

“What’s on your plate?”



**HUNT PARTNERS
PRIVATE EQUITY
WHITE PAPER 2009**

NOTE

Over the last four months, Hunt Partners hosted several private luncheons with MD's of the leading Venture Capital and Private Equity firms in India. The forum aptly called "What's on your plate?" was Hunt Partners' endeavour to bring likeminded professionals together for a casual free-flowing conversation on some very pertinent issues facing the alternate investment space. The report is a result of those discussions.

Disclaimer:

This report has been prepared by Hunt Partners on the basis of the forum 'What's on your plate?' Hunt partners is not responsible for views and opinions expressed by individual participants in this report. Reproduction, redistribution or commercial use of its contents is strictly prohibited without prior written permission.

FOREWORD

Private Equity and Venture Capital has had a bull run for the past four years with deals awash across the print space. At times it was difficult to separate fact from fiction, but that was the kind of frenzy that PE generated, with well known and obscure companies, both talking the valuation game - too much money chasing too few deals was the oft cited complaint. It was a unique period, when making an investment (instead of creating an exit) was considered an achievement, and becoming an investor was the most coveted job in the market.

Circa 2008, saw it all come to a grinding halt. And Hunt Partners wanted to capture this phase which was every bit as momentous as the dizzying heights were. Most unique however was how the world could change in just five months. The mood has turned from euphoria to caution and now to confusion, and the dialogue in every successive session reflected this. The questions came in thick and fast - where are the deals, who is investing, what do the valuations look like and what do the cash strapped entrepreneurs do? Will newbie investor teams manage to raise a fund, will second timers manage to raise a fund, and will there be capital recalls? With an eclectic mix of PE and VC professionals, lawyers and entrepreneurs putting forth their views the discussions were always sparkling as was the attendance.

While everyone is uncertain about the duration of the economic slowdown, there is no doubt about the recovery. And, India is still hot as an investment destination. Most investors are trading cautiously and would rather not make an investment than a bad one; while closure is a long-winded process and valuations are being negotiated, the PE and VC community continue to believe that this is a difficult, but yet opportunistic time to invest. The pertinent question is who will blink first; the illiquid entrepreneur or the investor who needs to get a deal done.

The dynamism of the market forces is also clearly reflected in India's competitiveness index and the fact that global funds continue to repose their faith in the system. The India story is still alive; however the times ahead will surely test even the best of firms in the industry.



WHAT'S ON YOUR PLATE? VC - PE LUNCH FORUM I

Venue: The Four Seasons, Mumbai

Date: September 12, 2008

Attendees:

Manik Arora	Managing Director	IDG Ventures
Raj Dugar	Sr. Managing Director	FIL Capital Advisors India
Hetal Gandhi	Managing Director	Tano India Advisors
Abhay Havaldar	Managing Director	General Atlantic Partners
Gopal Jain	Managing Director	Gaja Capital Partners
Darshika Kothari	Partner	AZB Partners
Deepak Shahdadpuri	Managing Director	BCP Advisors
Kunal Shroff	Managing Director	Chrys Capital Investment
Vivek Talwar	Managing Director	Nitco Tiles

"INVESTMENT OPPORTUNITY AND VALUATIONS"

The session unfolded under two macro themes with Abhay Havaldar moderating the session the thoughts have been captured, reflecting the manner in which they were aired.

- Valuations and Deals
- Working the Portfolio

Deal valuations are justified by the operating performance, where past performance is an indicator of the future; therefore, while establishing a valuation, regardless of the stage of investment one must create a 5 year financial model.

While exit multiples are important, growth is the most important factor - many deals had been done with a short term view.

In the prevailing market conditions, promoters are more concerned about valuations as compared to the "terms" of the deal. While each entrepreneur has his own structure, driving valuations has become the need of the hour for them. Several PE firms on the other hand tend to benchmark valuations vis-a-vis the market, without focusing on the business and wonder whether the company would give a return of 3-4x.

For promoters, the market has matured and until recently companies have more than a few funding options. Last year it was Hedge Funds that were top of mind.

With the markets heading south, entrepreneurs are hesitant to do deals and this is the stage wherein structure plays a large role. A lot of PE players have benefited from unique structures and exit multiples reflect that.

The one factor that is certainly a challenge is the entry EPS and whether this is sustainable. You have to price the margins.

A strategic question now is what is going through the promoters' mind? If you look at the Ranbaxy story were the promoters looking at value maximization or complete control? A lot of entrepreneurs actually prefer heading big companies as that is a greater emotional need than money in the bank. For others the difficulty is how to grow strategically without relinquishing control of operations.

PE investors are driven by references while selecting a promoter - he must have a clean chit; having a good promoter is the most important consideration while making an investment. Ideally, one should have known and tracked the person for at least five years - getting into his house and meeting the family can prove to be truly insightful. In India, even the CEO needs to be entrepreneurial; the US CEO mentality does not work here.

All promoters don't approach PE in the same manner. While some are humane, others have a flawed attitude and all the investor can do is stand up to them by walking away from the deal. There are situations when one has to decide at the time of the deal whether to finish the deal and handle all the problems later or simply walk away. Moments of decision such as these are pure adrenalin for most PE professionals.

WHAT'S ON YOUR PLATE? VC - PE LUNCH FORUM II

Venue: The Four Seasons, Mumbai

Date: October 10, 2008

Attendees:

Sumit Chandwani	Sr. Director - Investments	ICICI Ventures
Pravin Gandhi	Managing Director	Infinity Technology
Rajesh Gupta	Managing Director	S N Gupta & Co.
Shujaat Khan	Managing Director	Blue River Capital
Shankar Narayanan	Managing Director	Carlyle India Advisors
Abhay Pandey	Managing Director	Sequoia Capital India
Jasmin Patel	Managing Director	FIL Capital Advisors
Abhijit Pawar	Publisher	Sakaal Group
Hemang Raja	Managing Director	Credit Suisse PE Asia
Manikkan Sangameswaran	Managing Director Head of Infrastructure & Real Estate	Babcock & Brown
Vikram Utamsingh	Executive Director	KPMG
Dinesh Vaswani	Partner & Joint Head of India	Englefield Capital

Gastronomy and ideation, the twain meet again in our second edition of the Private Equity Luncheon. The theme continues from where the discussion last left off- "Investment Opportunity and Valuations" albeit a different set of participants get to air their views.

The session started amidst a great amount of hilarity with Pravin Gandhi, the moderator decrying his role in a Private Equity forum being a Venture Capitalist himself. The discussion quickly moved to the most pertinent question in these times - markets. The biggest challenge in the downward spiraling market is the rapidity of the fall with the accompanying strain on the credit markets and the entire banking system. Garnering funds from the public markets and private equity will be a challenge as everyone will reduce risky assets. On the positive side, there are better investing opportunities for the classic PE investor as there will be no competition from hedge funds or top investment banks and the valuations will be realistic for a change. One of the biggest challenges is that the investment community cannot look at the public markets as a means to exit.

The question that begs to be answered is that, are entrepreneurs ok with current valuations?

With a credit freeze and liquidity drying up, investment bankers don't make the 'take it or leave it' calls to PE players. Deals will take time to close as promoters face the reality of the market and think a deal over as many times as possible before committing. The crux of the matter is that most PE players are investing in a time when there is substantial slow-down and the exits will span a good 4-6 years instead of the quick flips that had become common. That kind of time horizon ensures reasonable valuations and long drawn out deal closures.

Entrepreneurs on the other hand are really looking for a PE partner who will stay with them over a period of 4 to 6 years and really show faith in the company. The promoters feel that PE investors behave more like debt funds. And as a result, companies are coming up with innovative ideas to fuel growth without relying on investments from PE players. But, promoters in today's market are also stuck with projects that they can't complete due to lack of funds.

On the part of global fund, the trend of increasing capital allocation to Asia is quite visible. So while a 2% allocation may have gone up to 5%, the aim is to garner over 15-20% in the next five years. Firms are clear that they need to move money to Asia sooner than later but they want to do it without creating disruptions and flooding the market with capital. An international firm like Carlyle is sitting on billions of dollars raised recently, but they made no investments in 2008 in their growth capital fund. Meanwhile, entities like Englefield have increased fund size to primarily invest in India and the US, which is a strong statement of intent.

The reality of the situation is that all the PE players felt bad about missing out on deals till the first quarter of 2008. The last 6-9 deals finalized have become talking points in the market and are beginning to look ugly. That may change in the next five years but in the interim, nobody wants to err and justify themselves to their LP's. Even for the deals that close, there are hectic parleys and valuations are being re-negotiated keeping the markets in mind. Having said that, there are still some sectors that PE players are betting on - Healthcare has a high degree of stability as do sectors such as education and print media.

While there are challenges in the financial services market, there is a severe paucity of talent for the portfolio companies. It is especially tough to get CFO's. There are two kinds of individuals who make the move into PE portfolio companies - professionals who take a risk and move for the equity upside in early stage companies and others who make a move to a regular operating company with over Rs. 500 crore in revenue. The lack of equity upside with IPO's looking scarce will keep one set of people away while it will be business as usual for the others.

WHAT'S ON YOUR PLATE? VC - PE LUNCH FORUM III

Venue: The Leela, Bangalore, Bangalore

Date: November 28, 2008

Attendees:

Ranjan Biswas	Partner	Ernst & Young
Parag Dhol	Director	Inventus Capital
Srinath Dasari	Partner	AZB & Partners
Mohanjit Jolly	Executive Director	Draper Fisher Jurvetson
Chandrasekar K	Managing Director	ePlanet Advisors
Jacob Kurian	Partner	New Silk Route Advisors
Sandeep Maini	Chairman	Maini Group
T C Meenakshisundaram	Managing Director	IDG Ventures
Prashant Prakash	Partner	Accel
Ganapathy Subramanian	Managing Director	JumpstartUp
Srini Vudayagiri	Managing Director	Lightspeed Advisors

The third edition of our forum had all the usual ingredients - good food, stimulating discussion and this time to top it all a new city, Bangalore. Our own Managing Partner, Arjun Erry gallantly moderated.

The Bangalore financial services circle had its definite views and began on a serious note with advisory services noting the differences in the past six months. While earlier boutique banks gave the established players a run for their money, deals are easier to bag now but difficult to close. To ensure closure, the big players are putting their best people behind these deals.

The word that encapsulates the mood of the market perfectly is uncertainty. Both the entrepreneur and the investor want more than 100% assurance when they finalize a deal which has never been possible as no deal is foolproof. As a result, no sector has been spared in this down turn unlike in 2001-2002 when the impact was slightly narrow. The venture capitalists are sitting on volumes of money waiting for the right company to come along but when it does, but get mired in the valuations game.

Entrepreneurs are caught between the credit crunch, shy investors and promised expansion plans. Harking back to the down turn in 2001, it was a slow buildup which allowed all to prepare for the crises. There is a general feeling that this time around it was a blitzkrieg which allowed no room for contingency planning. Promoters have a cause for worry with export oriented players having to grapple with lesser orders and changing payment terms. Most entrepreneurs have taken the approach of conserve cash, no unnecessary expenditure and a deferment in investments for three to six months.

When it comes to making investments, the VC players are especially focused on teams that they invest in. In the last quarter for the first time, the funds raised by the VC firm were more than what they returned to their LP's. This net outflow phenomenon has happened after 6-7 years.

This theme of uncertainty has percolated down to hiring, where companies and investors perceive that it is easier to get good quality people, but harder to get people out of their safety cocoons and move to possibly riskier opportunities. While the need for good people is as strong as ever especially in the mid market area, there are even more reasons for expectation in salary increase. People try and bargain for a salary increase as high as 90% and are no longer enamored by ESOP's as a tool for retention or wealth creation.

For some Venture Capitalists, this is a time for investing and scouting for opportunities as they have the funds to deploy. And likewise, in the technology arena, there is a bunch of founders who are geared for their second innings after discovering themselves in their first stint of business, earlier on in the dotcom phase. These people are keen to either back start up's in India or start something of their own.

Venture funded companies that are doing interesting businesses in niche spaces will perhaps eventually meet their milestones and look attractive to PE players at reasonable valuations. However several others may flounder. Therefore, most VC's have tailor made their investment strategies for India by moving away from early stage investments, a deviation from their parent company's strategy. Additionally, they are looking at sectors beyond technology along with mixed stage investments instead of being straitjacketed.

While conducting due diligence, most investors do assess the existing talent in the target company, so that post investment, they can put an operational structure in place and identify gaps to be filled. It's actually a great positive if the entrepreneur knows his areas of strength and weakness; else they tend to resist the transition that is apparent to everyone else.

While professionalizing a company is a step in the right direction for entrepreneurs, the board should ensure that the entrepreneur continues to remain integrally involved with the business. An entrepreneur's ability to make quick decisions and dive into swift action is a long term asset for any company.



WHAT'S ON YOUR PLATE? VC - PE BREAKFAST FORUM IV

Venue: The Four Seasons, Mumbai

Date: December 23, 2008

Attendees:

Jayanta Banerjee	Sr. Director Corporate & Strategic Initiatives	ICICI Venture Funds
Srinivas Baratam	Managing Director	Lazard India
Anand Dorairaj	Partner	New Silk Route
Rajeev Gupta	Managing Director	Carlyle India Advisors
Gopal Jain	Managing Director	Gaja Capital Partners
Rahul Khanna	Managing Director	Clearstone Venture Advisors
Rishi Navani	Managing Director	Matrix India
Darius Pandole	Partner & Director	New Silk Route
Deepak Shahdadpuri	Managing Director	BCP Advisors
Padmanabh Sinha	Managing Director	Temasek Holdings

The fourth edition of the Private Equity forum was a slight departure from its previous editions. For one it took advantage of the rare, pleasant winter morning in Mumbai, and it also had an audience which consisted of Wharton students, and several MD's from corporate India. Having had enough of doom and gloom, we decided to introduce an element of excitement into the proceedings by enticing the panelists to debate amongst each other. The issue was topical and controversial "The Competitiveness of India Inc".

As almost all the PE players had invested extensively in India already, the panelists found it difficult to critique India's competitiveness quotient, but nevertheless an enervating discussion ensued.

Some of the grouses were familiar with most of the PE players highlighting low exports resulting in a negligible share of global trade. With most of these investors focusing on both China and India the differences seem even starker. India is also ranked a meager 27th when it comes to sophistication and ease of conducting business. Also, with bureaucracy and red tape at every turn, negotiating the environment in India is tough going. Further, when it comes to Innovativeness, India is ranked 32nd which is quite a big stumbling block for investors. Most international investors have been bred on the 'ideation boom' in Silicon Valley, but scouting for that innovative pearl in India is a big challenge.

While India may be third in terms of talent availability, its record of spreading literacy is abysmal. Education at all levels across the country is extremely poor which puts a shadow of doubt over the talent pipeline in the future. Infrastructure is another bottleneck in India especially when the comparison invariably is China. While China has readied the infrastructure in anticipation of future investments, India is struggling to play catch up. A bulk of India's efficiencies is dependent on cheap labour which is not an extremely reliable resource as is the fickle monsoon -a large part of India's economy is still agri based, and so our woes begin with lack of rain. India shining is not inclusive and with very few genuine wealth creation vehicles, the discrepancy between the affluent and the poor seems unbridgeable. Another clear indicator of India's lack of competitiveness on the global scale is that very few Indian companies figure in the Global Fortune 500 List, this is compounded by the fact that most businesses are family legacies, and true entrepreneurs are few. The macro view is that India is governed by a political economy rather than the real economy with deeply embedded corruption that affects the man on the street.

But India still beckons with the country riding up on global GDP charts. Recent trends clearly show that there is slow but sure progress in the areas of manufacturing excellence, education, infrastructure and ethics. Besides we are blessed with a vibrant and large domestic market. When compared to China, a unique differentiator is our immensely buoyant private enterprise. Companies such as Tata's, Birla's and Bharti have been success stories despite the poor infrastructure. With the Indian government committed to improving infrastructure, Indian enterprise can only get more competitive.

The last few years have seen a confident India exert itself in overseas markets, through mergers and acquisitions. Propelled by its young socio-demographic profile, the country can surely attain global pre-eminence in the years to come.



412 B, Trade World, Kamala Mill, Lower Parel, Mumbai 400 013, India

T : +91-22-4340 1100

E : mumbai@hunt-partners.com

www.hunt-partners.com