Private equity funds Homing in on India

Vibrant sectors of the Indian economy, including infrastructure, real estate and manufacturing, have attracted private equity funds from around the globe, who have been pouring billions of dollars in recent months, writes **N.B. Rao.**

PRIVATE equity (PE) funds from around the globe are being lured by the enormous opportunities that are on offer in many sectors of the Indian economy. Several domestic business groups and banks are also floating PE funds, hoping to capitalise on the huge requirements for finance from rapidly expanding sectors of the economy.

Factors that are boosting the inflow of PE funds – besides the prospects in different sectors – are the sharp drop in stock market indices that have consequently resulted in a significant fall in stock offerings, the spurt in interest rates that are making borrowings dearer, and tough Reserve Bank of India (RBI) norms relating to external commercial borrowings and foreign currency convertible bonds.

PE funds, once convinced about the soundness of a business organisation, its plans and revenue streams, are patient and willing to wait for a reasonable period for returns; unlike other investors they are not obsessed with quarterly performance reports and are also not easily unnerved by downturns in a business cycle.

Not surprisingly, most of the PE funds' inflow into India has been in sectors that generally have a relatively long gestation period. According to IndusView, a New Delhi-based corporate finance and cross-border advisory firm, the real estate and infrastructure sectors accounted for 50 per cent of the total $10 billion PE inflows into the country in 2007. The telecommunications sector attracted $2.1 billion in PE funding.

Globally, real estate PE funds raised about $50 billion last year. The sub-prime mortgage crisis in the US and the sharp fall in property prices in many developed countries are forcing them to look towards countries like India and China.

Bundeep Singh Rangar, London-based chairman of IndusView, believes that India's PE market has the potential to expand four-fold over the coming years.

"The infrastructure sector will provide the necessary edge," he points out. "India can also be expected to maintain the top

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slot in Asia, ahead of China." And of course, the other powerful Asian economies.

The PE business took off in India in 2005, when the country attracted about $2 billion in such funding. A year later, India saw $7 billion in PE funds infusion, though China was the top market with $13 billion in investments.

But in 2007, India overtook China, getting over $10 billion in PE funding, as against $8.3 billion by China. India continues to maintain the lead even in 2008. Hong Kong-based Asian Venture Capital Journal (AVCJ) notes that India attracted $6.8 billion in private equity investments during the first six months of the year, a 3.2 per cent increase over the first-half of 2007; China saw PE fund inflows of $5.8 billion, a three per cent expansion.

Interestingly, the deals are also getting bigger. While in 2006 there were less than a dozen deals of over $100 million into India, last year saw nearly 50 big ticket deals valued at $100 million and above.

But overall, PE funding into Asia fell by 22.7 per cent to $32.4 billion during the first-half of 2008. Interestingly, AVCJ Research indicates that aggregate private equity capital under management for Asia-Pacific has touched the $200 billion-mark.

Says Paul Mackintosh, managing editor, AVCJ: "Asia-Pacific private equity has shed some of the froth and over-exuberance of the past few quarters, but is performing well in the face of global difficulties."

Analysts expect India to continue attracting billions of dollars in PE funding over the coming years, with projections of $50 billion by 2010.

"The global credit crunch has tightened the availability of banking finance, forcing investors in India and worldwide to reach out to private equity funds as an alternative source of funding their capital investment and expansion programmes," explains Caroline Williams, private equity partner, of the Walkers group, Cayman Islands. "Despite India's recent weakened economic outlook and inflation at a 13-year high, the infrastructure sector continues to attract global equity funds. Additionally, India is realising increased interest from offshore money, which will be invested into the national infrastructure programme over the next five to seven years."

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She cites the example of Red Fort Capital, a Cayman Islands-based, India-focussed private equity fund (set up by G.B. Singh, a former top DLF executive, his son

SWANKY COMMERCIAL SPACE : International PE firms are investing billions of dollars in commercial projects across India,

US FINANCIAL CRISIS AND INDIA

THE current financial crisis that has swept across the US, resulting in the sale of some firms (Merrill Lynch), government bail-out of others (American International Group, Fannie Mae and Freddie Mac) and bankruptcy proceedings against a few (Lehman Brothers Holdings Inc) has left India's financial services sector virtually unscathed.

Arvind Virmani, chief economic advisor, Government of India, points out that it will have a minimal impact on the Indian economy, which is projected to grow at around 8 per cent in the current fiscal and 9 per cent in 2009-10. The Indian financial system will also remain largely unaffected by the crisis, he adds.

Goldman Sachs, a leading investment bank that has now transformed itself into a commercial bank, also feels that India's financial sector will be insulated from the global crisis. "The financial sector remains essentially sound, mortgages are a fraction of total credit and exposure to inflated real estate is small," says Tushar Poddar, vice-president, Asia economics research, Goldman Sachs. "We believe the credit crisis, which reversed the tidal wave of cheap foreign capital over the past few years, will have less of an impact on the economy's fundamentals."

In fact, the financial crisis rocking America offers new opportunities for private equity funds and sovereign wealth funds (SWFs) to invest in India. Demand for funds, especially from sectors like infrastructure, real estate and construction, will continue to grow, and PE funds and SWFs are expected to meet much of the requirements.

Foreign institutional investors (FIIs) have also been making record purchases of debt instruments in India, especially after the recent events in the US. For instance, during the first fortnight of September, they made net investments of over $2.45 billion in debt instruments, according to the Securities and Exchange Board of India (SEBI). During the first eight months of 2008, their net investments in debt instruments added up to a mere $1.2 billion.

Montek Singh Ahluwalia, deputy chairman, Planning Commission, believes the country's strong economic fundamentals will insulate it from the global financial crisis. The expected downturn in the global economy is also unlikely to impact the Indian GDP.

"The Indian banking system is not directly related to it," he says. "The estimated exposure (to the turmoil in the US financial markets) is very small and a direct impact almost negligible.

"India's large foreign exchange reserves will help the country tide over a temporary downturn, while the high savings rate and a reservoir of management and entrepreneurial skills are some of India's strong economic fundamentals that will insulate us from the global financial meltdown," asserts Ahluwalia.

Parry, and associate, Subhash Bedi), which recently announced plans to raise $600 million for an infrastructure fund that will invest in the ports and power sectors in the country. Red Fort has already stitched up seven deals worth $200 million in the real estate sector this year; by the end of the year, it hopes to add another five deals worth $100 million.

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Deutsche Bank, through its global alternative investment management business, RREEF Alternative Investments, has also made a foray into the real estate sector. The PE firm plans to invest over $1 billion over the next three years across India's real estate and infrastructure sectors, says Kurt Roeloffs, ceo, RREEF Asia-Pacific.

Investments into the real estate sector took off after the Securities and Exchange Board of India (SEBI), the capital markets regulator, allowed PE funds to invest in the sector about two years ago.

Analysts expect about $12 billion of PE funds to enter the real estate sector – including homes, offices, townships and hotels – over the coming year.

One of the biggest investments is by American property fund, Tishman Speyer Properties LP (Limited Partners), which aims to raise a billion dollars in a PE fund over the next few months for projects in India.

According to Revathy Ashok, managing director, Tishman Speyer, India, the firm has already raised $350 million in a private fund this year, which has gone in for funding three projects in south India.

Another major American PE fund that is investing in the Indian real estate sector in a big way is Walton Street Capital, which has real estate assets worth nearly $15 billion spread around the world.

The PE firm is raising nearly a billion dollars for an Indian realty fund, which it hopes to close by March 2009. It had earlier raised a $2.5 billion global fund, much of which was invested in India, including in special economic zones (SEZs). "There is a lot of opportunity for private equity in the Indian real estate sector," says Amber Malhotra, executive director, Walton Street Capital India.

Red Fort is investing about $775 million in a chain of budget hotels across the country. Other major PE investors targetting the real estate sector include Blackstone and Starwood Capital.

"Private equity funds are extremely keen to identify and invest in growth opportunities in the Indian pre-IPO (initial public offer) market," notes Richard Addlestone, another private equity partner with Walkers. "This enthusiasm, coupled with a lack of viable investment opportunities in other markets, has made private equity financing an easier source of capital than financial institutions that are scaling back their lending activities in emerging markets."

India's emergence as a major destination for PE funds has resulted in firms being able to rustle up large amounts – of up to $1 billion – within two to three months of the launch of India-specific funds.

IDFC Private Equity – a subsidiary of Infrastructure Development Finance Company Ltd – India's largest and most active private equity firm, manages a corpus of $1.3 billion. It recently raised $700 million for its third fund in just a month.

HIGH STAKES : The telecom sector is attracting PE firms

GRASPING FINER POINTS OF PE BUSINESS

INDIA'S top business schools have been a happy hunting ground for international private equity firms, who depute bright young graduates to offices in London, New York, Hong Kong, Singapore, or even Mumbai.

But these days, top executives from private equity funds are heading to B-schools for a different purpose: to conduct training programmes and give lectures on esoteric investment-related subjects for the students.

The Indian Institute of Management (IIM), Ahmedabad – and even IIMs from other centres – are offering courses in PE to their students.

Many IIM students are looking at entrepreneurial careers and are keen on grasping the finer points of private equity investments. The alumni association of IIM Lucknow and a student body at the Indian School of Business, Hyderabad, recently organised PE conferences for their students. Other B-schools are also charting out similar plans.

> We are talking to investors from the United States, Switzerland and Japan and should be able to wrap up the new fund by the end of 2008.

India-focussed PE funds raised over $3 billion in the first-half of 2008, as against $8.5 billion in 2007. Such funds are expected to raise another over $5 billion during the second-half.

Sequoia Capital recently raised $725 million for an India-focussed fund, taking its total corpus in the country to $1.8 billion. "This demonstrates our belief in the strong growth potential in India," says Sumir Chadha, managing director, Sequoia Capital India.

Other large PE firms that are raising funds include Jacob Ballas Capital ($500 million), UTI Ventures ($450 million) and IL&FS Investment Mangers ($400 million).

Jina Ventures, a New York-based PE firm, plans to raise over $200 million by the end of this year, to invest in the Indian manufacturing and life sciences sector. About two years ago, it had raised $50 million and invested in a dozen Indian firms; it has since exited from all these investments.

Ron Shah, managing director, Jina Ventures, says, "We are talking to investors from the US, Switzerland and Japan and should be able to wrap up the new fund by the end of 2008."

PE funds are also investing in the ports and marine infrastructure sector in the country, as it is expected to grow phenomenally over the coming years. "We are interested in marine infrastructure and even the real estate around it," says Aashish Kalra, co-founder and managing director, Trikona Capital Ltd. The firm has invested in Pipavav Shipyard Ltd, which is building one of the largest integrated shipbuilding facilities in the country. PE majors like 3i Group Plc – which has invested in Mundra Port and SEZ – are also evaluating various offers in the sector.

Tuscan Ventures Pvt Ltd, another PE fund, has invested in two Singapore-based companies that offer shipping and logistics industry training services.

Private ports and other operators of marine infrastructure are also eyeing PE

ATTRACTIVE OPTIONS : The infrastructure and real estate sectors have attracted the maximum amount of inflows from PE funds, in India

funding for their projects. Krishnapatnam Port Co Ltd in Andhra Pradesh is in talks with PE funds for raising nearly $225 million.

With over $20 billion expected to be invested in a number of ports and shipyards along India's coastline, PE funds are eagerly looking at options in the burgeoning sector.

All the top international PE players today have a presence in India and are making investments in various sectors.

They include the Blackstone Group, Kohlberg Kravis Roberts, W.L. Ross & Co, Warburg Pincus, Providence Equity Partners, Carlyle Group, Actis Capital, 3i Group Plc, Deutsche Bank and Temasek Holdings of Singapore.

W.L. Ross is pumping in $80 million into low-cost carrier SpiceJet. "This financing is intended to give SpiceJet the staying power to get through the industry consolidation that is underway," remarks Wilbur Ross Jr, chairman, W.L. Ross.

ON THE FAST LANE : The transport sector has huge funding needs and PE firms are meeting their demand

Providence Equity Partners invested nearly $650 million in Aditya Birla Telecom, while Kohlberg Kravis Roberts put in $250 million into Bharti Enterprises, which owns Bharti Airtel.

Blackstone invested $165 million in Gokaldas Exports, a Bangalore-based apparel-maker, last year.

Indeed, dozens of international PE firms are pouring billions of dollars into vibrant sectors of the Indian economy, hoping to reap handsome dividends when they exit from the companies after a few years.

BANKS TO FLOAT PE FUNDS

INDIAN banks are gearing up to launch private equity arms, enabling them to capitalise on the growing demand for such funds from different sectors of the economy.

State Bank of India, the country's largest commercial bank, will soon be launching a PE fund, targetting small and medium enterprises (SMEs). "We are awaiting regulatory approval for the new fund," says Om Prakash Bhatt, chairman of the state-owned bank. "We plan to have a 20 per cent stake in the fund."

The fund would have a corpus of over $100 million and private investors would be able to invest between $2 million and $20 million, adds Bhatt.

ICICI Bank, the second-largest bank – and the largest private bank in India – also plans to launch a PE fund focussed on the SME sector. It is aiming at a corpus of $200 million.

According to Sanjeev Sehrawat, general manager, business banking group, ICICI Bank, "We plan to form a special purpose vehicle, in a joint venture with a partner, for the new PE fund." The bank sees tremendous scope for growth in the SME segment, which currently accounts for nearly 10 per cent of its total advances.

YES Bank, another private sector institution, has also approached the Securities and Exchange Board of India (SEBI) for launching a couple of PE funds, including one dedicated to SMEs. The size will range from $50 million to $100 million.

One bank that has already gone ahead and established a PE fund is Axis Bank. Says Alok Gupta, managing director and ceo, Axis PE: "The private equity segment gives opportunities that are not usually found in the equity space. This fits the bank's growth strategy and helps us to take advantage of the high capital base."

Axis PE, which has raised $150 million from domestic and international institutions, expects to rustle up $500 million for the fund. It has already made investments worth nearly $50 million in two companies in hotels and energy infrastructure sectors.

"Both these investments fall in line with our vision of investing in high-growth potential sectors," notes Gupta. "In the hospitality space there is huge demand-supply gap."

But the most significant investment in the PE sector will be by Reliance Capital Ltd, part of the Anil Dhirubhai Ambani Group (ADAG). It plans to raise $1 billion abroad for a PE fund. The promoters will be investing $200 million in the fund, which aims to invest around $100 million in companies in fast growing sectors including logistics, pharmaceuticals, retailing and media.