Home is where the heart is

Indian private equity has typically been associated with technology companies seeking to expand internationally. While that remains a key strategy, more and more investors are seeking to exploit the domestic consumer boom. Andy Thomson *reports.*

According to many professionals that you speak to, the future of Indian private equity lies within its own boundaries. That might appear rather narrow-minded; parochial perhaps. But then think about the size of the domestic opportunity. Compared with less than half a billion residents in the whole of the European Union, India is currently home to around 1.1 billion people. If pursuing an opportunity of that size makes Indian funds parochial, it's a tag they can probably live with.

Gopal Jain first saw the potential to help Indian companies grow to meet domestic demand back in the mid-1990s as head of research at VLS Finance, an Indian merchant bank. He made a series of venture capital investments in what he paints as a benign competitive environment: "Back then, what I did was opportunistic. There were very few other investors and it was possible to buy great businesses at a discount to net asset value." It was amid what he describes as "the first summer of Indian economic reform" that he backed the likes of Apollo Hospitals, which is now the largest private healthcare provider in Asia.

In 1999, Jain was recruited by Boston-based venture firm View Group to head up its new Indian office. For the next four years, Jain's horizon became global as he set about implementing View's strategy of providing Indian companies with capital and strategic advice to access global operations and markets. Growing internationally has indeed been the predominant strategy in relation to private equity investing in

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Ahuja: Nimbus controls religion

Indian companies in recent years as technology businesses in particular have sought strategic alliances with, and acquisitions of, foreign firms; often with the eventual aim of listing on Nasdaq.

But now it seems the cycle has turned again. By the time Jain left View Group last year, "the compelling proposition was [once again] domestic demand-led". In response to this, he launched Gaja Capital Partners with two co-founders as a mid-market private equity firm seeking investments of $5-15 million in companies focused on India. He has a catchier way of describing the fund's aims: "we're seeking to identify the 800 pound gorillas of tomorrow".

Jain relates that the environment in which he is investing now is very different to that which prevailed back when he was first targeting domestic firms in the mid-90s – and herein can be found the key to why all eyes are now on the domestic market once again. "Then, there was the promise of huge domestic consumption, but it hadn't really arrived yet," he says. Now it has: the Indian middle class has grown, the average consumer has become increasingly affluent, and that's essentially why the domestic opportunity – particularly in relation to consumer services - is now firmly back in vogue.

That said, there is a trade-off for firms like Gaja Capital Partners. While the market has got bigger, the number of competitors hoping to help companies grab a slice of that market has also increased significantly (as our table of Indian-focused fundraisings in the following pages gives some flavour of). Over the last year or two, India has become a very popular place to raise private equity funds, including quite a few of the start-up variety.

BLUE DEBUT

One of these was Blue River Capital, which launched a debut fundraising last year under the stewardship of Shujaat Khan and former GE Capital Commercial Finance executive Muneesh Chawla. Khan boasts an impressive CV as a former managing director and investment committee member of ChrysCapital, the highly respected Indian investment firm which earlier this year closed a $550 million fourth fund.

Given the co-founders' pedigree, Blue River was never going to be just another 'me-too' investor. Confirming this impression further, the firm has honed a niche strategy which involves aiming to be the first professional investor in family owned businesses that require help with corporate governance issues. Says Khan: "Most family business owners have the right intentions – hence, we don't look to change management – but their decision-making tends to be intuitive. We bring in professional processes. It's a delicate balance though, because we're only a minority investor. We try to influence firms intelligently and not force a particular way of doing things on them."

Given its subtle nuances, this was arguably not the easiest of strategies to convey to would-be investors. Nonetheless, 12 months after launch, Blue River closed its debut vehicle on $130 million earlier this year. While conceding that "it's always hard for a first-timer", Khan says "receptivity for India was high".

The Blue River fund drew commitments from 20 investors, predominantly institutions and large family offices from the US and Western Europe. It's informative to note that the firm did not pursue domestic sources of capital. Local players say that the likes of ICICI Venture (a subsidiary of ICICI Bank) and IL&FS Investment Managers (the private equity arm of IL&FS Investment Bank) are naturally in a strong position to seek support from their parent groups as well as other institutions that these parents may have relationships with.

But firms such as these, stress observers, are the exception rather than the rule amid a paucity of domestic LP capital. Says Khan: "The institutional market for private equity investment is highly undeveloped in India. Insurance companies and pension funds, for example, are often barred from investing in alternative assets."

So will domestic investors end up missing out on the opportunity that's taking shape under their own noses? Many will, but Gopal Jain sees signs that some at least are preparing to jump on the bandwagon. Gaja Capital is currently a fundless sponsor, investing its own resources and those of others into investments on a deal-by-deal basis. The 'others' includes

Peck: hospitals looking healthy

"leading local families" and, by the middle of next year, when the firm hopes to have concluded its debut fundraising, Jain says he anticipates that these families as well as some domestic institutions will have become Gaja LPs.

ALL ABOUT GROWTH

What then is the opportunity that is prompting new funds to spring up on a regular basis? Primarily, it appears to reside in growth capital. A recent study from consultants Bain & Company forecast that the value of Indian deals would grow from a total of $2.2 billion last year to $7 billion by 2010. This may have been a conservative assumption given that a Venture Intelligence India survey revealed that $5.4 billion was ploughed into Indian private equity in the first nine months of this year. Either way, the Bain study concluded that the vast majority of investment, even by 2010, would be in the form of growth capital.

So why is growth capital predominant? One obvious reason is that companies can simply ride the wave of strong Indian GDP growth, which was running at 8.9 percent in the first quarter of the fiscal year 2006/07.

Sri Rajan, head of Bain & Company's private equity practice in India, offers a fuller explanation: "Firstly, apart from public sector companies, a significant portion of Indian industry is still controlled by private concerns and families, and, in both cases, change of control is a significant issue. Secondly, the government has not really gone through as yet with large-scale divestments of state-owned assets. Thirdly, access to capital is possible either through an IPO or a secondary offering in the public markets. Entrepreneurs wanting capital can raise cash on the stock market without giving up control."

Another important point to note is the position that private equity firms now appear to have carved out for themselves as growth capital providers of choice. While development finance institutions (DFIs) remain an important source of capital in India, some observers noted to PEI Asia that they have become less of a natural partner for corporates than used to be the case.

By the same token, they say, banks are showing more of a tendency to focus on their retail rather than corporate activities. With more, and larger, funds at their disposal, private equity funds have stepped into the spaces left behind.

And what spaces exactly are they stepping into? Well this brings us back to the burgeoning army of domestic consumers, which has been the inspiration for some of the country's higher-profile deals of recent times. Take, for example, the first investment made in India by London-listed global investor 3i back in August last year. The $45 million bet on sports marketing and entertainment firm Nimbus Communications was, at the time, the largest ever private equity investment in the country's media and entertainment industry. It was also a classic consumer play.

Anil Ahuja, managing director and co-head of Asia at 3i, explains: "There are two major religions in India: cricket and Hindi movies. And Nimbus controls cricket." [Earlier this year, the firm paid $612 million for the television broadcasting rights to the Indian cricket board's matches from 2006 to 2010]. He elaborates: "Indian cricket is the most valuable cricketing asset in the world. When cricket is being shown on TV, you can forget about every other channel because it's the only one that matters. And there's a large middle class you can reach with advertising."

CLASS DEAL

There are a number of other sectors that domestic investors highlight as being in the vanguard of the consumer boom. Education, for example, has been deposited squarely into the spotlight by the 9x return achieved by Gaja Capital from one of the two investments it had made to date. Fifteen months ago, Gaja backed Educomp Solutions, a provider of learning solutions to Indian schools. Gopal Jain says the firm had a near-monopoly position in a number of its activities focusing on content supply to India's schools - of which there are around one million. The firm's subsequent IPO in India and Singapore was oversubscribed by around 35 times.

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A third sector that has attracted much attention in India recently is healthcare given the presence of an ageing, but increasingly affluent, population. For example, Actis, the UK-based emerging markets investor, in July this year invested $15.5 million of growth capital to fund the expansion of Sterling, a hospital chain in Gujarat. Says Actis South Asia managing partner Donald Peck: "The hospital sector is under-served in what is a relatively prosperous state. Our idea is to develop the brand regionally as well as consolidate other regions."

Increasing wealth is a recurring theme and is also responsible for a retail boom. The headlines in this respect have been generated by a rush of luxury designers like Hugo Boss and Louis Vuitton into Mumbai and New Delhi. On a more prosaic but arguably no less significant level, the second of Gaja Capital's two investments went into Vishal Retail, which, in the words of Jain, "wants to be the Walmart of second-tier cities in India". In the six months since the investment was made, he says, the firm has already almost doubled its number of stores from 22 to 42.

What these examples help to illustrate is that there is no shortage of opportunity on the new deals front. As many of the firms making these investments are relative newcomers, however, there is still a question mark over how easily they can be liquidated in the years ahead. An observer points out: "One of the assumptions in the West is that, if you have a healthy business, you can exit. It doesn't work that way in emerging markets."

Perhaps not surprisingly, those firms canvassed by *PEI Asia* expressed optimism about exit prospects. International trade buyers are scouting India with more urgency than ever before, they say, while domestic M&A is gathering momentum and a strong stock market makes the IPO a realistic prospect.

Another intriguing exit possibility can be glimpsed in the small but growing band of LBO firms dipping their toes in Indian waters. Might they one day be the buyers of today's growth stories once the latter have attained the critical mass to which they aspire? At which point, global horizons may develop. Until then, the opportunity lies closer to home. ■