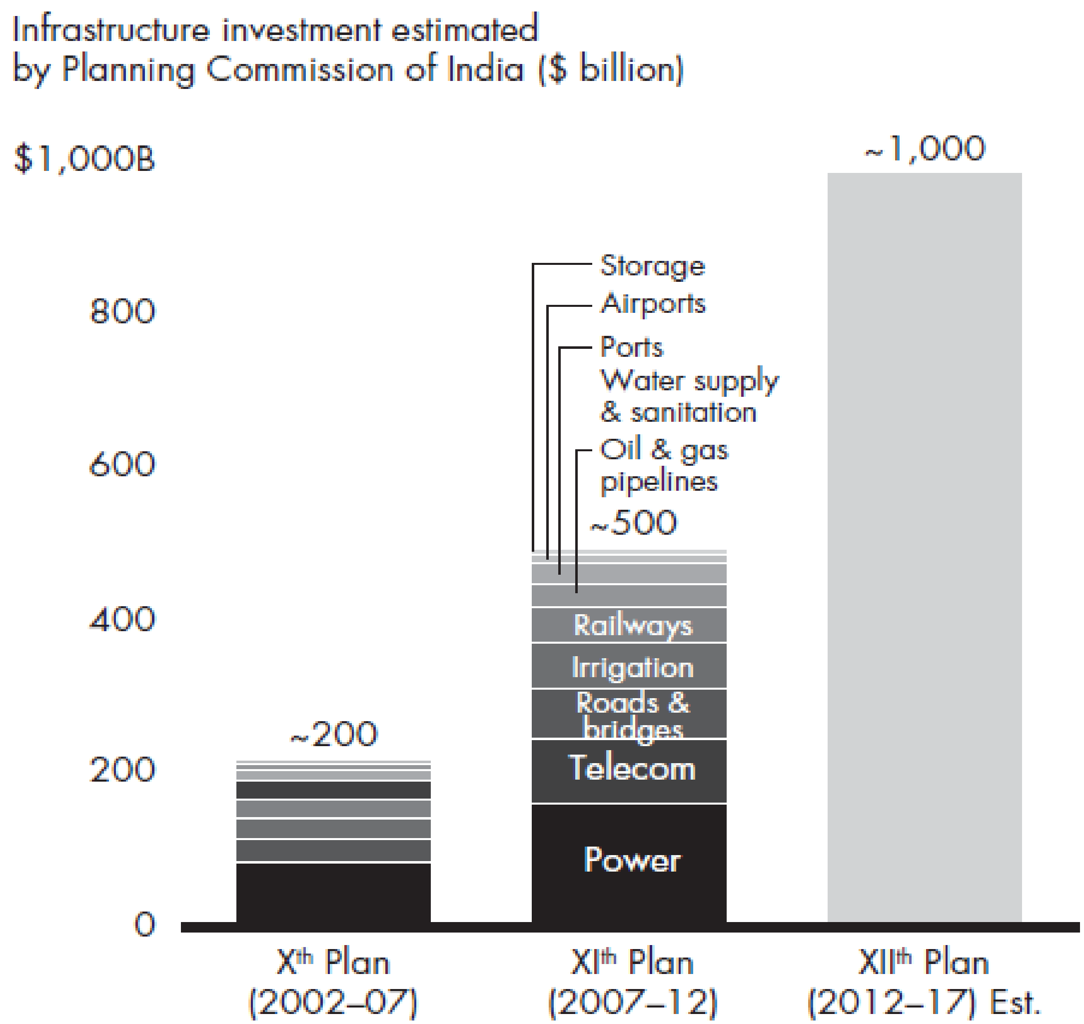
With global brands such as Wal-Mart Stores Inc. coming into India and organized retail being more or less dominated by companies such as the Future Group, Spencer’s Retail and Aditya Birla Retail Ltd, there is huge interest on backing their national or regional vendors in food sector.

- **Infrastructure**

Poor infrastructure makes Indian companies less competitive as compared to their global counterparts. However Infrastructure is set to be one of the biggest gainers of private equity (PE) investments in India in 2011, with fund managers expecting investment in the sector to grow at 25-50 per cent over the next 6-12 months.

Private equity is well positioned to contribute to, and benefit from, the rapid growth of the infrastructure sector in India. Given the focus of the Central Government XIth and XIIth Five-Year Plans on the sector and the increasing role for private enterprise in infrastructure development, PE can be both an important source of capital, as well as a potent provider of capabilities and expertise.


Infrastructure investment estimated by Planning Commission of India
~$200B
~$500B
~$1,000B
100%
80
60
40
20
0
Private
Public
Private
Public
Private
Public
Xth Plan (2002–07)
XIth Plan (2007–12)
XIIth Plan (2012–17) Est.




Investment in infrastructure in India is growth investment, with the majority of assets still being built or in the Greenfield stage, unlike developed markets where the assets are already operational and generate a steady income.

- **Automotive sector**

Nearly every automobile company is investing at a higher rate than ever before to achieve a high growth trajectory. The overall investment in the sector has been increasing quite rapidly. In 2010 Indian automobile companies invested an amount of Euro 3.12 billion.

For example, MarutiUdyog had invested Euro 1.02 billion; Tata Motors invested of Euro 306 million in its compact car project. Not only Indian companies but also foreign players like Hyundai invested more than Euro 582 million in India

- **Manufacturing sector**

India is ranked second in the world in terms of manufacturing capability, according to the “2010 Global Manufacturing Competitiveness Index’” by Deloitte Touche Tohmatsu and the US Council on Competitiveness. India’s workforce of scientists, researchers, and engineers, together with its English-speaking workforce and democratic regime, the report says, make it an attractive destination for manufacturers. In the last quarter of the year, the manufacturing industry showed positive results, despite less than impressive performance in other sectors.

# Growth in India’s manufacturing sector

Approximately 50 sectors in India’s domestic manufacturing sector grew by 39 percent during the April – December 2010 period, achieving the “excellent growth” category. These segments are air conditioners, natural gas, tractors, nitrogen fertilizers, ball bearings, electrical and cable wires, auto components, construction equipment, electric fans and the tire industry. Twenty-two segments entered the “high growth” group, registering a growth of 17.3 percent during the first nine months of the existing fiscal.

Industries such as utility vehicles, crude oil, power transformers, energy meters, alcoholic beverages and textile machinery have registered around 10-20 percent growth.

Exports from Indian SEZ's (Special Economic Zone) grew by over 68 percent (to EURO12.55 billion) as compared to the corresponding period of 2009-10.

India is quickly rising as a worldwide manufacturing hub with a huge number of companies changing their manufacturing base to the country. Also India has the largest number of companies, outside of Japan, that have been recognized for excellence in quality. The government has issued the new "Consolidated Foreign Direct Investment Policy," which came into effect April 1, 2010. The government is also planning to set up National Manufacturing and Investment Zones (NMIZs).

In 2011 first quarter the largest PE investment in manufacturing sector were the Euro 680 million commitments by Bain Capital and Singapore's GIC to Hero Investments, the Hero group holding firm, which is to buyout Honda Motors' 26 per cent stake in listed 2-wheeler maker Hero Honda.

# Key driver for the growth of PE in India

As per the Goldman Sachs research, India is the second largest growing economy in the world. With the IMF predicting growth of 6 percent in 2011, India's economy remains hugely attractive to both domestic and private investors. It has become a very attractive destination for global investors.

# Drivers for the growth

1. Relaxing the regulatory barriers of foreign investments in India.
2. Consistently impressive GDP in excess of 9% till the first quarter of 2011 driven by
   - Huge capital inflow
   - Spurt in demand generated by growing Indian middle class with higher disposable incomes, resulting in higher purchasing power.
   - Human capital and competitiveness in high-growth sectors, with one of the best higher education systems in the emerging market and widespread knowledge of English
   - Higher number of people with university degree.
   - Abundance of entrepreneurial talent and high self-confidence.
   - Very high growth in sectors like Telecoms, ITES, Financial services, Real Estate, Infrastructure and Manufacturing.

3. Political stability and other favorable macroeconomic variables like-
   - Sharp rise in foreign reserve due strong exports, it crossed Euro 136 billion mark in February 2011
   - Strong domestic savings investments rates further enhanced India's reputations as one of the favored investment destination.

The above factors coupled with excess liquidity during the economic boom world over from 2003 to 2007 and pressure to diversify internationally in the globalization era, has resulted in radical growth of PE investments in India till date.

The cost effectiveness of emerging markets compared to mature market for building new business further boosted the inflow.

# Key PE deal drivers in India

1. The credit crunch – The financial crisis is causing many business owners to reconsider Private Equity. There is a continued need for growth capital and with credit less available than it was, private investment offers a means to fill the gap.

2. Succession issues – As business culture changes, some owners choose to sell to a third party rather than pass on their business to family members.

3. The need for scale – Businesses are coming together to achieve scale in the market and capital is required to finance these deals.

4. Rationalization – Conglomerates are selling non-core units, which provide deal opportunities for Private Equity firms.

# Room for new PE players in the market

The India PE market is dominated by non-Indian GP's, even though many large domestic GP's already exist in the market. A key explanation for this phenomenon is the tax regulations, which make it more conducive for GPs to be incorporated outside India. LP's consist of foreign players due to nonexistent Indian endowment funds; Indian pension funds are not permitted to invest in private equity.

Indian high net worth investors, on the other hand, prefer to invest in their own businesses or real estate. The Private Equity market in India has revealed a lot of potential, but also in India the economic downturn has caused a sharp fall in total PE activities. 2008 saw a decrease of 44% in PE deal value compared to 2007, while the first half figures for 2009 showed less than 10% deal value of the whole of 2007. Nonetheless, with slowdown in funding from banks & IPOs, Private Equity is expected to remain a primary source of raising capitals in India and this leads to room for foreign players to enter the Indian market.

# Challenges for PE players in India

India has large numbers of family run business. The biggest issue for the PE players is to deploy corporate governance in the family run organizations and in conservative companies. There is a perception that at least some of these companies lack the professional management, transparency and modern management systems that investors would expect elsewhere in the world. The Satyam scandal also raises concerns regarding family-managed listed firms. To some extent, the anxieties of General Partners are justified, but it would be misleading to suggest that poor governance is endemic in family-run or managed businesses.

According to Bain and company survey, they find mismanaged expectations to be the biggest challenge for private equity deals. Strategic minority investments in smaller companies hold the potential for big pay offs. But shopped around by investment bankers, they are sold only to the highest bidder. And the purchase price begins to rise; the potential for returns starts to fall. “Most deals are being intermediated, which invariably increase the level of competition for a deal which in turn, can have impact on the return.

In fact, the rise of the Private Equity industry in India has fostered a greater awareness of governance issues and the requirements of investors. Companies seeking cash in order to grow have often recruited independent board members and invested in both professional management structures and modern systems. As such, they have been preparing themselves for investment while gearing up for growth.

However, some concerns are valid for particularly for international Private Equity firms. Players who have been involved in the Indian Private Equity industry for some time are better placed to identify the good from the bad – having been on the ground and had firsthand experiences.

Newcomers will necessarily have that knowledge and India is not a well-researched market. So, the only way for international General Partners to make the distinction between well and badly governed companies is to work with those people on the ground who have local knowledge and to undertake detailed on the ground due diligence.

Without this information, there is a danger that international funds will be fully aware of potential governance pitfalls. Related to this is the challenge of working with family firms - the bulk of investments in India being minority stakes, providing growth capital. As a result, General Partners have only a limited amount of influence over the direction a company takes and may find it hard to drive through the measures necessary for faster growth. This problem may be compounded by the dynamics of relationships within family companies and investors should be wary of businesses where the owners are split on future strategy. Again, the key is to know the company, including family dynamics and the roles and responsibilities of continuing family members.

The study indicates that there is a strong correlation between investments in PE-VC markets and capital markets. This trend is observed not only in developed markets like the US and UK but also in emerging markets like India and Brazil. It was also observed that even the sector wise trends PE investments in India are positively correlated with the movements of respective sector indices for most of the sectors.

# Legalities for foreign PE players

The Department of Industrial Policy and Promotion (DIPP) has relaxed rules on foreign direct investment (FDI). Under the new rule that came into force on 1 April 2011, foreign firms will not require an approval of their local partner while investing in the field where the joint venture operates. The government has also removed the need to subject certain conditions for 100% FDI in seeds and planting materials. In addition, the policy on local firms issuing shares to foreign firms has been relaxed, but needs to adhere to overseas direct investment regulations. The policy covers issuing shares for consideration other than cash.

The norms for convertible instruments have been relaxed to encourage venture capital and private equity deals. Companies will be given the option of prescribing a conversion formula or specifying the price upfront for convertible instruments.

# Overview of Tax and Regulations in India

India's new government has published proposals for a series of tax reforms scheduled to come into force in 2011. The aim of the proposals – currently at the consultation stage – is to simplify the tax system, and in this sense the reforms are to be welcomed. However, from the perspective of both global and domestic investors, some proposed measures might give cause for concern. The government is committed to reducing corporation tax from 35 percent to 25 percent. They also wish to introduce a flat rate capital gains tax.

In the past, companies were able to claim a tax holiday in the development stage of their business. However, under the new code, the government is proposing an asset-based tax that will apply to all companies. Although only two percent, this will disproportionately hit asset heavy businesses, even when those businesses are not making profits. Other losers include companies that are currently exempt from capital gains tax. Under the new proposals all businesses will pay the flat rate. The reforms will also see the tax authorities given more power to crack down on tax avoidance structures.

It is impossible to predict the final outcome of these reforms as their proposals are still at the consultation stage. But this in itself makes it difficult for businesses to restructure themselves in order to minimize their liability under the new rules. Those that do, run the risk of hitting tax avoidance regulations that have yet to be finalized.

Generally, however, over the past few years, the Private Equity industry in India has been encouraged by deregulation. For example, the licensing system that restricted trading within sectors to a limited number of companies has largely been abandoned. This has encouraged competition by allowing entrepreneurs to challenge incumbents

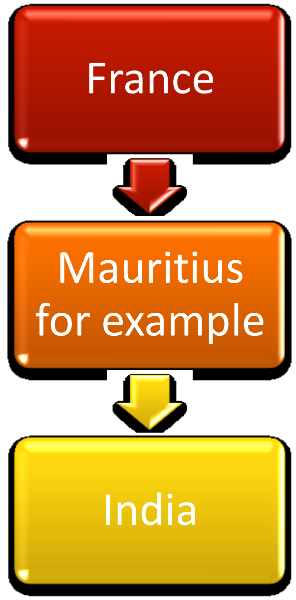
# DTAA

India has agreement of Double Tax Avoidance Agreement with many countries. This agreement helps international investors, private equity and venture capitalist players to save on domestic taxes (for e.g. such as capital gain tax), while routing their funds in out and the country.

In short DTAA can be best used if entities are formed in Mauritius, Cyprus and Singapore. All three have their own pros and cons.

*For funds to be tax efficient we are consulting with KPMG consultant. Please find their proposal in attached file*

# Flow of funds model in order to avail DTAA benefit




## Opportunity for International PE players in India

The old licensing system, which rigidly controlled ownership of companies within sectors, has now been largely abandoned. The subsequent freeing up of the economy has led to a surge in entrepreneurial activity. This in turn has created demand for capital coupled with the expertise, that can help ambitious companies grow.

Private Equity firms provide much of this capital and expertise and international firms are particularly well placed to provide both, as they are seen as a gateway to both the international financial markets and a range of potentially valuable business contacts, ranging from suppliers and customers to potential partners. Drawing on their experience working with fast-growth businesses elsewhere in the world, international firms are also viewed as being able to provide help and advice on strategic issues. However, there is a caveat here. Indian business culture differs from that of the US and Europe. A deal acceptable to a business owner in London, California or Paris will not necessarily be acceptable in India. Global funds recruiting international expertise should also prepare to work closely with Partners in India or else set up an office staffed (at least in part) by professionals with experience of the domestic market.

# Deal opportunities

Private Equity funds working in India to date have been for the most part limited to minority ownership deals. The buyouts that have characterized the industry in Europe and the US have been largely absent from the Indian market, a situation due in part to regulation preventing companies from borrowing to acquire. Therefore, as leverage in domestic transactions is not an option, neither is financial engineering. Equally important, India's business owners traditionally seek to pass businesses on to family members rather than sell. On the plus side, the rapid growth in India's economy offers both General and Limited Partners the prospect of healthy profits on minority stakes. Indeed, even in the downturn, General Partners in particular are bullish about potential profits, with 61 percent predicting returns of 25 percent or more in 2011.

In the longer term, buyout opportunities are likely to increase as the business culture changes. We are beginning to see a new generation of owners less constrained by the traditional belief that selling a business is a sign of failure. Growing numbers of conglomerates selling non-core divisions may also boost the buyout market.

# Due diligence and Valuation

There are lots of consultancy companies available for due diligence and valuation services. The important thing before the DD process is conducted is that clear conditions have to put down on the Term Sheet.

# Due diligence can be performed in all the areas mentioned below

Operations: efficiencies, improvement opportunities, system/process

Market: market share, competitors, benchmarking, market positioning

Management: team working, strategy, integrity

Legal: legal liabilities,

Technical: review of technical aspects, specific to sectors

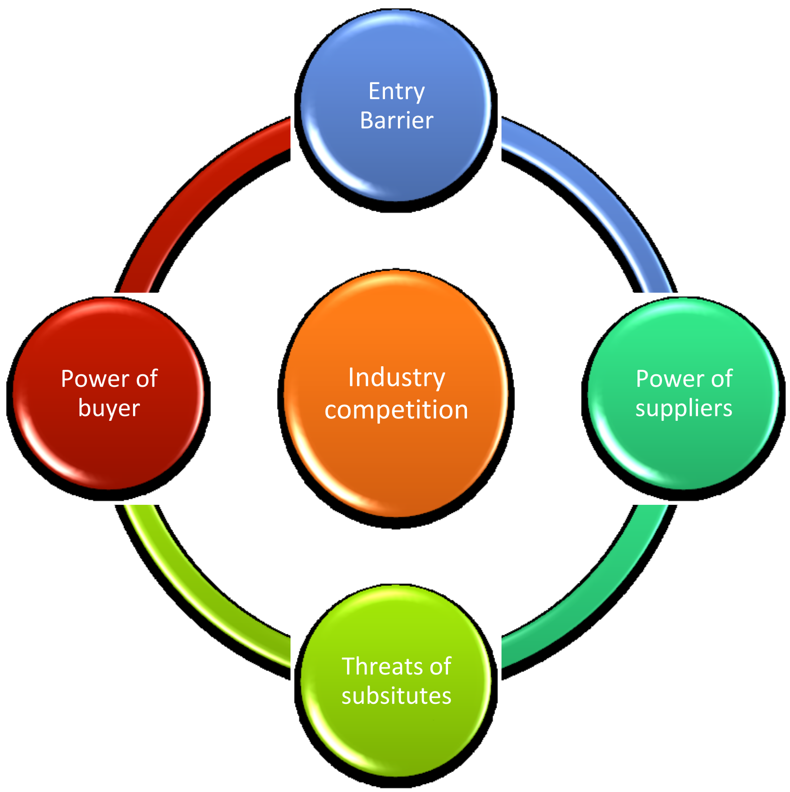
Human resources: IR issues, policies, pay benchmarking

Environment: waste disposal, permits/ regulations, liabilities

# Exit opportunities

A successful and long established stock market provides Private Equity funds with a clear route to exit. There is also the opportunity for overseas listing. Again, international funds are particularly well placed to provide advice to investee companies on IPO's elsewhere in the world – albeit 51 percent of international General Partners and 42 percent of local General Partners prefer strategic sales to IPOs (32 percent of General Partners and 22 percent of local funds respectively).SEBI (Security Exchange Board of India) is well organized body which takes care of IPO regulations in India.

# 5 forces Analysis for Private Equity Company in India



# Entry barrier

The main barriers to entry for PE in India are complex regulatory issues and an increasing number of PE players looking at the same investment opportunities. Nevertheless, it could be argued that setting up investments and exiting investments in India is easier compared with other PE emerging economies. Although the perception is that there are too many PE houses chasing few good deals, capital is not in short supply and there are today several other fundraising options available to owner- managed businesses looking for growth capital investment. Further, a large number of corporate and large conglomerate Indian business groups are still skeptical of the role that PE can play. This latter situation needs to change as it is likely that those corporate that have a global business strategy will need to link up with PE in order to execute their global expansion aspirations. For foreign PE players to enter Indian market is not an easy task due to the large differences in culture and trade practices compared to western countries. Lack of understanding of the Indian market (behavior norms, legal, tax, .) makes the task more difficult. Indian PE players still does not have good relationships with foreign LP’s other than few top players. Entry barrier in terms of setting up a company is not very difficult, but running successful operations totally depends on the experience and quality of the team in India.

### Threat of substitutes

In this case the threat can be from Indian banks, NBFC, Angel investors and Indian VC’s. Banks and NBFC do not much possess much of a threat, as they are highly risk averse. Angel investors and Indian VC’s are still emphasizing on growth stage companies.

### Power of Buyer

In this case it will be the entrepreneur. Power lies with him as he has to decide who to partner with, but if we come to some kind of value addition with our European experience; it will change the whole game. Things must be clear at the time of negotiating with the entrepreneur to avoid power struggle later.

### Power of supplier
In this case it will be LP's and sponsors. We have to convince them and once they commit things become easy for us.

### Competitiveness of the Industry
There is a huge competition between the industry players to get the quality of deals. To overcome this we really need to be well equipped (training, network, consultants etc.), focus where to invest and see how we can add value with our collective team effort. The ability to source proprietary deals will assume increasing importance in the face of increasing competition. The Indian business environment is driven by relationships; the level of comfort that a senior PE individual can bring to the owner of a target business that is seeking funds can go a long way to consummating a deal. Therefore, new PE houses setting up shop in India should appreciate the importance of hiring the right country head and having local teams "on the ground".

## SWOT Analysis
SWOT Analysis of Private Equity Company entry in the Indian market.

## Strength

- Availability of liquidity
- Wealth of investment experience with the team members in Foreign PE.
- Ready set up in India.
- In depth experience of operational and entrepreneurial back ground of Indian team members.
- Strong will to set up a fund for India.

## Weakness

- Lack of Indian/global experience within Foreign PE team.
- Lack of PE investment and exit cycle in the current Indian team

## Opportunity

- India is the fastest emerging market in the world.
- Lot of synergy can be built with the present portfolio companies and the future investments in India
- Value creation can be done in the investment company by giving them exposure to European market, Chinese office, global strategy and corporate governance.
- Growing and large entrepreneurial spirit in India.
- Favorable economics, demographics, political situation and efficient exchange board in India.

## Threat

- New Implication of DTC

- Growing number of PE players in India. Capital is available in abundance and PE players need to distinguish themselves to win deals.
- Lack of governance among the business family and entrepreneurs.

# Proposed USP of Private Equity Company in India

- Capital.
- Operational and strategy building for entrepreneurs.
- Exposure to European and Chinese market through the network.
- For exit, strategic alliance with European partner/ buyer, IPO overseas, selling equity to foreign fund.
- Corporate governance and strategic exposure with the global outlook.

# Recommendation

From this report it is evident that it was a comeback for PE in 2010 and 2011 started with impressive investment numbers. Indian PE has re-emerged in good shape from the testing times of the global credit meltdown and subsequent economic retrenchment. Deal activity has rebounded more quickly than in other Asia-Pacific markets, the exit markets are healthier than ever and capital continues to pour into an expanding number of domestic and international PE funds.

While the period ahead looks bright, it remains to be seen whether current conditions will prove to be a sturdy platform for sustained growth. Certainly the Indian growth story remains on track and continues to attract PE interest. New opportunities in several under-penetrated sectors like infrastructure, financial services, healthcare and manufacturing are waiting to be tapped and appear to be generating an increased level of PE engagement.

The PE industry itself is demonstrating interesting signs of growth and evolution. The number of domestic funds continues to expand, GP's with experience gained in the global PE funds are spinning out new breakout funds and promoters are warming up to the idea that PE partners are more than just another source of capital and can help them achieve exceptional growth, way beyond what the promoters can achieve alone. But for all of the change and novelty the industry has witnessed, some characteristics specific to India PE appear to remain firmly fixed and continue to challenge PE investors, promoters and policymakers. For example, PE deal making will continue to expand, but for the foreseeable future deal size will remain small—mostly in the Euro 20 million to Euro 30 million range—and acquisitions will be limited to minority stakes. As competition to purchase high-quality assets intensifies, PE firms need to continue to find ways to demonstrate what makes them distinctive and superior to other providers of capital.

For those PE funds that are not currently investing in the Indian market, the issue is not "if," but " will be a good time to enter the market, as we experience lot of developments happening in India, in many different spheres. In order to be efficient our fund need to be well structured in order to be tax efficient. The Management team should be well guided, trained, experienced and motivated to get better results from investments.

In order to optimize funds' performance we need to formulate key issues such as:

- Size of the fund for India?
- Size of deal?
- What should the investments focus be?

- Key investment techniques and negotiations
- How can we create value and minimize the risk in the portfolio?
- Determining the right time for exit and its appropriate strategy
- Who should be on the team?
- Should we create USP's such as Cross border deals?
- How do we enhance the market reputation and perception of portfolio companies?

India can be a platform for Private Equity Company to get its global wings due to its growing economy; it can be a secondary market to present portfolio companies, availability of talent pool in India, geographical location, large English speaking population etc. These all factors if well utilized and groomed, they can transform in to sustainable competitive advantage for Private Equity Company.

# Conclusion

**This is an exciting time to be involved in private equity (PE) in India.**

According to a recent study over 366 PE firms currently operate in India and another 69 have raised or are in the process of raising funds. Large global PE investors are either setting up dedicated Indian funds or increasing allocations for Indian investments in their global portfolios. Fund sizes have increased dramatically from Euro 25 to Euro 100 million just a few years ago, to between Euro 400 million and Euro 1 billion. Average deal sizes have also increased to about Euro 50 million in 2007, while the average deal size was Euro 8 million in 2002.

Starting from a meager five deals and a total investment of Euro 20 million in 1996, Euro 11 billion was invested across 339 deals1 in 2007, making India one of the top seven PE investment destinations in the world. According to a recent study, there are over 366 PE firms currently operating in India and another 69 have raised or are in the process of raising funds, cumulatively offering Euro 30 billion for investments in India from July 2007 through December 2010.

The strong economic interest in India has resulted in a bullish stock market that has facilitated successful PE exits but has increased valuation expectations. Today, there is a healthy mix of auction-based and proprietary-based transactions in India. Most PE houses are sector-agnostic although, to differentiate themselves in an increasingly crowded marketplace, a few sector focussed PE houses are now establishing themselves in the country. As the strong global interest in India continues and competition for deals increases, the challenges will be to differentiate, source good proprietary deals, and, most importantly, nurture portfolio investments.

Our research found that PE houses felt restricted in India by the predominance of family-owned businesses, lack of large buyout opportunities, and restrictions on the financial leverage that buyers can use. Despite this, however, 63 percent of the 119 PE firms say they would be targeting India in the next five years compared with 37 percent having investments in India currently.

The India’s economy continues to accelerate, and the PE opportunity grows. The emerging market in India is one of the most interesting PE stories. The Indian PE market is attractive for many reasons: its entrepreneurial status; the associated ease and benefits of an English-speaking culture; an investment base that truly understands the multiple opportunities for PE; and a developing infrastructure with strong underlying economic growth. These opportunities are compounded when we consider the tougher market conditions elsewhere in more traditional PE territories. The future for a prosperous PE market in India is very bright indeed.

# Appendix 1

**Macquarie-SBI Infrastructure Fund**

**Number of Deals: 3**

**Deal value: $531 million**

The joint venture between Macquarie Capital, State Bank of India and the International Finance Corporation, that targets investments in infrastructure and allied assets, struck three deals in telecom tower business, airport infrastructure and power. The firm's over half a billion dollar investments included a $300-million transaction to buy around 11% stake in Viom Networks, that brought together the passive telecom infrastructure businesses of Quippo Telecom Infrastructure Ltd and Tata Teleservices under one roof last year. The fund that had its initial close in April 2009 had said it was raising further capital with the target of having commitment of $1.5 billion at the end of the capital raising period. One of the few large infrastructure-only funds that are seeking investment opportunities in the country, Macquarie SBI Infrastructure Fund comes with a strong parentage and high quality investors backing the fund managers. Given the large investment appetite in the country for improving the infrastructure to support high growth in the coming years, we have certainly not heard the last of Macquarie SBI Infra Fund that may continue to be among the chartbusters in the coming year too.

**Temasek Holdings Advisors India Pvt. Ltd.**

**Number of Deals: 5**

**Deal value: $ 462.3 million**

One of the two sovereign wealth funds of Singapore, Temasek was back among the top investors' charts after going slow for the last two years. The firm (among the most active sovereign funds in India) spread its investments across financial infrastructure, healthcare, power and construction. Its two biggest deals included the $200-million transaction in GMR Energy besides a deal to buy

5% stake held by New York Stock Exchange in National Stock Exchange. It also invested in Max India, Sobha Developers and a project of Lodha Group.

The sovereign fund--that last year changed its global charter what analysts viewed as Temasek downplaying its links to government policy or strategic interests as it eyes more overseas investments—has assets under management of over $140 billion (as per its website). The bounceback in global stock markets allowed Temasek's portfolio value rocket 43% to its highest level ever for the year ended March'10 but also saw profits shaved by a fourth. The fund that counts marquee names of Indian business among its portfolio has Asia at the centre of its investment focus and with India playing a key role. Temasek is likely to continue as a leading investor in the near term.

**Blackstone Advisors India Pvt. Ltd**

**Number of deals: 4**

**Deal value: $431 million**

The top bracket buyout firm that made some untimely management buyouts and other investments in the so-called 'wrong' sectors at the peak of the stock market boom has not let some setbacks bother it much. It struck one of the single biggest investment ever by a private equity firm in the sunrise sector of power by picking a stake in Moser Baer Projects Pvt Ltd for $300 million. Add to it its investment in Monnet Power Co and you get the drift, Blackstone is genuinely bullish on power sector in India. Blackstone also invested in agri related firm REI Agro and struck a deal in the mass media space by investing in Jagran Media Network Pvt Ltd, the holding firm for Jagran Prakashan. Although this $50-million deal was just about a fifth of its failed deal to buy a stake in Ushodaya Enterprises which owns Eenadu group in Andhra Pradesh three years ago, 2010 was the biggest year for Blackstone that has invested over $1.25 billion in the past five years.

**Olympus Capital Holdings Asia**

**Number of deals: 2**

**Deal value: $308 million**

The independent middle market private equity firm that has invested over $1.3 billion in over 30 portfolio companies throughout Asia, including China, India, Japan and South Korea, has made one of its biggest investment commitments in India this year. Its $300-million partnership with Tata Power comes at a time when almost everyone is betting on energy. The firm, that also counts among its portfolio firms Quattro BPO, crane moving services firm Sanghvi Movers and Orient Green Power, set up its India office two years ago and looks set to surprise the markets with few standalone large deals in the future too.

**Kohlberg Kravis Roberts & Co.**

**Number of deals: 3**

**Deal value: $289 million**

The firm most synonymous with the clan of global buyout giants had been sewing few big transactions every two years. It didn't disappoint in 2010 when private equity firms entered a more mature investment territory in India. KKR, that has in the past completed buyout of Flextronics Software Systems and later invested a large sum in Bharti Infratel along with other investors such as Temasek, cut multiple deals in India this year spread across power, hospitality-cum-retail and cement businesses.

Its biggest transaction was co-investing around $200 million in Coffee Day Resorts (holding company of Café Coffee Day besides operating firm of hotels and resorts) along with New Silk Route and Standard Chartered Private Equity. It also put in money as pre-IPO deal in Avantha Power & Infrastructure, the power arm of Gautam Thapar-led Avantha Group and took a contrarian call by investing in the cement business of Dalmias. Having roped in former chief of Citibank in India Sanjay Nayar, KKR is likely to be a more permanent figure among the top PE firms in India.

CONTACT US:

## ADVENT UK LTD

**Patricia Goodenough, President.** pg@advent-uk.com

**Anuj Arora, Indian Project Development.** aa@advent-uk.com

LONDON OFFICE: Suite 8, 28 Old Brompton Road, London SW7 3SS. Tel: +442078013080

PARIS HUB: 15 Rue Clement Bayard, 92300 Levallois, FRANCE. Tel : +33147489197

Registration N° 3485818, Registered office Penhurst House, 352 Battersea Park Road, London SW11 3BY.

**Skype: adventuk**