# Reflections: Indian private equity in 2012


*Last year, without a doubt, was challenging for the private equity (PE) business in India.*

Though the year, specifically the first couple of months, witnessed PE firms make a bunch of successful exits, the mood turned sombre when the government, as a part of the budget proposals, announced some draconian tax legislation which left majority of the PE community in a quandary. PE funds were not even thinking about further investments, but more worried about the impact the proposed legislation will have on their existing investments and business models.

Owing to the high valuations at which the investments were made in 2007 and 2008, a number of portfolio investments of PE funds are currently not 'in the money' and with the falling Indian rupee (down 23%), exits were becoming even less attractive. In this scenario, the intended change in tax laws spooked the community far more than a strategic foreign investor. As India struggled to find a positive mention in investors' discussions during Q2, inbound investments into the country dropped sharply; PE investors thought the same. Even as the regulators looked to take some rearguard action from Q3, the adverse sentiment significantly impacted PE investments for the year. While one hopes for a pragmatic end to the tax and regulatory challenges of 2012, the clear message from the investing community is for a stable regulatory regime, which is progressively liberal.

Another factor which caused a lot of grief to the investment community was the complete policy inertia, as the government struggled to deal with various corruption scandals it faced during the year. The global financial crisis too created significant challenges for businesses. In particular many Indian businesses which had become increasingly globally aligned over the last four-to-five years and with greater exposure to Europe were the worst hit. Some of these businesses were PE funded, and these investments continued to challenge the fund's Indian portfolio.

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## *Uncertainty takes away the charm*

Looking back at the year, aggregate PE investments declined 15%, at 8.85 billion USD across 406 deals as compared to 10.35 billion USD from 481 deals in 2011.

Sector-wise, IT and healthcare contributed the most to PE deal activity in 2012. IT and ITeS accounted for over one third of the total deal value and volume in 2012. Nearly 3.25 billion USD was invested in 162 deals in IT. This was greatly aided by the 1 billion USD Genpact deal. In 2011, IT sector witnessed investments worth 1.85 billion USD across 158 deals. The healthcare sector showed the highest incremental growth with 48 deals worth 1.23 billion USD. Last year, the sector saw 418 million USD in investments across 38 deals. As PE funds focussed on consumer-centric investment during the year, healthcare proved to be a perfect defensive play for them.

Despite a slump in the overall deal value, banking and financial services maintained their relative attraction to PE funds. However, energy, engineering and construction (E&C) and manufacturing witnessed the largest declines. While in energy and E&C, the total investments reduced to one third, (from 1.7 billion USD to 478 million USD and from 1.09 billion USD to 366 million USD respectively) PE interest in manufacturing reduced to a fifth as compared to 2011 (from 1.57 billion USD to 345 million USD). The infrastructure sector also suffered in terms of fresh investments, due to lack of a clear policy regime, further accentuated by policy inertia. Another cause for the cautious approach was the fact that most of the funds are sitting on negative returns (2007 and 2008 investments). While some of them will typically have a longer holding period, at the moment, a number of infrastructure investees seem to be suffering from highly levered capital structures, caused by pricey assets and contracts bought over the years.

## *Revived stock market provides lifeline for exits*

In terms of exits, the year saw over 4.2 billion USD of exits in value terms ( 98 deals) as compared to 2.8 billion USD (80 deals) in 2011. The first quarter of 2012 saw a bunch of exits through the stock markets, and as the markets revived towards Q4, there were signs that it may facilitate further exits over the next few months. The year also saw a number of secondary exits, as PE firms found it easier to support management teams with a proven track record, even at lower anticipated returns than those achieved by the outgoing investors.

## *Outlook for 2013*

Despite the challenges of 2012, the new year promises to be more positive. The following trends can change the game in 2013:

- During 2012, there were clear signs that Indian promoters are willing to be pragmatic. This will potentially create opportunities for PE funds to look at businesses, which have a good operating model, but have suffered owing to over-ambitious expansion, and/or poor capital structures.
- The global crisis meant that in some cases, global strategic investors may be looking to monetise their Indian assets (e.g., the Clariant deal late last year). The rumoured Lafarge deal, if it happens, could be another instance where emerging market growth needs support from local funding, as global players struggle in home territories. It is expected that there would be more such opportunities in 2013.
- Relaxation in the FDI regime, particularly in retail businesses, is expected to spur investments in the sector. From a PE perspective, sectors which support retail back-end will be of interest. In particular sectors such as logistics and warehousing, food processing and the services segment in general should be of interest to PE funds.

Apart from investing activities, a number of PE firms will be focussed on raising their next round of funds, and this will be an indicator of how the global investment community looks at India. From an Indian fiscal standpoint, there has never been a greater need for foreign investment in the country. The role of PE investors in supporting Indian businesses is well-acknowledged. The question is whether the policymakers have done enough to encourage them to look at India differently from the last year- we will have to wait and watch.

*(** Sources: Venture Intelligence and PwC Research)*

*(*** Real estate deals are not included in this round-up)*



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