

Our Current Perspective on Private Equity Investing in India

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Gaja Capital Partners

Presentation Plan

- **India's growth story is compelling, but there are concerns**
- **External trends**
 - Fed rate hike
 - Increase in oil prices
 - China slowdown?
- **Issues facing the Indian economy**
 - Back to the days of current account deficit
 - Increasing fiscal deficits
 - Challenges of coalition politics
- **Markets are not cheap anymore**
 - Markets scaling new heights
 - Most capital not native
 - Lowering IPO barriers
- **Our approach to address these concerns**

Examining the ecosystem for PE in India: recent trends

Culture of entrepreneurship

- New breed of entrepreneurs behind emerging growth stories
 - IIT/IIM grads from 1980s and 1990s
 - Second generation entrepreneurs from family owned businesses
 - Local entrepreneurs seeking national scale

Large domestic markets

- For the first time sustained government expenditure driving consumption in certain verticals
- Investment cycle on the upswing



INDIA

Established law and regulation

- High level of intervention by SEBI, Finance Ministry and RBI

Mature financial markets

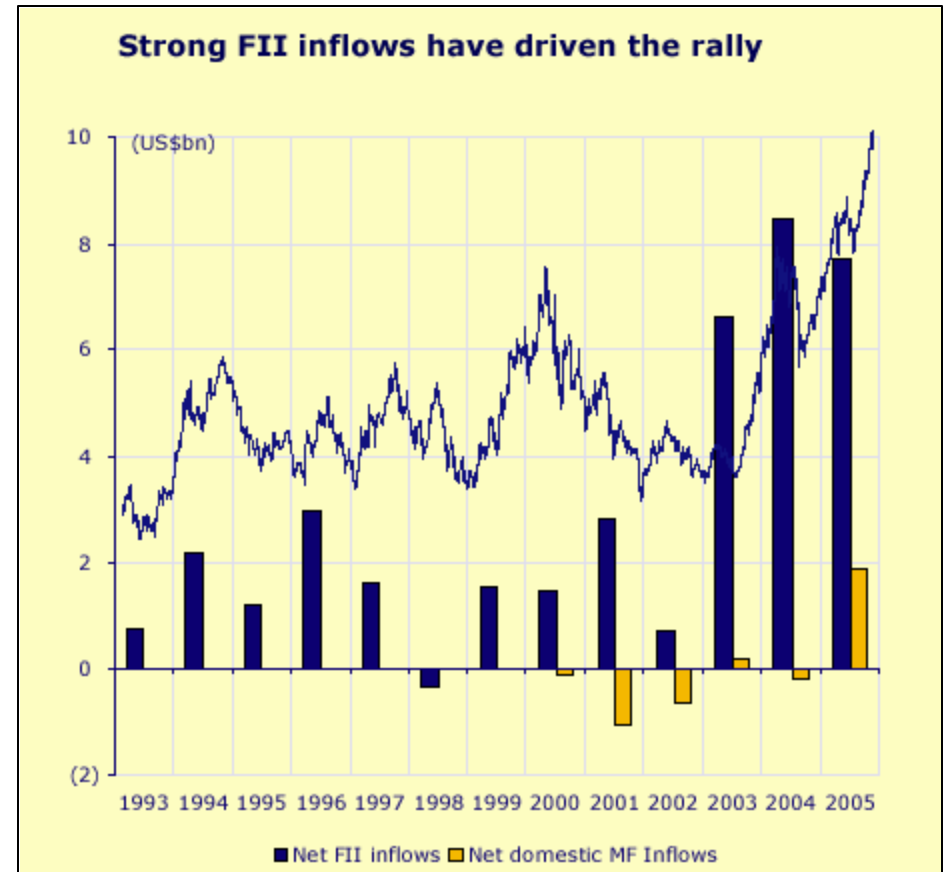
- Increasing number of exits through IPOs
- Domestic corporates are turning strategic buyers
- Commodity markets developing at an increasing pace

<u>Macro Trend</u>	<u>Description</u>	<u>Impact</u>
Fed rate hike	<ul style="list-style-type: none">• Fed Funds rate projected to rise by 175 bps to 5.5%	<ul style="list-style-type: none">• Relative attractiveness of emerging markets like India• Expected risk premiums to rise• Impact on capital inflows
Increase in Oil prices	<ul style="list-style-type: none">• Oil prices threaten to increase from \$65-70 to \$80-85	<ul style="list-style-type: none">• Impact on India's BoP• Impact on India's GDP
Slowdown in China?	<ul style="list-style-type: none">• Cost pressures on Chinese companies hurting profitability• Full impact of oil price increases yet to be felt• Domestic demand slowing down	<ul style="list-style-type: none">• Lower commodity prices• Impact on India's exports

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- **Fed rate hike**
 - Set to increase 175 bps to 5.5%
 - Asset price pressures
 - Fed to increase rates to combat lowered risk premiums
- **FII are dominant players in the Indian equity markets**
 - Own 40% of free float market cap
 - Largest investor group
 - Increased hedge fund exposure
- **Impact**

 - Relative merit of emerging markets
 - Expected risk premiums to rise
 - Capital inflows could be affected



Source: CLSA

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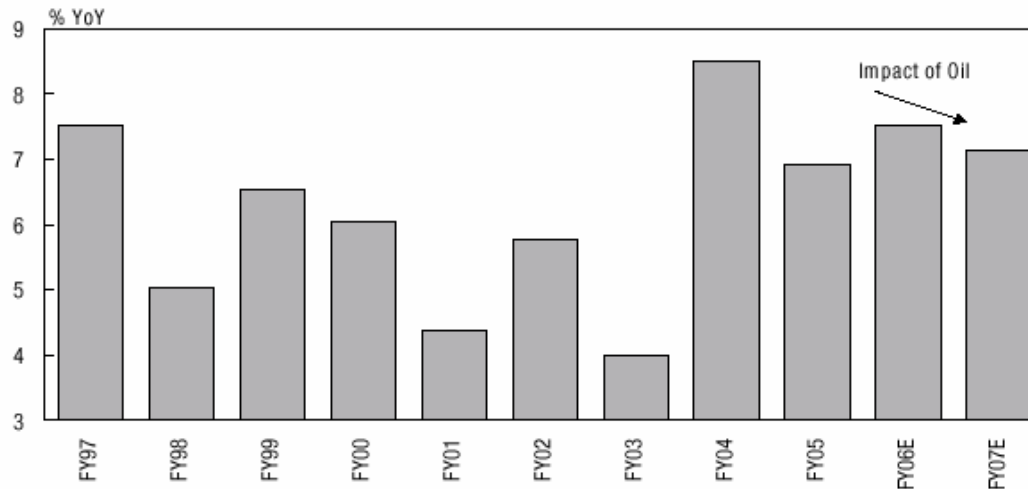
- **Oil prices**

- Threaten to increase from current levels of \$65-70 to \$80-85
- India imports more than 70% of its crude oil requirements
- Profits and dividends from Oil PSUs significant component of government revenues

- **Impact**

- Widening current account deficit
- Reduced GDP growth - \$10/bbl increase shaves off 80bps
- Inflationary pressures

Annual trends in GDP – Oil at US\$60/bbl would shave off 30bps of FY07E growth



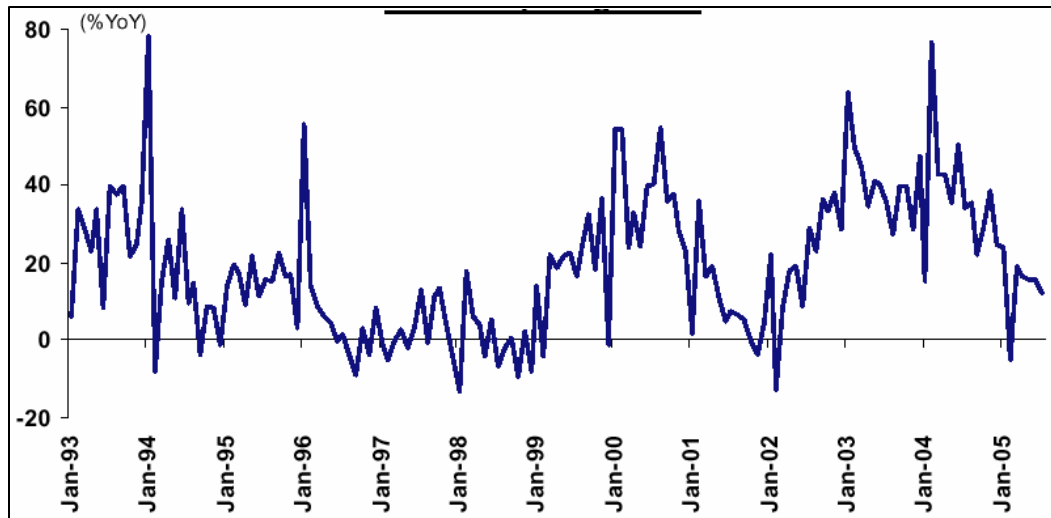
Source: CSO; Citigroup

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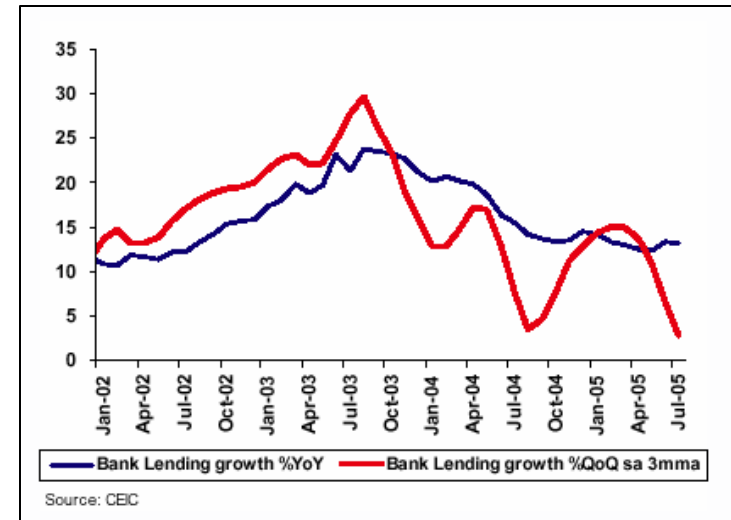
- **China showing signs of a slowdown**
 - Lower import growth shows demand is slowing
 - Credit growth is slowing

China Import Growth



Source: CLSA

China Bank Lending



Source: CLSA

- Large portion of India's manufacturing sector is commodity manufacturing
- China key competitor of Indian exports

➤ Impact

- Lower commodity prices – will affect corporate earnings
- Renewed Chinese thrust on exports could hurt India's exports – example, auto ancillaries

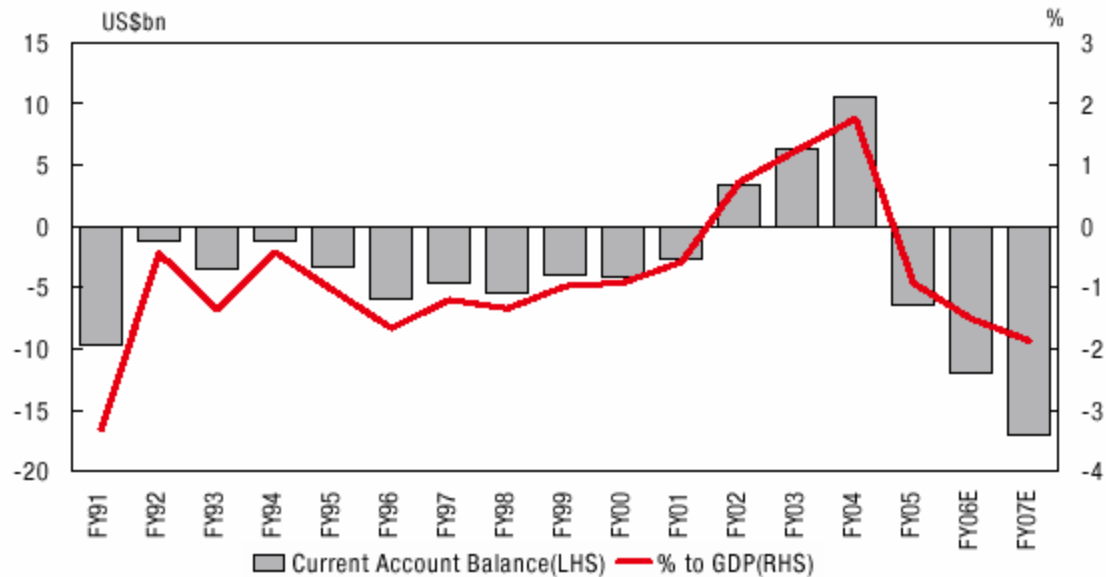
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Current Account Deficit	<ul style="list-style-type: none">• Current account deficit back after a period of four years• Capital inflows > current account deficit• Balance of Payment pressures	<ul style="list-style-type: none">• Weakening BoP position could reverse rupee appreciation trend
Increasing Fiscal Deficit	<ul style="list-style-type: none">• Government not passing energy prices to consumers• Slowdown in pace of reforms• Increase in subsidies and populist expenditures	<ul style="list-style-type: none">• Inflationary pressures• Higher interest rates• Higher and newer taxes – impact on corporate earnings
Challenges of Coalition Politics	<ul style="list-style-type: none">• Communists in government• Ruling coalition (UPA) infighting	<ul style="list-style-type: none">• Early elections• Slippage in pace of reforms

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- **Current Account Deficit**

- Set to increase from \$6.4 billion to \$12 billion by 2006
- Total capital inflows are currently higher than current account deficit

Current Account Deficit to widen further (US\$bn, % to GDP)



Source: RBI; Citigroup

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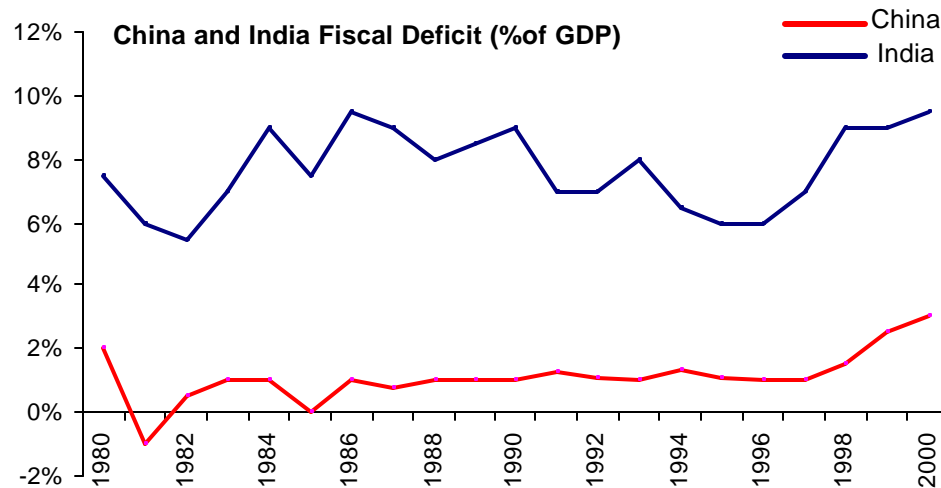
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- Weakening BoP position could reverse trend of rupee appreciation

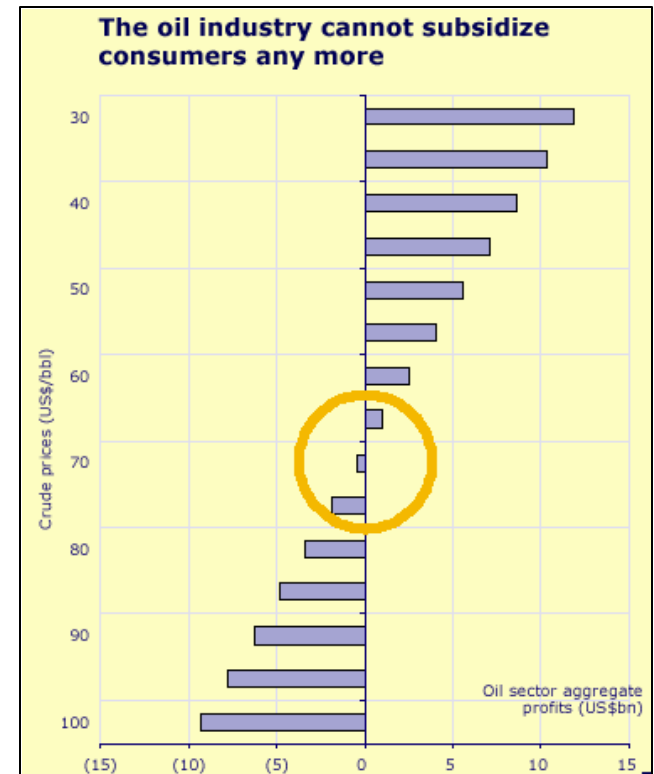
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• Increasing Fiscal Deficit

- Increased energy prices not being passed on to consumers
- Government slow on divestment: reducing government stake to 51% can generate \$25 billion (3% of GDP)
- Increasing expenses: Guaranteed Rural Employment Guarantee Scheme – outlay is \$7.8B (~1% of GDP)



Source: China Statistical Yearbook RBI, Morgan Stanley Research

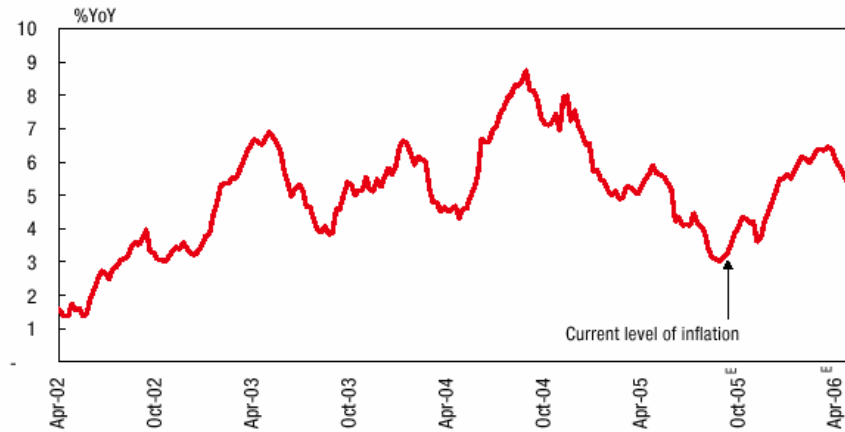


Source: CLSA

➤ Impact

- Inflationary pressures
- Higher interest rates
- Higher and newer taxes (e.g. Fringe Benefit Tax)
- Impact on corporate earnings

Current and Likely Trends in Inflation – The sweet spot is over



Source: Office of Economic Advisor; Citigroup

Source: Citigroup

Real interest rates are at a three-year high



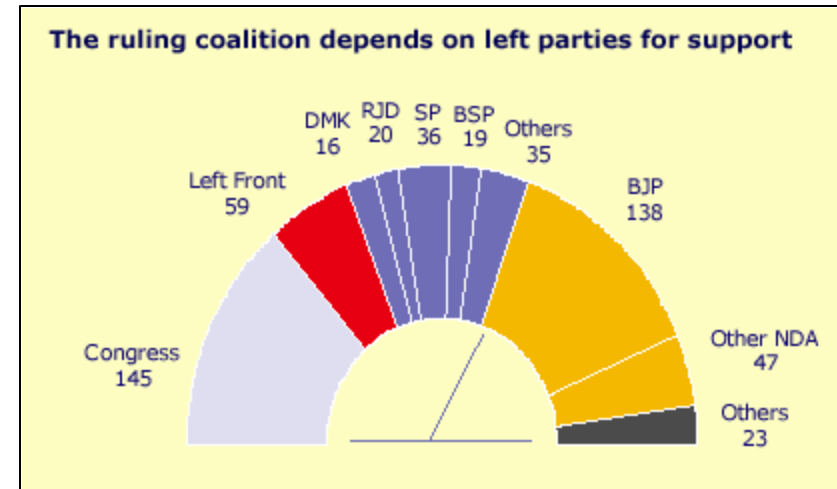
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- **Challenges of coalition politics**
 - Communists in government
 - UPA infighting
- **Signs of strain already evident**
 - Unprecedented number of labor disturbances have surfaced last year
 - Unrest at Honda's unit in Haryana was the largest – causing >\$30 million in losses
 - Airport employees threatened to strike against privatization of Mumbai and Delhi airports

➤ Impact

- Early elections
- Reforms on the back-burner – labor reforms, reduced subsidies, privatization and divestment



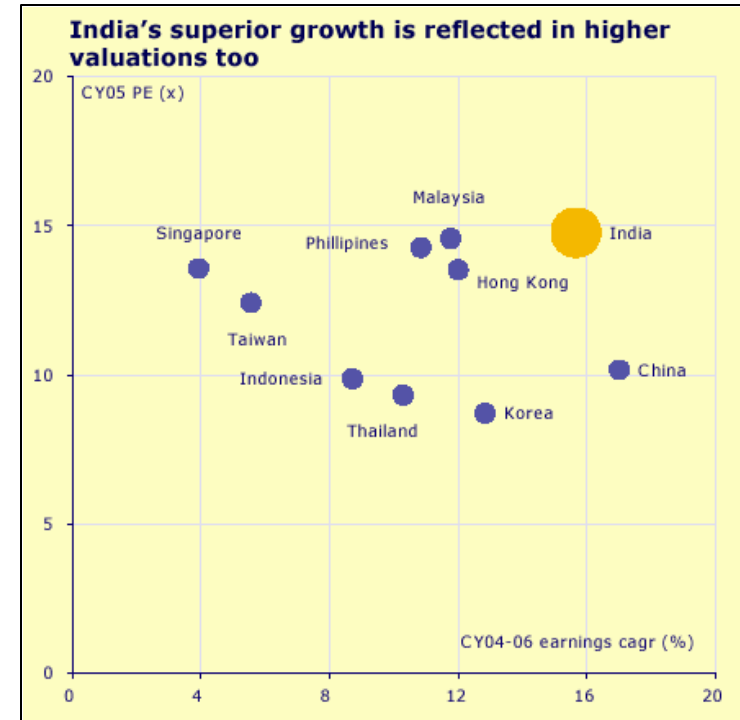
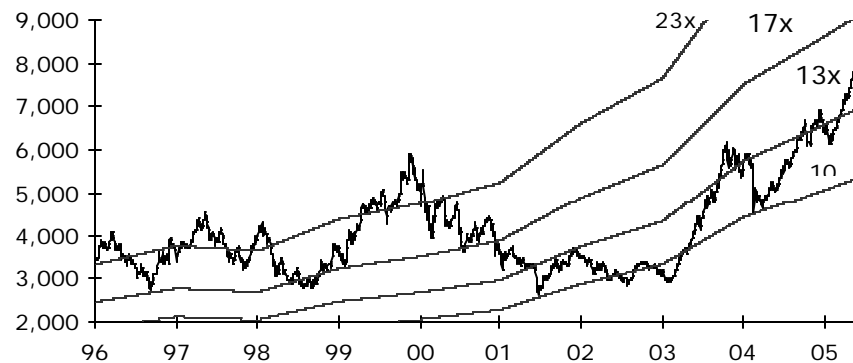
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Markets scaling new heights	<ul style="list-style-type: none"> • Structural flaw in the market – buy on margin but cannot sell on margin 	<ul style="list-style-type: none"> • No longer cheap • P/Es among the highest in Asia
Most capital not native	<ul style="list-style-type: none"> • Therefore, must measure merit against other economies 	<ul style="list-style-type: none"> • Higher risk premiums • Arbitrage on growth no longer easy
Lowering of IPO entry barriers	<ul style="list-style-type: none"> • \$6.9 billion raised from the primary markets – highest ever (638% rise compared to 2004) 	<ul style="list-style-type: none"> • Public competing with Private on valuations

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- **Markets scaling new heights**

- Markets have re-rated 16% since May 2005
- Market cap to GDP is higher than Asian average of 64%



Source: CLSA

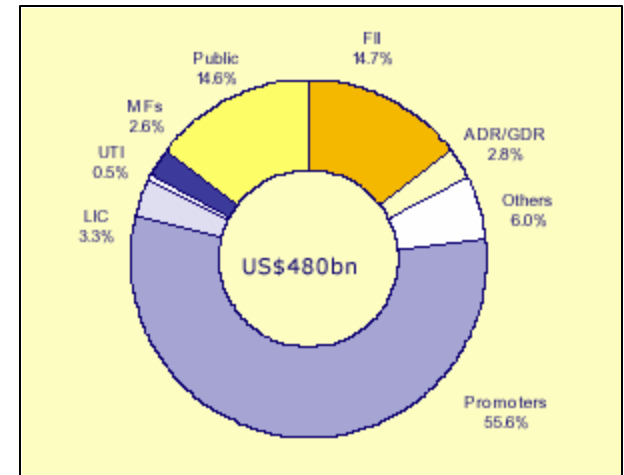
- **Impact**

- Market is no longer cheap - P/Es among the highest in Asia
- Public markets affecting private equity valuations

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- **Current rally was driven by strong FII inflows**

- FII's are the largest investor group owning 40% of the free float market cap
- Net inflow since 2H2003 has been \$21 billion – 6.5 times the 1993-2002 annual average

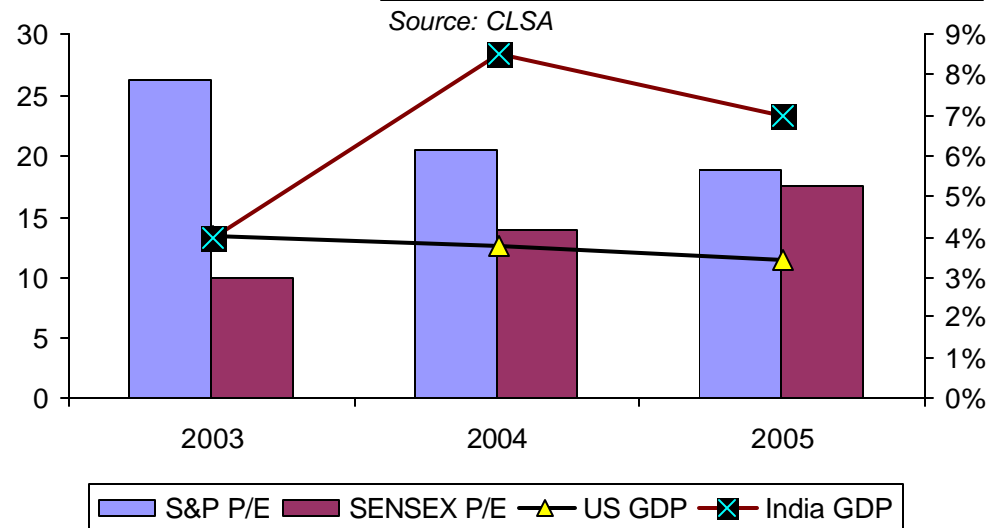


- **Must measure merit against other economies**

- The spread between the average P/Es of US and Indian stocks reduced substantially

➤ **Impact**

- Higher risk premiums
- Arbitrage on growth no longer easy



Source: Bureau of Economic Analysis, Bombay Stock Exchange

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- **\$6.9 billion raised from the primary markets**
 - 638% rise over last year – highest ever
 - Comparable to the total money raised in 1995–2003
 - 78 IPOs closed since Dec 2003

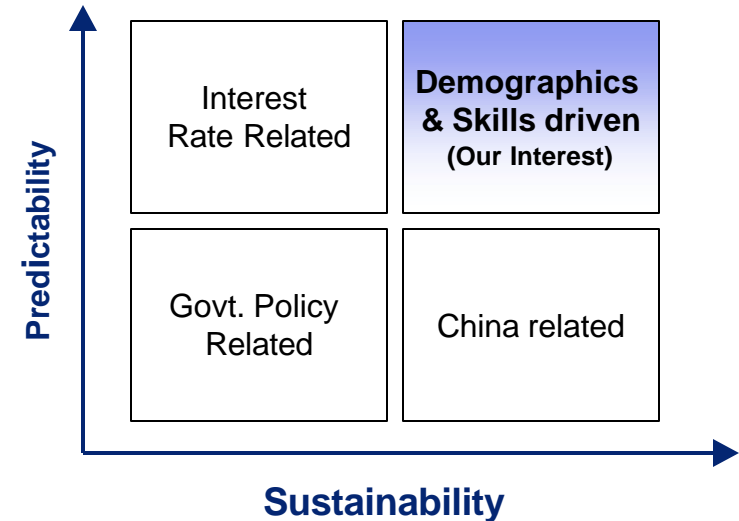
- **Size barriers to an IPO have been lowered**

➤ Impact

- Public markets competing with private equity on valuations
- Demand for growth capital being met by public markets

Our approach to addressing these concerns

- **Dig Deeper**
 - Focus on businesses not just sectors
- **Select the right consumption drivers**
 - High on predictability and sustainability
- **Be Nimble**
 - Asset class flexibility to improve pricing power
- **Focus on Private**
 - PIPEs no longer viable means to buy value
- **Monopoly is the best form of competition**
 - Create proprietary deal flow
- **Focus on Exits**
 - Good time to sell not necessarily the best time to buy
 - Create and seize exit opportunities
- **Tide is turning in favor of entrepreneurs**



About Gaja Capital Partners

- **Gaja Capital Partners, LP is an India-focused private equity firm**
- **Investment premise**
 - Create value from rapidly growing domestic demand in India
- **Investment approach**
 - Value style investing
 - Proprietary deal creation
- **Core team based in Mumbai**
 - Team comprises experienced fund managers and serial entrepreneurs
- **For further details visit: www.gajacapital.com**

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