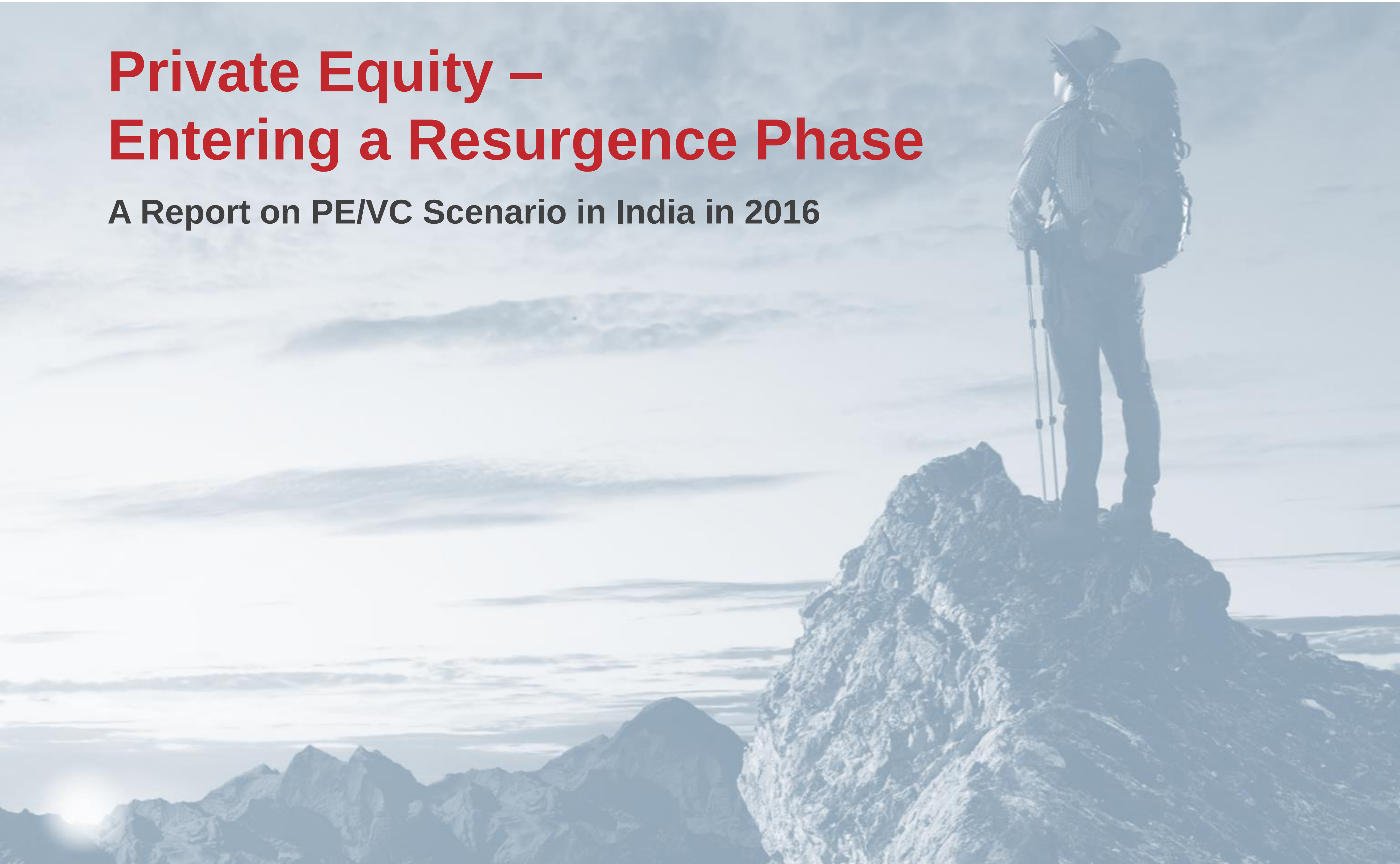
FEBRUARY 2017

AVALON Consulting

Private Equity – Entering a Resurgence Phase

A Report on PE/VC Scenario in India in 2016



Executive Summary

PE/VC Investments: Continued Momentum from 2015

- India continued to maintain the momentum of investments from 2015 - PE/VC investments sustained at similar levels and in the last 2 years has seen a cumulative capital deployment of ~Rs. 200,000 Cr.
- Investments into IT/ITES witnessed a decline in 2016, while Energy, BFSI and Manufacturing saw sustained inflows with a large telecom deal skewing 'Others'
- India continues to be a growth oriented capital driven market despite buy-out deals increasing in the last two years - this is not a sustainable trend and depends on the availability of a few large opportunities
- These PE Investments continued despite obvious headwinds faced by Indian economy; a mini-recovery on the back of good monsoon was snuffed out by demonetization

PE Exits Situation: Major corrections in the investment cycle over 2015 and 2016

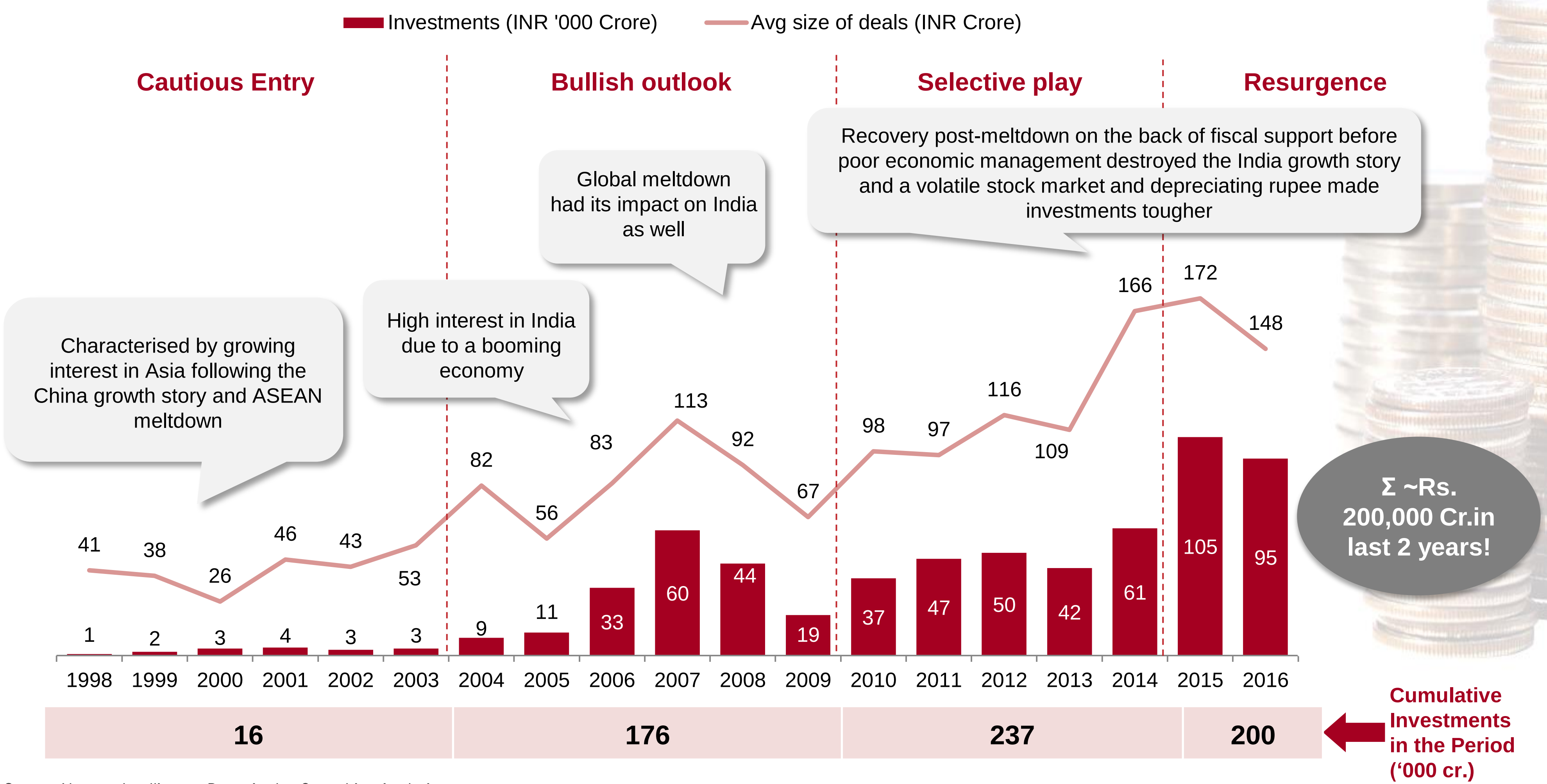
- Exits continued to be robust with about Rs. 24,500 Cr. of invested capital exited in 2016, the highest in the last 6 years, at a reasonable IRR
- Manufacturing and Healthcare accounted for 50% of the total exits by invested value. Investments in Media, Healthcare and BFSI yielded attractive returns in 2016
- Exits from 2-5 year old investments continued to grow in 2016 (like in 2015) indicating that the exit cycles for PE investments are back on track
- The share of >6 years investments in the total un-exited PE investments, remains high in 2017. Our detailed analysis of these investments indicates that the 'difficult to exit' investments seem to be a few bad eggs in the 8-10 year bucket – cumulatively accounting of <10% of the total un-exited investments
- The correction in exits also seems to be acknowledged by the investing community given the significant quantum of new fund raised by PEs for investment in 2016

2017 onwards: PE Industry – Possible 'Resurgence Phase'

- Thus, the PE industry in India is likely to enter a 'Resurgence Phase' – hopefully, the India growth story will recover stronger from the demonetization shock and support the robust deployment and exit of capital in the next 3-4 years, barring any global headwinds
- Each year is likely to see a 'new high' in investments and exits, barring self induced shocks like demonetization, political rancour preventing economic decision making and global protectionism and shocks de-railing the growth story of the Indian economy

PE investments in India hit historic highs with about Rs. 200,000 Cr. investments in the past two years

VC/PE Investments in India (Rs. '000 Cr.)



Source: Venture Intelligence Data, Avalon Consulting Analysis

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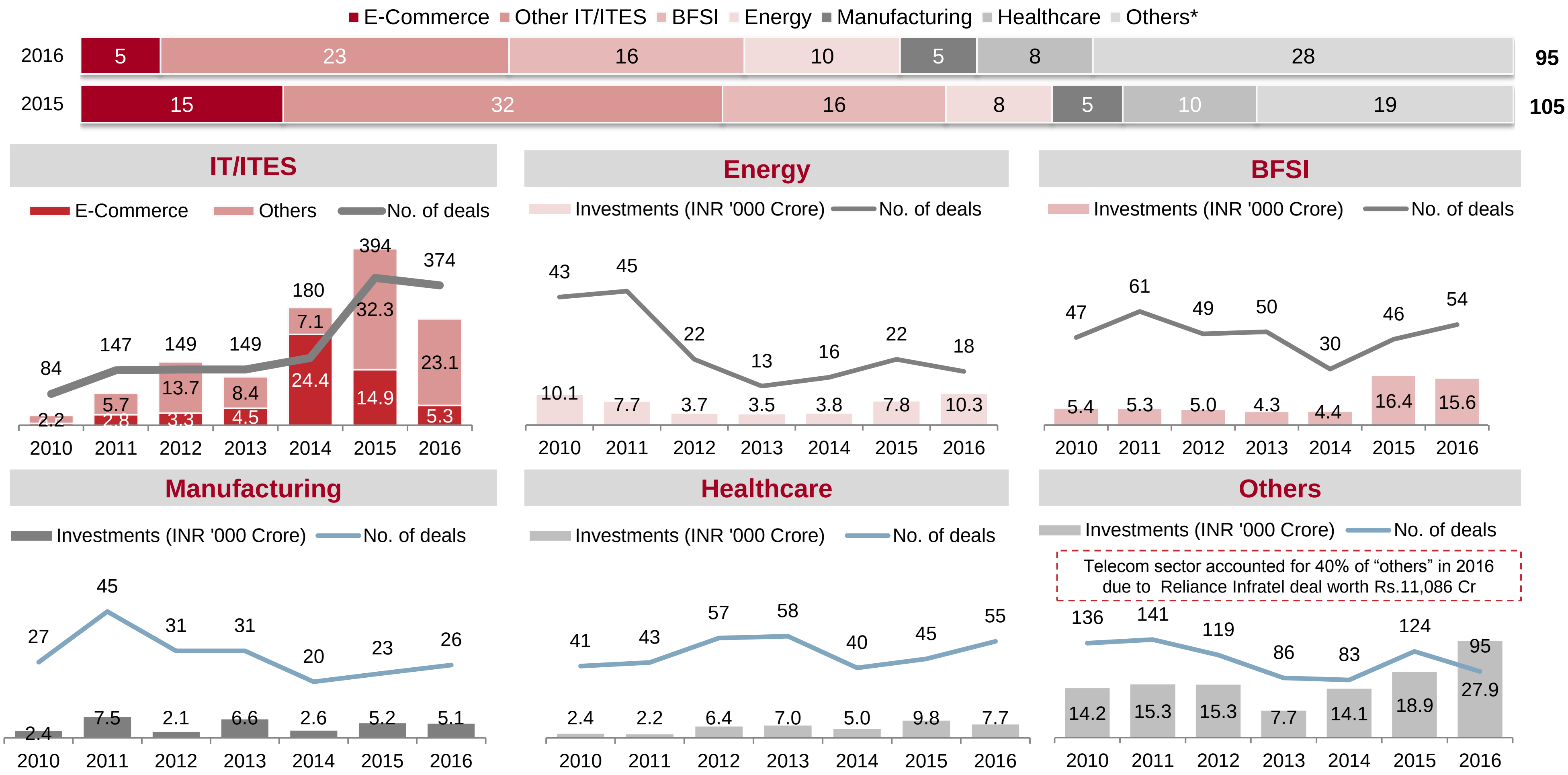
IT/ITES investments dropped significantly in 2016 while Energy, BFSI and Manufacturing saw sustained inflows with a large telecom deal skewing 'Others'

VC/PE Sector inflows – 2010 to 2016 (‘000 Crore)



** Others include Telecom, Shipping & logistics, Travel & transport, Engg. & Construction, etc.*

Source: Venture Intelligence Data, Avalon Consulting Analysis

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Top 10 investments accounted for ~40% of the investments in 2016 of Rs. 95,000 Cr.

Top Investments across sectors in 2016

Industry	Company	Investors	Stage	Investment Amount (Rs. '000 Cr)
Telecom	Reliance Infratel	Brookfield	Buyout-Large	11.1
Energy	Resurgent Power	ICICI Venture, CDPQ, SGRF, KIA, Others	Growth-PE	5.7
IT & ITES	MphasiS	Blackstone	Buyout-Large	5.5
Travel & Transport	Bangalore International Airport	Fairbridge Capital	Late	2.2
BFSI	GE Capital Services	AION Capital, Others	Buyout-Large	2.0
IT & ITES	One97 Communications	SAIF, Alibaba, MediaTek	Late	2.0
Manufacturing	Sanmar Group	Fairbridge Capital	Late	2.0
BFSI	SBI Life	Temasek, KKR	Late	1.8
Engg. & Construction	Essel Highways	Goldman Sachs	Late	1.7
Manufacturing	Sigma Electric	Argand Capital Partners	Buyout-Large	1.7
Total				**35.7**
Total 2016 investments				**95.0**

~40% of total

Source: Venture Intelligence Data, Avalon Consulting Analysis

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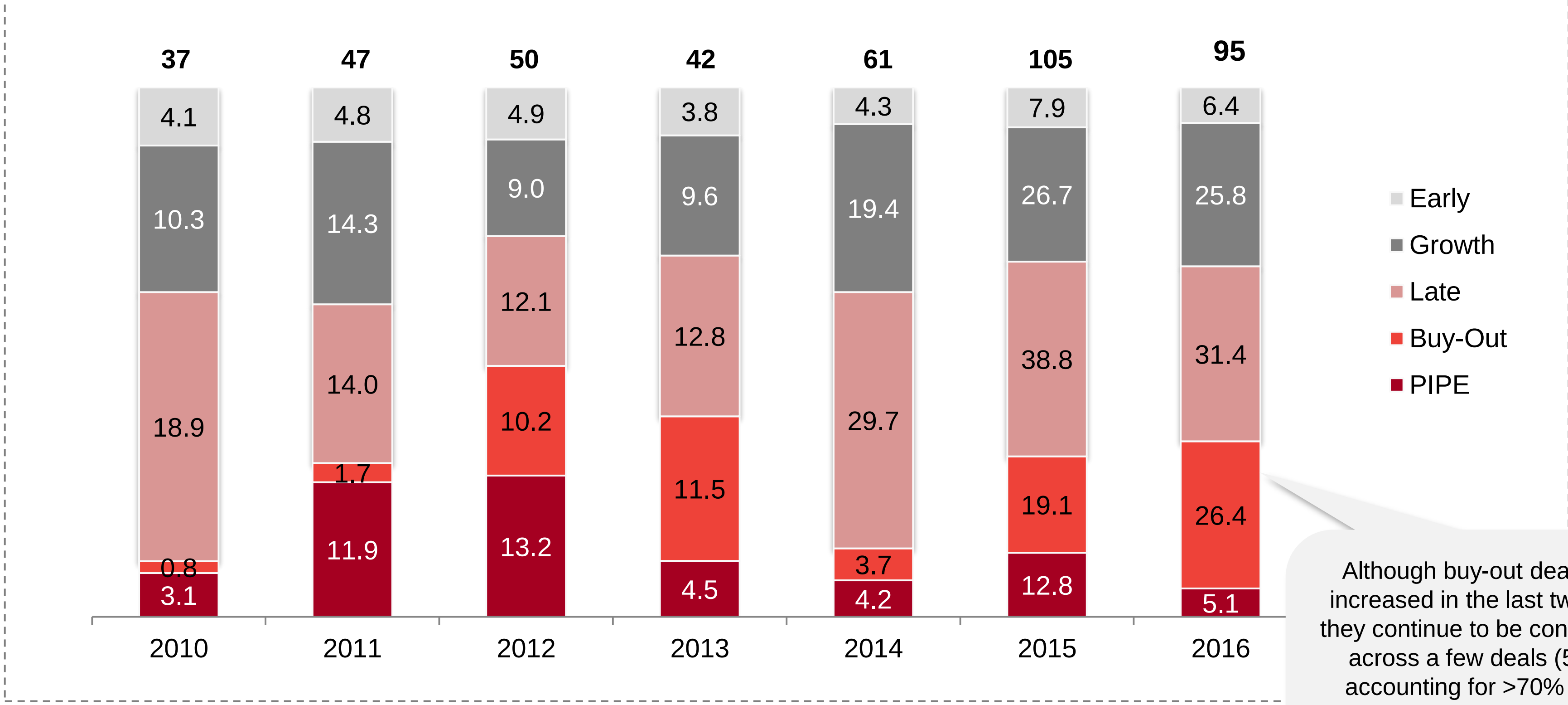
India continues to be a growth oriented capital driven market despite buy-out deals increasing in the last two years - this is not a sustainable trend and depends on the availability of a few large opportunities

Investments by Deal Type – 2010 to 2016 (‘000 Crore)

PIPE vs Non PIPE deals (‘000 Cr) – 2010 to 2016



Although buy-out deals have increased in the last two years, they continue to be concentrated across a few deals (5 deals accounting for >70% of deal value) and hence is not as yet a sustainable trend in the Indian context

Source: Venture Intelligence Data, Avalon Consulting Analysis

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These PE Investments continued despite obvious headwinds faced by Indian economy; a mini-recovery on the back of good monsoon was snuffed out by demonetization

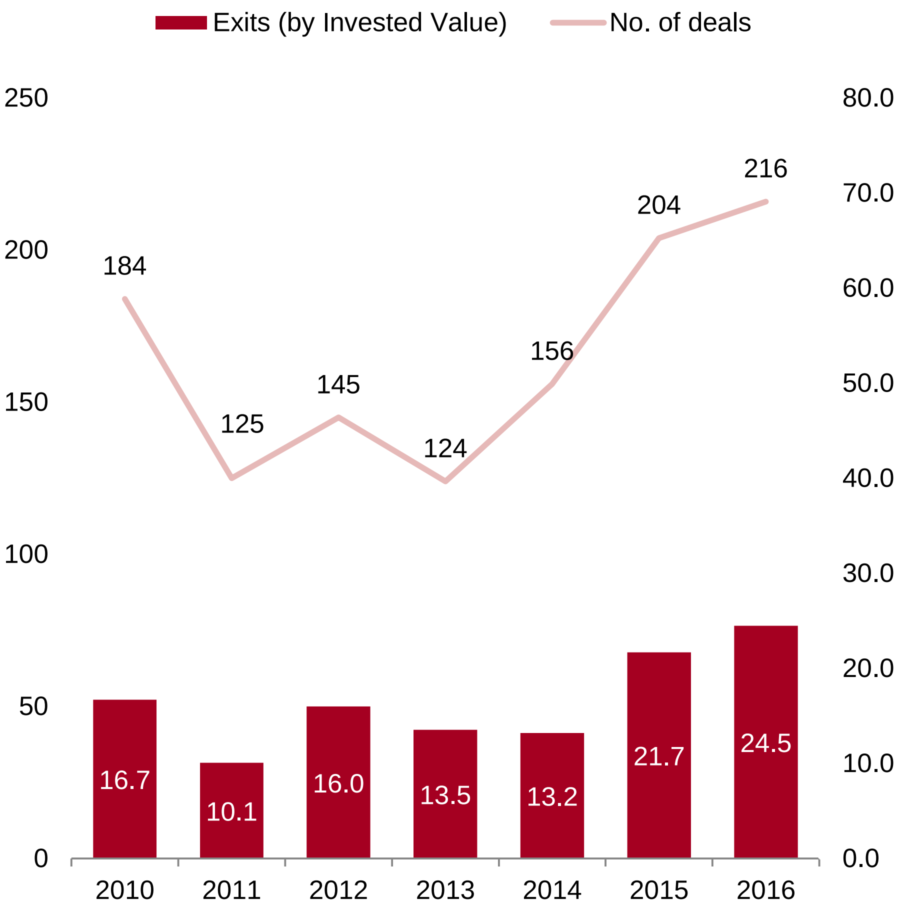
Highlights of Macro Economic Factors - 2016

Inflation Under Control	▪ Inflation remained control for most of the year, at 5-7%. This lent a lot of stability to the market
Good Monsoon	▪ India had a good monsoon in 2016 after 2 continuous years of drought
Increase in Oil Prices	▪ After a sharp drop in 2015 to less than USD 30 per Barrel, Oil prices steadily increased in 2016 to over USD 50 per barrel
Low Growth in Bank Credit	▪ The bank credit in real terms shrunk in 2016 because of de-growth in Industry and SME loans
Private Sector Investment Slump	▪ Weak domestic demand, and uncertainties in key global markets manifested in high fluctuations in IIP – this has led to delays in major investment decisions by corporates
Rising Bank NPAs	▪ The gross NPA ratio of SCBs increased to 9.1 % from 7.8 % between Mar-Sep 2016, pushing the overall stressed advances ratio to 12.3 per cent by Dec 2016
Demonetization	▪ As things were looking fairly good after 3 Quarters, demonetization was a shock that the economy was not ready for
Currency Devaluation	▪ After a reasonably steady exchange rate for most of 2016, the Federal Rate hike towards the end of 2016 coupled with the demonetization led to a sharp drop in the Rupee

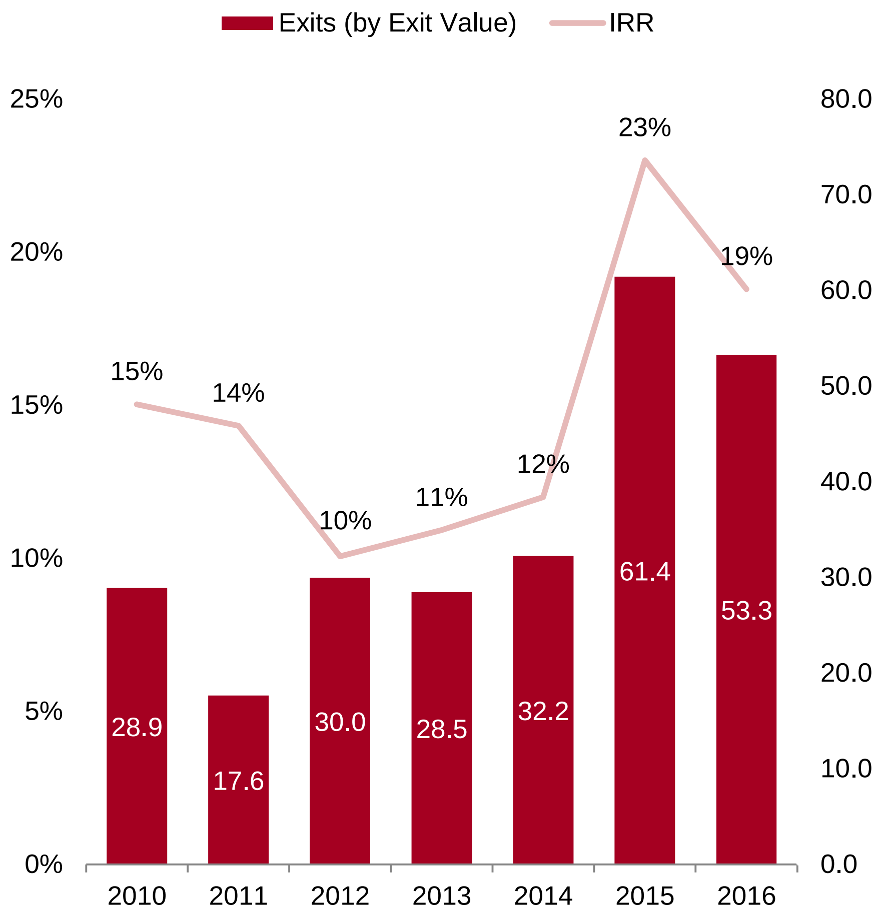
Source: Avalon Consulting Analysis

Exits continued to be robust with about Rs. 24,500 Cr. of invested capital exited in 2016, the highest in the last 6 years, at a reasonable IRR

VC/PE Exits at Invested Value ('000 Cr., % IRR)



Note – Includes investment value of M&A, PMS and IPO deals



Note – Includes exit value of only M&A and PMS deals; does not include IPOs

Source: Venture Intelligence Data, Avalon Consulting Analysis

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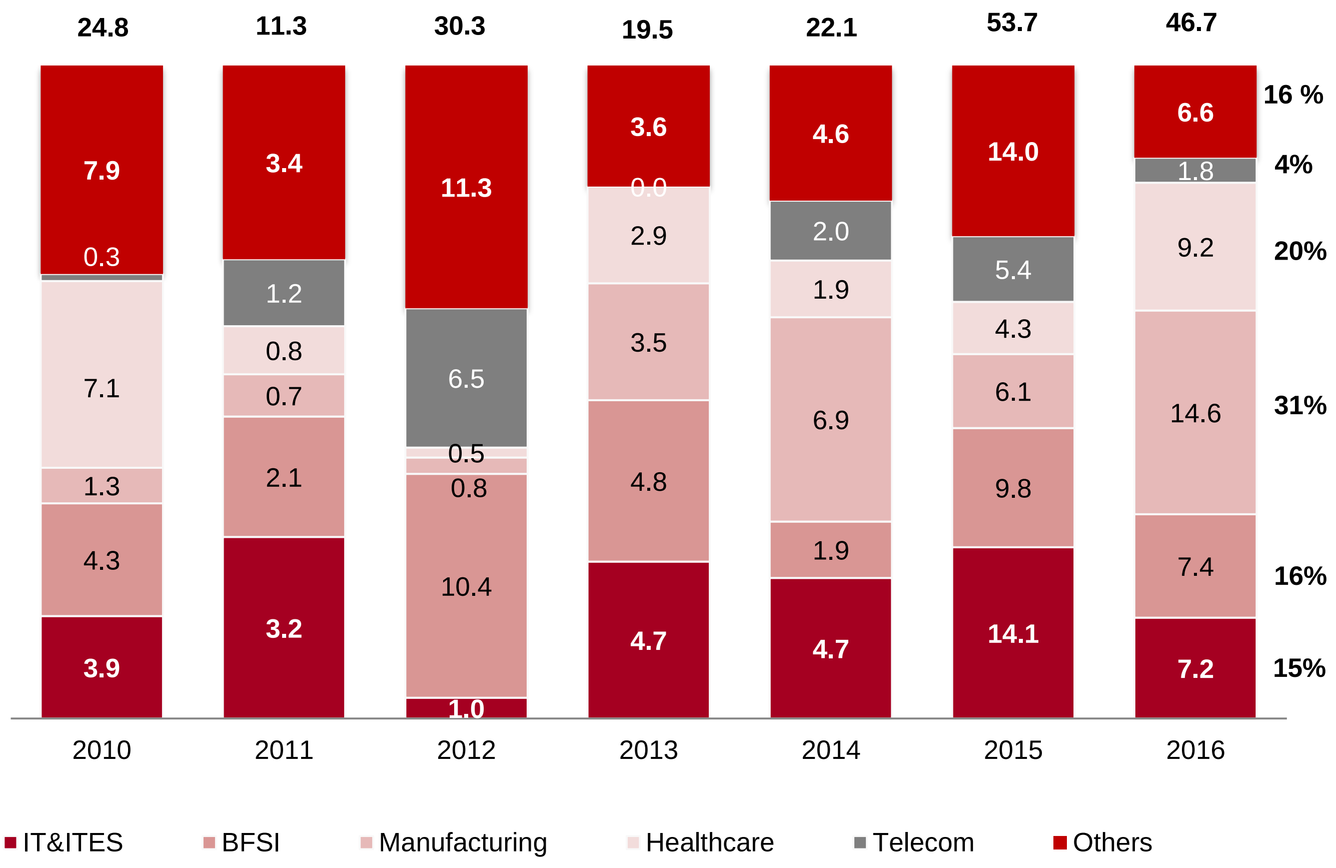
Manufacturing and Healthcare together accounted for 50% of the total exits; share of IT & ITES dropped significantly from previous year

Exits by industry (In Exit Value - '000 Cr)



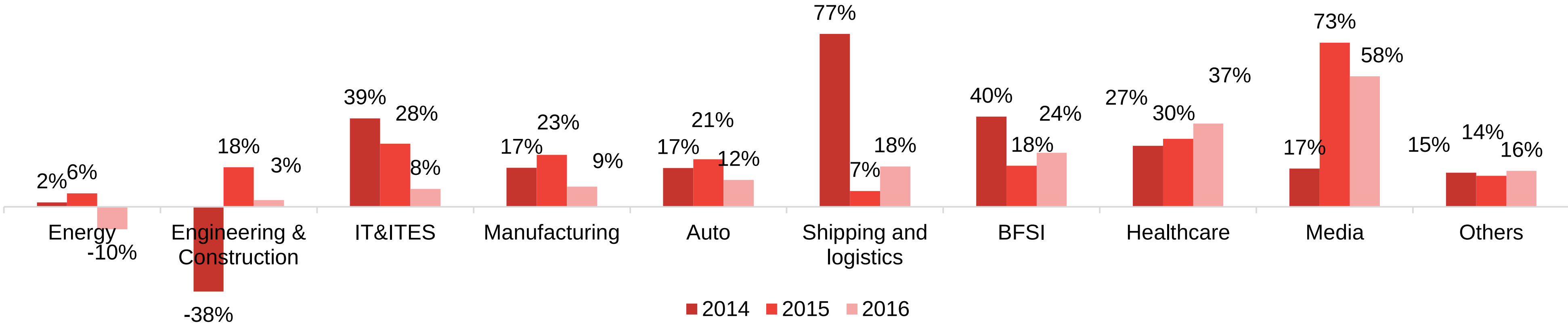
IFC's exit from Alliance Tire Group at Rs. 7,053 Cr. and Blackstone's exit from International Tractors at Rs.1,680 Cr. were the top exits in 2016 in Manufacturing

Source: Venture Intelligence Data, Avalon Consulting Analysis

Investments in Media, Healthcare and BFSI yielded attractive returns in 2016

% IRR - industry wise (2016)

IRR industry wise (2014-16)



Key Exits with attractive IRR 2016

MEDIA

- Aditya Birla's exit from Wonderla Holidays via Public market sale for 25 Cr with an IRR of 63% (Invested in 2014)

HEALTHCARE

- KKR's exit from Gland Pharma via strategic sales for 3738 Cr with an IRR of 44.5% (Invested in 2013)
- Advent International's exit from Care Hospitals vis secondary sale for 1240 Cr with an IRR of 21% (Invested in 2012)

BFSI

- IFC's exit from Equitas Holdings via Public market sale for 1460 Cr with an IRR of 26.4% (Invested in 2012)
- IFC's exit from Ujjivan Financial Services via Public market sale for 530 Cr with an IRR of 28% (Invested in 2012)

SHIPPING AND LOGISTICS

- Fung Capital's exit from Future Supply Chain via Secondary sales for 382 Cr with an IRR of 15.3 % (Invested in 2009)
- New Silk Route's exit from VRL Logistics via Public market sale for 148 Cr with an IRR of 24% (Invested in 2012)

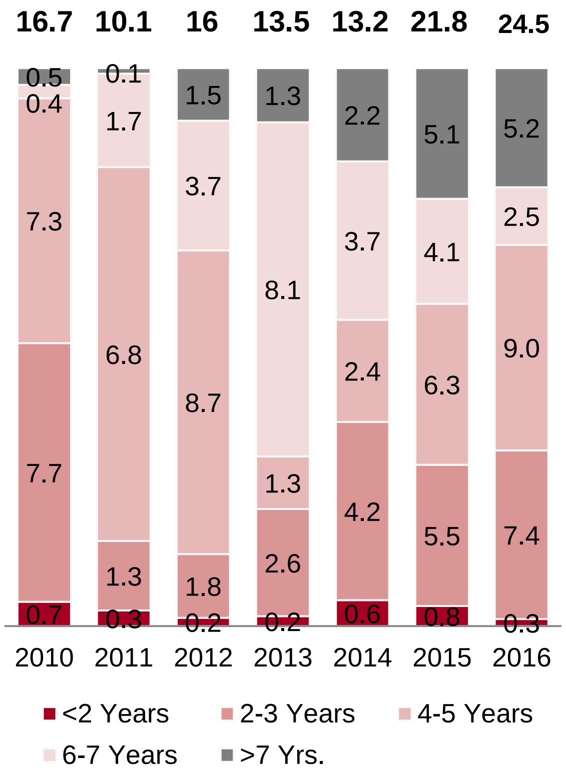
Source: Venture Intelligence Data, Avalon Consulting Analysis

Exits from 2-5 year old investments continued to grow in 2016 indicating that the exit cycles for PE investments are back on track

Exits and IRR (Rs. '000 Cr. / %)

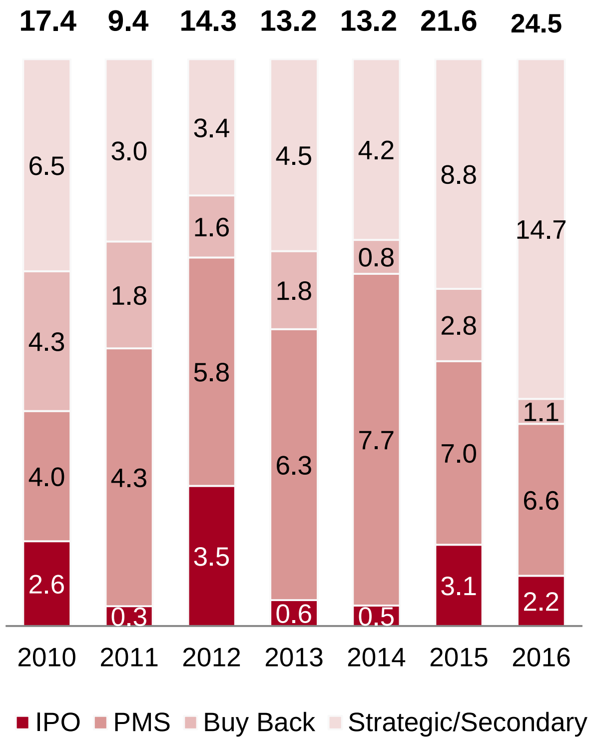
Exits from 2-5 years rose in 2016…

2010-16 Exits at Investment Value
(Rs. '000 Cr.)



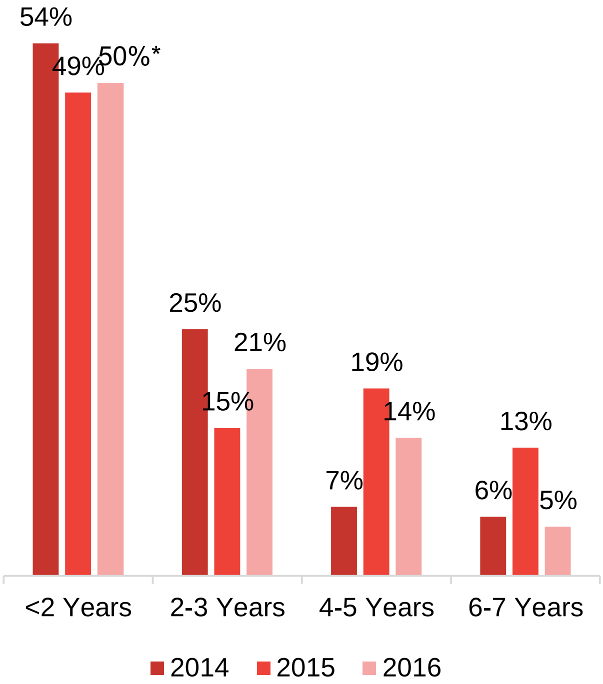
…mainly through PMS and Strategic/Secondary…

2010-16 Exits by Transaction Type
(Rs. '000 Cr.)



…delivering encouraging returns to investors

2014-16 IRR by Age at Exit
(%)



* Estimate

Source: Venture Intelligence Data, Avalon Consulting Analysis

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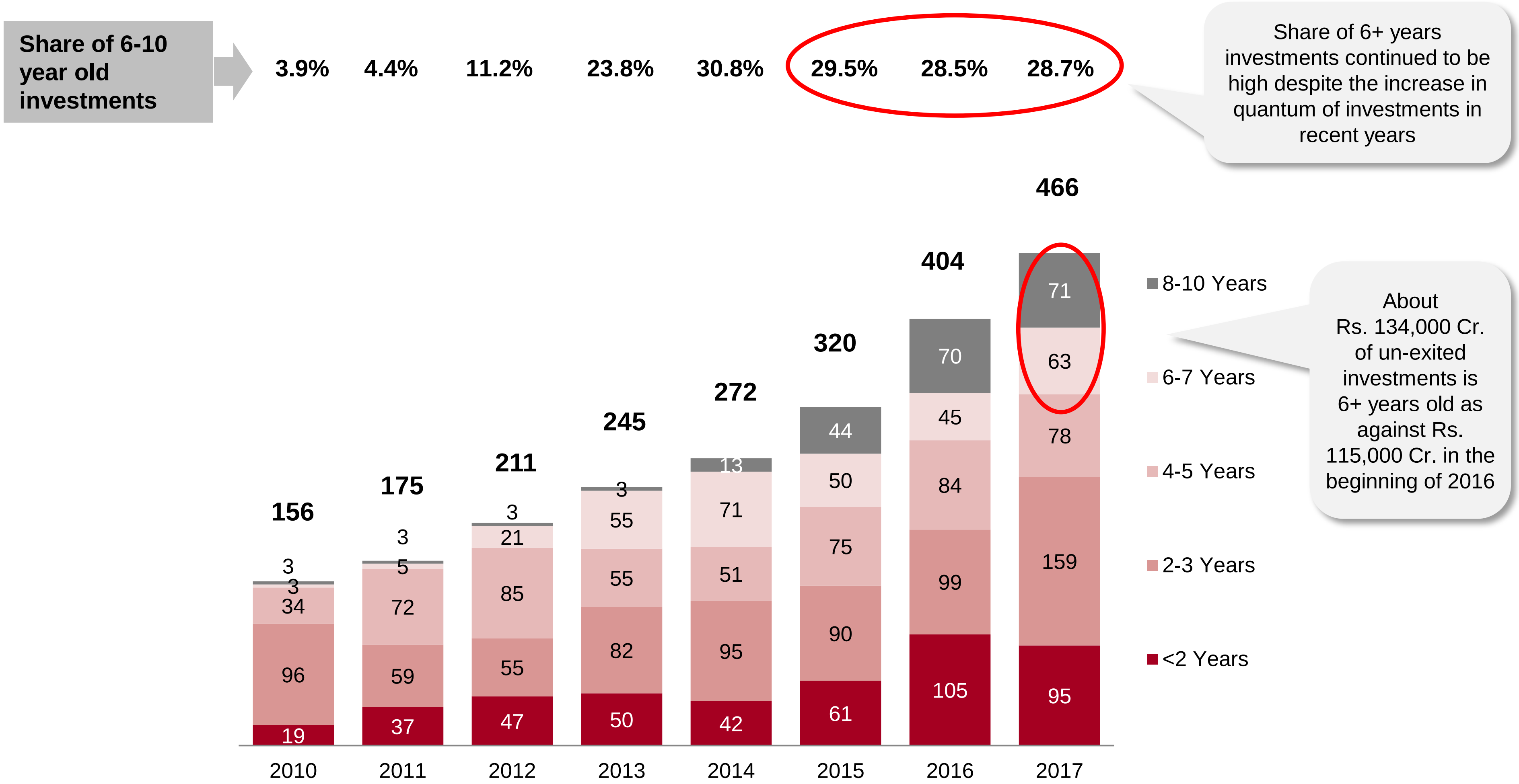
The share of >6 years investments in the total un-exited PE investments still continue to be high, and need a closer look to understand the extent of challenge faced in exits

Net (Un-exited) PE/VC Investments at the Beginning of the Year ('000 Cr.)

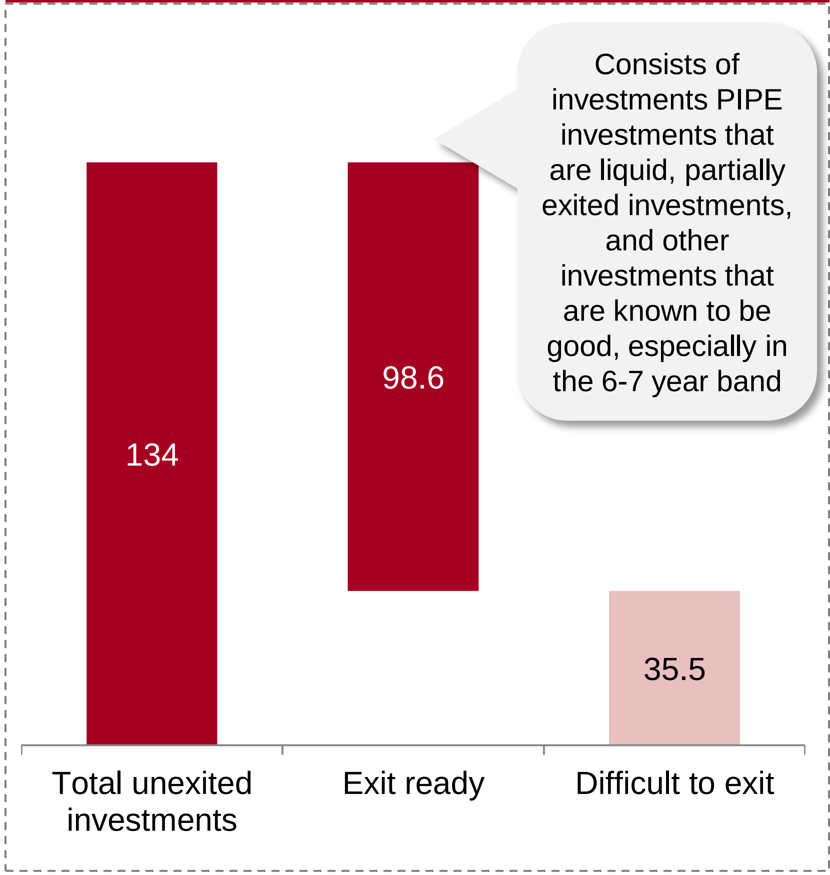


Source: Venture Intelligence Data, Avalon Consulting Analysis

Our detailed analysis of the >6 year investments indicates that the 'difficult to exit' investments seem to be a few bad eggs in the 8-10 year bucket

6+ Years Old Un-exited investments by Exit Readiness

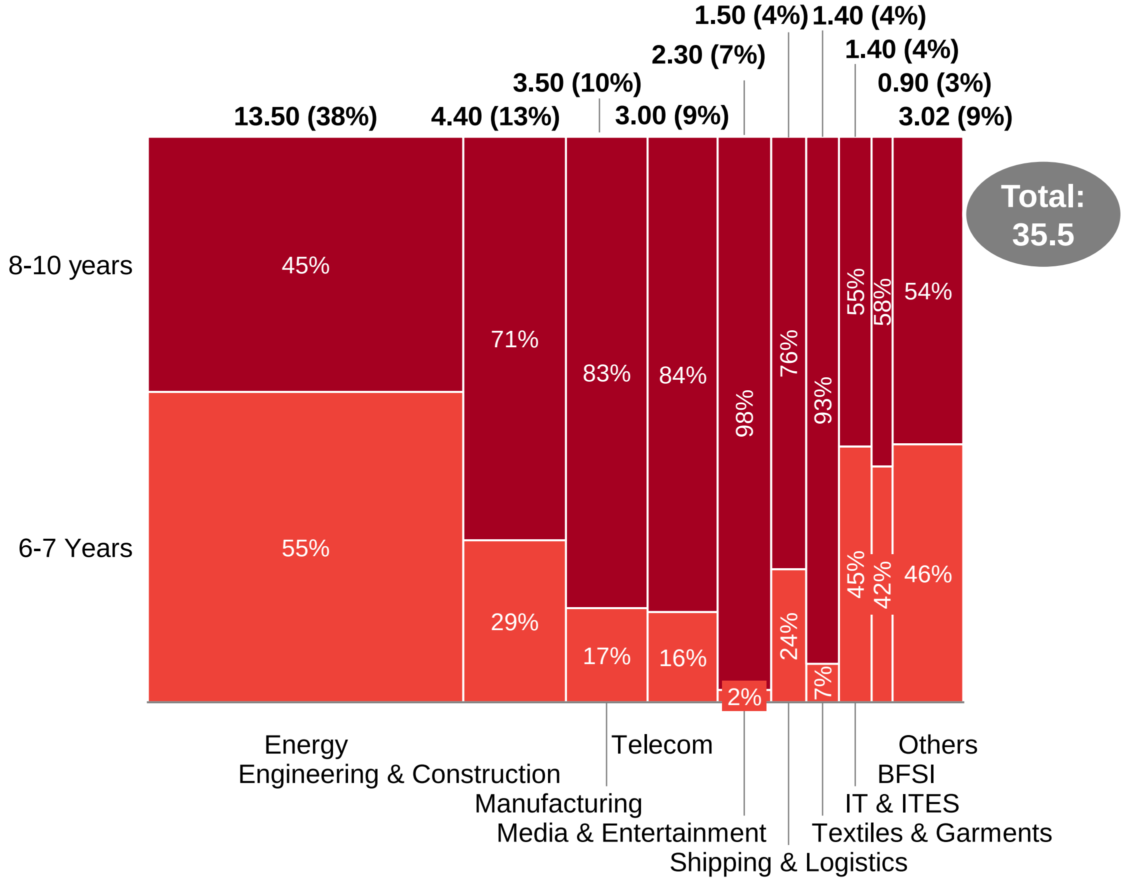
Investments in 6-10 year old investments (‘000 Cr)



**Excluding partially exited investments*

Source: Venture Intelligence Data, Avalon Consulting Analysis

“Difficult to Exit” Investments by Sector / Age



About one-third of investments in the 6+ year category can be considered to be 'difficult to exit', most in the 8-10 year bucket. A large part of these are in infrastructure projects which are in trouble and failed business models

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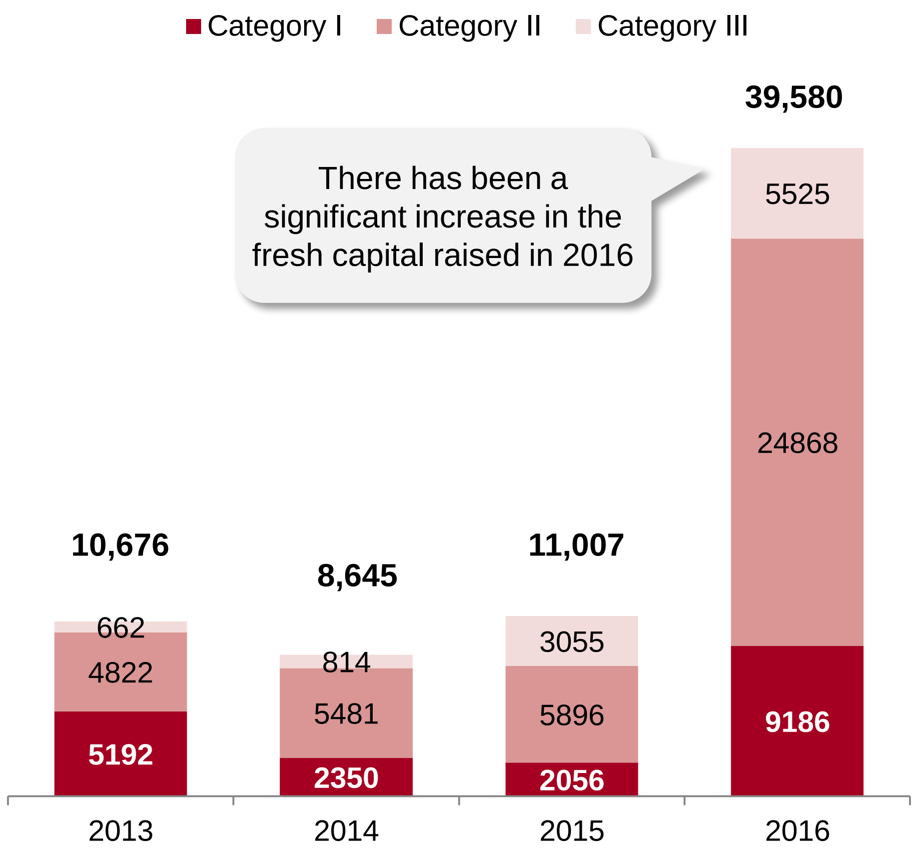
The correction in exits also seems to be acknowledged by the investing community given the significant quantum of new fund raised by PEs for investment in 2016

Incremental AIF Corpus reported by SEBI (in INR Crores)



"Dry powder- the amount of cash with private equity and venture capital funds - stands close to a six year high of $ 7.1 Bn. 2017 should turnout to be a year of deployment"

-Deal street Asia

Source: SEBI, Avalon Consulting Analysis

Thus, the PE industry in India is likely to enter a 'Resurgence Phase' – hopefully, the India growth story will recover stronger from the demonetization shock and support the deployment and exit of capital in the next 3-4 years

PE Industry in India – Entering a Resurgence Phase

- PE **investments** have seen a **strong upswing in the last two years** – nearly Rs. 200,000 cr. have been invested in Indian businesses
- **Exits** have also seen a **strong buoyancy** – **2016 was the largest quantum of exit in the history of PE** in India at a reasonable IRR, repeating the 2015 performance
- More important, the **exit cycle has seen significant corrections**:
  - **Most of the exits are in the 2-5 year investment** range with good IRRs. Some of the 'difficult to exit' >6 year deals have also managed to exit in 2015 and 2016
  - **The share of >6 year old un-exited investments has reduced** in recent years compared to 2014 (the 'logjam' phase) and even within these only about 25% are **'difficult to exit' (~Rs. 36,000 cr. in an an overall un-exited pool of >Rs. 460,000 cr. - <10%)**
- This has resulted in an **unprecedented fresh capital raise in 2016** among India dedicated funds
- With a further **~Rs. 100,000 cr. of investments 'ready to exit' over the next couple of years**, there will be plenty of **secondary deals** which can **take up the fresh capital** and allow Indian entrepreneurs to pursue their growth ambitions
- **Barring** self induced shocks like **demonetisation, political rancour rising** to a new level and impacting economic decision making or **global protectionism and headwinds**, hopefully the **Indian economy** will recover and sustain it's **growth story in FY18 and FY19** and create the appropriate environment for PE to play a robust role in fuelling growth
- Thus the **next 3-4 years** will **possibly see** the PE industry in India **entering a 'Resurgence Phase'** – deploying and exiting investments in a robust manner

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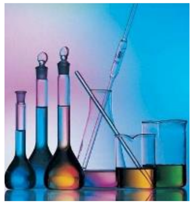

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