
Deloitte Corporate Finance Services India Pvt. Limited

India private equity confidence survey



The India private equity confidence survey

The private equity market in India has continued to show positive trends during the second half of 2007, with increasing confidence in the long term growth prospects of the market. The average rating given by private equity managers to the long terms prospects of the India private equity market increased from 8.4 in h1 2007 to 8.6 in h2 2007. However, there remain concerns about a potential decrease in returns due to high valuations and changes in the regulatory environment.

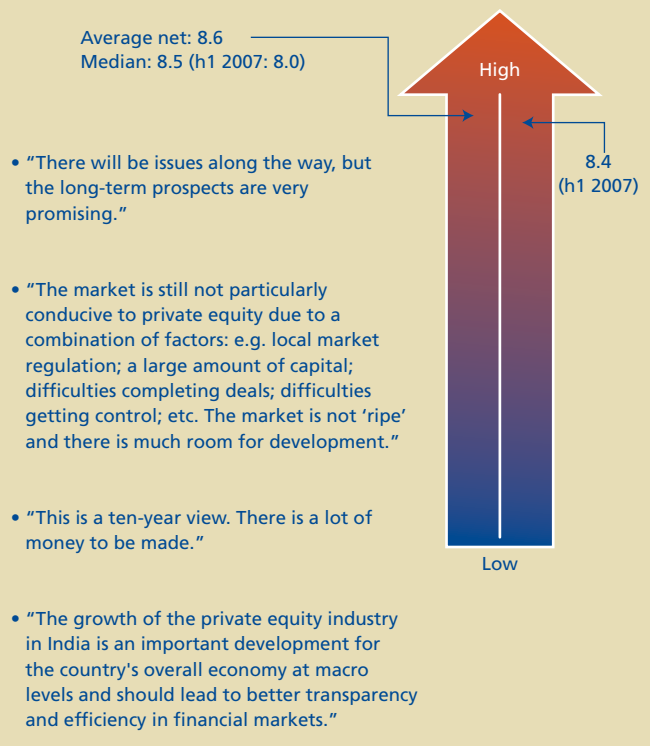
The latest survey showed mixed views about the direction of entry multiples in the next six months, though respondents were generally positive about new investment and exit activity. Even though 52% of the private equity managers surveyed believe that returns are expected to decrease (mostly due to prices paid for deals recently), long term confidence in the India private equity market remains positive.

Changes in the regulatory environment were perceived as important factors impacting the PE environment in India. Most of the respondents felt that recent changes around convertible preference shares and the curbs that continue to be imposed by the RBI had reduced flexibility in deal making due to the impact on deal structures.

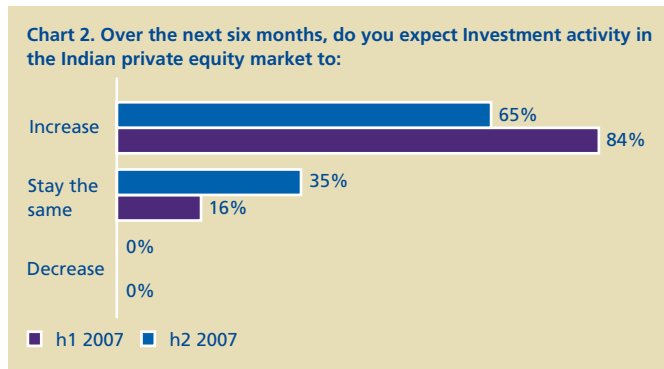
The ability of an individual private equity house to add value to a business appears to be the most important competitive differentiator when it comes to selecting investors in early stage deals. For later stage deals, price and terms related to the investment are still the key factors. As one of our respondents said during the survey, "Money is now a commodity here..."

Sandeep Gill
Managing Director
Deloitte Corporate Finance Services India Private
Limited

Chart 1. How confident are you in the long term growth prospects of the Indian private equity market?



Outlook for overall levels of investment activity



Why increase

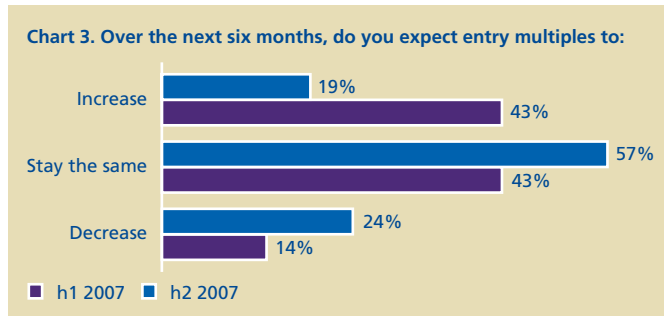
“With the public markets choppy due to global issues this will mean that more companies plan to raise money from private equity.”

“Although India is sufficiently isolated from global conditions to mean growth will continue, volatility in global markets could lead to a reduction in public market valuations to some extent, which should create good opportunities for public/private arbitrage.”

Why stay the same

“On the one hand, there is so much value left and so much money around, but on the other hand the IPO markets are getting tougher and some fingers will be burnt – this could temper things.”

Entry multiple for deals



“It depends on the segment of the market – prices in late-stage private equity will rise, but in early-stage private equity they will fall. This is all due to the supply of capital.”

Why increase

“It’s liquidity driven. There continues to be more money coming in and the pressure on multiples is still there. We’re seeing hedge funds, high-net-worths etc participating on the bigger more stable deals, and investors now from Japan and Korea.”

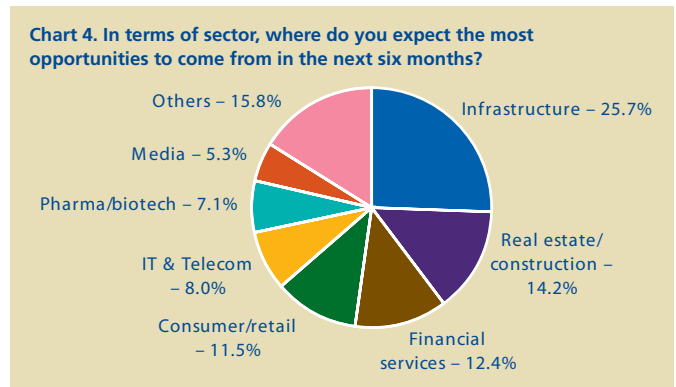
Why stay the same

“There are pull and push factors in play that will serve to cancel each other out. On the one hand, the global economy is pulling down prices, but the growth market in India is pushing them up as private equity houses price in growth.”

Why decrease

“India is already a developed market and valuations are challenging and stretched. Most private equity players do not expect p/e arbitrage between the private and public markets and therefore growth has to play out to achieve the desired IRR. Given this, if the public market prices fall then I suspect the private market valuations will fall also.”

Sector



“Overall, the growth in India is very broad, but there are three primary structural drivers that will have an impact on which sectors see most activity: 1) domestic consumption; 2) exports in areas of competitive advantage for India; 3) infrastructure. Sectors associated with these drivers will do well.”

“Any sector connected to the infrastructure value chain will do well (e.g. construction, power equipment, shipyards). In terms of infrastructure it is said that India is 20-30 years behind China and we need to develop.”

“There could be some pain in the infrastructure / real estate sector following some quite speculative investment activity.”

Level of competition



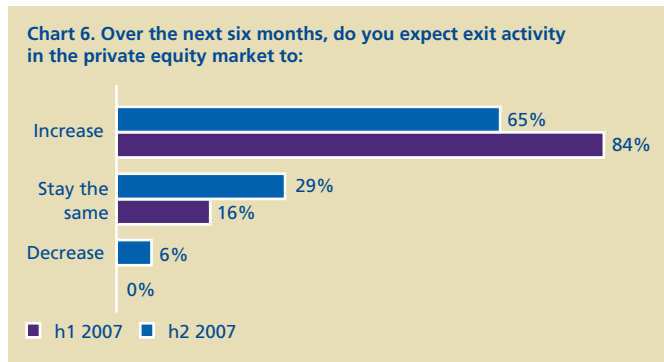
Why more

“Competition from other private equity houses will increase, as it will from hedge funds, but public market levels are not sustainable so there will be less competition from this source”

Why stay the same

“Competition levels will increase for larger deals (\$50m+) but will stay the same for smaller deals, where levels of competition are already very high”

Exit activity



Why increase

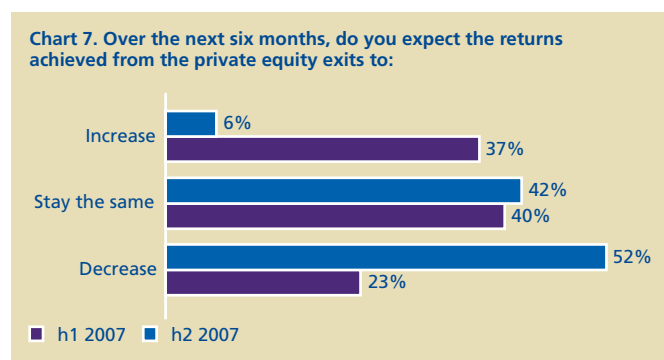
“There have been lots of investments over the last 2 years and some harvesting is due. However, if the capital markets don’t co-operate it will be interesting to see how exits are executed.”

“There are a lot of strong companies in private equity portfolios and coupled with favourable market conditions this will lead to an increasing number of exits.”

Why decrease

“Market volatility will be the main driver behind a decrease in activity. It’s going to be a good time to buy, not sell.”

Returns



Why increase

“Investments made 2 or 3 years ago that exit in the next 6 months will do very well. More recent vintages will see more muted returns.”

Why stay the same

“In terms of private equity adding value, I don’t see this changing. There have been other factors that have influenced returns in recent times, like stock market fluctuations and currency swings, so you can’t discount these making an impact in future.”

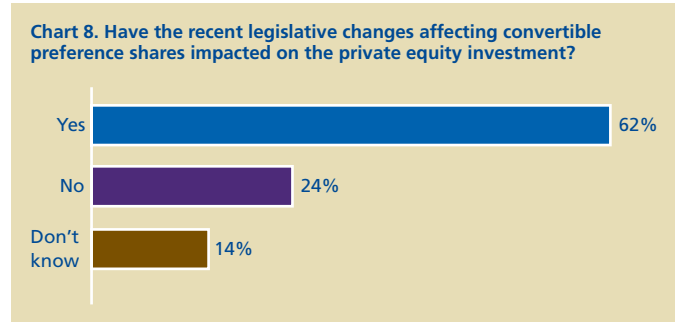
Why decrease

“There is no more low-hanging fruit. India has been discovered. We will see more moderate - 20-25% - returns going forward.”

“The 30-40% days have passed. Valuations have moved up and underlying conditions are tougher.”

Regulatory changes

• Convertible preference shares



Why yes

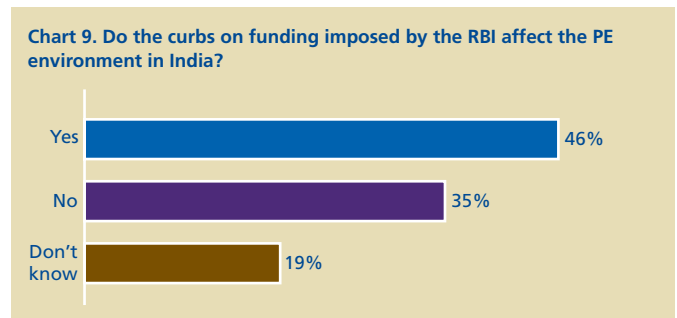
“It has reduced the structuring options open to investors. While investors are happy to back managers and to make it clear that they are on their side, if the structuring options don’t exist then managers are effectively penalised.”

“This will have an impact in specific sectors such as real estate where the instrument was extensively used.”

Why no

“I don’t think this is having a major impact - people have been reconciled with the fact that they don’t have that much flexibility in structuring investments for some time so are used to taking more equity.”

• RBI curbs



Why yes

“This has had an impact on structuring, completion and on deal flow and has opened up the need for more equity. It has had the effect of dampening prices, so to some extent it is a mixed blessing, but overall it will have a long-term negative effect because people have the same return targets but with lower leverage.”

Why no

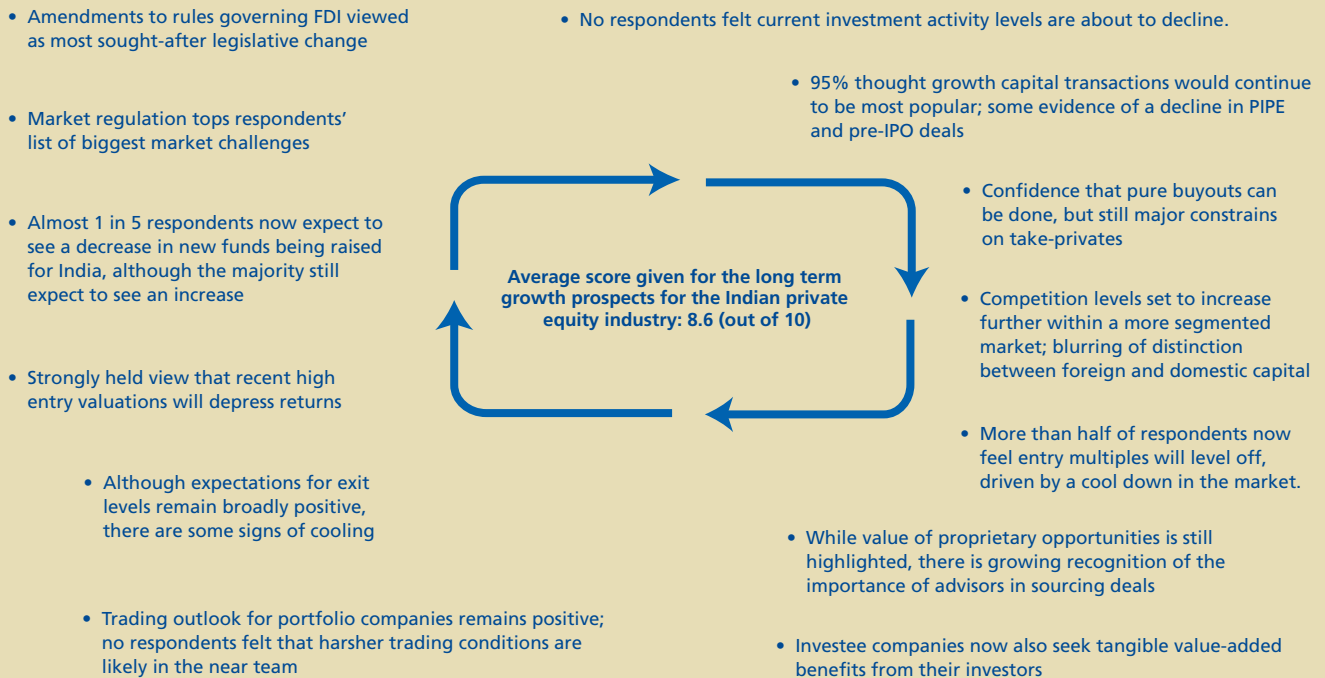
“This is not significant, but it is a nuisance. You can work around it (e.g. with structures outside India), but it slows the velocity of the market.”

“It doesn’t really have an effect. Regulations in this area are more liberal in India than in many other emerging markets.”

“This is actually a good, positive thing for private equity in that it means people have less access to ‘easy capital’ and consider private equity instead.”

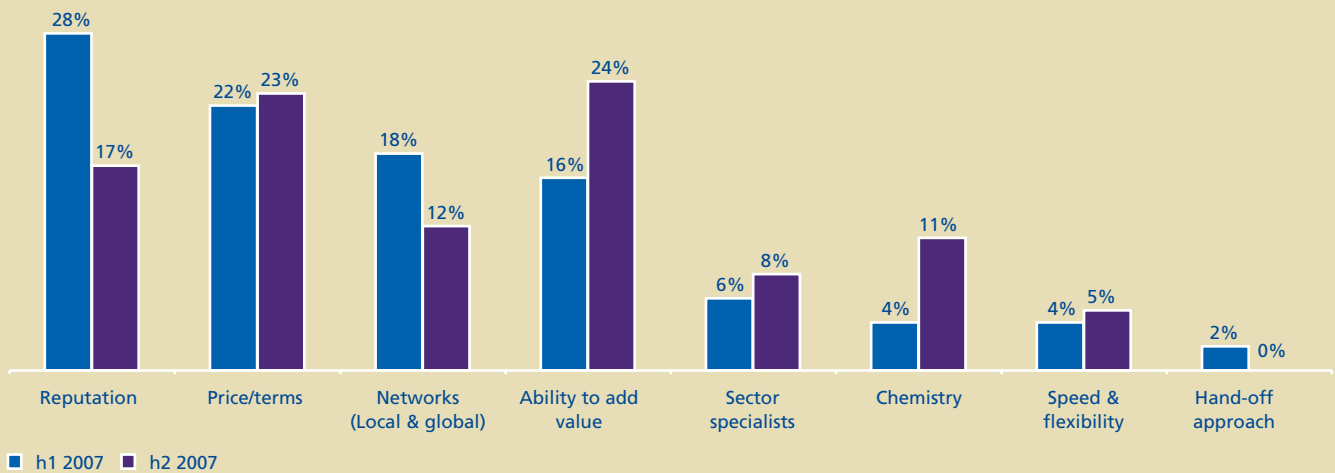
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Chart 10. What the results show through the private equity cycle



Differentiating in a competitive market

Chart 11. What do you believe are the most important differentiators between private equity firms when it comes to winning deals?



"Entrepreneurs are chasing smart money and using this to distinguish one private equity investor from another. The most important value-add factors are the PE's track record with helping with M&A and strategic changes, and the extent to which the entrepreneur can lean on the PE house. Entrepreneurs need someone with a valuation perspective and a market view."

"People ask for a lot of value-add. The contacts you bring are very important but they are not what give you the winning edge. The key is your relationship with the founder, especially in the case of smaller deals. This boils down to integrity, conduct, experience and understanding of price expectations."

"It can vary by sector: in certain sectors, entrepreneurs and managers look at an investor's ability to add value first and foremost; in others, it is much more about price, dealing with foreign regulations, etc."

"For late-stage companies it will be price – they don't need value-add, they just need dumb money. For earlier-stage businesses there is more of a need for value-add."

"Money is now a commodity here..."

Headline indicators		H1 2007		H2 2007
New Investment Activity	→	✓	→	✓
Entry Multiples	→	×	→	=
Exit Activity	→	✓	→	✓
Returns	→	=	→	×
Funds Raised	→	✓	→	=
Long Term Confidence	→	✓	→	✓

✓ opinions were generally positive = opinions were mixed × opinions were generally negative

Principal contacts

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