Private Equity in India

Introduction

Private Equity is playing an important role in today's Indian Economy. India has seen a boom in private equity activity in recent years with the growth of local funds and the arrival of global players. Beyond their financial contribution private equity firms need to be able to add value, as required, in strategic, operational and human capital matters.

Private Equity fund expects a good return from an investment with capital appreciation in 7 – 10 years.

Private Equity Investor ⇄ **Private Equity Fund Manager** ⇄ **Portfolio Company**

Buy-to sale Orientation

In the Late Nineties, the interest of the Private Equity Player in India was in Information Technology Sector. With the downfall of the Information Technology Sector in 2001-2002, the Private Equity Investors diversified their interest in different sectors of the Indian Economy like Pharma, media, entertainment etc.

The Private Equity plays its role from a Venture Capital – Early Stage or Idea to the huge leverage buy out in which they acquire the entire company. India is closing to China as an equally attractive destination for Private Equity.

Private Equity Investments in India during Jul-Sep 2010: 88 Deals, US$2,046 Million – Source Venture Intelligence

India Law Offices
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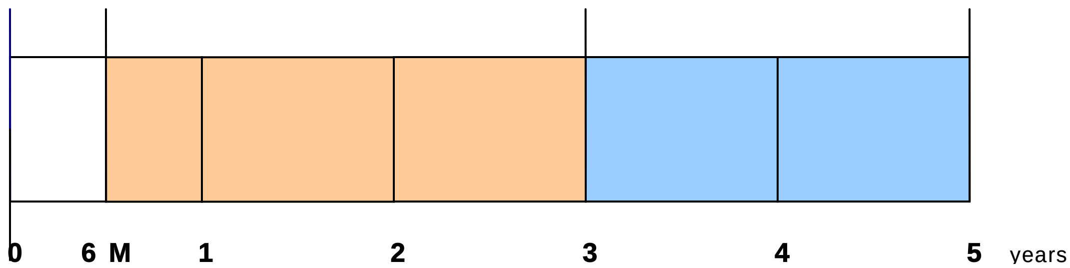
Mumbai Chennai Bangalore Hyderabad Kolkata Pune Chandigarh and other cities

India Law Offices – View: For major Indian Companies, it is easier to go for an IPO but Private Equity Placement is preferred due to the Financial Contribution & expert knowledge that is to the business.

Private Equity – Stages of Business



Note: Years are only for illustrative purpose

Zero Level or Seed Stage Business (Just an Idea)

- Seed Stage Financing: Investment provided to research business idea, develop prototype or conduct research.

Start-up Stage Business (6 Months – 3 Years)

- Start-up Stage Financing: Investment in a Legal Entity with expressed business and market plan.

Expansion Stage Business (After 3 Years)

- Expansion Stage Financing: Investment in a Legal Entity that has started Sale or revenue & crossed the break even and now a Legal Entity, is looking to increase the capacity or any other expansion.

Classification of Private Equity

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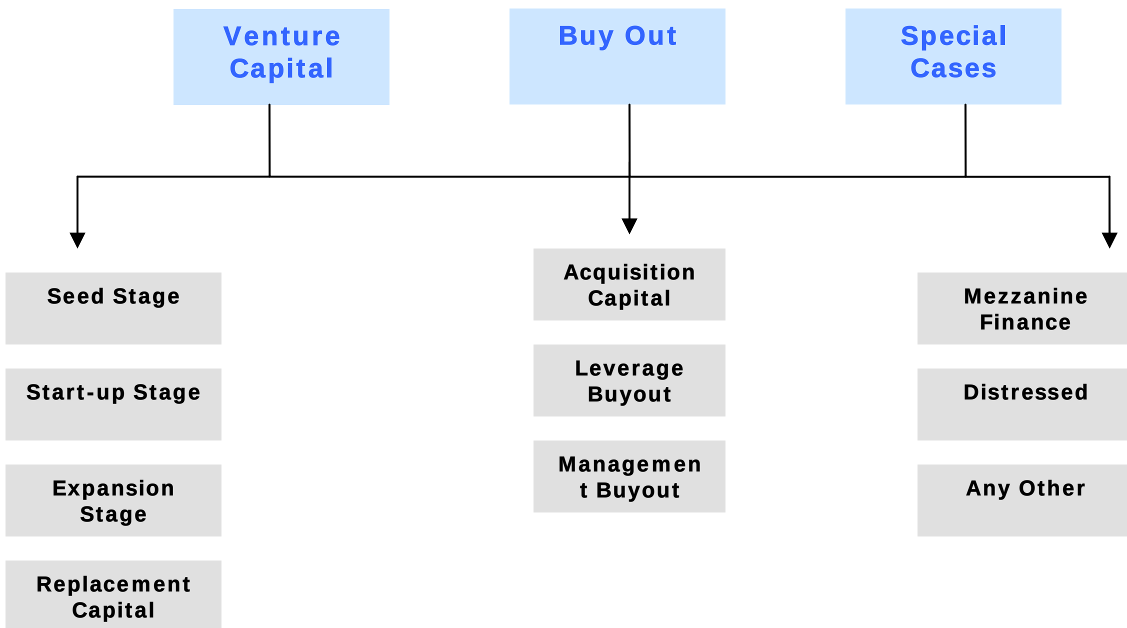


1. **Venture Capital**
   a. **Seed Stage**: Investment provided to research business idea, develop prototype or conduct research. (At Zero Level, just an Idea)
   b. **Start-up Stage**: Investment in a Legal Entity with expressed business and market plan. (After 6 Months – 1 Year)
   c. **Expansion Stage**: Investment in a Legal Entity that has started Sale or revenue & crossed the break even and now a Legal Entity, is looking to increase the capacity or any other expansion. (After 2-3 years)
   d. **Replacement Capital**: Purchase share from existing investor or to reduce financial leverage.
2. **Buy Out**
   a. **Acquisition Capital**: Investment in the form of debt, equity or quasi-equity to a Legal Entity to acquire another company.
   b. **Leverage Buyout**: The acquisition of another company by an LBO firm using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition.

c. **Management Buyout**: Investment provided to the management to acquire a company in specific product line or division.

3. **Special Cases**

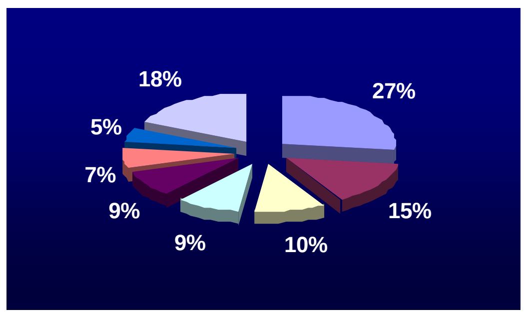
a. **Mezzanine Finance**: A hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. Mezzanine financing is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company.

b. **Distressed:** Investment provided to a Legal Entity in need of restructuring or financial distress.

c. **Any other Form of an Investment**

High Priority Sectors for PE Investment

Sector	Percentage
IT / ITES	27 %
BFSI	15 %
Energy	10 %
Engineering & Construction	9 %
Healthcare & Life Science	9 %
Manufacturing	7 %
Agri-business	5 %
Other	18 %



Source: Venture Intelligence PE Deal Data base

Key Barriers for Private Equity in India

- Competition

- Fiscal / Regulatory Issues / Corporate Governance
- Management
- Ethics

Foreign Direct Investment – Venture Capital

Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provisions of the Foreign Exchange Management Act (FEMA) 1999.

Under the FDI Scheme, investment (Equity, Compulsorily Convertible Preference Shares, Compulsorily Convertible Debentures, ADR /GDR, etc.) can be made by a non resident in the Indian Company, under the following routes:

Procedure under Automatic Route

FDI in sectors/ activities to the extent permitted under automatic route does not require any prior approval either by the Government or RBI.

Procedure under Government Approval

FDI in activities not covered under the automatic route, requires prior Government approval. Such proposals are considered by the Foreign Investment Promotion Board (FIPB).

With the new master circular on FDI being issued by the RBI, SEBI registered FVCI are allowed to invest in domestic venture capital undertakings and domestic venture capital funds through the automatic route subject to the SEBI regulations, RBI Regulations and FDI Policy (sector specific caps). However, in case the entity undertaking venture capital fund activity is a trust registered under the Indian Trust Act, 1882, FDI would be permitted with approval.

Taxation – Venture Capital

Indian VCFs are entitled to tax benefit under Section 10(23FB) of the Income Tax Act. Any income earned by a SEBI registered VCF (established in the form of trust or company) set up to raise funds for investment in a VCU is exempt from tax.

"venture capital undertaking" means such domestic company whose shares are not listed in a recognized stock exchange in India and which is engaged in the—

(i) business of—

- nanotechnology;
- information technology relating to hardware and software development;
- seed research and development;
- bio-technology;
- research and development of new chemical entities in the pharmaceutical sector;
- production of bio-fuels;
- building and operating composite hotel-cum-convention centre with seating capacity of more than three thousand; or
- developing or operating and maintaining or developing, operating and maintaining any infrastructure facility as defined in the Explanation to clause (i) of sub-section (4) of section 80-IA; or
- dairy or poultry industry;

Process

1. Introductory Meeting
2. Management meeting and receipt of business plan
3. Discussion on Investment plan
4. Valuation of Shares
5. Due Diligence
6. Share Holder Agreement and Share Subscription
7. Completion of pre-disbursement condition

Exit Strategy

Most of the Private Equity Firms consider their exit option prior to investing. Exit Route includes:

1. **Initial Public Offer:** Initial Public Offering is referred to as sale of equity of the company to the public. An IPO is usually considered as a better exit strategy considering highest exit value. But an IPO comes at high expenses and less flexibility. Therefore, IPO is an appropriate opportunity for a company with a good history that comes with the objective of growth also.

2. **Secondary Market Sale:** In a secondary sale market, stake held by a financial investor is sold to another investor or strategic investor (companies operating or willing to operate in a same sector.)