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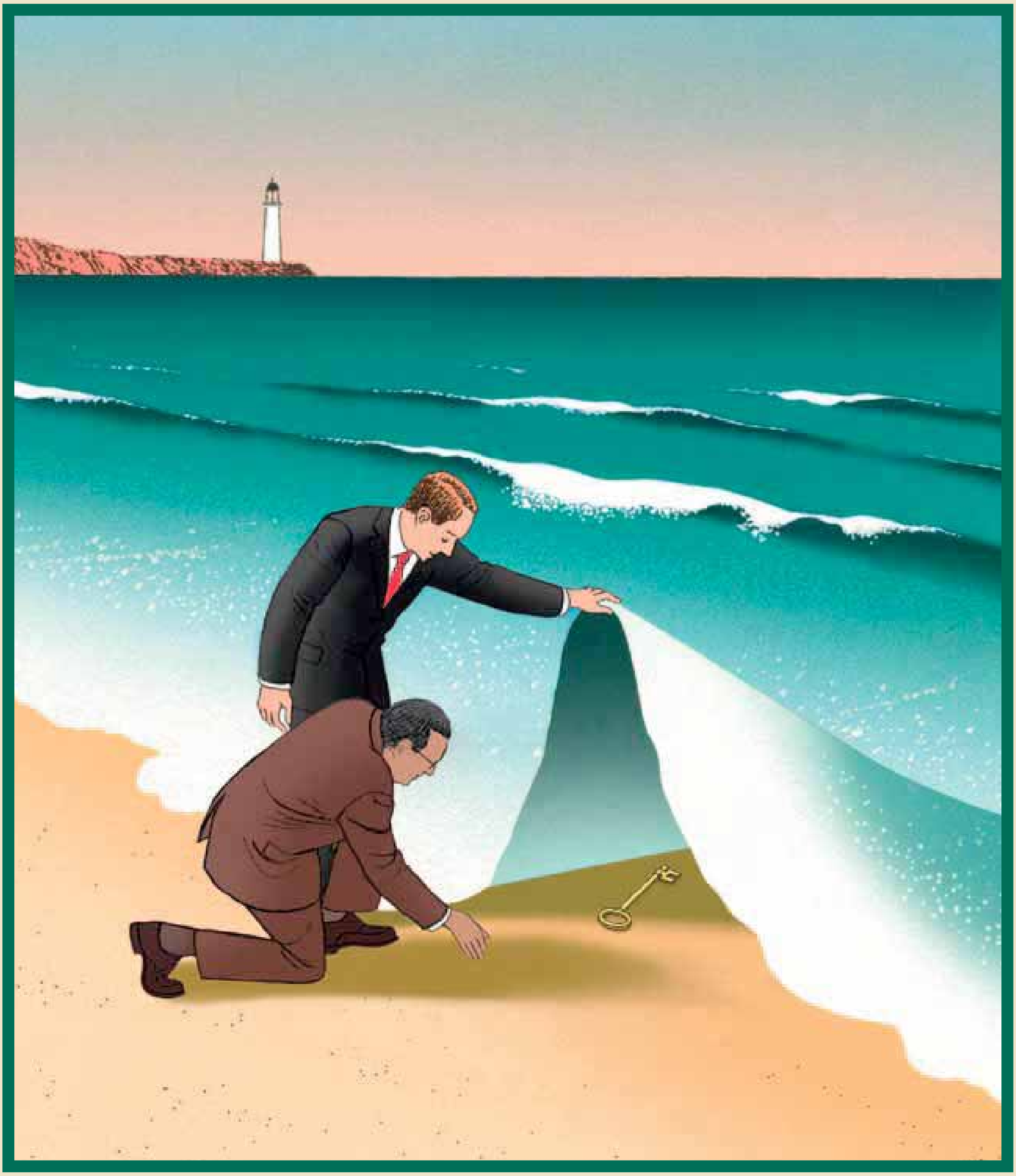

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A public affair

OF THE 14 PRIVATE EQUITY-BACKED IPOS on Indian bourses since the start of the year, New Silk Route Advisors (NSR) had a hand in three: Ortel Communications, VRL Logistics, and Coffee Day Enterprises, the latter alongside several other investors.

Parag Saxena, CEO at NSR, puts this down to preparation. The firm's work began in early 2014 with a study indicating that the New Democratic Alliance, led by Narendra Modi, would win the general election and take a pro-business stance. Planning for the IPOs – ensuring the portfolio companies could respond with the nimbleness required by the public markets – started not long after that.

Approximately 20 more PE-backed companies have submitted draft offer documents over the course of 2015, adding to the backlog from the previous year. Given the time it takes to get through the approvals process, many of these candidates will have to wait until 2016, but the number of IPOs in 2015 is already the highest in five years. Between 2012 and 2014 there were only 12 in total.

The broader private equity exit picture is also encouraging: investors have generated proceeds of $8.1 billion, a record high. The number of liquidity events is tracking last year's total but strong trade sale activity is pushing up the total in US dollar terms.

In fairness, that trade sales have generated more than three times the full-year figure for 2014 is due to a small number of large transactions. Led by the $1.17 billion acquisition of a 51% stake in Viom Networks by American Tower Corporation (partial exits for IDFC Alternatives and Macquarie SBI Infrastructure Management), the 10 largest deals account for 80% of the $6.2 billion trade sale total.

The IPO revival points to an increase in open market sales down the line, but few industry participants have confidence in a sustained flow of public market exits. As Brahmal Vasudevan, CEO of Creador, put it to AVCJ recently: "The windows are quite narrow. What usually happens is people get carried away when markets are doing well and they try to hold things longer to get a better return."

There are various measures that could make IPOs and open market sales easier, not least reducing the amount of time it takes to get approval for listings and follow-on offerings, changes to post-issue lock-up procedures, and perhaps even a separate platform for start-ups where compliance requirements are less stringent. More institutional and retail investors need to get involved as well.

A more overriding need, expressed by NSR's Saxena among others, is that Indian companies need help in building scale. It is apparent in certain areas – Viom, a telecom tower business, is a particularly strong example from the infrastructure space, while Coffee Day has achieved scale in the consumer sector – but not all. Public market investors find it easier to get behind a business that boasts stability and meaningful size.

In the meantime, the best preparation for an IPO might be to ensure that a public market listing is not the only option.

Tim Burroughs
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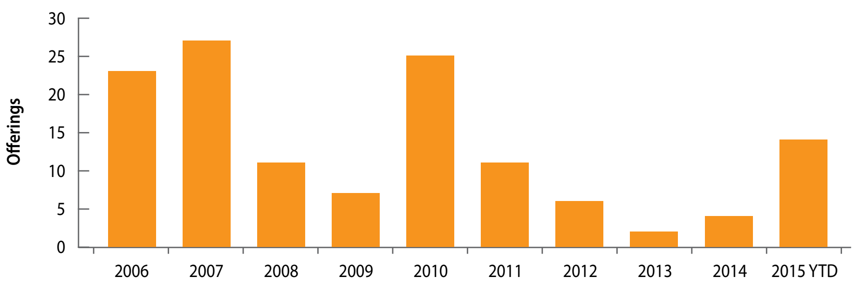
PE-backed IPOs on Indian exchanges



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NEWS

AUSTRALASIA

CHAMP's Ferris to lead Innovation Australia

Bill Ferris, co-chairman and co-founding partner of CHAMP Private Equity, has been appointed chairman of Innovation Australia, an independent, government-established body with a mandate that includes supporting start-ups and VC. He will serve a three-year term.

KKR backs Australia ultrasound start-up

KKR has committed $35 million to Signostics, an Australian medical technology company that produces hand-held devices used to conduct ultrasound tests and bladder scans. The company was founded in Adelaide in 2005, but ahead of this investment re-domiciled to the US.

GREATER CHINA

CDIB Capital launches cross-strait VC fund

CDIB Capital, the PE arm of Taiwan's China Development Financial, is raising a later-stage venture fund to focus on cross-strait expansion. The fund, CDIB Capital Taiwan Partners, is targeting $170 million and wants 20-30% of the corpus to come from foreign investors.

Carlyle to sell EBC to DMG Entertainment CEO

The Carlyle Group has agreed to sell its majority stake in Taiwan broadcaster Eastern Broadcasting (EBC) to Dan Mintz, CEO of US-based media company DMG Entertainment. Mintz told media that he had signed a deal to purchase the asset at a valuation of $600 million.

Ping An leads $200m round for Mogujie

Ping An Ventures, a VC arm under Ping An Insurance, has led a Series D round worth $200 million for Mogujie.com, a Chinese social networking and shopping platform. Tiantu Capital also participated. The new capital has been earmarked for product development.

Alibaba picks Gobi, CDIB to run HK, Taiwan funds

Alibaba Group has officially launched its entrepreneur funds - worth a collective $450 million - in Hong Kong and Taiwan, picking Gobi Partners and China Development Industrial Bank (CDIB) to manage the vehicles in those respective markets. The initiative, known as Alibaba Hong Kong Young Entrepreneurs Foundation, which is worth HK$1 billion ($129 million), was announced in February.

Ameba closes second China VC fund at $157m

Ameba Capital, an early-stage VC firm co-founded by former executives from Alibaba Group and Kingsoft, has closed its second renminbi-denominated fund at RMB1 billion ($157 million). Founded in 2011, Ameba raised $25 million for its debut fund, principally from successful Chinese entrepreneurs in the technology sector. All existing LPs in Fund I have re-upped in the new vehicle. A new generation of tech

entrepreneurs, whose businesses were backed by the debut fund, also committed capital.

"Over the past few years, our portfolio companies' entrepreneurs worked very closely with us and we have built mutual trust. The companies grew to a stage where the founders wanted to sell. Following their exits, they have excess cash and they want to continue working with us as LPs. With them, we can build a bigger ecosystem in the technology space," said Ameba co-founder Andrew Teoh, who previously led corporate finance and corporate development in Alibaba.

The venture capital firm also brought in two institutional LPs into Fund II: one traditional renminbi fund-of-funds and one Greater China-focused family office.

Fund I has backed 35 start-ups, including online fashion site Mogujie, taxi-booking app Kuaidi Dache, personal finance app Wacai, and online education firm Chuanke. There have been six exits through sales to internet firms and listed companies, or through listings on the New Third Board. Several other portfolio companies are also considering listing on the board

Education platform TutorGroup raises $200m

TutorGroup, a Chinese online education platform, has raised $200 million in a Series C round of funding from GIC Private and the Russia-China Investment Fund (RCIF). Goldman Sachs and Silverlink Capital also participated, followed by existing backers including Alibaba Group, Temasek Holdings, Qiming Venture Partners, SBI Holdings and CyberAgent Ventures.

KKR makes $90m fish food investment

KKR has made a fifth investment intended to leverage rising food quality and safety in China by taking a significant minority stake in Yuehai Feed Group, which primarily supplies shrimp farms, for about $90 million. The PE firm will support geographic and category expansion.

Tiantu to list on New Third Board

China consumer-focused GP Tiantu Capital has been approved to list on the National Equities Exchange and Quotation (NEEQ), also known as the New Third Board. It has raised a total of RMB2.68 billion ($420 million).

Cinema ticket sales app Wepiao raises $234m

Wepiao, a Chinese mobile app specializing in movie ticket sales, has completed a Series C round worth RMB1.5 billion ($234 million) led by state-backed Beijing Cultural Assets Chinese Film & Television Fund. Other new investors include CITICS Prosperity Fund, GGV Capital, China Southern Asset Management, Gopher Asset Management and New Hope Group.

CreditEase's unit files for US IPO

Yirendai.com, an online peer-to-peer (P2P) online platform owned by China-based micro-credit loan player CreditEase, has filed for an IPO in the US. The company started as a bricks-and-mortar operation, linking individual lenders to small-scale borrowers. Investors include IDG Capital Partners, Morgan Stanley Private Asia and KPCB.

Partners Group backs baby products retailer

Partners Group has acquired a minority stake in Aiyingshi, a China-based maternity and baby products retailer, with a view to helping the

NEWS

company secure acquisitions and licensing agreements overseas. The investment facilitates an exit for China New Enterprise Investment (CNEI) and two other shareholders.

B2B travel site raises $78m Series B

Lvyouquan.cn, a Chinese business-to-business (B2B) online travel platform, has raised RMB500 million ($78 million) in a Series B round of funding from a group of domestic investors. The company's backers include E-House Capital, Guangzhou Nan Yue Fund, Haitong Kaiyuan Investment, and Principle Capital.

ZhongDi Dairy targets $65m Hong Kong IPO

China ZhongDi Dairy Holdings, a private equity-backed dairy farm operator that supplies raw milk to leading brands such as Mengniu Dairy and Yili Group, is targeting a Hong Kong IPO of up to HK$508.4 million ($65.6 million). Investors include CITIC Capital and Vertex Investment.

NORTH ASIA

APG, CPPIB join e-Shang in logistics venture

Canada Pension Plan Investment Board (CPPIB) and Dutch pension fund manager APG Asset Management will establish a logistics-focused joint venture in South Korea with e-Shang, a Chinese warehousing operator backed by Warburg Pincus. It will be funded initially by equity investments totaling $500 million, with an option to increase capitalization to $1 billion.

SOUTH ASIA

Ola receives $500m Series F round

India ride-hailing service Ola has completed a Series F round of funding, raising $500 million at a reported valuation of around $5 billion. The round was led by new investor Baillie Gifford with participation from existing backers such as Falcon Edge Capital, Tiger Global Management, SoftBank Corp, DST Global and Chinese peer Didi Kuaidi.

KKR buys controlling stake in Avendus

KKR has bought a 70% stake in Indian financial services firm Avendus Capital for an undisclosed

Bain makes part-exit as Bellsystem24 goes public

Bain Capital has made a partial exit from Bellsystem24 as the Japan-based call center business raised JPY48.1 billion ($391 million) through an IPO. The company plans to broaden its service offering and expand into Southeast Asia. Bellsystem24 sold approximately 32.5 million shares - including 3.1 million new shares - at JPY1,478 apiece. Bain reduced its holding to 14.5% from 50.1%, while Itochu Corporation, which bought a 49.9% stake in Bellsystem24 last year, now has 41.1%.

Bain acquired Bellsystem24 from Citigroup Capital Partners Japan for JPY100 billion (then

$1.16 billion) in 2009. The company is a customer relationship management (CRM) outsourcing business built on a call center model. After spending two years stabilizing the business, the PE firm focused on changing the operating model to more of a performance-based higher-value offering. To this end, David Garner, who had substantial experience running CRM businesses in the US, was brought in as chairman. He led the transition internally and also brought customers around to the new way of working.

In addition to building its domestic customer base in the traditional sense, Bellsystem24 wants to leverage the Itochu relationship and bring in more business from the conglomerate's subsidiaries. The company is also broadening its product offering to include a suite of cloud-based technology services and expanding operations into Southeast Asia.

sum. The GP's purchase comprises newly issued shares and shares from existing Avendus investors; the selling shareholders are Eastgate Capital and Americorp Ventures.

Premji, Temasek buy into ICICI insurance unit

PremjiInvest – the family office of Wipro Enterprises chairman Azim Premji – and Singapore's Temasek Holdings have agreed to pay INR19.5 billion ($296 million) for a 6% stake in the life insurance unit of ICICI Bank. PremjiInvest will take a 4% stake in ICICI Prudential Life Insurance, with Temasek taking a 2%.

OrbiMed exits Ecron Acunova for $17.4m

Indian life-science technology company Take Solutions has agreed to pay INR1.15 billion ($17.4 million) for Ecron Acunova (EA), providing an exit for healthcare-focused private equity firm OrbiMed Advisors. EA was OrbiMed's first investment in India. The GP paid $6.5 million for a minority stake in the company in 2009.

Sequoia, Lightspeed back Craftsvilla

Sequoia Capital and Lightspeed Ventures have led a $34 million Series C round for Indian online ethnic products marketplace Craftsvilla. The two VC firms are existing investors in the firm, as are fellow participants Nexus Venture Partners and Global Founders Capital. A vehicle connected to DST Global came in as a new investor.

Bessemer leads $25m round for UrbanClap

Bessemer Venture Partners has led a $25 million Series B funding round for Indian local services marketplace UrbanClap. Existing investors Accel Partners and SAIF Partners also participated.

NEA, Accel commit $12.5m to MindTickle

Accel Partners and New Enterprise Associates (NEA) have invested $12.5 million in a Series A round of funding for Indian business training and networking platform MindTickle. This is NEA's first investment in MindTickle, and the second for Accel, which committed $1.8 million to the company in October 2014.

SOUTHEAST ASIA

Lakeshore closes first Thailand fund at $60m

Lakeshore Capital Asia has closed its first Thailand-focused fund - one of the few such vehicles, if not the only fully institutional player - at $60 million. Lakeshore Capital Fund I launched with a target of $60 million, although this was subsequently upgraded to $100 million. LPs include the International Finance Corporation.

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Treading water

India's internet giants are becoming more acquisitive, but they still play a minor role in VC firms' planning. To raise their influence these companies first need to stabilize their own operations

AS AN ACTIVE INVESTOR IN INDIA'S TECH start-up scene, Helion Venture Partners has learned to factor in the possible moves of the country's internet giants. It has seen these companies make inroads into the territory of several of its portfolio companies, including online grocery business BigBasket and mobile payment solutions developer Ezetap.

Yet the firm's views on the likes of Flipkart, Snapdeal, Paytm and Ola – which between them control sizeable portions of the e-commerce, online payment and transportation services spaces – extend only to concerns about competition. So far it considers trade sales to be an unlikely exit opportunity, because for the most part these companies simply seem to be uninterested.

"Most of the larger giants have still not made very large acquisitions," says Rahul Chowdhri, a partner at Helion. "There are very few examples, unlike in the US where a Google or a Cisco Systems or a Yahoo will make multi-hundred-million-dollar acquisitions. India still does not have enough of those examples."

Despite the absence of big-ticket sales, India's major tech players have shown increasing interest recently in expanding their businesses. Their desire has brought both caution and excitement to the VC community, as investors balance the possibility of selling their portfolio companies with that of suddenly facing a rival with much deeper resources.

At the same time, size does not equate to freedom of movement for these giants. They must be careful about their exposure – ever conscious of the dangers of overreaching when competitive threats remain in their core markets – and are therefore likely to remain a small part of India's exit market, at least for now.

Close to home

The areas in which India's tech giants have shown the greatest interest in recent years are online-to-offline (O2O) local services and financial technology. This interest has taken several forms, and the companies involved have tended to mix their strategies depending on the situation.

One route that has proven popular is that of acquiring a start-up that is already pursuing the business in which the larger company wants to become involved. A prominent example of this was Snapdeal's purchase of mobile wallet FreeCharge; the online marketplace paid $400 million for FreeCharge in April.

"None of these companies has been around long enough to be shy of buying talent or buying teams and businesses," says Rahul Khanna, managing partner at venture debt firm Trifecta Partners. "So Snapdeal acquiring FreeCharge is an example of that, where they said, 'Look, here's a business we think we should own, why bother repeating it.'"

> "Some of them will have burnt their fingers. For example, in the hyper-local logistics space you've seen so much consolidation, where companies have been sold for as low as $10,000. It's bound to happen when they make rash decisions about wanting to invest in a sector just because others have" – Vishal Pereira

Both Snapdeal and rival online marketplace Flipkart have led the way in terms of acquisitions. Snapdeal, however, has accelerated its buyout activity recently, making five acquisitions in 2015, according to AVCJ Research – as many as in the previous five years combined. By comparison, Flipkart has made seven acquisitions since 2011 and three in the last year.

On the other hand, Flipkart has outdone its competitor in terms of venture capital transactions. It has made three investments this year, as opposed to one for Snapdeal.

Other major tech players, such as Amazon India, e-commerce and mobile payments platform Paytm, and taxi aggregator Ola, have been more restrained on this front. AVCJ Research has no records of acquisitions in India for any of the three, and no records of VC investments for Ola – though in this category Amazon and Paytm have been more active. Amazon has made four VC investments since 2000, two of them in the last year, while Paytm has made three, all in 2015.

The factor that unites these different approaches is that they are meant to expand the core business, rather than entering entirely new areas. Ola's approach shows this; the company has taken steps to broaden its own offerings through internal initiatives rather than through M&A, taking advantage of its network of drivers to enter the grocery and food delivery verticals. The company has also entered the crowded fintech space with its own mobile wallet app.

"Now that they have spent a significant amount of customer acquisition money, it makes a lot of sense for them to try and increase the activity of these same customers, rather than expecting a very large amount of activity just from the cabs business," says Vishael Pereira, managing director at investment bank and consultancy firm CreedCap Asia Advisors.

In this way, adding additional lines of business in this way helps the giant generate more revenue from its existing customer base. It is an important consideration, because once a company has attained a large enough scale, it may no longer be feasible to rely on organic expansion to meet revenue needs.

The M&A activity of the other majors fits this pattern. Flipkart's well-publicized acquisition of online fashion and apparel shop Myntra in 2014 boosted its previously weak representation in the fashion sector. Snapdeal's purchase of FreeCharge stemmed from a desire to have its own payment system rather than partner with one of India's many independent fintech developers, which would have taken a cut of the revenue and made use of Snapdeal's customer information as well.

These companies are at a disadvantage in this regard, compared to their counterparts in other countries. Though they have raised large

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amounts of money, the major Indian players have not achieved the national dominance of a Google or Amazon in the US, or of an Alibaba Group or Tencent Holdings in China.

Because of this, the Indian giants have to focus on winning in their core business sectors before trying to attack new areas, which leads to the complementary nature of their deals. Though Alibaba and Tencent have also pursued investments to expand their own businesses, they have been able to pursue a broader focus, both in terms of industry sectors and geographies. Some Chinese giants have even made inroads into India, as when Alibaba invested in Paytm, or when Xiaomi launched a research and development center in Bangalore.

Another limiting factor in the India market is the fact that the tech giants are not yet showing a profit. Rather than making acquisitions from their own money, the companies are still reliant on outside investment to support their expansion strategy.

"They're still getting their own business models right, and they're actively trying to recruit senior management to come and run these core businesses, and drive them to profitability," says Ben Mathias, managing director and head of India at Vertex Ventures, the VC arm of Singapore's Temasek Holdings. "So they don't exactly have the bench strength to go and expand into new business areas, and be nimble about it."

This means that despite their deep pockets, managers at the major players cannot count on the flow of money continuing. They must divide their attention between raising additional funds and running their own businesses. This is another difference between the largest Indian internet players and their Chinese counterparts, which are profitable and in many cases are listed companies, giving them additional streams of capital.

Coming consolidation

While there is still plenty of competition in India's start-up sector, industry professionals warn that this is not likely to remain the case. In the fintech space, for example, the many available payment options are likely to create confusion among consumers, resulting in pressure for affected companies to rally around a common standard.

"Today I need to have Paytm if I want to use Uber; I need to have the Ola money wallet if I want to use Ola; I need to use FreeCharge if I want sweet deals on Snapdeal shopping. It's just very hard for me as a consumer to figure out where to keep my money," says Dhiraj Poddar, director at TA Associates. "I think it's still early enough that multiple players can try to build or acquire this, but at some point you'll expect the customer to decide where he's really focusing on keeping his money, and he'll do it where the use case is highest."

Other sectors are already starting to see consolidation. CreedCap Asia's Pereira, who told AVCJ earlier this year that he expects no more than one in five local logistics start-ups to make it past the seed round, says the shakeout has already begun, with overeager investors that jumped into the space without enough forethought having to take a loss.

"Some of them will have burnt their fingers. For example, in the hyper-local logistics space there has been so much consolidation, where companies have been sold for as little as $10,000," he says. "It's bound to happen when they make rash decisions about wanting to invest in a sector just because others have."

> "Every 2-3 years we have a big rally up and then we have a quick correction down. And in that, only three or four companies will stand" – Ben Mathias

If the crowding of the market is a warning sign for India's tech investors, the growing interest of the major internet players could offer the prospect of relief. The increasing moves toward acquisition certainly indicate that an investor holding on to the right property could find a willing buyer.

Flipkart's purchase of Myntra is an example of the possibilities of this approach. However, Helion's Chowdhri is one of various industry players who say they do not consider the chance of a trade sale to be worth making it a major part of their plans.

For one thing, the tight focus of the tech giants on their core business means that start-up backers cannot be sure that their portfolio companies will be attractive to the giants. For another, many investors feel that India's exit market lacks clarity.

Flipkart is a case in point. When the company launched in 2007, its founders were planning to sell out to Amazon after a few years. That goal was upended when Amazon itself launched in India in 2013. However, since then Flipkart has continued to raise funds; indeed, the company has raised more money since 2013 than it did before the US giant entered the market.

The continued success of Flipkart has raised the hopes for many Indian investors of following a similar path and finding the next unicorn themselves. Pereira says this is the focus of the biggest investors today, though not all VC professionals agree that just following up a success story is the priority. Vertex's Mathias notes that many investors focus on building up companies so they can weather the swings of the investment market's cycles.

"I've learned in India over the last 10 years that there is significant value to being able to survive cycles," says Mathias. "And India does have cycles sort of in a compressed fashion. Every two or three years we have a big rally up and then we have a quick correction down. And in that, only three or four companies will stand."

Even when a sale to a tech giant is available, investors may be wary of handing over control. An acquisition can be a boon for a start-up, with the availability of additional resources, more freedom to operate, possible synergies with the parent company, and access to a larger customer base.

On the other hand, if the parent does not understand the company it has purchased, it might not manage it properly, causing friction within the larger group and reducing efficiency of operations. A sale that goes badly runs the risk of hurting everyone involved.

Where to next?

Investors are confident that India's tech giants will continue their expansion and strengthen their presence in the M&A markets; the question is which sectors will they turn to next.

Pereira thinks that e-commerce players might turn toward the logistics space next, in order to own the entire supply chain and better control costs, while Mathias believes that an omni-channel sales strategy might be in store, with online retailers investing in brick and mortar retail outlets to reach a new customer base. Both caution that this is only speculation, however.

India's VC investors cite this uncertainty as the reason that it is critical not to plan on the actions of the tech giants when they make their investment decisions. Helion's Chowdhri points out that the tech sector is still very young, and that few of the features that are taken for granted today were even conceived of ten years ago.

"Just because mobile phones were being used, nobody knew whether cash-on-delivery would take off or not. A lot of other things have to come," Chowdhri says. "It's like making a movie; a good movie is not about one particular thing, it is about multiple things coming together. So, I just shrug if somebody says they knew this would happen, or this was the data point, and it was obvious."

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Proxy play

A sizeable portion of the PE capital entering Indian financial services has targeted wealth management as local players look to scale up their offerings on the back of growing private wealth

AVENDUS MADE ITS NAME AS AN investment bank – one of the top three in the market and a sought-after advisor on India consumer internet transactions. New majority owner KKR plans to use this business as the foundation stone for an integrated financial services platform.

Alongside the financial advisory business, Avendus has a private wealth management operation and an alternatives business. Both of these are primed for expansion, leveraging synergies with the investment bank, whether it is sourcing high net worth clients or dipping into the knowledge base of mid-cap companies for investment opportunities, and with each other.

Sanjay Nayar, KKR's India CEO, compares the model to the traditional merchant banks "which were customer-centric and developed business models based on the trust they generated and the high-caliber advice they could offer."

By focusing on the business owner segment, Avendus covers about two thirds of India's wealth, and 40% of its wealth management business comes through introductions from the corporate advisory team. Introductions are also made in the opposite direction. Another platform will be added with the creation of a non-banking finance company (NBFC).

"When you have business owners as clients it is not just about the fact they have wealth," says Ranu Vohra, CEO and co-founder of Avendus, explaining how the NBFC and the wealth management arm will co-exist. "They have committed that wealth to products and companies and therre may be a mismatch between what they have and what they would want to put into a business. Having a non-bank that can offer a credit solution is very important."

Two poles

KKR's Avendus play is one of a number in India's financial services space, almost all of which are predicated on a level of differentiation or service that distances them from the norm. According to AVCJ Research, PE firms have deployed around $4.3 billion in the sector this year, the most since 2007. They tend to gravitate towards one of two poles: NBFCs leveraging greater penetration in rural areas; and wealth management services tailored to high net worth individuals (HNWIs).

"A lot of the ROE [return on equity] in the middle often gets competed away" observes Pawan Singh, a managing director at Bain Capital, which invested $200 million in NBFC L&T Finance in September. "If you look at NBFCs, where people have created differentiation and earned higher ROE, has changed over time as segments become more crowded. Some NBFCs are trying to grow financial inclusion on the margin, servicing customers who today don't have other formal options. Catering to HNWIs for wealth management services is a different business and plays on a different kind of tailwind."

A unifying element is the erosion of market share among the public sector banks, which is being picked up by private banks, NBFCs and other specialty finance providers. Inefficiency and capital constraints are contributing factors, as well as a lack of nimbleness in termss of providing products that meet customer demand.

> "A lot of wealth has been created but more importantly people are now going through formal channels" – Bhavik Hathi

The latest installment of the Capgemini and RBC Wealth Management's Asia Pacific wealth report puts the number of HNWIs in India – defined as those with at least $1 million in investable assets, excluding primary residence – at 198,000 in 2014, up from 84,000 in 2008. They have total assets of $709 billion.

"A lot of wealth has been created but more importantly people are now going through formal channels," says Bhavik Hathi, a senior director at Alvarez & Marsal (A&M). "Almost 60% of the market was unorganized but as of 2015 this was down to 20%."

On broad level, KKR's Nayar says growth in India's wealth management industry is conditional on savings rates going up, capital markets maturing, and the rupee becoming fully convertible. Vohra compares the current level of sophistication in the industry to that of investment banking 10 years ago. "A lot of families have small family offices or a company CFO that helps out on family investments. As their wealth grows and as the time they have to focus on investments reduces, there will be large demand for advisory services," he says.

Avendus' wealth management business recently surpassed $1 billion in assets under management and the company is looking to reel in larger rivals such as Kotak Wealth Management and IIFL Wealth Management. (The latter agreed to sell a minority interest to General Atlantic for $173 million in October.)

While several international players are also competing in this market others have stepped back. UBS has wound down its local operation, while Morgan Stanley and RBS both sold theirs. Local HNWIs' discomfort with the fees charged for services is often given as a reason.

Growth capital

The domestic incumbents require private equity capital and support as they look to expand and fill this perceived gap in the market. One area in which KKR intends to help Avendus is in the talent acquisition, retention and development that are part and parcel of scaling up most financial services businesses.

"They need to hire the right people and expand product offerings," adds A&M's Hathi. "Many wealth managers have been limited to recommending their group company's products, but they are becoming more mature in terms of giving exposure to a wider variety of products and tying up with global partners."

While the NBFC space is reasonably diverse, the question for wealth management is whether there are enough viable investment targets to sustain the recent space of PE investments.

Sanjeev Krishnan, India PE leader at PwC, notes that not every financial services deal will get funded because there have been concerns in the past about the quality of promoters. Menon Raghubir, a partner with Shardul Amarchand Mangaldas & Co, concurs, saying he anticipates no more than a couple of deals a year at best.

"Most of the big boys aren't willing to sell," Raghubir says. "Some boutique shops might be interested and Avendus is a classic example of a business set up by a few entrepreneurs. But how many more are there with the same market reputation? Pretty much none."

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The digital divide

India's IT services providers firms have moved beyond their humble beginnings to encompass a wide range of outsourced functions. Private equity backers will continue to be key to their evolution

AS INTERNET USERS ACROSS THE developed world conduct their connected lives, most of them give little thought to the digital infrastructure that underpins the technology they use. The vast majority could not tell you where to find the servers for the site from which they bought their airline tickets, or who developed the software they use every day at their jobs.

The answer to these questions would often be India, which became the back office location of choice for assorted multinationals in the 1990s, with a number of these providers subsequently going independent. The fact that users around the world can rely on the country's IT services without ever knowing where they come from is a testament to the professionalism that has made the sector one of the most compelling investments for private equity firms.

"A few years ago this was a field in which you made pure minority growth investments, or venture investments," says Cyrus Driver, Asia head of private equity at Partners Group. "It's now a field that is conducive to leveraged buyouts and to control-oriented investors. Not only does it have relatively scaled up businesses, it is also a sector that, at least in the Indian context, has the most professional management teams."

India's IT and IT-enabled services (ITES) sector has come a long way from its beginnings in business process outsourcing (BPO). With many of the traditional call centers migrating to the Philippines and other countries, the sector has moved into a new phase, with companies more willing to assert themselves in acquisitions.

However, this new direction opens up new challenges as well. PE firms that have historically supported the players in this sector will be instrumental in its continued evolution.

Overcoming the skeptics

During the first wave of Indian outsourcing, entrepreneurs faced considerable skepticism that the model could work. The idea of trusting a company's support service to outsiders – and more than that, to people in a completely different country – was novel and untrusted.

"Back in the 1990s, the first generation Indian companies were renegades going out to the developed world, pitching that they could do tech services out of India. They were selling a concept, and it had never been done before at any major scale," says Prateek Dhawan, managing director at Everstone Capital, which has held a controlling stake in customer interaction management software developer Servion Global since last year.

That alien concept has turned into global market that IT consultancy IDC – citing BPO only – estimates will be worth $220 billion by 2018, growing at a compound annual rate of 5.6%. For business analytics services alone, IDC projects expansion from $58.6 billion in 2015 to $101.9 billion in 2019. The group noted that there is greater pressure on service providers to differentiate themselves by investing in specialist talent and intellectual property, and building truly global infrastructure.

> "Markets move fast and hence larger scale players are always on the lookout for 'acquiring' capabilities that they may have missed out on building organically. And so what you see is not only private equity deals for control, but also a lot of M&A in this market"
>
> – Prateek Dhawan

"New end market disruptions like social, mobile, analytics and cloud provide a huge market opportunity that will drive sustained growth for the Indian IT services industry for years to come," Dhawan adds.

The management teams that led that first wave have left their mark on the industry. Several PE industry professionals credit the IT sector with bringing a new, more flexible and adaptable management style to India.

The familiarity of investors with these teams is related to the fact that private equity has always been integral to the growth of India's IT services space. GPs have generally been willing to support the companies because their services are always in demand and therefore they have considerable leverage when setting the terms of their contracts.

"When we look at Indian IT service companies, these companies have a phenomenal return on capital. They generate a lot of cash, and they don't need a lot of capital to grow, so after the initial round of funding they're pretty much on autopilot. They don't need any external funding," says Gaurav Ahuja, director at ChrysCapital. The GP is one of the more active investors in ITES providers, having backed Indian companies such as Hexaware Technologies and US-based providers such as Infogain.

PE investors historically have also helped IT firms as they pursue new clients – given the asset-light nature of these businesses, capital tends to be directed towards customer acquisition. GPs can provide the needed financial support, along with advice for establishing themselves in the chosen market and presenting themselves to potential clients.

"If there is an Indian business that needs to sell in the US, they have to invest in front end infrastructure, be close to the customer, and deliver services offshore seamlessly," says Everstone's Dhawan. "This requires investment and capital to make it happen. We provide that growth capital and operational help in terms of customer connects, operational rigor, and hiring the right front end talent through our networks. That helps the companies scale up and tap into that overall market opportunity."

Target rich environment

The IT and ITES space is still congenial to PE investment. Of the top 10 private equity deals in India in the first quarter of 2015, five were for companies in IT or ITES. Additionally, data from Ernst & Young show that M&A activity in India in 2014 was led by the technology sector, including IT.

This rising tide of M&A has been fueled by increased LP investment in private equity funds, making more resources available for PE investment in general. Vikram Utamsingh, managing director with Alvarez & Marsal's transaction advisory group in Mumbai, remembers meeting with a global LP that was willing to commit additional capital for IT services transactions.

"The LP was clear on a framework of co-investing with their domestic GPs in the Indian market. This would allow the GPs to look at much larger size transactions than they're actually capable of doing on their own," says Utamsingh. "And the LP's approach was to say in some of these situations, we might even lead the investment opportunity or co-lead it with our GPs, and not just be somebody who's in the background providing the funds."

With this money on the line, and with the historical profitability of the ITES sector, GPs are also pushing their investee companies to be more active in taking risks and improving their position in a crowded market.

"We like IT services companies that are a little more aggressive on that front, and are happy to use that cash, because otherwise you're creating cash reserves that are not efficient for you," says ChrysCapital's Ahuja. "If you have the ability to use that cash wisely, and create a more comprehensive set of services, or create a more global company with clients across the world, I think that is more exciting to us."

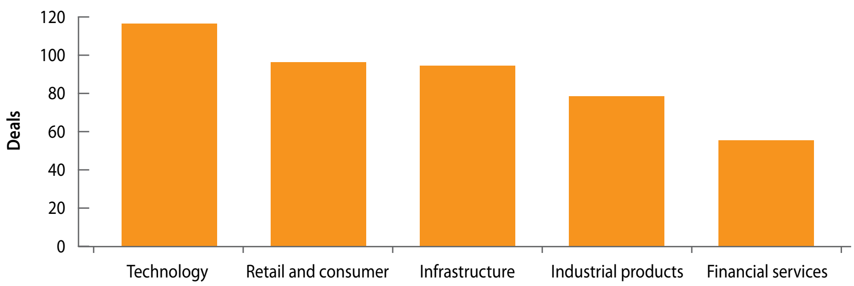
This investor pressure, combined with the previous success of the sector overall, has shifted the IT and ITES players in a new direction. Companies now seek to build a more effective platform that can generate returns more efficiently, rather than continuing straight-line organic growth.

Technological advances are another factor driving the changes in thinking among IT companies. The rise of SMAC – social, mobile, analytics and cloud – services has created an opportunity for the IT sector, which has already built up its communication infrastructure to support these new developments.

"I think the move has gone away from hiring heads, to acquiring more and more technology, and software platforms," says Gautham Radakrishnan, a partner at Tata Capital. "You hear this phrase about 'non-linear earnings growth' the big IT companies talk about. What they're really saying is they want to buy more IP, in order to be able to generate returns which are more linked to operating leverage than to scale in terms of numbers of people."

Private equity professionals again credit the nature of the management teams in the sector for its unusual amount of M&A activity. Founders of ITES companies, dating back to the beginning of the industry in the 1990s, have tended to see their businesses as means to an end, and to view a trade sale as a normal part of business rather than a relinquishment of responsibility.

Most active sectors for Indian M&A, 2014



Source: Ernst & Young

"Given the technical nature of this market, and the functional expertise that it requires, most entrepreneurs are professionals, who are more amenable to move on, sell control, take their chips off the table, and let somebody else scale to create more overall wealth rather than care about percentage ownership," says Everstone's Dhawan.

"In addition, markets move fast and so larger scale players are always on the lookout for 'acquiring' capabilities that they may have missed out on building organically. And so what you see is not only private equity deals for control, but also a lot of M&A in this market."

The two tiers

Not all IT and ITES companies are created equal, however. Industry professionals split the market into two tiers: the top one contains the large global players, such as Tata Consultancy Services and Cognizant Technology Solutions, while the lower one contains relatively smaller operators like iGate, which received support from Apax Partners in its acquisition of India's Patni Computer Systems in 2011 and was sold to CapGemini this year.

The second tier also contains more specialized players, such as healthcare-focused Sirius Technology, or analytics firm Mu Sigma. Private equity professionals say that the danger for these more niche firms is that it is unclear what their long-term relevance will be, and so investors are reluctant to commit funds to them. In addition, their smaller size keeps them out of the range of larger funds.

"The challenge for us given our check size is, barring a handful, a lot of the companies in those niche segments today are not big enough," says Pawan Singh, managing director at Bain Capital, which paid $1 billion for a 30% stake in pioneering BPO firm Genpact in 2012. "Over time, if they are able to scale organically and inorganically, they could become more interesting."

Second-tier firms also face a disadvantage when it comes to achieving scale on the level of the biggest players. Their more specialized nature keeps them from attaining the size available to a company with a broader focus.

"It's difficult to see how a niche service line-focused or vertical-focused player will get to the scale of one of the tier-one players. You could get consolidation in the middle tier-two players to create a more scale business, even if not quite tier one," Singh adds. "But the top players continue to distance themselves from the rest of the pack, and as they get bigger they will focus on certain sectors or segments. This will create opportunities for other players to come in and be more specialized under that umbrella."

Industry participants see further potential for sector growth in international expansion. As the services offered by the IT companies become deeper, they will require deeper collaboration with outside firms, at levels beyond the technology departments. Indian players already often deal with corporate sales and marketing offices at their foreign clients. In some cases the services they provide have become so comprehensive that they have to keep a representative on site to better coordinate services.

Vikram Hosangady, head of transactions and restructuring at KPMG India, notes that the changing nature of the IT sector also plays to the strengths of India, where large teams with diverse skills can be assembled quickly.

"When you look at a data analytics company today, it's not a person who just has an engineering degree or a computer training background. These are people who come from design schools, from advertising organizations, people who have creative skills," says Hosangady. "To get a pool of those people is not easy. And India allows that, because if you're setting up a city in cities like Bangalore or Mumbai or Gurgaon, you have access to very large pools of such talent."

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A larger slice

Corporate carve-outs are on the rise in India as companies divest due to financial pressure or strategic rationale. To get these deals, PE firms must demonstrate operational capability and corporate sensitivity

LARGE-SCALE MERGERS INEVITABLY generate smaller ripples as assets are divested to appease regulators and the unification of cement giants Lafarge and Holcim was no exception. Announced in April of last year, it took more than 12 months for the deal to close, with competition authorities in India, Europe and North America the last to grant approval.

The Indian authorities – concerned that the merger of two companies with a combined global market value of $50 billion and a combined domestic cement capacity of 68 million tons would undermine competition – made two requirements: Lafarge had to sell one cement plant and one grinding station in eastern India, with a capacity of around 5 million tons.

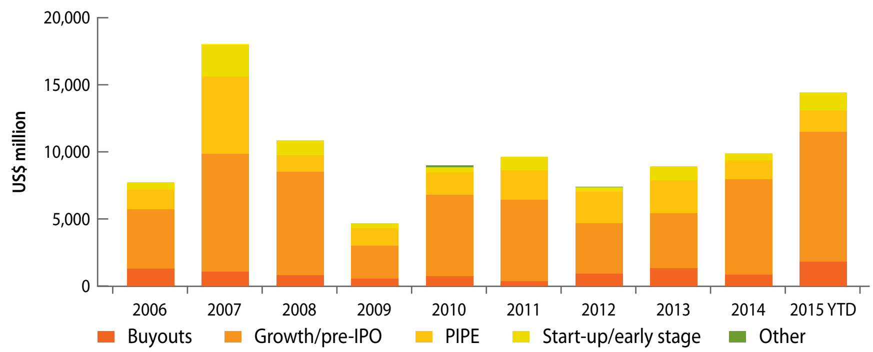
Several PE firms and strategic players submitted bids for the assets, and it was one of the latter, local conglomerate Birla Group, that won out. The merger also delivered an exit for Baring Private Equity Asia as Lafarge bought back a 14% interest in its India division. It sold the stake to the GP two years earlier (reportedly with a put-call option included) as part of an attempt to reduce group-wide debt.

Such divestments are expected to become more commonplace in India as local companies pick up the habits of their multinational brethren, driven by a combination of financial expediency and strategic rationale. However, as the Lafarge situation indicates, corporate players with deep pockets pose a strong competitive threat to private equity firms. For financial investors, timing and asset selection are crucial.

Buyouts are a rare commodity in India, with roughly half of the deals announced in 2014 falling into the growth and pre-IPO category – a consistent story over the past decade. However, control transactions are on the rise. AVCJ Research has records of 59 between 2012 and 2014, more than the combined total for the previous five years. Carve-outs of businesses from larger groups are contributing to this trend.

"It is becoming much more commonplace than it was in the past," says Manish Kejriwal, managing partner at Kedaara Capital. "There are a variety of reasons for this. For example, the large industrial houses, particularly those in commodities and infrastructure, are deleveraging their balance sheets and focusing on their core businesses. A resulting corollary is the disposal of unrelated businesses."

India PE investment by type



Source: AVCJ Research

Dhanpal Jhaveri, managing partner for private equity at Everstone Capital, notes that control deals make up half his firm's deal flow and a good percentage of those are corporate divestments. "Relative to what the situation was 2-3 years ago, the deal flow has gone up several times," he says.

The home front

Everstone has announced two carve-outs this year: it bought Aon Hewitt's Asia Pacific payroll business, much of which is based in India; and Hindustan Unilever's bread and bakery business. Both of these were divestments by foreign companies that appointed banks to run sale processes, but industry participants also claim to be seeing more activity from domestic players as well. Historical reservations about selling off businesses appear to be abating.

Industrial conglomerate Larsen & Toubro (L&T) is a high-profile example. The company has sold off minority stakes in several businesses in the last year or so. Its executive chairman has admitted that certain divisions, particularly asset-heavy ones, may need to be exited completely in order to simplify group operations and improve return on equity.

It was reported that potential buyers were sounded out for L&T's valves and alloys businesses, although no transactions have resulted. One source notes that an auto wire harnessing manufacturing asset was also put up for sale, prompting interest from private equity and strategic players. The deal didn't happen because no one was willing to meet the seller's valuation expectations.

"You see large groups once in a while coming to the market and trying to cut off the tail of these very small businesses that are quite decent in size for private equity to acquire," says Vikram Utamsingh, co-head of India at Alvarez & Marsal. "This is a slow trend and it will emerge over time."

In other situations, divestments are not necessarily a matter of choice. Jaypee Group has offloaded a string of cement and power in the past 18 months as it attempts to service a debt burden of more than INR600 billion ($9 billion). Anil Ambani's Reliance Group is also under pressure due to high debt levels and falling stock prices, leading to Reliance Infrastructure's recent sale of a 49% stake in its electricity business to Canada's Public Sector Pension Investment Board.

The introduction of India's bankruptcy code could see further examples of this behavior. The Ministry of Finance released a proposal last month that would replace the assortment of regulations pertaining to insolvency with a single code and a new tribunal system to ease the burden on the courts. It is hoped the reforms will shorten the average 4.3 years it takes to wind up a company, according to the World Bank, and improve a debt recovery rate that is currently a paltry $0.25 on the dollar.

"The most important aspect is to allow liquidation to happen," says Everstone's Jhaveri. "It is important in situations where a company gets into stress and it makes more sense to shut it down and sell the assets rather than continue with the business. Land, for example, could be a very valuable asset that is locked up. The code provides an accelerated way to deal with it."

PE investors are looking to the code to help clear up companies that have continuously renewed their credit lines without taking meaningful steps to reduce debt. "Once you have proper laws laid out, that rolling over of debt, with the banks knowing they'll never get paid back, will stop," says Parag Saxena, CEO of New Silk Route Partners. "We should start to see some impact from the bankruptcy laws in 2017."

Several industry sources observe that more pragmatic and forward-thinking family groups are considering divestments of non-core assets in order to ensure they are not under threat when the bankruptcy code comes into force.

There is, however, no guarantee that private equity firms will acquire these unwanted businesses. In certain situations, a PE buyer might be the logical choice. For example, the selling group may want to stop the asset going to a competitor or it would like to retain control in the long-term and simply use the PE firm as a white knight to hold the asset for a few years before completing a buy-back.

If the motivating factor is to get the highest possible price via a full exit, strategic buyers with plenty of cash and the ability to factor long-term synergies into price evaluations are more likely to prevail.

Sensitive issues

Another consideration is the complexity and sensitivity of transactions. "Carve-outs take a long time to do," says Gautham Radhakrishnan, a partner at Tata Opportunities Fund (TOF). "There are a lot of technical points, not least tax, regulatory and legal concerns, and then you have to back a management team that has done more than just serve a parent and is able to sail on its own."

As a private equity firm sponsored by Tata, TOF is in a unique position. It has visibility into the Tata group of companies and can therefore identify situations in which carve-outs might make sense. TOF also offers continuity in terms of Tata's high standards of governance, ethics and corporate culture, which reassures any Tata or non-Tata seller that TOF will behave responsibly. Radhakrishnan observes there are perhaps many "softer elements at play" in maintaining relationships in carve-outs that are more significant in an Indian context than in the West.

This sensitivity has a further impact on how deals are sourced. While some groups will want to run a process in order to get proper price discovery, others are more circumspect and so the onus is on the private equity firm to make the running. The GP must approach the parent company, outline the challenges it faces, and show how private equity can deliver a mutually beneficial solution.

"The real deals will be done where a private equity firm is very close to the specific industrial group or relevant family," says Kedaara's Kejriwal. "Most private equity firms have been dependent on bankers for deal flow but in this sensitive area, most deals will be proprietary in nature. It is about finding elegant and private solutions for families that are overleveraged."

Trust is a factor in this context, but so too is competence. The private equity firm's pitch is usually about the value it can create through a control transaction, which in turn places emphasis on operational capabilities. It is therefore no coincidence that Everstone's two carve-outs this year focused on sectors in which it claims to have particular expertise: business services and consumer.

"If PE firms are looking at carve-outs they would look at sectors in which they have bandwidth and experience," adds Menon Raghubir, a partner at law firm Shardul Amarchand Mangaldas & Co.

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Multi-pronged strategy

M.K. Sinha, CEO of IDFC Alternatives, explains how the firm has been focusing on private equity exits, gradual accumulation of assets in infrastructure, and opportunistic openings in real estate

Q: On the private equity side, there have been partial exits from Green Infra and Viom Networks and a full exit from Maharashtra Natural Gas in the past year. So realizations have been a focus…

A: The one weak spot in Indian private equity has been a lack of exits. We are now three funds old and we couldn't really go out and raise another fund without an exit track record. Indian PE as a whole has raised $100 billion in the last 15 years and returned $37 billion. In the last 12 years, we have invested about $1 billion in 42 companies and had exits from 27 of them, returning close to $1 billion. This includes all the companies in Fund I and most of the companies in Fund II. With Green Infra and Viom, we sold our Fund II interests in these companies and continue to hold our Fund III interests. Both are good build-out stories. Green Infra was conceived on paper by IDFC and we grew it into 650 megawatts of capacity with another 50 MW under construction. When we invested in Viom it had 72 telecom towers; now it has about 45,000.

Q: There have also been IPO filings from Parag Milk Foods and GVR Infrastructure. How dependent has IDFC been on public market exits?

A: We've always had a multi-pronged exit strategy – IPOs, trade sales and promoter buybacks. Typically, buybacks are typically situations where, four years after the investment, the promoter feels he sold out too cheaply and wants to buy back the stake. We usually agree to that request because there is no point staying in a company as an unwelcome guest. As for IPOs, it depends on sentiment. Right now I don't see any sustained trend of improvement in the market. Five or six months ago a few companies came into the market and a few more are in the pipeline. But will there be a flood of new IPOs? I doubt it will happen any time soon.

Q: When IDFC was raising its infrastructure fund, there were expectations of deal flow from conglomerates divesting assets. Is this happening?

A: It has not been as quick as we would have liked it to be. This is because of there are multiple stakeholders: the owner, who potentially wants to divest an asset; the banks that have to approve of the incoming shareholder; and the regulators that also have to approve the change in control. We are in the process of closing multiple such deals, and although it is taking a long time, the opportunity is there.

Q: How much capital has the fund deployed?

A: We have deployed about $200 million across three assets. Two of the three investments are thermal power assets – we acquired a 23% stake in a gas-fired power plant in northeast India, which is operational and owned by ONGC Tripura Power, and just under 20% of a thermal power station in central India alongside Dainik Bhaskar Group. The third investment is a $25 million commitment to a cargo-handling concession at Delhi International Airport. We will be more aggressive in acquiring road assets – we are currently looking at three, and in two cases we would take a controlling interest. We are looking at a solar platform, a wind platform, and a large renewables platform that includes solar and wind. We are also interested in transmission assets, ports and airports. We take minority interests alongside reputable sponsors; if we take a controlling interest then it has to be for an operating asset.

> "We are now three funds old and we couldn't really go out and raise another fund without an exit track record"

Q: What has been the nature of IDFC's real estate sector activity?

A: Our two real estate funds are both opportunistic. In 2010-2011 there were a lot of completed office buildings that had started construction pre-global financial crisis when absorption rates were high and the expectation was that this would continue. Post-financial crisis, the absorption rates fell off a cliff and a lot of developers had office buildings that were only 40-50% tenanted. They had their backs to the wall and wanted to monetize their investments. We believed in a long-term pick-up in the economy, so we put our money where our mouth was. IDFC is converting into a bank and so we couldn't hold such a large proprietary position on our balance sheet. This led to us exiting the office investments to The Blackstone Group last year, generating a 22% IRR. We are not as optimistic about the space right now. The acquisitions were made at close to the bottom. We sense now that we are not quite at the top for these kinds of assets, but we will get there in the next 6-12 months.

Q: The other real estate fund is a $125 million local currency debt vehicle. How was this opportunistic?

A: It was 2012-2013, the capital markets were dead for the real estate sector and private equity was off the radar. Developers didn't have liquidity and the banks were full up on real estate and not taking any incremental exposure to the sector. The only liquidity available was non-traditional sources of financing, such as the fund we have now and the NBFCs [non-banking finance companies]. The fund is about three quarters deployed and we target residential projects in the six major Indian markets. Mostly the debt taken is not used to complete buildings because they are more or less fully constructed. Rather, it is used to buy land and so we not only have the security of unsold apartments but also collateral beyond that.

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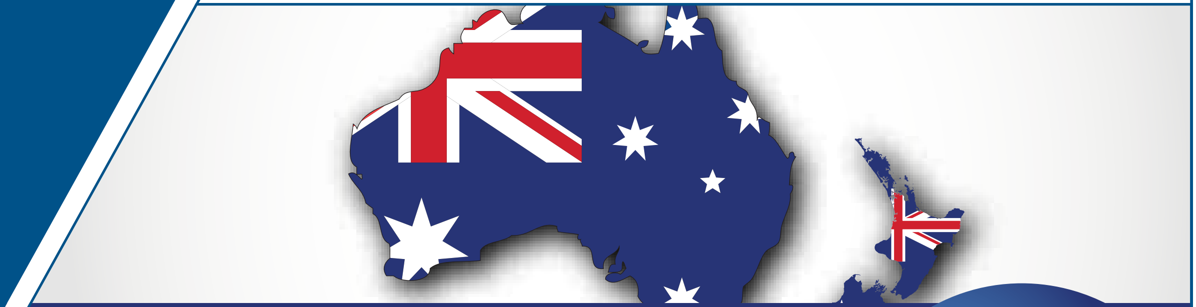

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