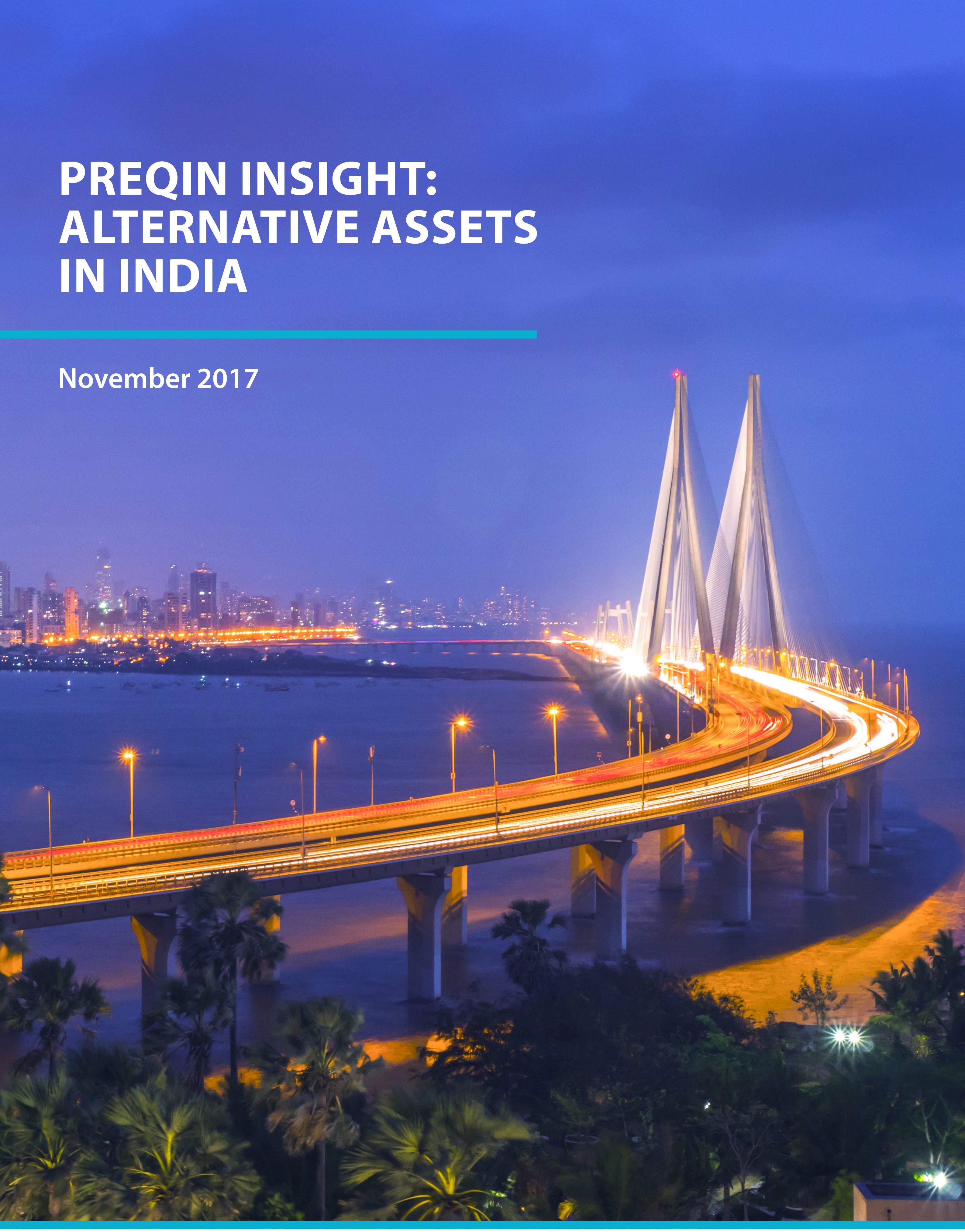
# PREQIN INSIGHT: ALTERNATIVE ASSETS IN INDIA

November 2017



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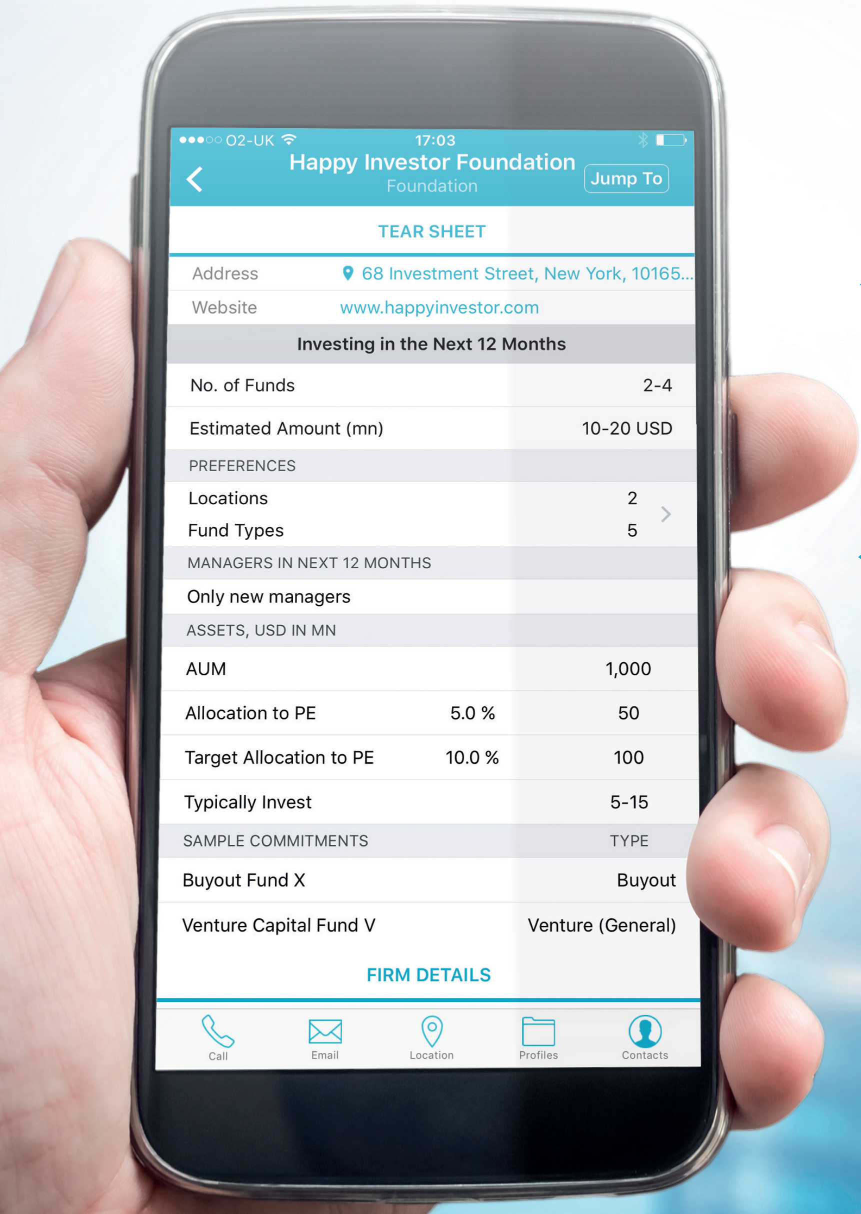


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# CEO's FOREWORD

## - Mark O'Hare

The alternative assets industry in India has grown significantly over the past decade, with assets under management (AUM) reaching $42bn in the private capital* industry (i.e. closed-end private funds) as at December 2016, while hedge fund AUM has reached $1.4bn (as at July 2017). The ecosystem of institutional-quality fund managers has also evolved, with 221 private capital fund management firms and 46 hedge fund management firms now active.

As impressive as these figures undoubtedly are, they also demonstrate the potential – and strong likelihood – of further future growth. An interesting metric is to look at alternative assets AUM in $bn in relation to GDP in $tn. India has $20bn of private capital AUM per $1tn of GDP, as compared to a figure of $25bn for Asia-Pacific as a whole and $62bn for the global average. In hedge funds, the comparison is even more stark: $0.7bn of AUM per $1tn of GDP in India, as compared to Asia-Pacific as a whole at $5.8bn, and the global average of $45bn.

For an explanation, one needs to look no further than the level of development of the economy generally, with India having a GDP per capita of $6,600, compared to China at $15,400 and advanced European and North American economies at $40,000-60,000. This in turn highlights the potential growth for India's alternative assets industry: with GDP growing at 7% p.a., this is likely to deliver a compounded growth in Indian alternative assets over the long term, as alternative assets participation rates in the economy converge on those of more developed economies.

Private equity comprises the largest part of Indian alternative assets, with AUM of $24bn. Just under 60% is focused on growth investments, with a further 31% targeted at venture capital investments. Other private equity strategies such as buyout are relatively less important in India at present. Outside of private equity there are significant sums targeted at real estate ($10bn), infrastructure ($4.4bn) and private debt ($3.3bn). These strategies will surely grow in importance as the economy develops, and especially so in renewable energy and infrastructure: in 2017, more than twice as much renewables capacity will be added to the grid as coal.

At present the interests of local India-based investors are overwhelmingly focused on venture capital (of interest to 97% of India-based alternative assets investors) and growth strategies (60%). If patterns from other markets are replicated in India, the interests of these investors will broaden to include other strategies as the market evolves.

Looking at performance, distributions from India-based private capital funds in 2016 surpassed $12bn, continuing the consecutive three-year run of positive net cash flows to investors from funds in the region. This improvement in cash flow to investors shows the existing value creation in the region and the potential for further growth. Preqin's databases hold net returns information for over 8,900 private capital funds globally and we are always ready to support fund managers in sharing further information with Preqin to support their own development and that of the industry. For more information, please visit: www.preqin.com/sharedata.

Indian alternative assets are at a critical juncture of development, with huge potential for further growth. We hope that this report – and more critically the data available online at www.preqin.com – will help our customers to develop their businesses in the country.

We thank our customers for your support, and will continue to develop the service to meet your requirements.

Happy investing,

Mark O'Hare

*Due to the immaturity of the natural resources market in India, the AUM figure could not be calculated for this asset class at present.*

# KEYNOTE ADDRESS

## - Gaurav Kapoor, **DFID India**
## - Ashwani Bhatia, **SBI Capital Markets**

**What are your thoughts on the exit environment for private equity investments in India? Do you believe that reforms such as the proposed bankruptcy law will help?**
Exit environment for private equity investments in India is maturing. Over the last two years about $20bn worth of exits have taken place. A lot depends on the skill of the fund manager in navigating their exits whether via stock market listings or through secondary or strategic sales. And there has been a shift to fundamentals that is driving the underlying ability for exits e.g. robust value accretive growth in the portfolio company which is then seen to be attractive for a secondary or strategic investment. Despite volatility in some sectors, India's listed markets have grown steadily over the last five years. It is expected that the IPO market will see about $10-15bn of new listings in the next 12 months, offering many private equity investors good opportunities for exits.

The government's policy making has been supportive to the private equity industry. The Alternative Investment Funds (AIFs) category has benefitted from simpler regulations in structure plus efficient transfer of assets including tax and dividend distribution where the views of the industry were taken on board and acted upon. The Bankruptcy Act is expected to further bring in process clarity with regards to stress assets and resolution of non-performing loans. It is early as some big assets are being brought in e.g. in the steel sector. It has been received positively by investors as the various stakeholders would now tend to move in a predictable manner under the provisions of the Act. The Act and other initiatives from the government are expected to improve the ease of doing business rankings, giving confidence to investors.

**What do you think of private equity valuations in India? Do you think they are still justified or are overvalued, as more and more investors turn to private equity?**
With about 300 private equity funds, the private equity industry in India is competitive. With fewer companies at scale and with attractive governance structures, sometimes there are more funds chasing fewer deals, which has an impact on valuations. Having said that, most private equity fund managers are well aware of when a deal can get too expensive and we have not yet seen in India examples of reckless valuations by the broader community of investors – at least in the private space. Even when the public markets have been frothy, these valuations have generally not moved to the private space.

We believe valuations will further rationalize and turn attractive as investment opportunities within the economy diversify in terms of size, sector and geography. There are quite a few promising and nascent sectors which are as yet undervalued. There are also promising entrepreneurs and second-generation promoters who are ambitious and keen to find their niche space in which to excel. In turn, as private equity managers also refine their strategies and include such emerging sectors, we believe valuations will be justified. Exits will then be on growth multiples based on solid fundamentals and not the short-term reward that we expected in the past when short-term money was expecting an early flip on assets.

**What are your opinions on the trend of foreign investment in domestic private equity funds in India? Where do you see it going in the near future?**
Around $7bn in dry powder is still available waiting for the right opportunity. Banking, non-banking finance companies, IT and manufacturing, healthcare and housing have been attracting the bulk of the foreign investments and many of these sectors will continue to attract capital in 2017-2018 as well.

Consolidation of some sectors, such as renewable energy, will make the sector a play for scale. It is also likely to draw in specialist fund managers that can create value through building synergies at scale and investing in innovation in newer sectors e.g. battery operated and hybrid transportation. We also expect newer sectors within India's diversifying economy to surface investable projects e.g. through the urban, smart cities or transportation sectors where valuations are expected to be more moderate in view of less established business models.

Venture debt is a nascent instrument with a mere handful of funds operating in India. We see an appetite in the industry for more such strategies which offer an investor a decent risk-adjusted return in view of the India and currency risk. Such instruments can also offer an investee company a choice not to dilute its equity substantially at an earlier stage. We also expect further growth in early and growth stage deals for pure play private equity players.

**What are your thoughts on the listed infrastructure trust scheme in India, with the recently launched IRB InvIT Fund? Do you think this type of investment vehicle will pick up? Will it offer a viable alternative for liquidity and exit provisions for infrastructure investments in India?**
InvITs allow predictable cash flows to be monetized making it a viable alternative for liquidity. These are early days and the liquidity will need to be tested over the medium and long term. The new asset class is expected to attract new and potentially large investors, such as pension, insurance or mutual funds, depending on the credit rating of the

sponsor of these and the quality of the underlying assets, to meet the risk/return profile such investors seek.

For investments locked in SPVs, these instruments will potentially unlock value without holding company discount that equity listings entail. Also these trusts match the investment and investment profile (e.g. low risk, low return) better than other available instruments. With these, investors looking for yield in stable assets get a direct investment opportunity in operating infrastructure asset class which better matches the longer-term horizons that they seek.

**What are your thoughts on the recently launched National Infrastructure and Investment Fund? Do you think it will jumpstart investments in infrastructure projects, or will it suffer from the same implementation and operational woes that other government agencies such as IIFCL have faced?**

The National Infrastructure and Investment Fund (NIIF) is a grand plan from the Government of India but the fund rightly faces initial scepticism from institutional players largely for not having a track record and still evolving as a concept. For the first time, perhaps, the government is playing the key role of an anchor investor to deepen the private equity & venture capital industry. Whether it is through the INR 10,000 crore allocation to catalyze the small, medium enterprises through the Fund of Funds route with the Small Industries Development Bank of India or SIDBI and India's flagship Start Up India program or through the INR 20,000 NIIF to unlock the wheels of the infrastructure structure through a combination of strategies such as the umbrella NIIF or the Fund of Funds approach such as the UK-India Green Growth Equity Fund, with a £120m anchor commitment each from the Government of the United Kingdom and the NIIF, or the platforms approach.

Given the hesitation of investors in view of the mixed track record of the infrastructure sector and the ability of private equity managers to generate a return in view of the implementation issues, the NIIF was designed to encourage investors into infrastructure and support good fund managers by providing a base of 49% equity. Whether state involvement is likely to encourage or inhibit international institutional investors depends on an investor's perception of the arms-length relationship with the government and the value in tackling policy barriers as well as evidence of following international best practices like the ILPA guidelines.

**Indian infrastructure projects have often suffered from poor implementation. For example, a sizeable portion of the toxic loans being held by Indian banks stem from non-performing infrastructure assets. Is this something that impacts your investments as well? What do you think the future holds? With Asset Reconstruction Companies becoming a possibility in order to absorb bad loans from banks, do you believe this will provide an opportunity for private debt/infrastructure debt/distressed debt funds in India?**

Certain infrastructure asset classes have underperformed both from an implementation and a revenue perspective. While some assets classes like renewables have generally exceeded growth estimations, assets like roads have in particular faced implementation challenges. One of the biggest challenges has been land acquisition. Newer models of infrastructure such as the HAM model etc. build upon the learning from earlier challenges. India is likely to see continuous improvement as institutions become better in developing the projects and lenders become smarter in assessing the risk.

Different Combinations of NBFC, ARC and distress funds are extremely bullish on India. Almost all big names are raising and investing large sums in the debt/ distressed space. It is expected that this space will continue to see a lot of action in the coming years. It is expected to have a positive impact in helping accelerate India's capex utilization rates which currently limit new credit growth.

**There has been talk of a land reform bill in India, which would go a long way to cutting red tape for real asset investments. What else needs to be done in terms of reforms in order to make infrastructure investments in India more attractive?**

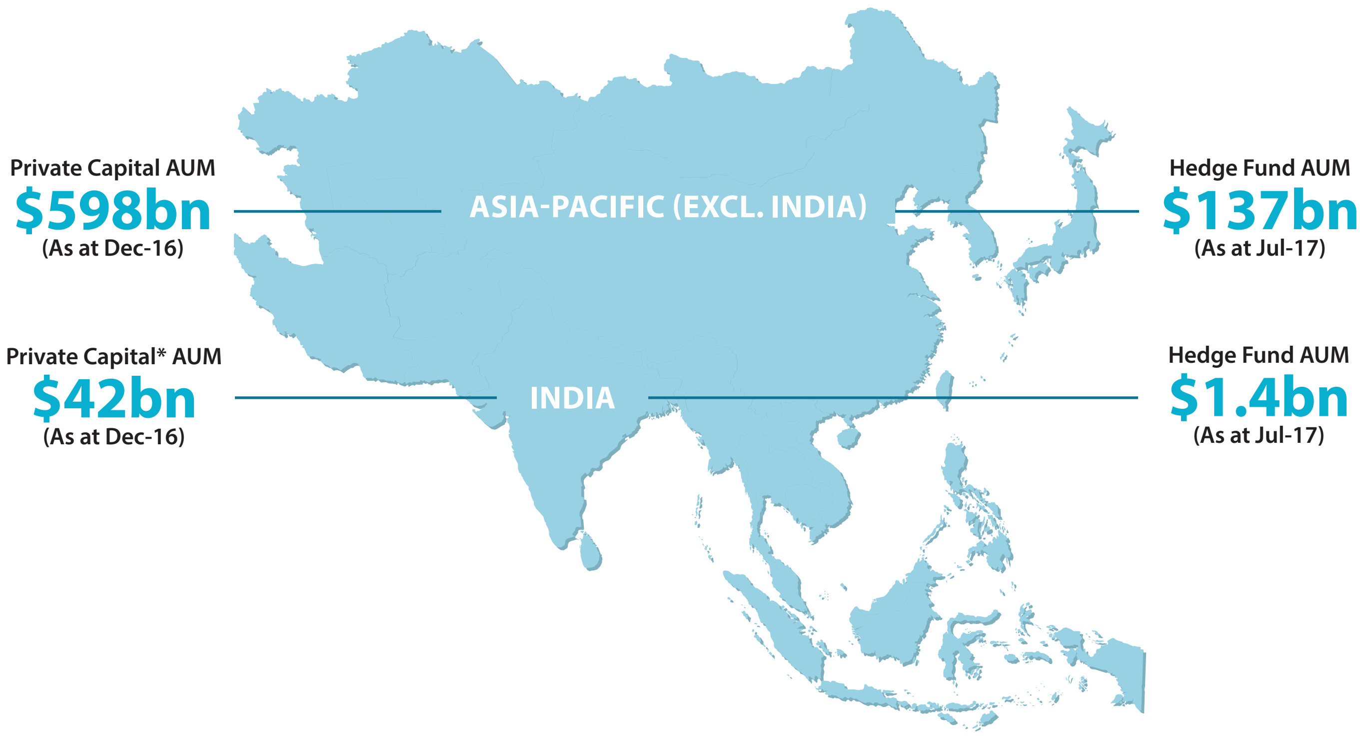
Land acquisition reform is right at the top of what is needed for better execution of projects, big and small. India can benefit from greater competition from global construction firms which in turn require a more predictable bidding environment and larger deal sizes. Some of these firms in turn are well positioned to attract global project finance. This will lift the quality of India's project finance market itself (which is now almost wholly dominated by domestic banks). Finally, enforcement of contract and speedier resolution of litigation is required for a thriving business environment – especially for infrastructure. The government is currently far more reform minded and is able to address legacy issues in the economy across sectors such as mining, coal, power etc.

**NEEV FUND**

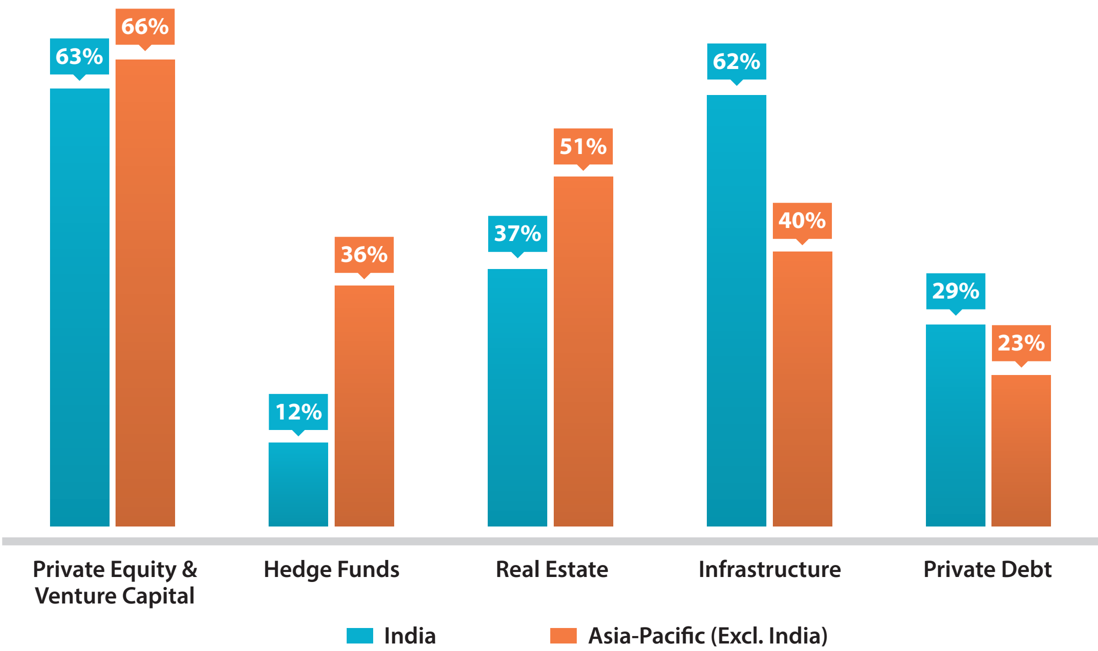
The Department for International Development (DFID), of the Government of the United Kingdom, joined hands with the State Bank of India (SBI) Group to set up the NEEV Fund, India's first low income state infrastructure Fund, which was launched by Prime Ministers Cameron and Modi in November 2015. The investment strategy of the Fund entails supporting small infrastructure companies and projects in sectors such as clean energy, agri-infrastructure and urban infrastructure. NEEV Fund aims to increase investor interest in the low income states and pro-poor sectors.

# IN FOCUS: INDIA VS. ASIA-PACIFIC

ASIA-PACIFIC-BASED ALTERNATIVE ASSETS UNDER MANAGEMENT




ASIA-PACIFIC-BASED INSTITUTIONAL INVESTORS ALLOCATING TO EACH ALTERNATIVE ASSET CLASS BY LOCATION (AS AT AUGUST 2017)




*Due to the immaturity of the natural resources market in India, the AUM figure could not be calculated for this asset class at present.*

# THE ALTERNATIVE ASSETS INDUSTRY IN INDIA - KEY FACTS

The alternative assets industry in India is worth a significant $43bn in assets under management across private equity, venture capital, real estate, infrastructure, private debt and hedge funds*. With 221 private capital fund managers and 46 hedge fund managers based in the country, the alternative assets industry is a small but growing space in India.

The majority (60%) of India-based institutional investors allocate to at least one alternative asset class. This may be indicative of how many investors in India recognize the benefits of exposure to alternatives, which may include low correlation to traditional asset classes, such as equities and fixed income, and the potential for high risk-adjusted returns.

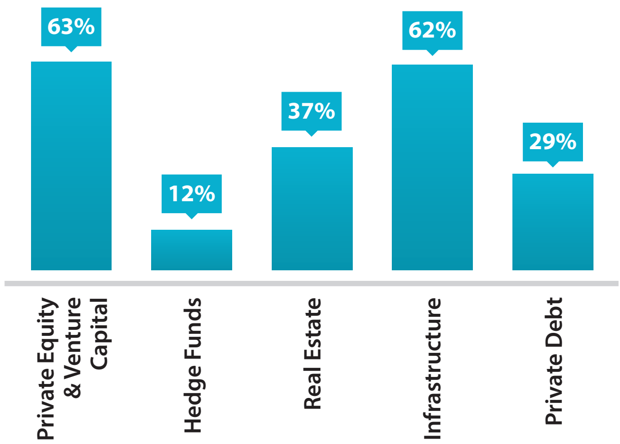
Private equity & venture capital (63%) and infrastructure (62%) are the most prominent asset classes among India-based investors.

## $43bn
Assets under management of the **alternative assets*** industry in India.

## 221
Number of **private capital** fund managers located in India.

## 4,534
Number of **venture capital** financings in India since 2008 (worth an aggregate $32bn).

### PROPORTION OF INDIA-BASED INSTITUTIONAL INVESTORS ALLOCATING TO EACH ALTERNATIVE ASSET CLASS




> ***The government's policy making has been supportive to the private equity industry. The Alternative Investment Funds (AIFs) category has benefitted from simpler regulations in structure plus efficient transfer of assets including tax and dividend distribution where the views of the industry were taken on board and acted upon***
>
> ***– DFID India and SBI Capital Markets***

**Private equity** and **infrastructure** are the most preferred alternative asset classes among India-based investors, with 63% and 62% of India-based investors allocating to each asset class respectively.

## 60%
of India-based institutional investors invest in at least **one alternative asset class**.

## 63%
Private wealth (wealth managers and family offices) makes up the largest proportion of investors in **hedge funds**.

**Due to the immaturity of the natural resources market in India, the AUM figure could not be calculated for this asset class at present.*

# AIFs IN INDIA
## - Navita Yadav, **Vistra ITCL**

### 1. LANDSCAPE OF ALTERNATIVE ASSETS IN INDIA

Alternative investments mainly comprise private equity (PE) and debt as well as business trusts. Since business trusts in India are in the preliminary and evolving stage, this article will mainly focus on the landscape of Alternative Investment Funds (AIFs) in India.

AIFs refer to any privately pooled investment fund (whether from Indian or foreign sources) in the form of a trust, company, body corporate or Limited Liability Partnership (LLP) which is not covered by any regulation of the Securities and Exchange Board of India (SEBI) governing fund management, nor under the direct regulation of any other regulator such as Insurance Regulatory and Development Authority (IRDA), Reserve Bank of India (RBI) or Pension Fund Regulatory and Development Authority (PFRDA). So AIFs include the likes of hedge funds, venture capital funds, commodity funds and so on and so forth.

AIFs perform a chain of activities beginning with the mobilization of the savings of individuals directly, or indirectly through institutions such as pension funds, insurance companies, banks and endowments, and investing them in promising enterprises, adding strategic value to portfolio companies, monitoring the investments and exiting with the aim of realizing a reasonable risk-adjusted return.

Gradually, affluent, high-net-worth and family office investors in India are using alternative investments in their portfolios over and above their existing stocks, bonds and cash investments.

Specifically, for India, there are three types of AIFs: Category I, Category II and Category III.

Category I includes start-ups, early stage ventures, small and medium enterprises (SMEs) and infrastructure and are closed-end funds.

Category II are typically PE/debt funds with no specific incentives of concessions. They do not employ leverage or borrowing and are closed-end funds.

Category III includes hedge funds – diverse/complex trading strategies and may employ leverage. This category includes both open-ended and closed-end funds.

### 2. PREFERRED JURISDICTION FOR FUND FLOW IN INDIA

As per the second report of The Alternative Investment Policy Advisory Committee dated 1 November 2016, the bulk of private equity & venture capital investments have come from overseas through jurisdictions such as Mauritius and Singapore.

There was some market hesitation about the changes introduced by the amendment of the India-Mauritius and India-Singapore tax treaty as it gives India a source-based right to taxation of capital gains arising out of sale of shares.

However, the amendment should be seen as a welcome change as it brings certainty coupled with easing of tax rates in India and added benefits in respect of interest income. Mauritius will now emerge as the preferred jurisdiction for debt considering the lower withholding tax rates for interest income.

Further, investments through Mauritius will be less likely to be questioned under the General Anti-Avoidance Rules (GAAR), which allow Indian tax authorities to re-characterize transactions on grounds of lack of commercial substance, among other things, and has come into effect from 1 April 2017.

The amendment can also be seen as India's attempt to comply with the Base Erosion and Profit Shifting (BEPS) action plan towards removing the non-double taxation.

The re-negotiation of beneficial tax treaties and other steps taken by the Indian Government indicate its intention of achieving a stable tax regime. The stated tax policy of the government is to plug tax leakages while providing a certain and predictable tax landscape to investors. In the long run, stability, predictability and fairness of the tax system can prove to be far more attractive and reassuring to a foreign investor than uncertainty on taxation of shell entities.

### 3. MARKET GROWTH

Between 2001 and 2015, venture capital and private equity of more than $103bn was invested in Indian companies. These investments were made in more than 3,100 companies across 12 major sectors, including those critical for the country's development. The enterprises have ranged from start-ups to mature, mid-sized companies[1].

A significant portion of these investments have been made by global fund managers operating India-focused offshore funds, global fund managers operating in India and India-based fund managers operating offshore funds, investing in the form of foreign direct investment (FDI).

Both manufacturing and services sectors attracted foreign equity participation in FY 2015-2016. While the manufacturing sector accounted for around half of the total FDI, 'Information and Communication Services' (20.1%) and 'financial and insurance activities' (11.2%) were the other major activities attracting FDI [2].

#### 3.1. Trends of Capital Flow*

FY 2016-17 witnessed a total inflow of funds from foreign portfolio investors

*1 Second report of The Alternative Investment Policy Advisory Committee dated 1 November 2016*
*2 RBI Census on Foreign Liabilities and Assets of Indian Direct Investment Companies for 2015-16*

(FPI, including FII and QFI) to the tune of $7.45bn, out of which $8.57bn was comprised of equity components, and there was a negative inflow of $1.12bn in the debt market. In contrast, during the FY 2017-2018, FPIs invested over $15bn in India up to 23 August 2017, of which 6.24% was equity and the balance has been through debt[3].

**3.2. FPI Entry Statistics in India***
Among the source countries for FDI, Mauritius had the largest share (20.8%) followed by the US (17.4%), UK (15.1%), Singapore (10.9%) and Japan (8.0%)[4].

**3.3. Investment Climate in India**
The economy as a whole performed well in 2016, growing over 7% with a stable rupee and political stability throughout the country. The Reserve Bank of India has taken a number of steps in the recent past to bring these offshore activities onshore, in order to deepen the domestic markets and enhance downstream benefits.

All these steps have seen an increase in foreign investment in India. With FDI flowing in substantially in the form of debt, one can safely presume that the offshore investors look at India as an avenue to secure fixed returns on investments and the risk appetite for equity, although increasing, is only marginal.

## 4. POPULAR INVESTMENT MODELS
There are three options available to set up a fund structure as an AIF in India, namely: (i) Trust (ii) LLP (iii) Company.

Almost all funds formed in India use a trust structure. The regulatory framework governing trust structures is stable and allows the management to write its own standard of governance. The trustee is in charge of protecting the interest of the beneficiaries/contributors. It is regarded as the legal owner of all the assets vested in the trust. Having an independent trustee thus becomes critical to ensure that the fund manager effectively carries out the functions assigned to it, that the trust complies with all the applicable laws and that the interest of contributors is well looked after.

Only a few funds are registered in the form of LLPs. The Registrar of Companies (RoC) does not favour providing approvals to investment LLPs. As per section five of the LLP Act 2008, only an individual or a body corporate is eligible to be a partner in an LLP.

There are no precedents for raising funds in a company structure.

As of 30 April 2017, there were 315 AIFs registered with SEBI.

India has seen a lot of movement in the alternate investment segment with over $14.77bn of commitments raised through the AIF route alone as of 30 June 2017[5].

**Sectors of Economy (As of 30 June 2017)**

| | Commitments Raised | Funds Raised | Investments Made |
|---|---|---|---|
| Category I | 3.43 | 1.25 | 0.97 |
| Category II | 8.93 | 4.23 | 3.41 |
| Category III | 2.40 | 1.89 | 1.66 |

Amount in US$bn (exchange rate US$1 – INR 65)

## 5. GOVERNANCE STRUCTURE
Due to the focus on digitization in the new era, SEBI introduced online filing of applications for AIF as well as the quarterly compliance reports. This would ensure transparency in the process, quick turnaround times and enable the fund managers to track the status of their applications.

The government and SEBI have been taking active steps to ensure there are clean and transparent governance practices adopted in financial markets at all levels by various entities operating in India. Strong and robust corporate governance norms have begun to see the light of day in the form of various measures such as laying express corporate governance policies in the documentation, in-built checks and balances in conduct of activities, tax and other regulatory reforms etc.

The importance of an independent player has received wide acceptance in structures being formed in India as well as on a global level. Vistra ITCL has emerged as a leading market player in terms of providing services of an independent fiduciary trustee to various funds and other structures operational in India.

3 *National Securities Depository Limited ('NSDL')*
4 *RBI Census on Foreign Liabilities and Assets of Indian Direct Investment Companies for 2015-16*
5 *SEBI*
**The figures used in this paragraph are for total FPI investment and are not necessarily restricted to alternative assets.*

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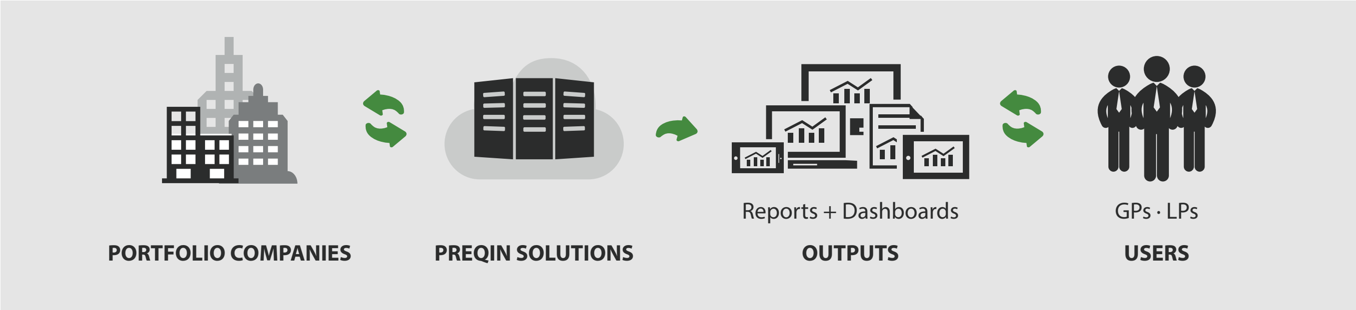


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# THE ALTERNATIVE ASSETS INDUSTRY IN INDIA

With a total of $43bn in assets under management (AUM), the alternative assets industry (taken to include private capital* and hedge funds) in India is relatively small but undeniably significant – and evidently growing. The country itself has seen the government take new measures to transform India's financial market and grow the economy, presenting many unique opportunities (and sometimes challenges) for homegrown fund managers as well as the domestic and foreign investors targeting alternative investments in India.

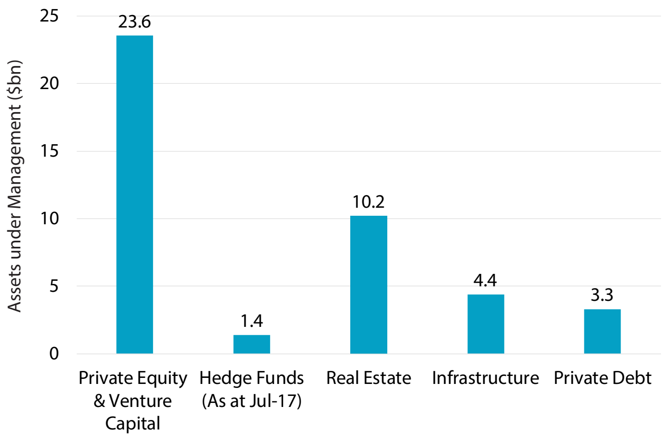
Using Preqin's market-leading alternative assets databases, this report provides an in-depth review of recent fundraising, investor activity and key statistics across five alternative asset classes in India.

## SIZE OF THE INDUSTRY

Fig. 1.1 shows that private equity & venture capital has the largest capitalization of the alternatives market in India, accounting for $24bn in unrealized value and dry powder (taken together to represent AUM), more than all other asset classes combined ($19bn). Looking at the data more closely in Section 2: Private Equity & Venture Capital, we can see that growth funds are the largest contributor to this figure with $14bn in AUM.

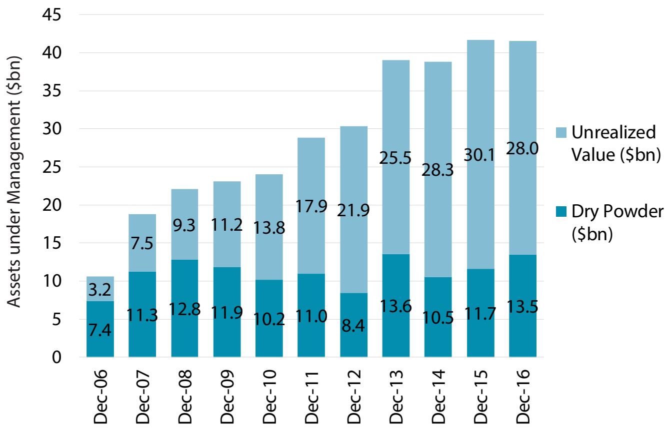
Private capital* assets have increased year-on-year generally since 2000, with the notable exception of the most recent year (as at December 2016), when the industry contracted slightly but recorded the highest amount of dry powder since 2013, indicative of the substantial amount of capital that fund managers are yet to deploy (Fig. 1.2).

**Fig. 1.1: India-Based Alternative Assets* under Management by Asset Class (As at December 2016)**



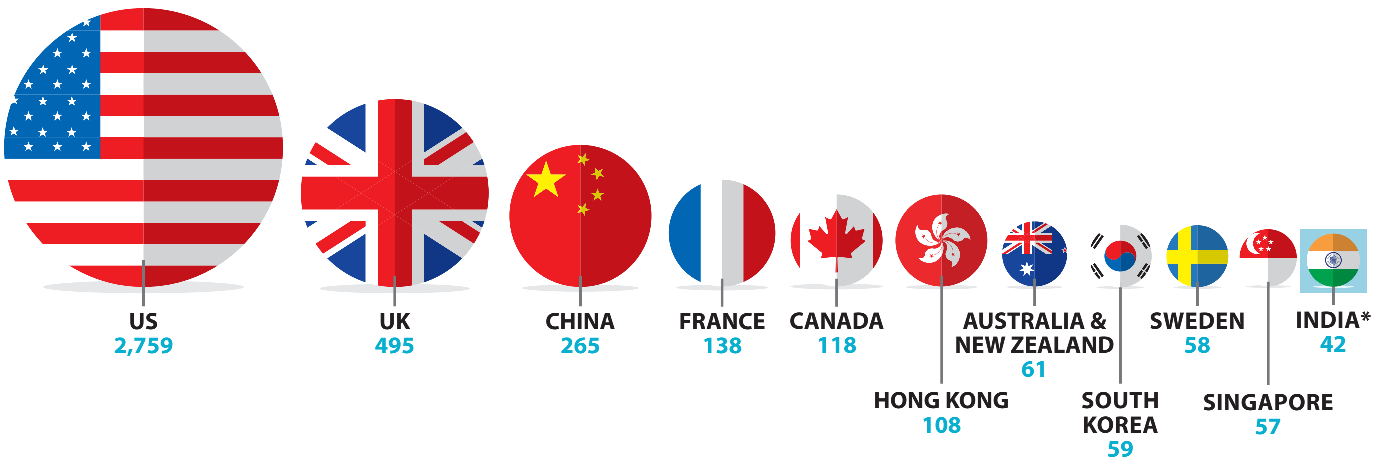

*Source: Preqin*

**Fig. 1.2: India-Based Private Capital* Assets under Management, 2006 - 2016**




*Source: Preqin*

**Fig. 1.3: Private Capital** Assets under Management ($bn) by Fund Manager Location (As at December 2016)**




*Source: Preqin*

*Due to the immaturity of the natural resources market in India, the AUM figure could not be calculated for this asset class at present.*

**Private capital (for each country listed except India) refers to the closed-end alternative asset classes of private equity, private debt, real estate, infrastructure and natural resources.*

Compared to other major markets, the alternatives industry in India remains in its infancy, with other countries in Asia-Pacific such as China ($265bn) and Hong Kong ($108bn) notably more established, as shown in Fig. 1.3.

> ***With a total of $43bn in assets under management (AUM), the alternative assets industry in India is relatively small but undeniably significant – and evidently growing***

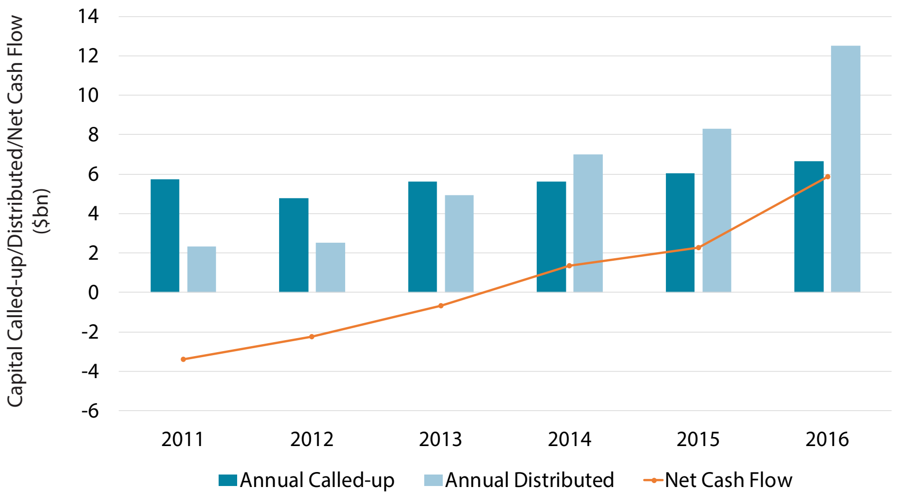
### FUND MANAGERS

The number of active private capital firms in the industry has increased annually, as seen in Fig. 1.4, indicative of the growing and burgeoning industry in India. Fig. 1.4 further illustrates the number of new firms launched each year versus active existing firms. The period 2005-2007 saw a rapid acceleration in the number of active India-based private capital firms. However, the rate at which new private capital firms in India entered the industry immediately slowed after 2008, perhaps indicative of how the financial crisis affected new firms entering the market during this time. As at September 2017, there are 221 India-based private capital firms active in the industry, and 16 new firms have entered the market so far this year (based on the vintage year of the first fund representing the year the firm was first established).

**Fig. 1.4: No. of Active India-Based Private Capital* Firms over Time, 2000 - 2017 YTD (As at September 2017)**


*Source: Preqin*

**Fig. 1.5: India-Based Private Capital* Funds: Annual Capital Called and Distributed, 2011 - 2016**




*Source: Preqin*

### PERFORMANCE

Performance data recorded by Preqin shows how much capital has been distributed back to LPs from India-based GPs. Estimated full-year distributions from India-based private capital funds in 2016 reached $13bn, continuing the three-year run of positive net cash flows to investors from funds in the region (Fig. 1.5). The success of 2016 was fuelled primarily by real estate and growth funds whose distributions accounted for 41% and 34% of the total distributions respectively. This improvement in cash flow to investors shows the existing value creation in the region and the potential for further growth. With large amounts of capital still to be realized from fund portfolios, there is potential for these high distributions to continue, assuming favourable exit conditions continue in the coming years.

### INVESTORS

Fig. 1.8 shows that a significant proportion (40%) of India-based institutional investors do not invest in alternatives, reiterating the relative unfamiliarity of the alternatives market for investors in India. However, as these institutions develop and mature, we may see this proportion shrink, as the demand for alternative investments to maximize portfolio diversification increases, as does their familiarity with the alternatives market.

Private equity & venture capital and infrastructure are the most prominent alternative asset classes among India-based investors: 63% and 62% of India-based investors allocate to each asset class respectively (Fig. 1.9). To a smaller but not insignificant degree, notable proportions of investors in India also allocate to real estate (37%) and private debt (29%). Only 12%, however, invest in hedge funds.

**Private capital in India refers to the closed-end alternative asset classes of private equity, private debt, real estate and infrastructure.*

### Fig. 1.6: Top 10 Performing India-Based Private Capital Funds (All Vintages)**

| Fund | Firm | Vintage | Fund Size (mn) | Fund Type | Net IRR (%) | Geographic Focus | Date Reported |
|---|---|---|---|---|---|---|---|
| ChrysCapital III | ChrysCapital | 2004 | 258 USD | Growth | 89.2 | India, US | 30-Sep-17 |
| India Value Fund I | True North | 2000 | 35 USD | Buyout | 34.0 | India | 30-Sep-17 |
| Baring India Private Equity Fund | Baring Private Equity Partners (India) | 1998 | 40 USD | Growth | 32.0 | Bangladesh, India, South Asia, Sri Lanka | 30-Sep-17 |
| ASK India Real Estate Special Opportunities Fund (Offshore) | ASK Property Investment Advisors | 2014 | 82 USD | Real Estate | 27.0 | Asia, BRIC, Emerging Markets, India, South Asia | 31-Mar-16 |
| ASK Real Estate Special Opportunities Portfolio I | ASK Property Investment Advisors | 2009 | 3,170 INR | Real Estate | 23.0 | India | 31-Mar-16 |
| Milestone Domestic Scheme III | Milestone Capital Advisors | 2012 | 3,940 INR | Real Estate | 21.0 | India | 30-Sep-16 |
| Inventus Capital Partners I | Inventus Capital Partners | 2007 | 52 USD | Venture Capital (All Stages) | 18.8 | India | 31-Mar-17 |
| ChrysCapital I | ChrysCapital | 1999 | 64 USD | Growth | 17.9 | India, Mauritius | 30-Sep-17 |
| YourNest Angel Fund | YourNest Capital Advisors | 2012 | 900 INR | Early Stage: Start-up | 17.8 | India | 30-Jun-17 |
| India Asset Growth Fund | Essel Finance | 2014 | 2,094 INR | Real Estate | 17.3 | India | 31-Dec-16 |

***Compiled from a universe of 42 funds fulfilling the selection criteria.*

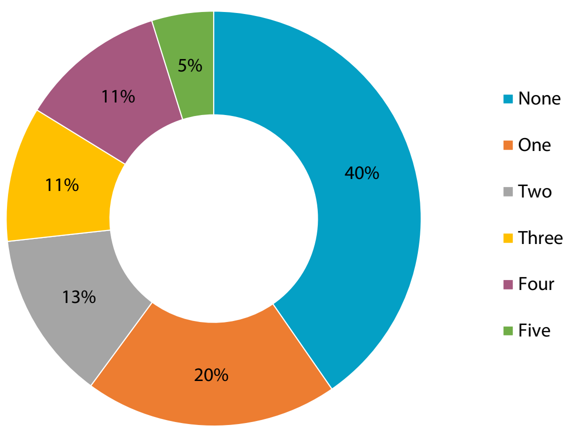
*Source: Preqin*

### Fig. 1.7: Notable Top Performing India-Based Hedge Funds (As at July 2017)

| Fund | Manager | Core Strategy | 12-Month Net Return (%) |
|---|---|---|---|
| Redart Focus Fund | Redart Capital | Long/Short Equity, Value-Oriented | 34.24 |
| Karma STAR Fund | Karma Capital Management | Long/Short Equity | 28.09 |
| Malabar India Fund | Malabar Investment Advisors | Long Bias | 25.46 |

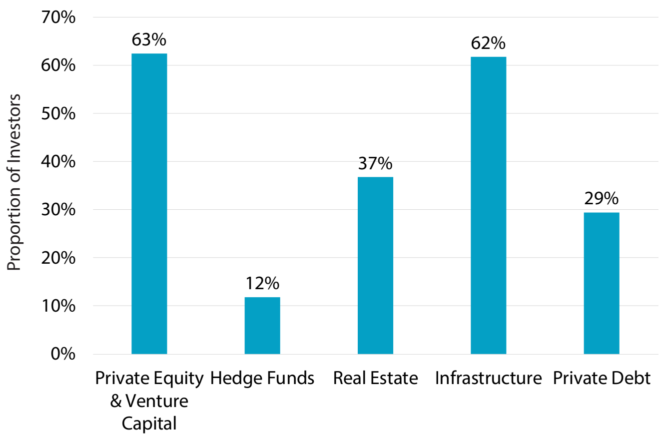
*Source: Preqin Hedge Fund Online*

### Fig. 1.8: India-Based Institutional Investors by Number of Alternative Asset Classes Invested In (As at August 2017)




*Source: Preqin*

### Fig. 1.9: India-Based Institutional Investors Allocating to Each Alternative Asset Class (As at August 2017)




*Source: Preqin*

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# SECTION TWO: PRIVATE EQUITY & VENTURE CAPITAL

# NAVIGATING THE INDIAN PRIVATE EQUITY LANDSCAPE

## - Gaurav Ahuja, **ChrysCapital**

**How is the fundraising environment for India? What are LPs looking for in Indian GPs?**

While LPs are warming up to India, they are taking a very cautious approach and focusing more on individual realized track records, rather than the overall macro or the "India potential". Only $50bn has been realized from $80bn invested in India prior to 2015, representing roughly a third of the overall cost, and LPs want to see a strong realized track record and consistent realizations before committing to a particular GP. Unfortunately, this LP concern runs deep with not just the emerging local managers struggling to get exits, but even some of the established GPs having disappointed on exits and realizations.

It is becoming harder to raise a fund on a story anymore – GPs trying to raise their third or fourth funds without showing meaningful realizations from prior funds will face significant challenges. It is not about how large investment and operating teams are: the more relevant question being asked is "after five, seven, 10 years, what has your team delivered?"

This has led to capital flowing to global and pan-Asian funds. LPs have favoured broader mandates rather than taking country-specific risk leading to mega fund raises, with global funds raising $10-20bn and pan-Asian funds raising $3-9bn. However, this trend is working in favour of the better performing, well-capitalized local funds – the mega funds are focused on larger ticket sizes of $100mn+, leading to lower competitive intensity for smaller check sizes of <$75-100mn where the local funds play, and increased appetite for exits that may be worth $200mn+.

To sum up, India is being viewed more positively than in the past, but discussions are becoming more manager-specific, and seasoned managers with strong distributions should have no issue raising capital.

**What are your thoughts on current valuation levels seen in the Indian markets?**

Valuations are generally high across the board and this certainly requires the GP to work harder and be more disciplined – you need to understand the sectors and companies you are looking to invest in even better than you have in the past.

GPs need to use their experience and sourcing engine to go deeper within sectors to identify either lesser-known, under-appreciated sub-segments where valuations are more reasonable, and/or identify areas where the growth potential is enticing enough to pay the higher valuation. An example could be focusing on pharma, where return on capital is higher and valuations more reasonable at a time when the industry is more focused on hospitals with lower return on capital and higher valuations. Another example is looking at smaller IT companies, at the $100mn revenue level, while the industry is focusing on larger $250-300mn revenue size companies. For digital IT services – which is the fastest growing area within IT services – one could consider paying a higher multiple given the superb growth potential. However, these insights only come from deep investment experience in these sectors and a structured sector strategy and coverage – basically sector specialization.

Another way to find attractive opportunities in an expensive market is to create them. For example, we are working with industry veterans to identify and invest in platform or control opportunities that may be underperforming in one or two areas, but allow us an attractive entry point and create the potential to deliver outsized returns. These are not turnaround situations, but opportunities in cash-generating companies where the existing management has taken it to a certain level and requires help in scaling up further. Here, we can leverage our 80+ years of industry experience to take these companies to the next level.

It is some of these strategies that have allowed us to construct an exciting portfolio at a meaningful discount to publicly listed comparables as well as the valuations we see in other private transactions. In fact, given where public markets are currently at, we are finding more attractive opportunities on the private side – over 75% of our investments in the past five years and 90%+ of investments from our latest fund, ChrysCapital VII, have gone into private companies (both in minority and control situations). Incremental pipeline is exclusively on the private side across very exciting minority, control and platform opportunities.

**What do GPs need to do in order to navigate this high valuation environment?**

We are sector specialists in IT, financial services, healthcare and consumer – and are sticking to these sectors that we know extremely well. Within these sectors, we are proactively reaching out to a greater number of companies in order to deepen our understanding and refine our sector theses. Being proactive allows us to identify breakout opportunities before the market and allows us to augment our intermediated deal flow with a strong representation from proprietary deal flow as well, which is at more reasonable valuation levels. It also allows us to demonstrate to the entrepreneur that we understand his/her sector well, have seen the full lifecycle (investment to exit) of several investments, have industry experts on our team and thus have the ability to truly add value to his/her business.

While mostly everyone will speak about the same sectors, being a sector specialist allows you to source deals at a deeper level where your understanding is superior and/or others may not be looking for opportunities.

Another way to navigate an environment of high valuations is to divert the focus away from pure valuation discussions. If you look at the venture experience in the US, the best venture capital (VC) firms get to see the best opportunities first – entrepreneurs seek out these VC firms. The discussion is not all about valuations, but as a start-up, can I leverage your ecosystem to increase my probability of success? This is what Indian GPs have to evolve into – sector specialists! Entrepreneurs will then seek out the sector specialists for their industry experience, their networks, their endorsement value – and this will also allow GPs to invest at reasonable valuations.

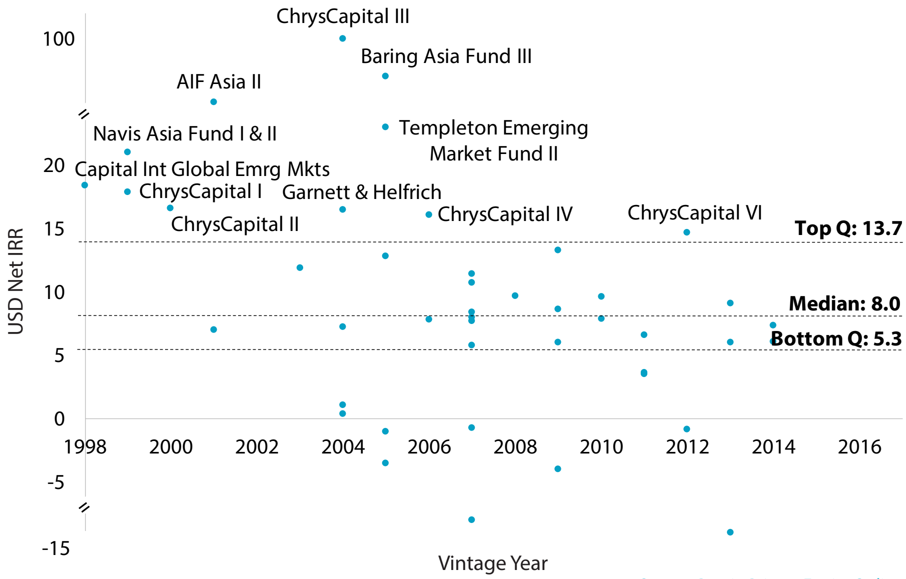
We see this happen even more in situations where a particular GP is exiting its stake, but the company is not raising primary capital. Given there will be no dilution for the entrepreneur, the entrepreneur is less fixated on the highest valuation, but more focused on bringing on a partner with strong industry experience that can truly add value to his business – this is why sector specialization is becoming increasingly important.

**Are you finding that entrepreneurs are now more open to GP feedback? In general, how has the nature and level of your interaction with portfolio companies developed over time?**
Receptivity to feedback is more sector specific and individual style specific. There are certain sectors in India which are more professionally managed and where management teams come from global backgrounds – such as IT, financial services, healthcare, consumer. Entrepreneurs and management teams in these knowledge sectors are more receptive to feedback and open to be influenced using data and your sector experience.

Engagement and influence in these companies is not determined by your stake in the company, but rather by your

### Top Performing Funds Investing in India (USD Net IRRs)

| Vintage | Max Net IRR | Min Net IRR | Median Net IRR | No. of Funds |
|---|---|---|---|---|
| Pre-2003 | 39.7% | 7.0% | 18.2% | 6 |
| 2003-2005 | 89.2% | -5.6% | 11.9% | 11 |
| 2006-2009 | 16.1% | -11.2% | 8.0% | 15 |
| 2010-2014 | 14.7% | -15.7% | 6.3% | 12 |




*Source: Preqin Private Equity Online*

*Note: Peer set includes PE funds over the last 20 years where:*
*- Net IRR is available*
*- Fund size between $50mn-$2bn*
*- Data that that has been updated post 2016*

sector experience – are you viewed as a sector specialist? Have you seen many full lifecycles of investments in their sector? What is your track record in their sector? Are you considered a thought leader in their sector? Do you have industry veterans on your team? If one can demonstrate sector specialization through a strong realized track record and in-house industry operating experience, then management teams are open to working with GPs to enhance shareholder value for all stakeholders.

It is no secret that private equity firms will have to optimize multiple functions within their portfolio companies to continue delivering excess returns – the company you exit has to look different from the company you invested in, that is where the alpha will come from. We take portfolio engagement and operational value-add very seriously as well. In fact, one of our recent initiatives has been around creating an independent portfolio management cell called Enhancin. The Enhancin team will draw upon our 80+ years of industry operating experience and work alongside our deal teams to optimize and enhance the operations of our portfolio companies. Now, it is interesting to note that more than two-thirds of our portfolio companies have seen EBITDA margins expand over our holding period, and so much of this has already been happening at the deal team level – Enhancin is just another way to deepen our engagement with our portfolio companies and create incremental value from operational improvements.

**How can an Indian GP differentiate itself in a market that may start to get cluttered soon?**
Globally, there would be three broad ways to differentiate yourself as a GP – by size (small, mid, large), strategy (early stage, growth, buyout), or sector specialization (business services, healthcare, financial services, industrials, etc.). Given that India is not a very deep market – $10bn invested annually; 60-65% growth investments, 25% early stage, and 10-15% buyout/control – we have found it most

appropriate and rewarding to be sector-led with a minimum deal size of $20-25mn. This way we can cover 75-80% of the addressable market across both growth and control opportunities in sectors where we have strong capabilities.

After making 80 investments over the past two decades and successfully completing exits from 65-odd companies, we do not feel constrained by the deal construct, whether it is minority or control. Our investment team has been covering our focus sectors for the past decade, decade and a half. We have three executives with over 30 years of industry working exclusively with us. We have a network and roster of industry veterans and CxOs whom we can rope into an MBO, MBI or any other control situation. Investing in businesses and in sectors that we understand extremely well or in other words being sector specialists is more important than specializations around size or strategy.

**Can you discuss the exit environment over the past few years and how ChrysCapital has navigated it?**

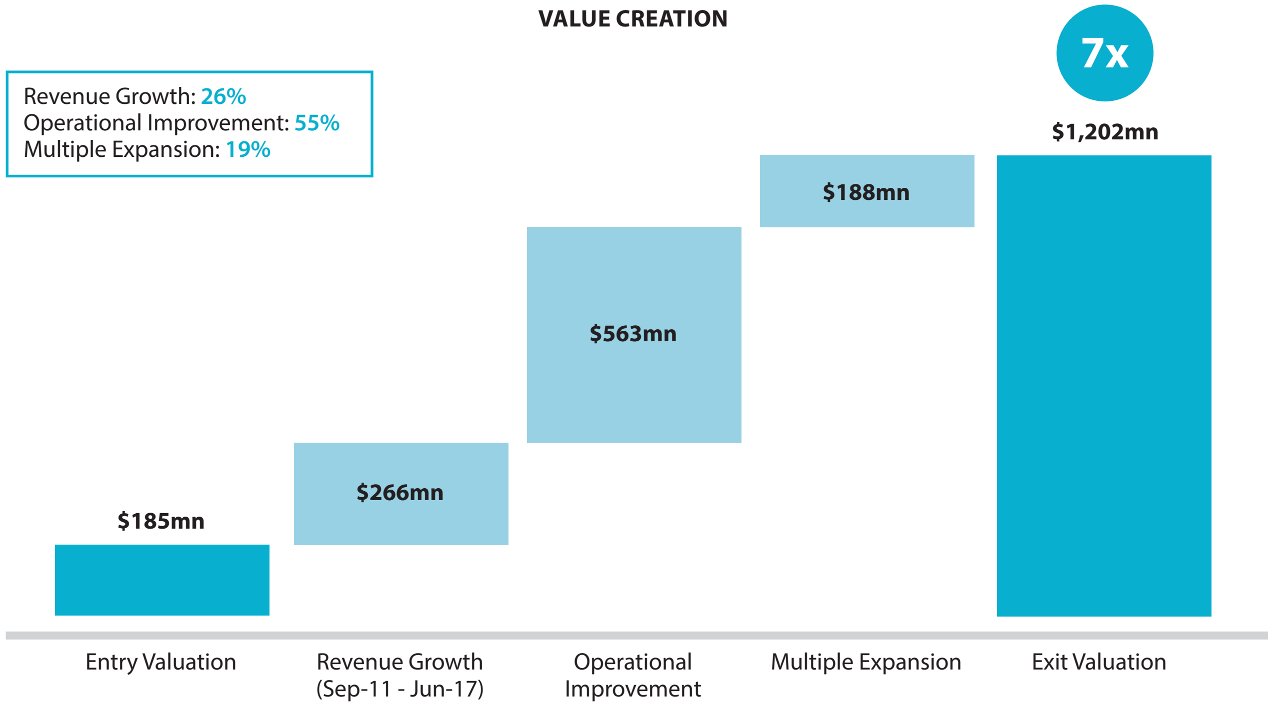
In general, I would say that the environment is conducive to exits. We have seen $10bn of exits in 2015 and 2016 each, and $7bn exited year to date in 2017. IPO markets have been instrumental in this – 50 IPOs in the past 18 months have raised over $10bn with 60% of these proceeds being secondary sales by investors. LPs are also cognizant of this trend and pushing their GPs for exits – they, too, understand that if you cannot exit in this market, then there is permanent impairment in the underlying portfolio.

You have to understand that lack of exits is the top of mind concern for LPs investing in India. Even today, with exits having picked up on an absolute basis, realizations are still lacking relative to the

## Case Study: Eris

**ChrysCapital V | Pharma/Healthcare | Private**
Investment Date: August 2011
Exit Date: June 2017

- One of the fastest growing Indian pharma companies
- Favourable chronic mix drove strong revenue growth and operating leverage




*Note: Financials translated to US$ for convenience at Rs.65.0/$*

amount of capital that has been invested in India. Many GPs have large unrealized portfolios and funds extended beyond their scheduled lives – it is important for us as an industry to continue to deliver realizations back to LPs.

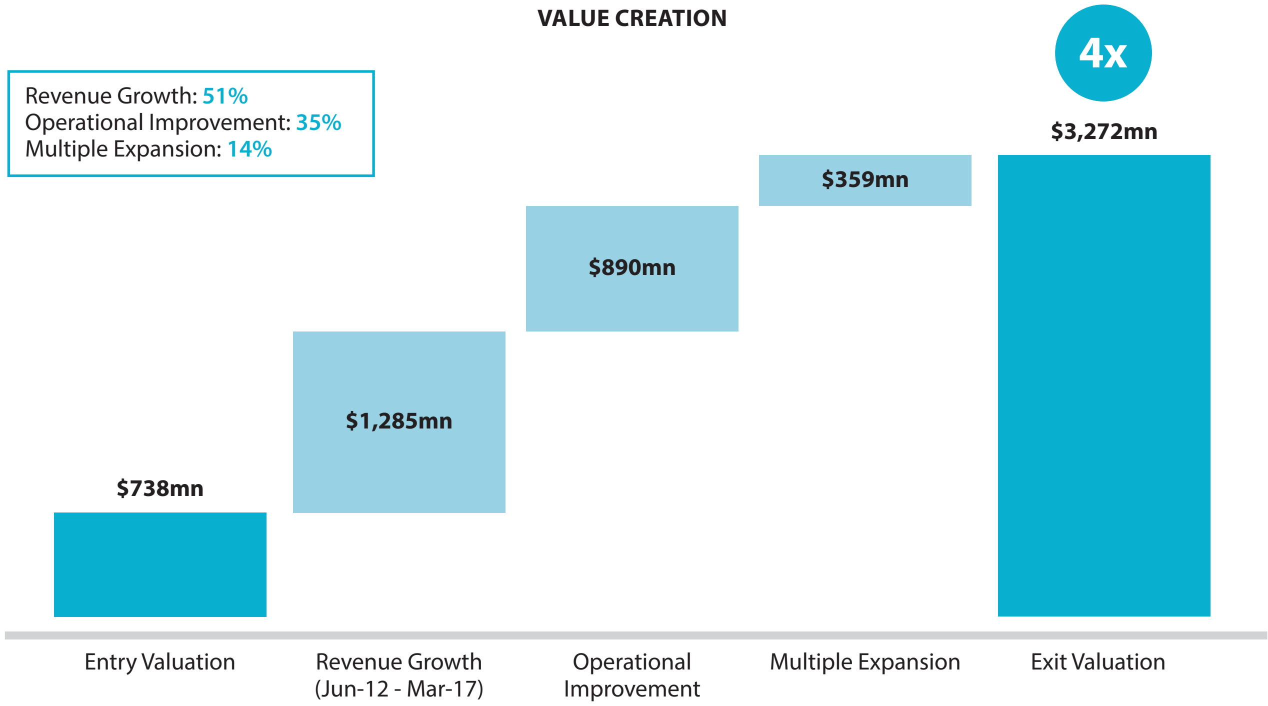
Exits are an important aspect of our business and our sharp focus on exits has allowed us to have a very different experience than the rest of the industry. We have completed close to 65 full exits, successfully monetized five of our prior funds with very strong returns and overall realized $5bn from our exits. To put things in context – our $2.6bn in investments is about 2-2.5% of the total dollars invested in India, but our $5bn in realizations is about 10% of total realizations from the Indian private equity industry. We have taken 10 companies public in the past 12 years, which is the most by any private equity firm in India. We have realized $2bn in just the past three and a half years itself, which again is a very large number in the context of the overall industry. The difference – invest in good sectors (sectors with a strong underlying growth and ROCEs) that you understand extremely well and choose the best risk-reward, rather than restricting yourself by minority versus control constructs.

## Case Study: Intas Pharmaceuticals

**ChrysCapital V | Pharma/Healthcare | Private**
Investment Date: June 2012
Exit Date: March 2017

- 10th largest domestic formulations company (4th largest in chronic) with a large export business
- Focus on chronic therapies for domestic and niche therapies (oncology & injectables) for export markets

**VALUE CREATION**




*Note: Financials translated to US$ for convenience at Rs.65.0/$*

**CHRYSCAPITAL**
ChrysCapital is one of the largest and most established India-focused private equity firms with over $3bn under management across seven funds. The firm has a strong sector specialization in Business Services, Financial Services, Healthcare and Consumer and looks to make minority and control investments in these sectors. ChrysCapital's investment team has over 150 years of investing, as well as over 80 years of industry operating experience. Since its inception in 1999, the firm has deployed over $2.5bn across 80-odd investments. ChrysCapital has also successfully fully monetized its first five funds with strong net USD returns and realized $5bn from close to 65 full exits.

**www.chryscapital.com**

# ASSETS UNDER MANAGEMENT AND DRY POWDER

The private equity & venture capital industry in India has grown significantly in recent years, with assets under management (AUM) standing at $23.6bn as at December 2016 (Fig. 2.1). While the most recent figure is one of the highest on record for the country, total assets are down by approximately $100mn compared to 2015 ($23.7bn). However, if the upward trajectory of private equity assets continues, this will be only a minor setback in an otherwise growing industry.

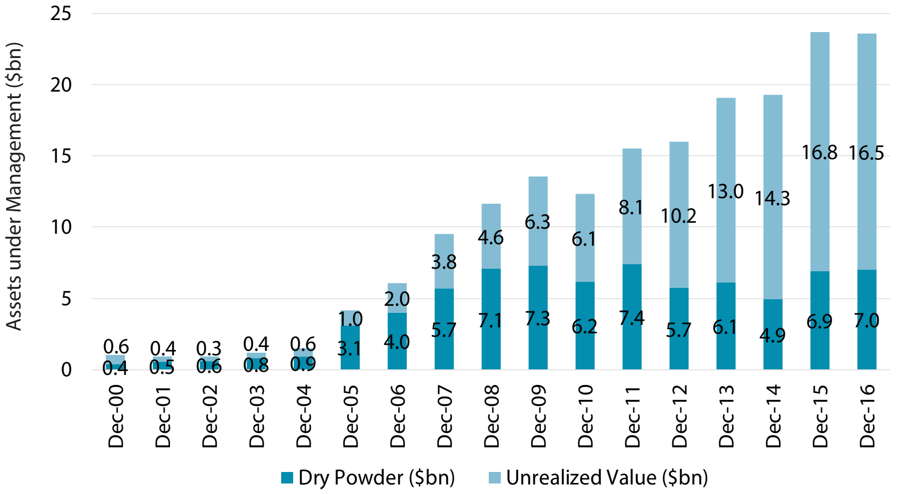
### STRATEGIES

Growth funds represent the largest share of the private equity & venture capital market in India, accounting for $14bn in AUM (Fig. 2.2). Venture capital funds have a market capitalization of $8.4bn, making them almost comparable to the real estate market in India ($10bn). Buyout funds make up just 6% of the private equity market in India, overshadowed by the prominence of growth and venture capital strategies.

### INDIA vs. REST OF ASIA-PACIFIC

While Fig. 2.1 shows the encouraging growth of the private equity & venture capital market in India, the industry is still relatively small compared to other countries such as China, Hong Kong and South Korea (Fig. 2.3). With each country presenting its own set of unique opportunities and challenges, India may be poised to overtake some of its counterparts in the coming years as regulatory reforms and an increasingly stable economy could help bring about positive benefits for the industry in India. India-based fund managers currently hold $7.0bn in dry powder, illustrative of the amount of capital still available to pursue these investment opportunities.

Fig. 2.1: India-Based Private Equity & Venture Capital Assets under Management, 2000 - 2016




*Source: Preqin Private Equity Online*

INDIA-BASED INDUSTRY ASSETS UNDER MANAGEMENT ($bn)

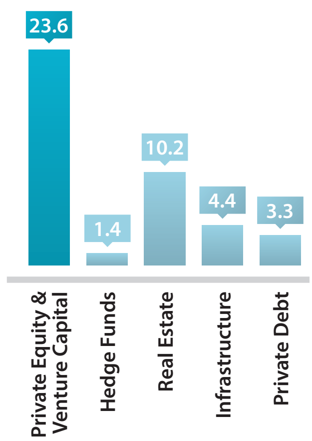
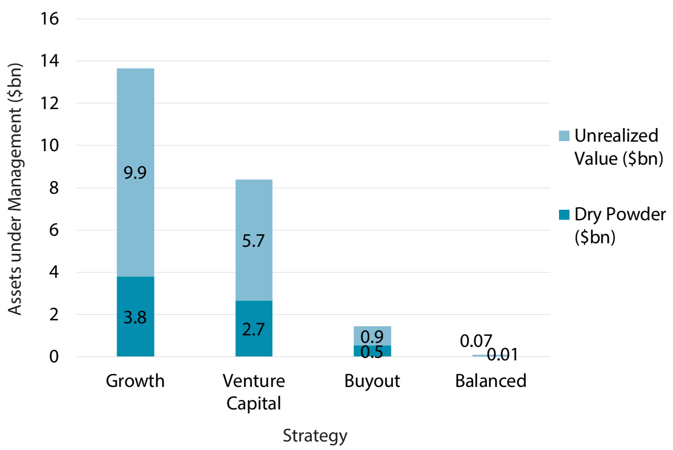
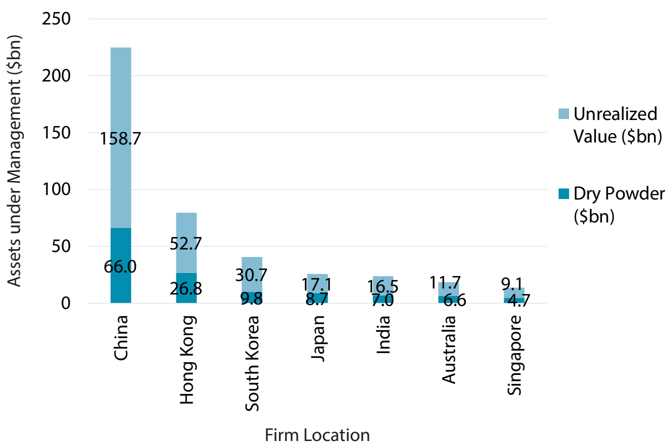



Fig. 2.2: India-Based Private Equity & Venture Capital Assets under Management by Strategy (As at December 2016)




*Source: Preqin Private Equity Online*

Fig. 2.3: Asia-Pacific-Based Private Equity & Venture Capital Assets under Management by Firm Location (As at December 2016)




*Source: Preqin Private Equity Online*

# FUNDRAISING

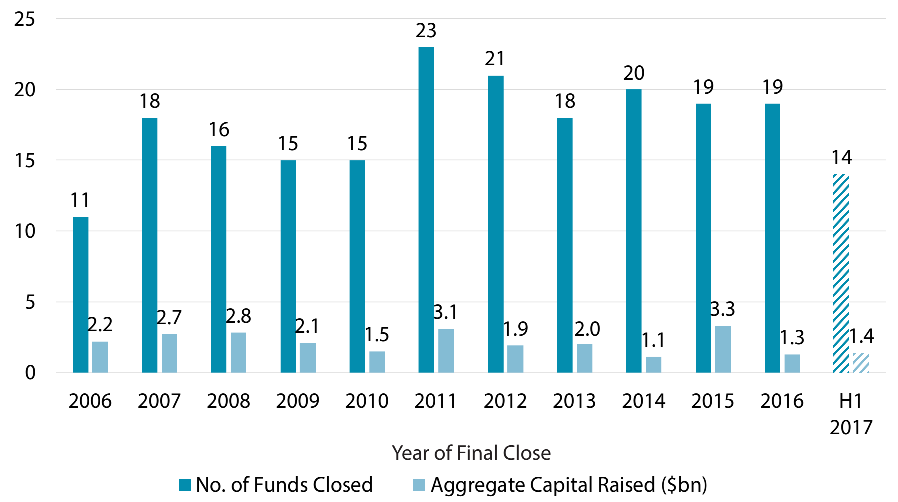
Over the years, the private equity & venture capital industry has risen in prominence in India, evidenced by an increase in the number of funds closed annually in the past 10 years. The aggregate capital raised by these funds reached highs of $3.1bn in 2011 and $3.3bn in 2015 (Fig. 2.4). These figures can be explained by a higher average fund size from a greater number of funds reaching a final close for these years. This includes an average size of $176mn for 2015, the highest average achieved since 2008.

## STRATEGIES

Venture capital funds have historically accounted for the largest proportion of funds closed annually in India since 2010 (Fig. 2.5), an indication of India's appetite for funding start-ups and early stage companies. Blume Ventures Fund II is one such fund which reached a final close in February 2017 on $60mn, targeting seed and start-up companies in India.

Growth funds have historically made up the second largest proportion of capital raised by private equity funds, but only account for just 14% of funds closed as at the end of H1 2017. It is likely that this proportion will increase over H2 to a level similar to previous years.

**Fig. 2.4: Annual India-Based Private Equity & Venture Capital Fundraising, 2006 - H1 2017**




*Source: Preqin Private Equity Online*

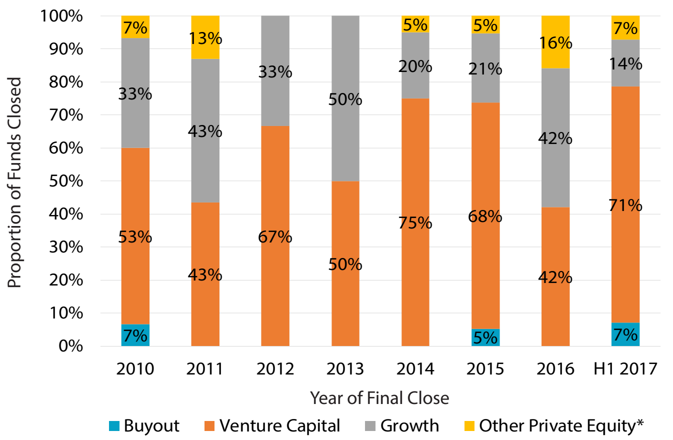
## FUNDS IN MARKET

As at August 2017, there are 96 India-focused private equity funds in market, targeting an aggregate $13bn (Fig. 2.6). The number of funds seeking institutional capital, as well as the aggregate capital targeted, have gradually increased since August 2012, illustrative of the burgeoning private equity & venture capital industry in India.

### FUND PROFILE

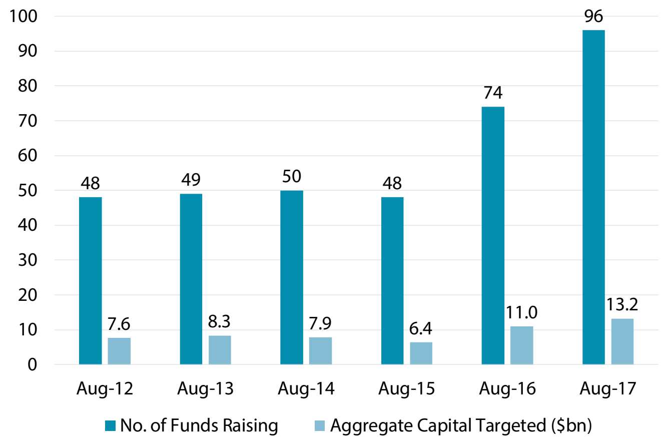
| | |
|---|---|
| **Fund:** | Blume Ventures Fund II |
| **Manager:** | Blume Ventures |
| **Final Size:** | $60mn |
| **Close Date:** | Feb-17 |
| **Strategy:** | India-based fund that targets seed and start-up companies in India, investing 30% of capital at seed level and the rest in Series As. |

**Fig. 2.5: Annual India-Based Private Equity & Venture Capital Fundraising by Fund Type, 2010 - H1 2017**




*Source: Preqin Private Equity Online*

**Fig. 2.6: India-Based Private Equity & Venture Capital Funds in Market over Time, 2012 - 2017**




*Source: Preqin Private Equity Online*

**Other Private Equity includes Balanced, PIPE, Hybrid and Fund of Funds.*

# GOVERNMENT REGULATIONS TO TRANSFORM INVESTMENTS AND EASE OF DOING BUSINESS IN INDIA

## - Gopal Srinivasan, IVCA

**What are your thoughts on the increase in private equity fund activity within India and do you see the trend continuing in the longer term?**
Increased number of private equity players in India – local as well as the global GPs – is but natural. India represents one of the most attractive long-term markets in the world, and private equity is a game of patient capital. Hence, people are coming here to invest based on what they think the five- to 10-year future will look like, and are not swayed by the current sentiment of a GDP slowdown, import expansion and export contraction. These are transient and related to the formalization of the economy that this government is avidly implementing through GST, demonetization, insolvency regulations and the digitization of payments.

We believe from the current investment velocity of ₹1 lakh crore that this industry has the potential to make investments of ₹3 lakh crore a year, of which at least a third could be represented by rupee capital, if policy measures are successful.

**How has competition for committed capital been among GPs based in India? Do you think LPs are proactive or passive in their search for fund investments?**
Global LPs have an over-hang of their past experiences with the India of 2006-2007 to 2011-2012. Returns in dollar terms and perhaps returns overall have not been attractive. This is attributed to the non-availability of attractive investments (resulting in adverse selection plus higher asset prices) as well the concomitant impact of the adverse rupee-dollar exchange rate changes.

As a result, the ability to raise new funds from global LPs has been mixed: it is either the venture capital funds that also have access to capital from developmental financial agencies or the larger bracket, ₹2,500+ AUM funds that have been able to access capital more easily. Domestic capital has been very favourable for venture capital funds, thanks to the breakthrough initiative of this government known as the start-up fund of funds administered by Small Industries Development Bank of India (SIDBI). Family offices have played a very key role in supporting Indian venture capital and private equity funds and from these participants there is indeed an active interest to invest in funds.

**What are the challenges that fund managers face in the current climate within Indian private equity? What is your advice to navigate these issues?**
The ease of investing in India has improved dramatically with over 20 changes to various regulatory frameworks. So, the challenges for GPs are the normal ones of finding the right investments at the right prices and of course, managing the portfolio successfully to an exit. Hence, one does believe that funds can now pursue their core investing activity, rather than worry about the ease of doing business, and the ease of investing. India is not a typical private equity market and hence, in the mid-market, successful private equity firms should not mimic the typical western model. Flexibility in stage selection and a pragmatic approach from opportunity to opportunity would be advisable to secure attractive return for investors.

**What initiatives have been taken by IVCA recently to boost or bolster private equity fund activity within India?**
IVCA has played a very key role in advocating significant regulatory changes ranging from Taxation, SEBI, DIPP and RBI for the private equity & venture capital community at large. It has made over 58 policy recommendations and has had more than 200 meetings with the government. Over 20 changes in various regulatory changes bear witness to this effort, working with a government that is keen to progress, and a regulator who listens to the industry. It is an active participant in the Alternate Investment Policy Advisory Committee of SEBI chaired by Mr. Narayana Murthy. It has helped focus the industry by the formation of Sector Specific Committees for VC, Credit, RE and Infra. It has also formed a "Manage in India" group to identify and ameliorate issues affecting the Indian domiciled fund managers, and domestic capital pool formation.

**What is your opinion on co-investment appetite within India? What are the key considerations that both LPs and GPs may have on this?**
Co-investing is an emerging idea in India. While it has been known to investors for some time, it is the global LPs who have been quite active. Indian family offices, insurance and private sector LPs are only slowly beginning to accept and practice it. One of the regulatory changes made recently of permitting funds to form SPV LLPs for individual investments will help make the execution of co-investments easier.

**What were the biggest moves that the government has made to spruce up the private equity space in India? Is there anything else you would like to see done going forward?**
If I were to pick four critical steps as the transformation for the industry out of the 20-odd measures that the government has taken, it would be:

1. On-shoring the fund pooling structures via the AIF system:

specifically, the policy to permit pooling of rupee and foreign flows into an AIF as the pooling vehicle. Further, downstream investments now have the colour of domestic money for Foreign Direct Investment purposes, even if from pools that co-mingle with foreign currency, provided the manager is an Indian AMC.

2. Over 20 new venture capital funds have been anchored from the government's fund of funds. This has also resulted in investments into these funds by domestic LPs including family offices, stimulating much needed domestic capital channelization to AIFs.
3. Another major breakthrough has been the simplification of AIF taxation. More specifically the granting of "pass thru status" for two categories of venture capital/private equity funds, as well as several other smaller changes.
4. Fourthly, SEBIs removing an important hurdle of eliminating the "lock-up" of one year that private equity investors had at IPOs of their investee companies. This has helped to unleash a wave of "pre-IPO" funds, and have attracted significant domestic UHNI capital.

**INDIAN PRIVATE EQUITY AND VENTURE CAPITAL ASSOCIATION (IVCA)**
The Indian Private Equity & Venture Capital Association's (IVCA) mission is to promote a healthy environment for the growth of private equity and venture capital which is much needed to support economic growth, good governance, entrepreneurship, innovation and job creation in India. IVCA stands for the values of good governance, environment protection and poverty reduction through growth of the private sector. IVCA reaches out to the far-flung areas of India and also stands ready to share and assist on a global scale.

**www.ivca.in**

# DEALS AND EXITS

## BUYOUT DEALS

Since 2008, there have been 1,068 private equity-backed buyout deals completed in India, worth an aggregate $41bn (Fig. 2.7). Buyout deal activity peaked in Q1 2012 when 54 deals were completed; however, India has since observed a general downward trend in the number of deals. Q1 2011 and Q3 2015 experienced the highest aggregate deal value, when both of these quarters completed $2.3bn worth of deals each. January 2011 saw the private investment in iGATE Patni (formally Patni Computer Systems); iGate and Apax Partners were investors in the deal and acquired a 63% stake in the business for $1.2bn.

The largest proportions of buyout deals completed in India in 2016 were in the industrials (23%) and business services (23%) sectors (Fig. 2.8). In H1 2017, consumer discretionary represented the largest share (31%) of deals (up from 9% in 2016), while business services accounted for a notable proportion (27%), having fallen 15 percentage points since 2016.

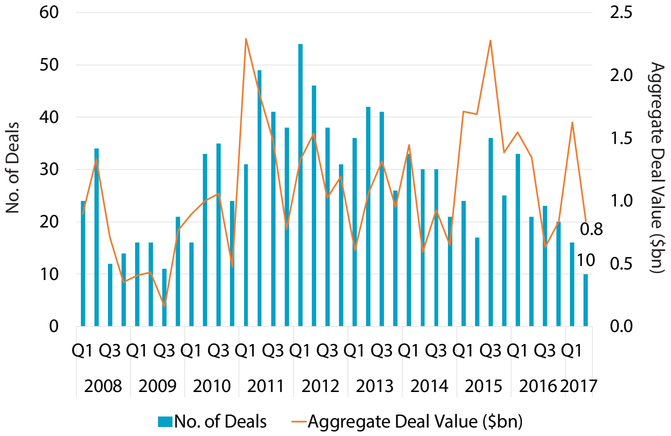
## VENTURE CAPITAL FINANCINGS

Since 2008, there have been 4,534 India-based venture capital financings, worth an aggregate $32bn (Fig. 2.9). In contrast to buyout deals, the number of venture capital deals has increased in recent years and Q1 2016 saw the highest number (306) of venture capital financings on record. Q3 2015 witnessed an aggregate $3.7bn in venture capital financings, recorded by 301 deals. The internet and telecoms industries are the most prominent venture capital deal types in India.

## EXITS

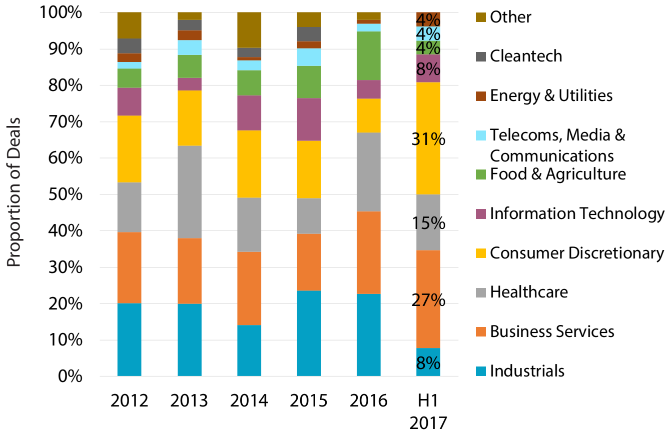
In H1 2017, half of all buyout exits were IPOs or follow-ons, while 35% were restructurings; a smaller proportion (15%) were sales to GPs (Fig. 2.10). Trade sales made up 73% of venture capital exits in H1, compared to 3% for IPOs.

**Fig. 2.7: Private Equity-Backed Buyout Deals in India, 2008 - H1 2017**



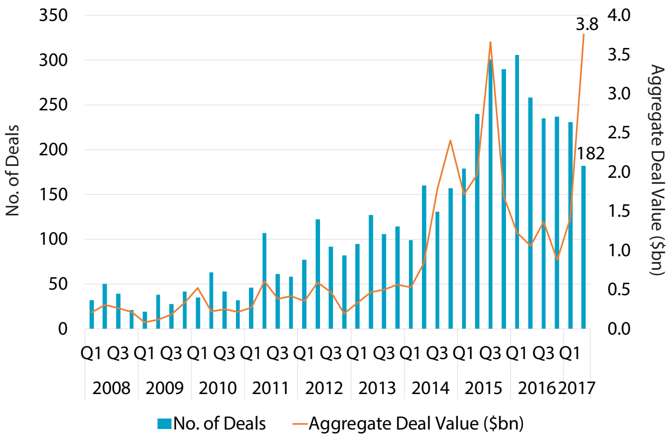

*Source: Preqin Private Equity Online*

**Fig. 2.8: Private Equity-Backed Buyout Deals in India by Industry, 2012 - H1 2017**




*Source: Preqin Private Equity Online*

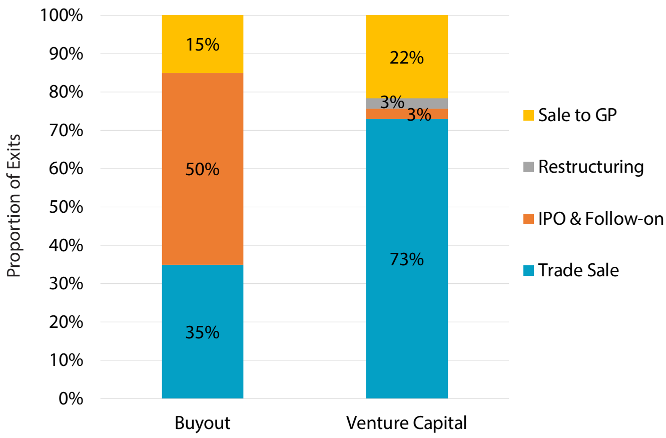
**Fig. 2.9: Venture Capital Deals* in India, 2008 - H1 2017**




*Source: Preqin Private Equity Online*

**Figures exclude add-ons, grants, mergers, secondary stock purchases and venture debt.*

**Fig. 2.10: Private Equity-Backed Buyout and Venture Capital Exits in India by Type, H1 2017**




*Source: Preqin Private Equity Online*


Source new investors for funds
Identify new investment opportunities
Conduct competitor and market analysis
Find potential deal opportunities
Develop new business

# INVESTORS

There are 81 institutional investors located in India that are currently active in private equity & venture capital investments. Encouragingly, this is a growing number and represents a 45% increase from 2013. Banks make up the largest proportion (20%) of India-based investors, as seen in Fig. 2.11. Family offices (16%) and corporate investors (15%) also make up notable proportions of India-based investors.

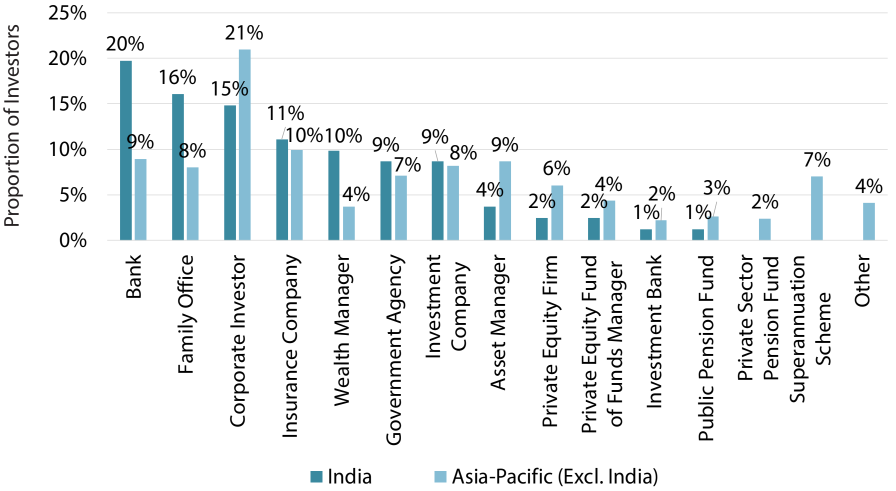
## STRATEGIES

Almost all (97% of) India-based investors have a preference for venture capital funds, an appetite shared by 70% of investors located elsewhere in Asia-Pacific (Fig. 2.12), suggestive of a strong inclination to invest in the relatively riskier early stages of a company's formation. Conversely, growth funds which invest in more mature companies are also highly targeted by India- and (rest of) Asia-Pacific-based investors: 60% and 56% respectively. India-based investors have little appetite for other private equity strategies, and buyout funds are only targeted by 18% of India-based investors compared to half of investors in the rest of Asia-Pacific.

## ASSETS UNDER MANAGEMENT

The composition of India-based investors is relatively on par with that of investors in the wider Asia-Pacific region in terms of AUM. As shown in Fig. 2.13, 49% of India-based investors have over $10bn in AUM, compared to 42% among other investors in Asia-Pacific. This illustrates that India-based investors across all firm sizes (small, medium and large) are active in the private equity & venture capital industry, meaning more diverse opportunities for fund managers looking to attract institutional capital.

**Fig. 2.11: Asia-Pacific-Based Private Equity & Venture Capital Investors by Type and Location**




*Source: Preqin Private Equity Online*

**NO. OF ACTIVE INDIA-BASED PRIVATE EQUITY & VENTURE CAPITAL INVESTORS**

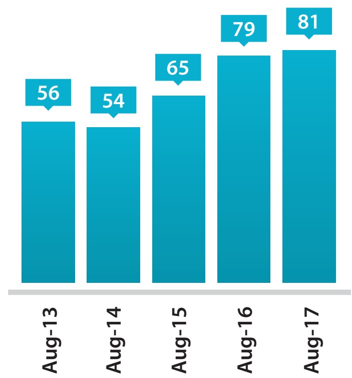
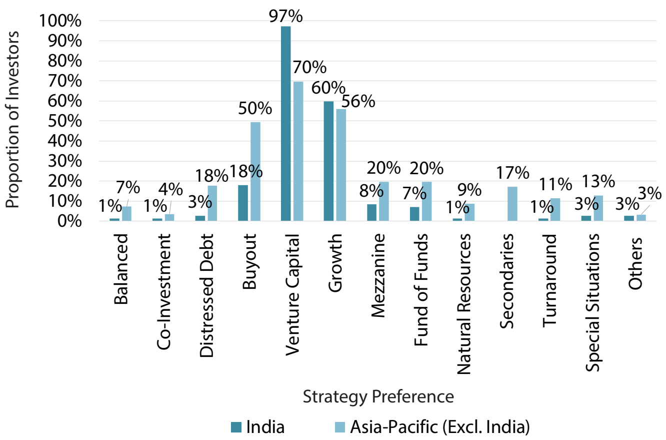
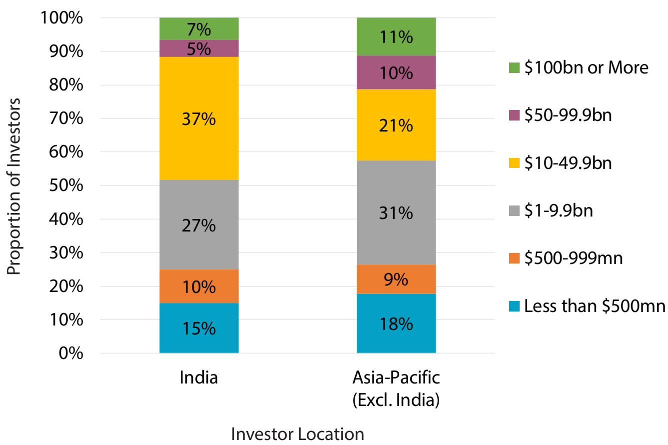



**Fig. 2.12: Strategy Preferences of Asia-Pacific-Based Private Equity & Venture Capital Investors by Location**




*Source: Preqin Private Equity Online*

**Fig. 2.13: Asia-Pacific-Based Private Equity & Venture Capital Investors by Assets under Management and Location**




*Source: Preqin Private Equity Online*

# SECTION THREE: HEDGE FUNDS

# INVESTING IN INDIA THROUGH A DIFFERENTIATED STRATEGY

## - Vineet Sachdeva, **Elysium Investment Advisors**

**How differentiated are you from the other India-focused funds?**

The India story is a long-term story; traditionally it has been a story of stock selection with growth being the driving criteria for investment. Most India funds are long-only funds following either of two approaches:

1. Relative benchmarking by being overweight/underweight to the benchmark
2. Concentrated mid-cap stock-picking approach

Both these strategies carry with them certain inherent risks. These risks include managerial bias in security selection, concentration risk, allocation risk, liquidity risk, information risk and transaction risk amongst others.

Additionally, relative benchmarked strategies tend to move together in market cycles. This characteristic results in periodic investor disappointment in adverse markets cycles. Concentrated strategies, especially focused on mid-caps, have the potential to deliver high returns but these can be very lumpy and volatile (especially during down markets when liquidity dries up in several of the underlying companies).

There are some funds that are focused on the traditional long-short, relative value strategies. Given that shorting is very restrictive in India, it becomes very difficult for managers to effectively build a short book. Therefore, long-short India funds are unable to hedge effectively leading to one-sided, high-beta returns. Also, given the nature of the market, it is not uncommon to see significant short squeezes which also make the returns quite volatile.

Elysium is well differentiated from other India-focused funds. We follow a systematic, non-biased approach to investing in the Indian markets. This helps us in delivering durable returns with low volatility. Elysium uses a combination of proprietary factor-based models and qualitative human inputs to build a long-term, high-quality portfolio. This enables the strategy to consistently generate investment performance across business cycles. We believe we are the only firm that offers this unique style of investing in the Indian markets.

**What is your investment process and portfolio construction mechanism?**

The core of our investing process is to be disciplined and have a low managerial bias. The firm follows a fundamental and rigorous stock selection process based on intensive research. The research focuses on factors that are relevant to the Indian equity market structure. Our investment process can be broken down into five steps:

1. Identify fundamental factors essential in an ideal portfolio
2. Test each of these factors through intensive in-house research
3. Assign weights using proprietary systematic model
4. Test for sector concentration and tail risk
5. A qualitative check for management and governance issues

The systematic portfolio construction method focuses on constructing baskets with different underlying themes. Each of these baskets individually beats the market across longer time periods. We ensure that there is very low correlation between the baskets so that the portfolio delivers superior performance across all market cycles (in addition to long-term performance).

A critical differentiator of our portfolio is that our portfolio is equally weighted, compared to benchmark-weighted portfolio construction for the majority of Indian asset managers. This eliminates bias in allocations and is another key characteristic of our portfolio construction process.

To effectively manage risk and liquidity, we predominantly have exposure to large caps (75-80%) with a smaller exposure to mid-caps (20-25%).

The large-cap strategy (75-80% of the portfolio) prefers firms with conservative financial management, a demonstrated history of operations, quality growth, operating businesses rooted in cash flow and a history of generating consistent shareholder rewards. Due to our rigorous approach, businesses exposed to high degree of regulation, and balance sheet indebtedness, tend to not get selected. This quality-focused orientation leads to a lower beta positioning relative to the market and most peers.

The mid-cap strategy (20-25% of the portfolio) focuses on quality growth companies, which have a history of rewarding shareholders. The qualitative intensity in gauging management quality is higher in the mid-cap strategy, and therefore the bar for selection is much higher. Here again, the focus is on selecting long-term outperformers with very low correlation between them so as to enable sustainable returns. Since inception (2014), the mid-cap strategy has delivered annualized returns (gross in INR) of 31% versus the NSE 500 return of 13%.

Risk management is a critical element in our investment process. Our proprietary risk models serve as an important force in risk identification and mitigation. We seek to minimize risk through diversification, bias elimination and large-cap orientation. Our ears-on-the-ground approach through on-ground presence and extensive relationships with senior management and corporations act as a further differentiator.

**The Indian market is known to be volatile, how do you manage this volatility and risk?**
When managing money in India, one has to ensure robust risk management practices with systems that are equipped to deal with volatility.

The very nature of our portfolio construction process ensures that we have these robust systems in place. Our portfolio is composed of highly liquid stocks with the large-cap portfolio focusing on those companies with an average market cap of around $7bn. The mid-cap portfolio has an average market capitalization of $1bn. Concentration risk, leverage risk and counterparty risk are minimal as we invest in a large number of stocks (average 60), have no borrowing against the portfolio and only use well-established multiple institutional intermediaries to trade with.

For the market neutral strategy, the use of highly liquid options and derivatives allow us to hedge long portfolio against any perceived future risk. Since inception (December 13), our market neutral strategy has delivered returns (gross in INR) of +19% compared to the much more volatile long-only MSCI India which has delivered returns of +11%. This strategy works very well for investors that believe in the India story, but are averse to the high volatility that comes with it. These returns have been achieved with a net of just 2% and no leverage. For investors that are not averse to leverage, this provides a superior return stream with very low volatility and drawdowns.

Over the duration of our investing history, we have encountered numerous periods of volatility. In the Taper Tantrum, May to August 2013, our long-only strategy returned +7% compared to -8% for the index. Between the months of March to August 2015 when the broad market index was down 10%, our long-only strategy returned +3% (INR), while the market neutral returned +13% (INR). In the EM meltdown in January to February 2016 when the broad market index was down 12%; our longs were down only 9.7%, while the market neutral was down only 1.5% (INR). These are just examples of instances when our portfolio has outperformed under extremely trying market conditions.

**As Indian stocks continue to outperform other major stock markets, do you foresee an increased interest from foreign investors in India-focused hedge funds?**
There has been considerable interest over the past few years from foreign investors in India. Given stable macroeconomic conditions, sound regulatory infrastructure and an investor-friendly policy environment, this interest is expected to grow further.

Till now, the majority of the options available to the investors were long-only funds (relative benchmarked and concentrated). For investors that invest in alternatives outside of long-only strategies, there was very limited choice. Recently, India has seen emergence of differentiated funds, both in long-only (systematic, factor based, theme based) and alternatives (long-short, market neutral, stat-arb, HFT). As the market matures, we expect the number of the alternatives to grow further. This will give a wider canvas of investors the ability to participate in the India growth story.

**In your opinion, which strategies will be highly employed by Indian hedge fund managers in the near future?**
As investors investing in India are becoming more sophisticated, they will look for a diversification of strategies in their portfolio. The long bias of the Indian market and the dearth of shorting opportunities have led to a slower evolution of classic hedge fund strategies. Though some of these strategies are employed by prop books and boutique funds (systematic long, CTA, HFT, stat-arb, volatility trading etc.), these will become more mainstream with the evolution of the market.

**How do you see your strategies evolve over the years with the maturing of the Indian hedge fund industry?**
We invest a lot in our strategies and try to continuously evolve with the emerging market scenario. We look at our future evolution across both dimensions – fine-tuning our existing strategies and researching new strategies that will fit into our long-term thinking. We believe that we are just at the beginning of the evolution of the Indian hedge fund industry and therefore we need to keep investing in cutting-edge research to stay ahead of the curve.

**Can you replicate your strategies to other markets?**
It is extremely difficult to identify factors that work in the developed markets and try to replicate them for emerging markets. Our models identify and appropriately size the factors that have worked and are expected to work specifically for the Indian market. Some of these will definitely work for markets that are in similar stages of evolution as ours. However, before we do that a lot of on-ground work needs to go into fine-tuning these models for that specific market. Once we consolidate our India business, we would definitely look to expand to these markets.

**ELYSIUM INVESTMENT ADVISORS**
Vineet Sachdeva is the co-founder and CEO of Elysium Investment Advisors LLP. Established in 2013 in Mumbai, the firm was seeded by Amit Patni, promoter of Patni Computer Systems. Elysium provides investment advisory services to commingled funds and managed accounts investing in the Indian equity market. The firm specialises in factor based systematic investing and advises clients on investing in a long only and a market neutral strategy. Vineet was formerly co-head of DE Shaw in India and has over 20 years' experience in the Indian financial markets. He has an MBA from IIM Lucknow and is a director on several boards.

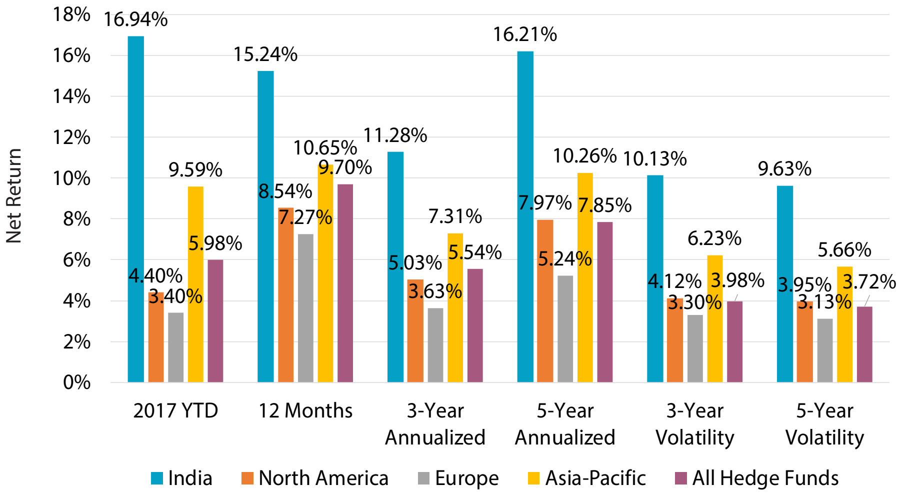
# PERFORMANCE

India-based hedge fund managers have seen significant outperformance across the long and short term compared with both their wider Asia-Pacific-based counterparts and the Preqin All-Strategies Hedge Fund benchmark (Fig. 3.1). India-based fund managers have generated an annualized return of 16.21% over the past five years, and 11.28% over the past three years, but such investments have carried a substantial degree of risk: volatility for these periods is at 9.63% and 10.13% respectively.

H1 2017 has seen India-based hedge funds continue to outperform all main regional benchmarks, achieving their highest return to date (+16.94%). However, while these funds have achieved significantly higher three- and five-year annualized returns than the MSCI Asia-Pacific Index, they have slightly underperformed the public market index over the past 12 months and so far in 2017 (Fig. 3.2).

> ***H1 2017 has seen India-based hedge funds continue to outperform all main regional benchmarks***

**Fig. 3.1: Performance of Hedge Funds by Manager Location***




*Source: Preqin Hedge Fund Online*

In terms of hedge fund managers based in the wider Asia-Pacific region, those based in Hong Kong have also performed well over the past 12 months (+13.52%) and in 2017 YTD (+12.58%), as seen in Fig. 3.3; this is likely a reflection of the size of the hedge fund industry in the country and experience of such managers.

**CUMULATIVE NET RETURNS OF INDIA-BASED HEDGE FUNDS IN 2016***

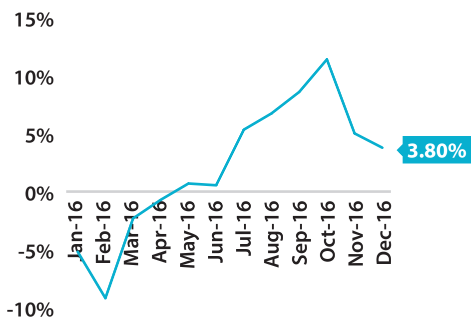
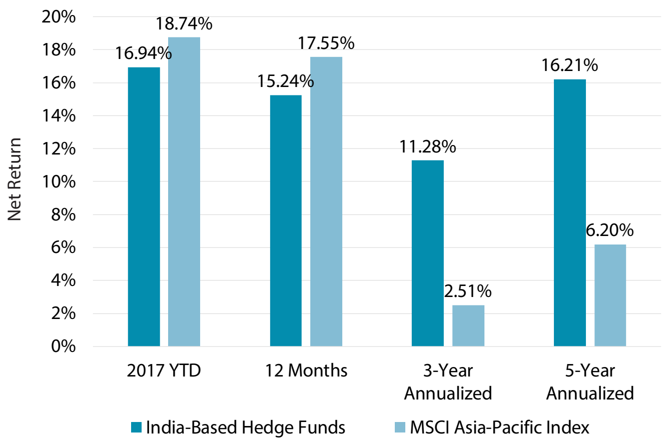



**Fig. 3.2: Performance of India-Based Hedge Funds vs. MSCI Asia-Pacific Index***




*Source: Preqin Hedge Fund Online*

**Fig. 3.3: Asia-Pacific-Based Hedge Fund Performance by Manager Location***

| 2017 YTD | 12 Months | 3-Year Annualized | 5-Year Annualized |
|---|---|---|---|
| India 16.94% | India 15.24% | India 11.28% | India 16.21% |
| Hong Kong 12.58% | Hong Kong 13.52% | Japan 7.32% | Japan 11.11% |
| Singapore 9.38% | Japan 13.06% | Hong Kong 6.71% | Australia 9.95% |
| Japan 6.66% | Singapore 7.86% | Australia 6.68% | Hong Kong 9.63% |
| Australia 4.05% | Australia 6.74% | Singapore 5.65% | Singapore 8.28% |

*Source: Preqin Hedge Fund Online*

**Please note, all performance information includes preliminary data for July 2017 based upon returns reported to Preqin in early August 2017. Although stated trends and comparisons are not expected to alter significantly, final benchmark values are subject to change.*

# FUND MANAGERS

There are currently 46 hedge fund managers active in India, collectively managing $1.4bn in AUM. These managers represent 4% of all Asia-Pacific-based hedge fund managers and just 1% of total regional assets; in contrast, Hong Kong-based managers represent the largest proportion of total hedge fund managers (39%) and assets (41%) in Asia-Pacific.

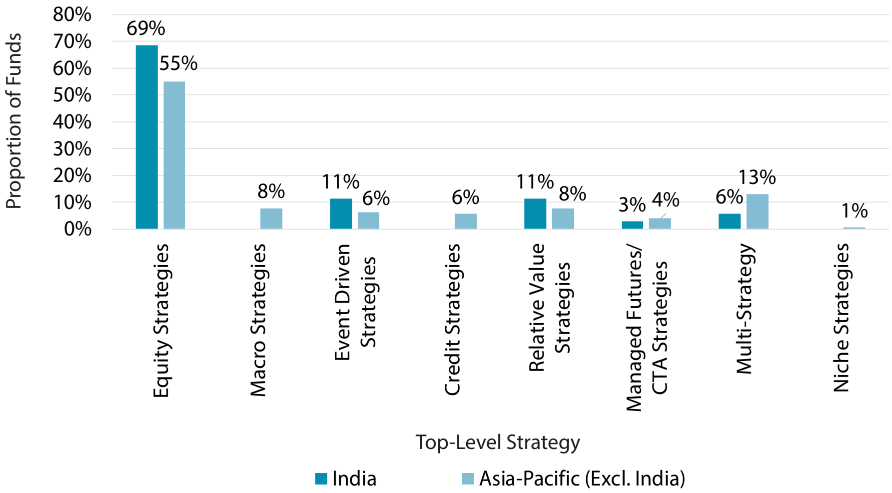
## STRATEGIES

The majority of active India-based hedge funds employ equity strategies, a trend seen in the wider Asia-Pacific region as well as in the global industry (Fig. 3.4). Event driven and relative value strategies are more prevalent among India-based managers, while more hedge fund managers based elsewhere in Asia-Pacific seek to diversify their offerings by operating multi-strategy funds. In contrast with fund managers in the wider Asia-Pacific region, India-based hedge funds do not offer macro, credit or niche strategies.

On average, hedge funds based in Asia-Pacific (excluding India) provide a slightly more diverse product offering than India-based managers (Fig. 3.5). While the majority (59%) of India-based fund managers offer one core strategy to investors, only 14% offer three or more core strategies, compared with 28% of managers based elsewhere in Asia-Pacific. This could reflect one of two things: as the market is still in its infancy, India-based hedge fund managers specialize in fewer strategies as they seek to build up their capabilities in the market before moving to employ other, perhaps more complex, strategies; or, with the market opportunities in India fairly limited to other regions (outside India), this may result in fewer opportunities for different products.

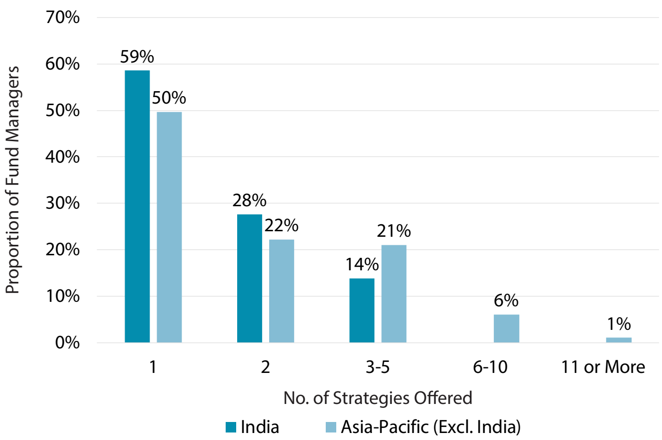
Prior to 2007, a total of 15 India-based hedge fund managers have been established with 29 India-based funds coming to market over this period. After 2007, at least one new hedge fund manager based in the country has been established, with a trend between 2013 and 2015 of a greater number of funds beginning their fundraising process than new managers – an indication that, at present, the Indian hedge fund industry is being driven by a smaller number of managers.

**Fig. 3.4: Asia-Pacific-Based Hedge Funds by Top-Level Strategy and Manager Location**



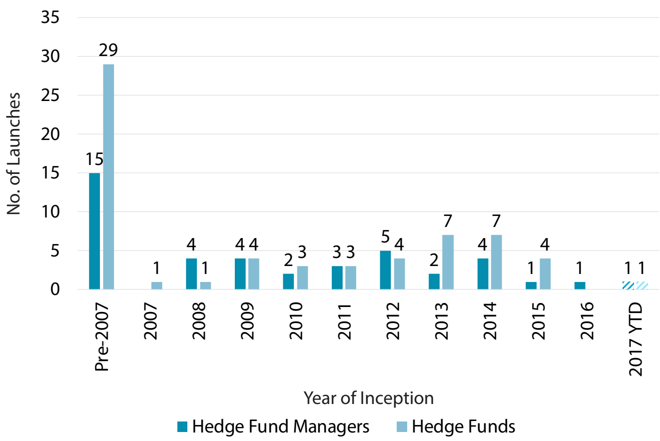

*Source: Preqin Hedge Fund Online*

**Fig. 3.5: Number of Hedge Fund Strategies Offered by Manager Location**




*Source: Preqin Hedge Fund Online*

**Fig. 3.6: Number of India-Based Hedge Fund Managers Incepted and Hedge Funds Launched by Year of Inception (As at August 2017)**



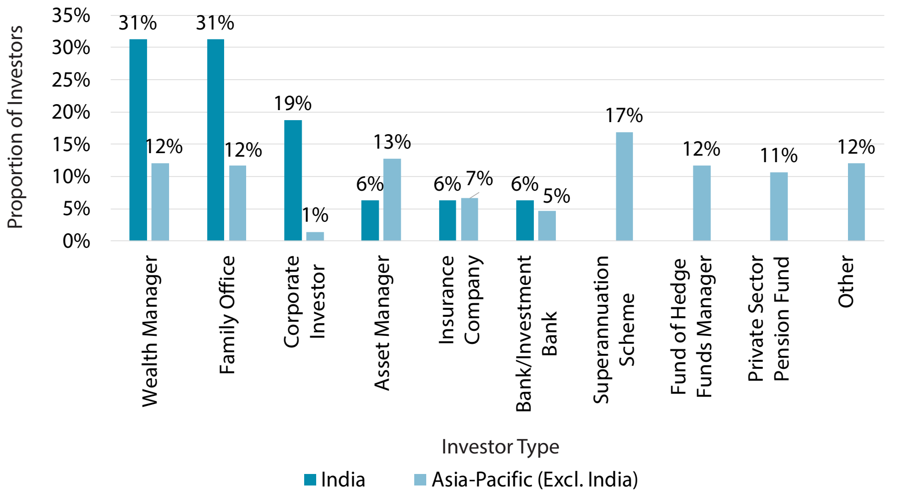

*Source: Preqin Hedge Fund Online*

# INVESTORS

While the hedge fund industry is largely established in regions such as North America and Europe, the market is still very much in its infancy in India, with 16 investors allocating to the asset class in 2017 YTD. Although relatively small in number, this is more than double the number in 2013 and shows how investors are increasingly recognizing the value of including hedge funds in their portfolios to achieve their investment objectives.

Institutional private wealth investors are the most prominent hedge fund investors located in India, representing 62% (Fig. 3.7). As the Indian hedge fund market develops, institutional investors such as pension funds, asset managers and insurance companies, which are active in the asset class elsewhere in the world, would be expected to emerge.

Fig. 3.7: Asia-Pacific-Based Hedge Fund Investors by Type and Location




*Source: Preqin Hedge Fund Online*

## STRATEGIES

Equity strategies are targeted by the majority (88%) of India-based investors (Fig. 3.8), which is expected for the less-established investors in the hedge fund industry, though these investors would expect to diversify their portfolios as they familiarize themselves more with the market. Macro and multi-strategy funds (38% each) and credit strategies (13%) are also targeted by hedge fund investors in India, illustrative of the typical approach taken by investors in a country where the hedge fund industry is still in its infancy.

## ASSETS UNDER MANAGEMENT

Fig. 3.9 shows that hedge funds are typically reserved for the largest India-based institutions, with all investors managing at least $1bn in assets, and implies that only the more sophisticated institutions invest in hedge funds. The breakdown of hedge fund investors by AUM differs from the rest of the Asia-Pacific region, where a substantial proportion (38%) of smaller investors (those with less than $1bn) also participate in the asset class.

### NO. OF ACTIVE INDIA-BASED HEDGE FUND INVESTORS

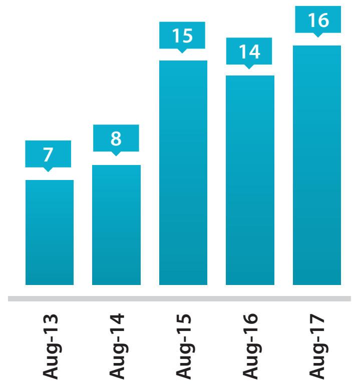
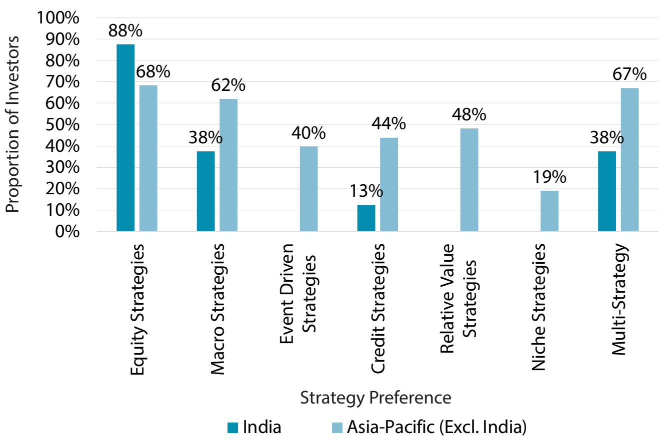
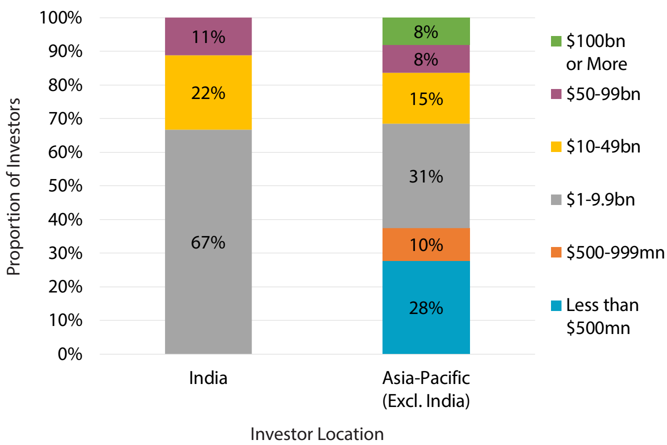



Fig. 3.8: Strategy Preferences of Asia-Pacific-Based Hedge Fund Investors by Location




*Source: Preqin Hedge Fund Online*

Fig. 3.9: Asia-Pacific-Based Hedge Fund Investors by Assets under Management and Location




*Source: Preqin Hedge Fund Online*

# SECTION FOUR: REAL ESTATE

# INDIA REAL ESTATE: LEARNINGS AND OPPORTUNITIES

- Prakash Kalothia, **Lapis India Capital**

**Can you explain how the Indian real estate market has evolved since 2005?**
India's policy for foreign direct investment (FDI) in real estate has been progressively liberalized over the years. When India allowed FDI in real estate in 2005, it was largely restricted to equity investments in large-scale greenfield developments. During 2006-2007, developers made commitments in excess of their execution capacity and GPs in general underestimated execution risks. Hence, those investments face several challenges including high valuations, inappropriate deal structures and large-scale developments in far-off locations.

Post the Global Financial Crisis, several real estate private equity funds either closed down their businesses or reduced their activity significantly in India, leaving a much smaller number of surviving funds. In 2009, SUN-Apollo/Lapis decided to make a mid-course correction in their investment strategy by moving up the capital structure to quasi debt and preferred equity structures and concentrating on for-sale mid-income housing, given its self-liquidating characteristic, in the top three markets (Delhi, Mumbai and Bengaluru). This refocused strategy worked and is delivering returns of c.2 times multiple and c.20% IRR (largely realized performance).

In light of liberalization of FDI norms that occurred in 2011, a few large global GPs and sovereign funds started to acquire suburban business parks. While most of these investments have not been exited yet, they are likely to generate positive returns given attractive in-place yields, rental growth and reduction of interest rates over the last three years. REIT regulations are now favourable for listings, which will provide liquidity to funds which have acquired/developed rent-yielding business parks.

**What are some of the key learnings from your 12-year journey as SUN-Apollo/Lapis India Capital?**
Based on our experience, we believe that well-located infill properties with good local developers are key to a successful outcome. Execution has been gradually improving in India. Even so, four- to five-year business plans or reasonable-sized projects with efficient designs are likely to do better than large townships or special economic zone projects. As enforcement of contracts can sometimes be time consuming, we believe 'control' over cash/bank accounts, voting rights over important partnership decisions and carefully drafted exit options along with intensive asset management have the ability to drive successful results. Our institutional training as a fiduciary combined with our local entrepreneurial approach has taught us to be nimble in the face of emerging market uncertainties without losing underwriting and asset management rigor.

Currency depreciation has been a significant value destroyer for the pre-2009 vintage funds. Since 2013, the Indian rupee has been largely stable given improving macroeconomics and high levels of foreign exchange reserves (c.$400bn currently). However, given the inflation and interest rate differential between India and the US, the rupee is likely to depreciate. For a four- to six-year business plan, in our judgement, the annual depreciation of the Indian rupee is expected to be in the c.3% range. We would allow for this c.3% expected depreciation in our business plan. The hedging markets are not deep, expensive and hence unviable.

**Is the market more transparent today than it was 10 years back? Has the quality of market information improved to support informed decision-making?**
The market is definitely more transparent today than it was 10 years back. The Narendra Modi administration has taken several steps, most notably the Goods and Services Tax (GST) and the Real Estate Regulation Act (RERA), to make the market more transparent and business friendly. RERA will ensure all important project information such as land title, any encumbrances on the project land, status of construction, sales data, etc. is available publicly. GST is expected to make the country a unified national market. These steps should also help in bringing more businesses in the fold of the formal economy.

The interface with local municipalities is relatively easier and more transparent than it was earlier. Zoning and building approval processes are being simplified across cities.

The quality and depth of information has significantly improved. To illustrate this point, today we can get tenant-by-tenant rent data for all office buildings in each micro market of Mumbai, which was not possible earlier. Similarly, on the residential side, we have data on stage of construction, units sold, capital values, price growth and sales velocity for almost all developments in all major markets across India.

**What is your read on the real estate market and investment environment in India today? Where do you see the opportunities going ahead?**
Given strong urbanization trends (c.150 million people moving to cities in the next 10 years), a young population (with a median age of 27 years), a fast-expanding middle class with per capita income expected to double in the next 10 years, and the fact that India has significantly under-built real estate infrastructure, demand for high-quality real estate remains strong across property types.

Considering that c.300,000 units are absorbed annually in the top seven cities at an average price of $100,000 for each unit, the funding requirement for the residential market is c.$30bn annually. Assuming a conservative equity requirement of 20-30% in the capital stack, it means $6-9bn of equity requirement per annum. Against this, the dry powder available with funds and developers today would add up to c.$1bn, leaving a large gap. Similarly, a significant gap exists between the availability and demand for institutional capital for commercial, retail, industrial and hotel property types.

India is an under-built and capital-starved market, and we are enthusiastic about opportunities across property types. In particular, we are excited about for-sale middle class housing ($75k-300k) and acquisition and development of grade A office-led, mixed-use developments in infill locations.

**Can you describe the key characteristics of the residential real estate market? As residential real estate sales have slowed over the last few years, what do you think would be the trigger points for sales revival? Where do you see opportunities in the residential market?**
The Indian residential market has been historically characterized by 'off-plan' sales where developers start selling units even before construction commences, based on approved masterplans. In projects by reputed developers, internal accruals from early collections, fund construction along with the help of minimal construction financing, relieving the need for additional equity beyond that required for land purchase and securing approvals.

We believe that the market has significant unfulfilled demand at affordable price points. Despite this, sales have been slow over the last four years due to delayed completions, high ticket sizes given large unit areas along with high price growth in the past, and lack of transportation and social infrastructure at some locations (like Dwarka Expressway in Gurgaon).

To address affordability, the end-user demand and sentiment, there is a need to focus on design and build more compact, efficient units having one-, two- and three-bed configurations in infill locations which are close to existing commercial hubs and connected to transportation nodes, sponsored by strong reputed developers at competitive price points.

Implementation of RERA, in our view, will boost the customer confidence gradually. We foresee increasing opportunities for equity and debt going forward as demand for pre-sales reduces and real estate developers seek to develop residential buildings to a certain acceptable stage before commencing sales.

Established markets of Mumbai, Delhi and Bengaluru will remain attractive, underpinned by employment generation and high office space absorption.

**What kind of opportunities do you see in "build-to-core" offices and office-led mixed-use developments?**
The CBD office space in Indian cities is largely strata sold and as a result of fractured ownership, buildings, in general, are not well maintained. Given the low focus on maintenance and harsh tropical climate, these buildings tend to deteriorate very quickly.

There is a case for 'build-to-core' Western-quality grade A CBD offices, selectively, considering the low vacancy rates, the ability to grow rents and the fact that even in major markets like Delhi and Mumbai, not many truly grade A office buildings have been built. The challenge is to find zoned land parcels at a sensible cost basis.

**Do you see opportunities in the retail space?**
Alongside the growth of e-commerce, brick and mortar retail will continue to be required. Today, there are very few high-quality retail centres in India (overall mall supply of c.75 million sq.ft for a population of 1.3 billion compared to c.4.3 billion sq.ft in the US for a population of c.320 million). Several retail malls which became operational over the last decade were ill conceived in weak catchments having inadequate parking, inconvenient access and were sub-scale with a poor tenant-mix, and as a result these malls struggled to generate sales to sustain contracted rent. The owners typically resorted to strata sales to service debt, permanently disabling the mall and leading to its decline.

As 100% FDI in single-brand retailing is now permitted, several major foreign brands have entered the Indian market and more brands are expected to establish operations in India. However, most brands find that availability of quality real estate is sparse, even in cities like Mumbai, Delhi and Bengaluru.

Given this trend, well-designed malls in strong catchments will do well and continue to present an attractive opportunity. Greenfield development of malls, however, has a longer timeline for stabilization compared to other asset classes, and hence is best suited in the hands of more patient capital.

**The industrial property type has seen interest from some large global investors given the introduction of GST, improvement in transportation infrastructure and increasing internet sales. What are your views on the same?**
GST would allow businesses to plan larger sized quality warehouses based on their distribution and demand as opposed to several sub-sized warehouses which were the result of the pre-GST multiple taxation structure. Also, due to the lack of brick-and-mortar retail stock in India and improving transportation infrastructure, the share of online retail is growing fast, creating a strong demand for quality warehousing spaces.

India is generally under-built across property types. More so, as far as industrial property is concerned. India has only c.110 million sq.ft of warehousing spaces, compared to c.10 billion sq.ft in China and c.9.5 billion sq.ft in the US. Except certain warehouses built with the support of institutional capital, most warehouses in India would fall within the so called 'cheap and cheerful' category.

A lot of the existing and currently under-construction warehousing is closer to manufacturing hubs given the availability of land. However, as manufactured goods are constantly under pricing pressures, we are not keen on such locations as it would be difficult to grow rents there. We prefer warehousing closer to large consumption centres and key infrastructure like ports and airports. However, it is difficult to find land in such areas at a reasonable cost.

As a result, it is hard to earn an attractive development yield, given current rents.

Other than one portfolio which has been transacted recently, there is not much to acquire in the industrial space in India. The opportunity is largely on the development side.

**Finally, are you seeing increased interest from foreign investors for real estate in India?**
Increasingly, we are seeing active interest from large sovereign wealth funds investing directly and through funds/managed accounts with reputed international/local asset managers. The interest among pension and endowment funds is picking up at a comparatively slower pace. Investors are investing across property types with increasing focus on acquisition of suburban business parks, retail malls and warehousing spaces. We are also seeing significant interest in the structured debt space.

The firm standing of the ruling political party BJP, good economic fundamentals, a prime minister with an appetite for reform and a potential demographic dividend from a young population make the country a very attractive long-term bet.

**LAPIS INDIA CAPITAL**
Mr. Kalothia is the founder and CEO of Lapis India Capital, a firm focused on providing investment advisory services to commingled funds and managed accounts with respect to opportunistic investments in Indian real estate. Lapis provides investment advisory services to SUN-Apollo, which raised $630mn in 2006/07. The Lapis team has over 12 years of private equity experience and has helped source, execute and manage 17 real estate transactions, involving over 100 individual properties ranging from residential developments and a shopping mall to office buildings and hotels. Mr. Kalothia has over 20 years of experience in Indian real estate, having previously worked with the SUN Group, Lend Lease and Larsen & Toubro. He received his BS in Civil Engineering and has an MBA in Finance. Mr. Kalothia is a fellow of RICS, a member of ULI and serves on the national real estate committee of FICCI and CII, the two major business associations in India.

**www.lapisindiacapital.com**

# ASSETS UNDER MANAGEMENT AND DRY POWDER

Within the alternatives assets industry in India, private real estate represents the second largest asset class ($10bn), behind private equity & venture capital ($24bn). Significantly, the private real estate industry is larger than that of hedge funds, infrastructure and private debt combined ($9.1bn).

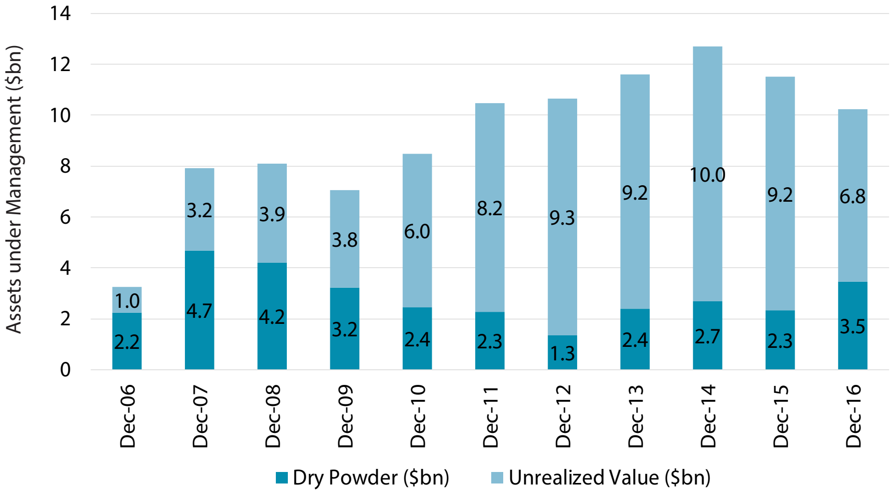
## ASSETS UNDER MANAGEMENT

After five consecutive years of growth, AUM of the private real estate industry in India has contracted annually since December 2014 – AUM fell 19% from $13bn to $10bn as at December 2016 (Fig. 4.1). For fund managers located in India, total dry powder ($3.5bn) is at its highest level since December 2008 ($4.2bn). The fall in AUM can be explained by more fund managers realizing their investments. While dry powder levels have increased, they have fluctuated annually as the Indian private real estate fundraising market is not as developed as the US and Europe.

## STRATEGIES

Opportunistic real estate funds represent the greatest proportion (65%) of industry assets in the Indian real estate market, and account for $6.6bn of real estate AUM in India (Fig. 4.2). These are followed by debt strategies which represent $2.6bn or 26% of industry assets. The Indian market operates differently to the developed markets, in respect of there being more development and project financing opportunities through debt in what is a growing economy. While fund managers in the country manage other real estate strategies such as core, core-plus, distressed and value added, all of these strategies together account for less than $1bn.

Fig. 4.1: India-Based Closed-End Private Real Estate Assets under Management, 2006 - 2016




*Source: Preqin Real Estate Online*

## INDIA-BASED INDUSTRY ASSETS UNDER MANAGEMENT ($bn)

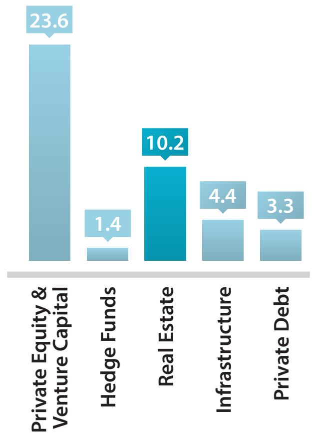
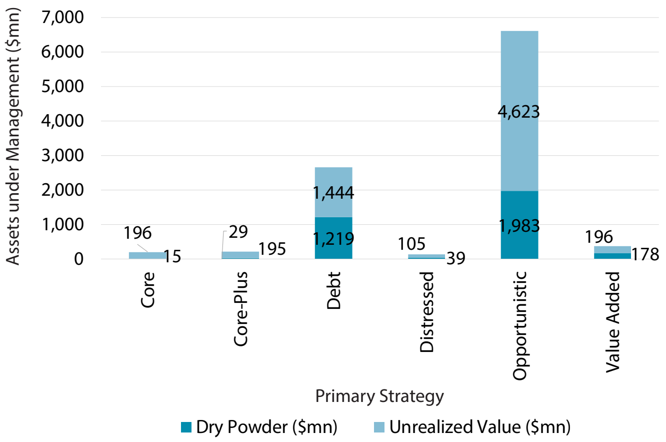
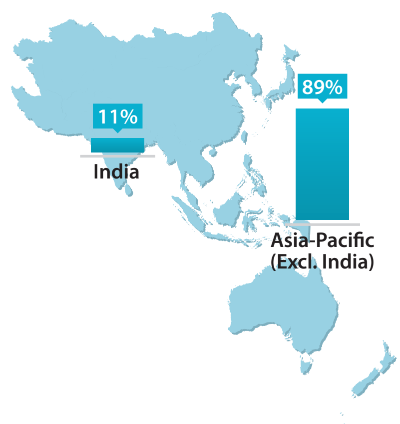



Fig. 4.2: India-Based Closed-End Private Real Estate Assets under Management by Primary Strategy (As at December 2016)




*Source: Preqin Real Estate Online*

Fig. 4.3: Location of Asia-Pacific-Based Closed-End Private Real Estate Industry Assets (As at December 2016)



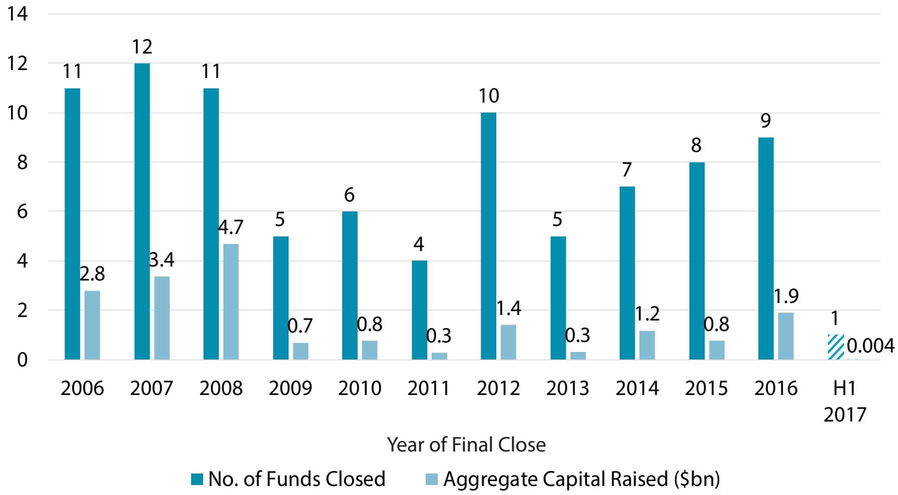

*Source: Preqin Real Estate Online*

# FUNDRAISING

The number of private real estate funds that have closed since 2006 has fluctuated each year, although this figure has risen consecutively between 2013 and 2016 (Fig. 4.4).

The years before the Global Financial Crisis (GFC) saw the highest levels of fundraising activity: fundraising records were set in 2008 when 11 vehicles raised a total of $4.7bn. Fundraising has slowed over H1 2017: only one fund closed for $4mn, and it is likely that, even with more data available at the end of the year, fundraising activity may be comparable only to the years directly after the GFC, which had some of the lowest totals in the period shown.

**Fig. 4.4: Annual India-Based Closed-End Private Real Estate Fundraising, 2006 - H1 2017**




*Source: Preqin Real Estate Online*

***As at August 2017, the number of India-based private real estate funds in market stands at a record high***

## OPPORTUNISTIC FUNDS DOMINATE

Between 2006 and H1 2017, opportunistic funds secured the most capital ($15bn), more than all other strategies combined, illustrative of the scope of institutional-grade real estate investments offered by the Indian market (Fig. 4.5). Debt funds closed during the same period raised the second highest amount of capital ($1.3bn) via 10 funds.

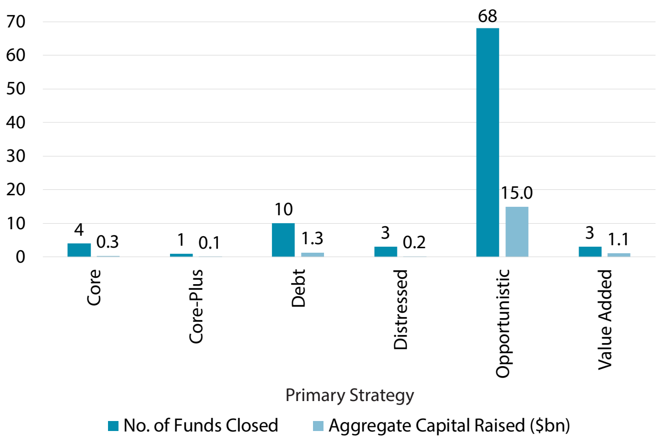
## FUNDS IN MARKET

As at August 2017, the number of India-based private real estate funds in market stands at a record high, with 29 funds seeking $4.9bn in capital commitments as seen in Fig. 4.6. This is significantly more than the $1.0bn that was targeted just five years prior in August 2012, and shows that fund managers believe there is opportunity to grow the industry within India.

**FUND PROFILE**

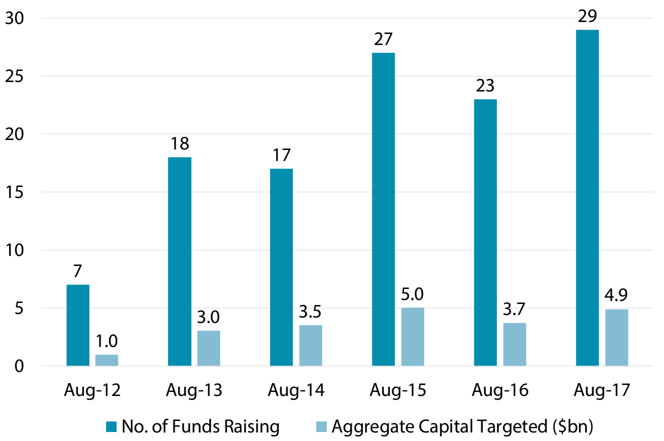
| | |
|---|---|
| **Fund:** | ASK Real Estate Special Opportunities Fund II |
| **Manager:** | ASK Property Investment Advisors |
| **Final Size:** | INR 13.4bn |
| **Close Date:** | Feb-16 |
| **Strategy:** | Invests in residential projects in six major cities across India. |

**Fig. 4.5: India-Based Closed-End Private Real Estate Fundraising by Primary Strategy, 2006 - H1 2017**




*Source: Preqin Real Estate Online*

**Fig. 4.6: India-Based Closed-End Private Real Estate Funds in Market over Time, 2012 - 2017**




*Source: Preqin Real Estate Online*

# INVESTORS

The number of India-based real estate investors has increased in recent years: as at August 2017, 49 institutional investors actively allocate to the asset class, an increase from 34 in August 2013.

## INVESTOR TYPE

Private wealth dominates in many emerging markets including India, with family offices and wealth managers accounting for the largest proportion (27% and 18% respectively) of investors active in real estate (Fig. 4.7). This differs to countries elsewhere in Asia-Pacific, where there are generally more traditional institutions, such as pension funds; superannuation schemes alone (because of Australia and New Zealand) represent 26% of real estate investors in the wider Asia-Pacific region.

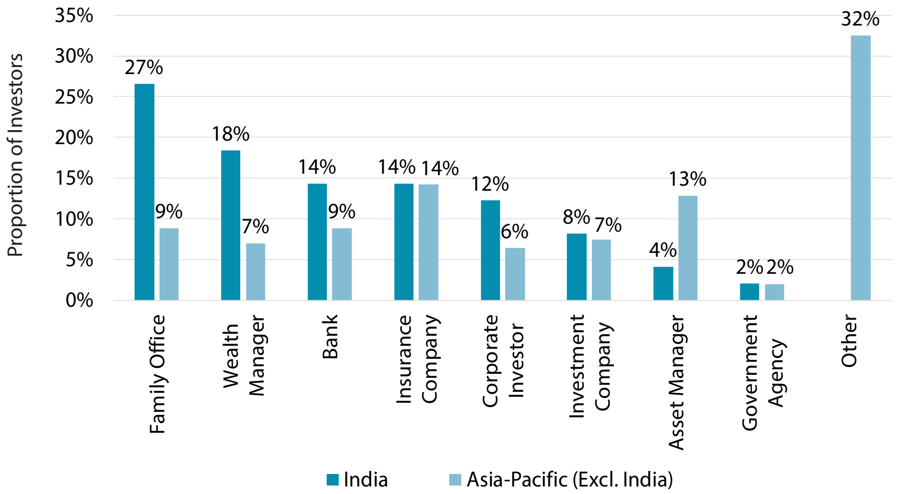
## STRATEGIES

A greater proportion of investors elsewhere in Asia-Pacific have a preference for investing in lower-risk core and core-plus strategies than their India-based counterparts (Fig. 4.8). A similar trend is seen in investor preferences for real estate debt and distressed funds.

## ASSETS UNDER MANAGEMENT

The largest investors (those with $10bn or more in AUM) represent a greater share (44%) of the investor pool in the wider Asia-Pacific region than in India (33%), as shown in Fig. 4.9, suggesting that the asset class may be difficult for some smaller India-based investors to access due to higher valuations pushing up the prices of assets.

Fig. 4.7: Asia-Pacific-Based Real Estate Investors by Type and Location




Source: Preqin Real Estate Online

## NO. OF ACTIVE INDIA-BASED REAL ESTATE INVESTORS

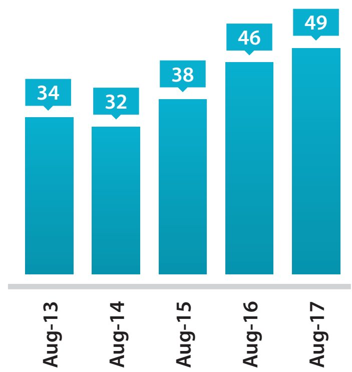
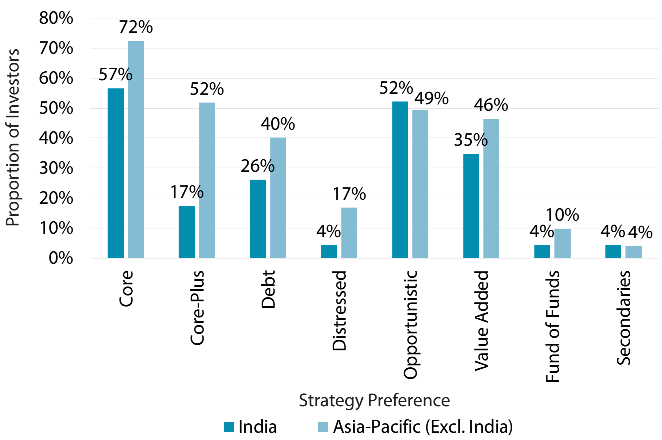
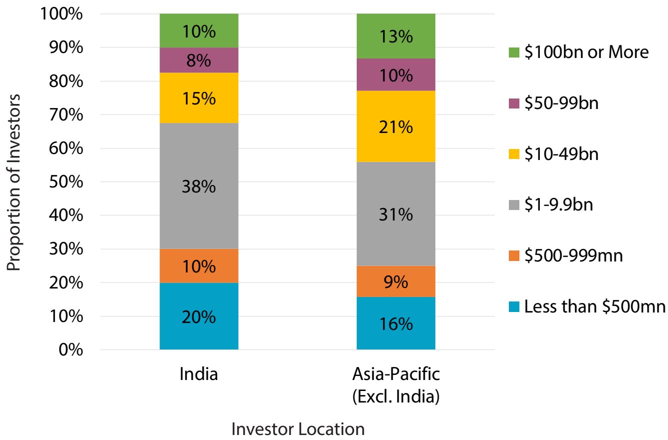



Fig. 4.8: Strategy Preferences of Asia-Pacific-Based Real Estate Investors by Location




Source: Preqin Real Estate Online

Fig. 4.9: Asia-Pacific-Based Real Estate Investors by Assets under Management and Location



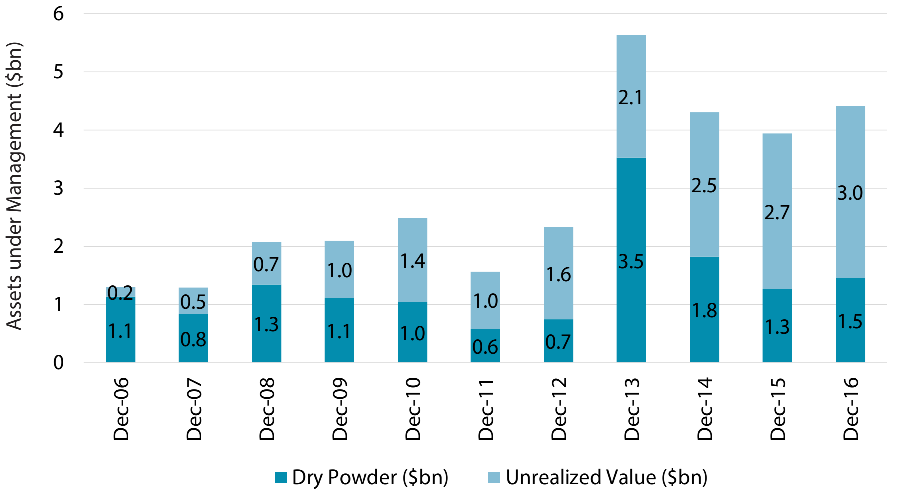

Source: Preqin Real Estate Online

# SECTION FIVE: INFRASTRUCTURE

# ASSETS UNDER MANAGEMENT AND DRY POWDER

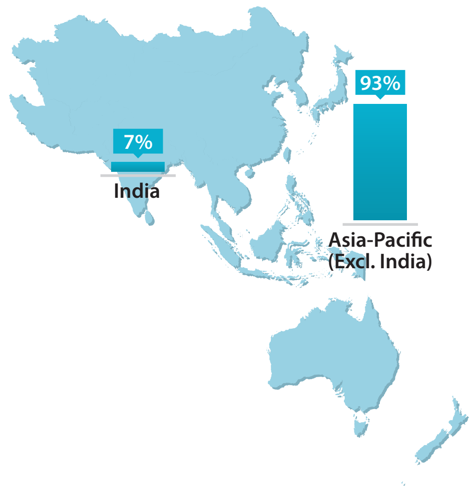
Unlisted infrastructure assets in India represent a small proportion of total Asia-Pacific-based assets, accounting for 7% of the $65bn infrastructure industry in the region. Within the context of the wider alternatives industry, unlisted infrastructure is the third largest asset class in India, behind private equity & venture capital and real estate, and is almost the same size as the Indian private debt and hedge fund industries combined. This could represent a major growth area and highlights the need for infrastructure in India. This has been further emphasized by the Finance Minister, Arun Jaitley, who recently estimated India's unmet need for investment in infrastructure at $646bn over the next five years. Sectors that will likely require investment include power, roads and urban infrastructure.

Fig. 5.1: India-Based Unlisted Infrastructure Assets under Management, 2006 - 2016



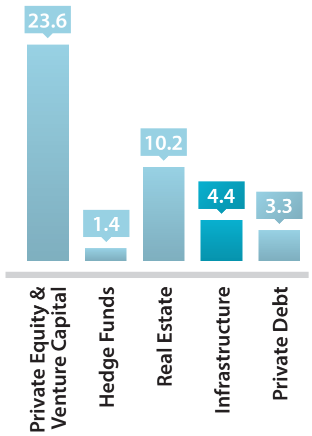

Source: Preqin Infrastructure Online

Fig. 5.2: Location of Asia-Pacific-Based Unlisted Infrastructure Industry Assets (As at December 2016)




Source: Preqin Infrastructure Online

INDIA-BASED INDUSTRY ASSETS UNDER MANAGEMENT ($bn)




## RECORD-HIGH UNREALIZED VALUE

Indian unlisted infrastructure AUM reached a record high in December 2013 of $5.6bn, with $3.5bn in dry powder and $2.1bn in unrealized value (Fig. 5.1). While such levels of dry powder have not been reached since then, unrealized value has remained above the $2.5bn mark since December 2014. Infrastructure is a growing asset class, with more recent figures suggesting its increasing prominence among firms based in India. The year-on-year growth in unrealized value since 2013 means that GPs are making investments and deploying capital.

> ***“As at December 2016, unrealized value for unlisted infrastructure in India has reached its highest level at $3.0bn***

However, the industry has contracted in recent years, and unlisted infrastructure AUM in India stands at $4.4bn as at December 2016, recording the highest level of unrealized value ($3.0bn) to date and indicative of the increasing maturity of investments in the country. As the market is small, there are likely to be fluctuations as not many GPs active in the asset class are based in the country. As the market grows more substantially, a more linear progression will be expected.

# FUNDRAISING

The level of aggregate capital raised by India-based fund managers in the last 10 years has fluctuated, which is likely to have been driven by a small number of firms over this period (Fig. 5.3).

## PROJECT STAGE

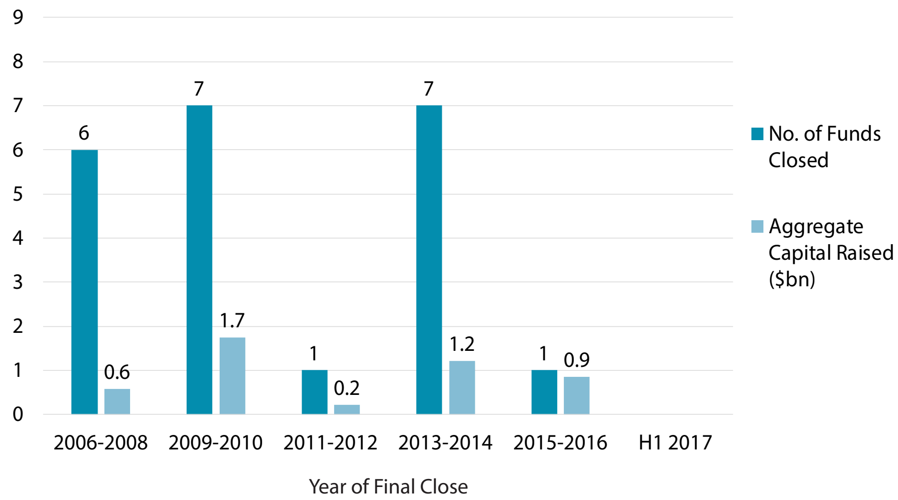
As the Indian infrastructure market continues to grow, so do the investment opportunities available to fund managers in the country, with the majority (82%) looking to finance new developments (Fig. 5.4). Unsurprisingly, brownfield projects also represent a significant proportion (77%) of funds closed in the last 10 years, with India regarded as a fast-growing emerging economy.

> ***The majority (82%) of infrastructure fund managers in the country are looking to finance new developments***

## FUNDS IN MARKET

As seen in Fig. 5.5, the number of India-based unlisted infrastructure funds in market peaked in August 2014, when 10 funds were targeting $6.2bn. While activity has slowed over more recent years, August 2017 sees eight funds targeting the highest amount ($8.8bn) of aggregate capital in the period shown. This seems to suggest that fund managers believe there is a greater demand for infrastructure investments in the region.

**Fig. 5.3: Annual India-Based Unlisted Infrastructure Fundraising, 2006 - H1 2017**

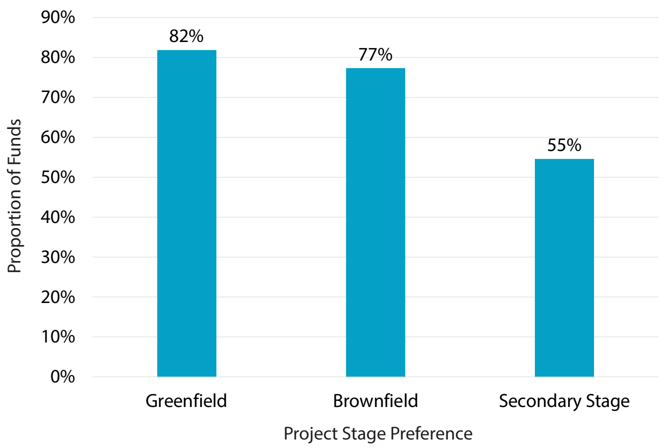



*Source: Preqin Infrastructure Online*

### FUND PROFILE

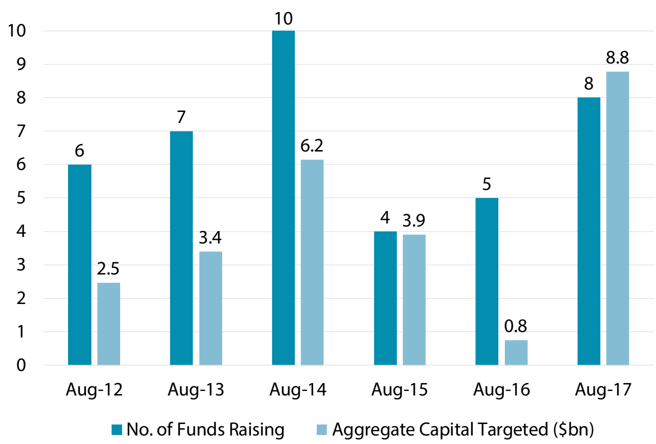
**Fund:** Resurgent Power Ventures
**Manager:** ICICI Venture Funds Management
**Final Size:** $850mn
**Close Date:** Sep-16
**Strategy:** Co-established with Tata Group, the vehicle seeks to acquire energy infrastructure assets such as thermal, hydroelectric and utilities transmission in India.

**Fig. 5.4: India-Based Unlisted Infrastructure Fundraising by Project Stage Preference, 2006 - H1 2017**




*Source: Preqin Infrastructure Online*

**Fig. 5.5: India-Based Unlisted Infrastructure Funds in Market over Time, 2012 - 2017**




*Source: Preqin Infrastructure Online*

# INVESTORS

There are currently 80 active institutional investors in India that allocate to infrastructure; this is more than double the number of investors from 2013 and illustrates the growing appetite of investors in India for the asset class.

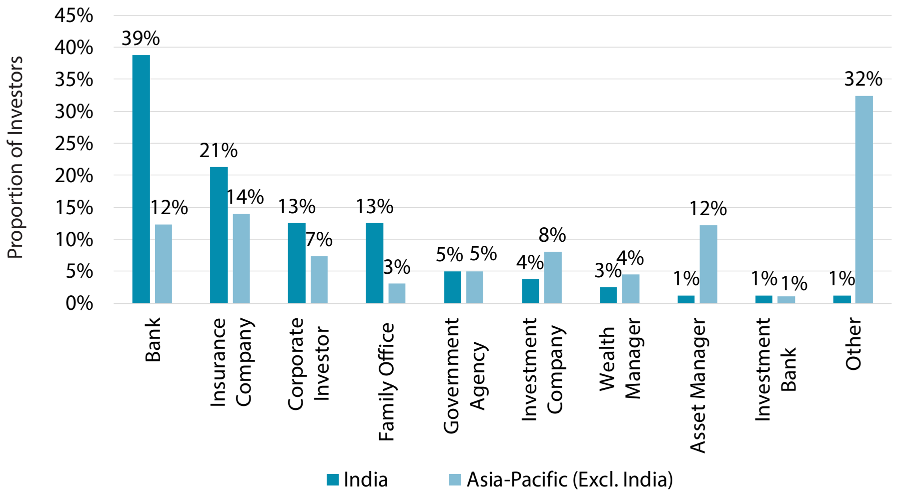
## INVESTOR TYPE

Banks make up the largest proportion (39%) of institutional investors in infrastructure in India, followed by insurance companies (21%), corporate investors and family offices (13% each), as shown in Fig. 5.6. This composition of investors is different to that of institutions in the rest of Asia-Pacific, where superannuation schemes (14%, because of Australia and New Zealand) which are categorized in 'Other', insurance companies (also 14%) and banks (12%) represent the largest share of the infrastructure investor pool.

## STRATEGY

While the majority (90%) of investors based elsewhere in Asia-Pacific have a preference for primary infrastructure strategies, this appetite is shared by only 66% of India-based investors (Fig. 5.7). Notably, 71% of investors in India target infrastructure debt funds, compared to just 48% of their wider Asia-Pacific-based counterparts.

**Fig. 5.6: Asia-Pacific-Based Infrastructure Investors by Type and Location**




*Source: Preqin Infrastructure Online*

## ASSETS UNDER MANAGEMENT

Infrastructure investors based in India and elsewhere in Asia-Pacific share a similar make-up in terms of AUM (Fig. 5.8). The largest proportions of both investor groups have AUM of $1-49bn: 70% of India-based investors and 54% of investors in the rest of Asia-Pacific. However, the largest investors (with more than $50bn in AUM) represent a greater proportion (30%) of the infrastructure investor pool in the wider Asia-Pacific region than in India (15%).

## NO. OF ACTIVE INDIA-BASED INFRASTRUCTURE INVESTORS

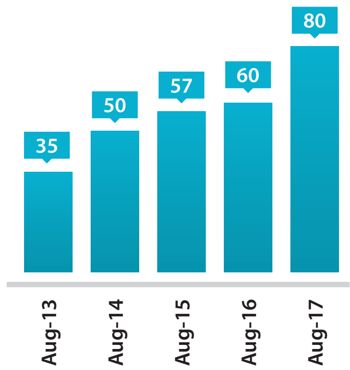
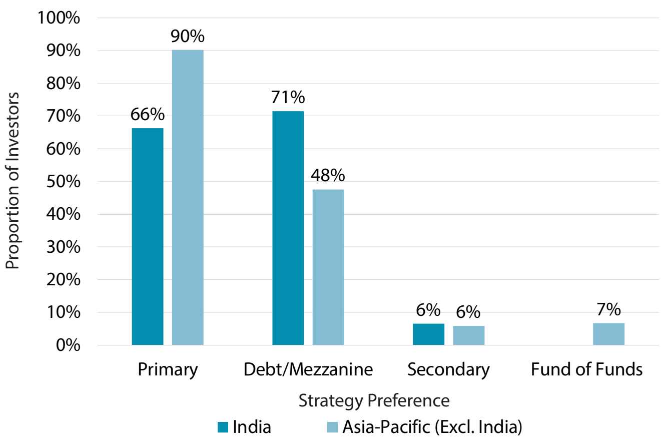
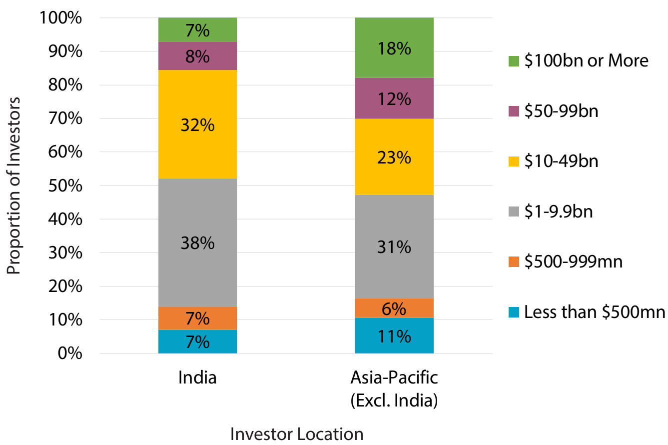



**Fig. 5.7: Strategy Preferences of Asia-Pacific-Based Infrastructure Investors by Location**




*Source: Preqin Infrastructure Online*

**Fig. 5.8: Asia-Pacific-Based Infrastructure Investors by Assets under Management and Location**




*Source: Preqin Infrastructure Online*

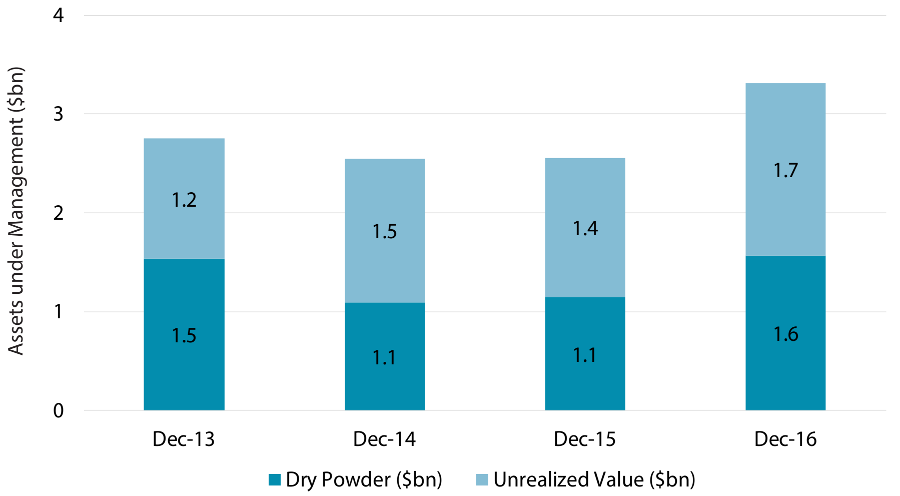

# SECTION SIX: PRIVATE DEBT

# ASSETS UNDER MANAGEMENT AND DRY POWDER

The private debt industry is still a relatively emerging asset class in India but has shown encouraging growth in the country since 2013, with AUM amounting to $3.3bn as at December 2016 (Fig. 6.1). While still a sizeable amount, the private debt industry in India represents 13% of the market across Asia-Pacific (Fig. 6.3).

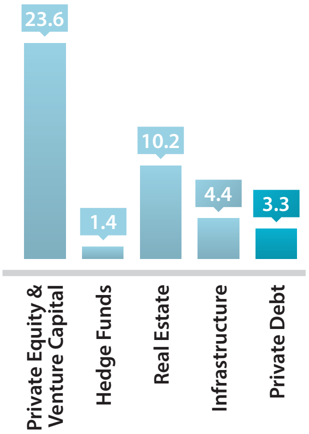
The rise in AUM over recent years may be attributable to the overall slowdown in the country's economic growth, which has led to a fall in its interest rates and, as a result, banks' reluctance to lend capital.

Fig. 6.1: India-Based Private Debt Assets under Management, 2013 - 2016




Source: Preqin Private Debt Online

INDIA-BASED INDUSTRY ASSETS UNDER MANAGEMENT ($bn)



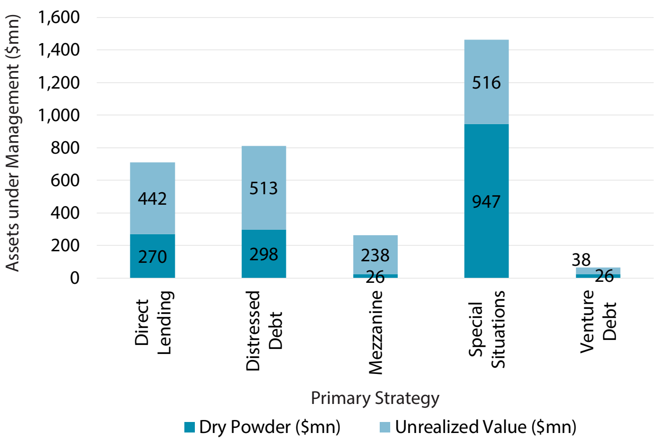

> ***The private debt industry in India represents 13% of the market across Asia-Pacific***

## STRATEGIES

Despite this, managers are seeing opportunities for private debt investments in India, notably within special situations strategies: this fund type represents the greatest proportion of industry assets in the Indian private debt market (Fig. 6.2). Distressed debt and direct lending vehicles also represent significant segments of the market, with $811mn and $712mn in AUM respectively.

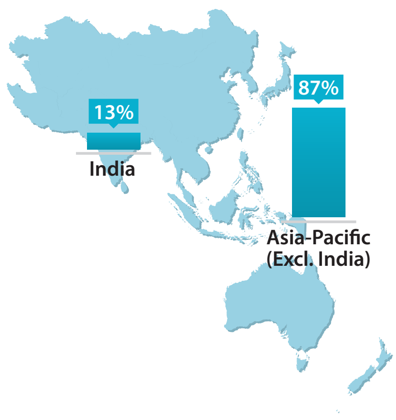
Although venture capital has seen significant market capitalization ($8.4bn) in India, venture debt represents only 2% of all India-based AUM in private debt.

Fig. 6.2: India-Based Private Debt Assets under Management by Primary Strategy (As at December 2016)




Source: Preqin Private Debt Online

Fig. 6.3: Location of Asia-Pacific-Based Private Debt Industry Assets (As at December 2016)




Source: Preqin Private Debt Online

# FUNDRAISING

The private debt industry in India is still in its infancy relative to markets in other regions. Just four private debt funds have closed each year from 2014 to 2016, raising varying amounts of aggregate capital – notably, 2014 saw a total of $1.1bn in capital raised, the highest amount over the period shown in Fig. 6.4. This can be attributed to the closure of the largest India-based private debt fund to date, AION Capital Partners, which reached a final close in May of that year. The vehicle is managed by AION Capital Partners, a joint venture established by ICICI Venture Funds Management and Apollo Global Management, and secured $825mn in institutional capital, above its $700mn target.

## STRATEGIES

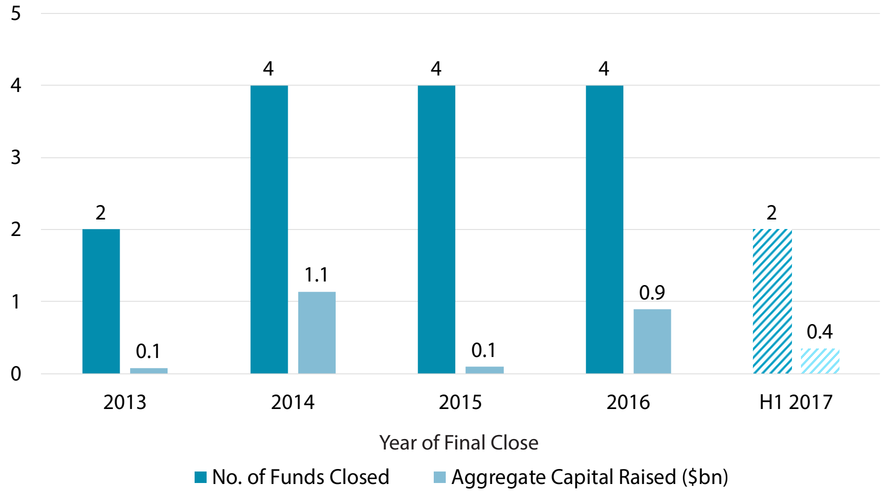
So far in 2017, just two India-based private debt funds have reached a final close, raising $350mn. While the highest number (8) of funds closed historically (as at August 2017) have focused on direct lending strategies, special situations vehicles have secured the most investor capital ($1.6bn, Fig. 6.5).

## FUNDS IN MARKET

As at August 2017, 12 private debt funds are in the process of raising capital, with five of these vehicles already having reached an interim close. Piramal India Resurgent Fund, which is managed by Piramal Capital, is the largest of these funds and is seeking $1bn for investment in distressed situations in the country.

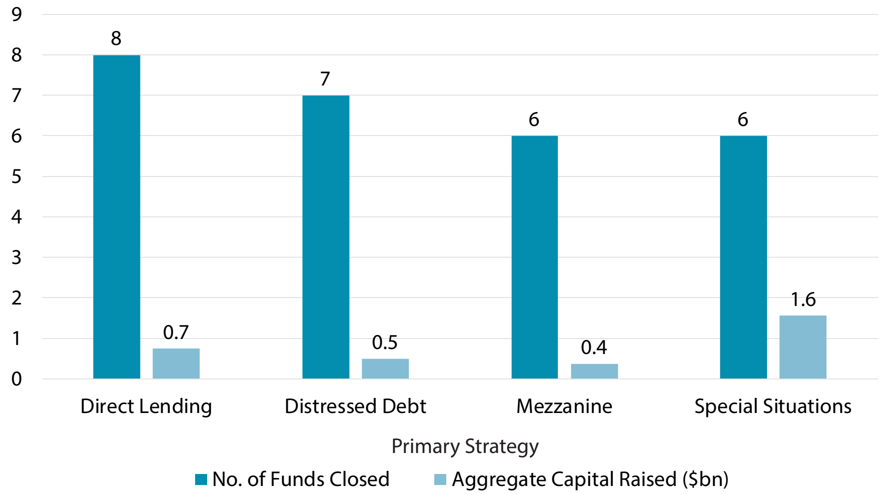
With $2.2bn in institutional capital being targeted by these 12 funds on the road, this could indicate fund managers' belief that there remains huge growth potential in the Indian private debt market over the coming years.

**Fig. 6.4: Annual India-Based Private Debt Fundraising, 2013 - H1 2017**




*Source: Preqin Private Debt Online*

**Fig. 6.5: India-Based Private Debt Fundraising by Primary Strategy, All Time (As at August 2017)**




*Source: Preqin Private Debt Online*

### FUND PROFILE

**Fund:** Kotak Special Situations Credit Opportunity Fund

**Manager:** Kotak Private Equity Group

**Final Size:** $525mn

**Close Date:** Mar-16

**Strategy:** Aims to buy non-performing assets from lenders and provide equity-like returns to investors.

### FUND PROFILE

**Fund:** India Resurgence Fund ("IndiaRF")

**Manager:** Piramal Group and Bain Capital Credit

**Status:** Raising

**Vintage:** 2018

**Strategy:** Distressed debt vehicle targets $1bn in capital. Will focus on acquiring stressed loans and will invest in potential turnaround companies and provide rescue capital.

# INVESTORS

There are 37 India-based investors active in the private debt asset class as at August 2017, marking a 131% increase from the same point in 2016.

### INVESTOR TYPE

Banks make up the largest proportion (27%) of private debt investors in India, compared to just 12% in the wider Asia-Pacific region (Fig. 6.6). A similar pattern can be seen among other investor types such as insurance companies, family offices, corporate investors and government agencies, where such institutions are more prominent in India than elsewhere in Asia-Pacific, as investors seek attractive risk-adjusted returns in a low interest rate environment. Conversely, asset managers in the rest of Asia-Pacific make up 16% of investors in private debt compared with 8% of India-based investors.

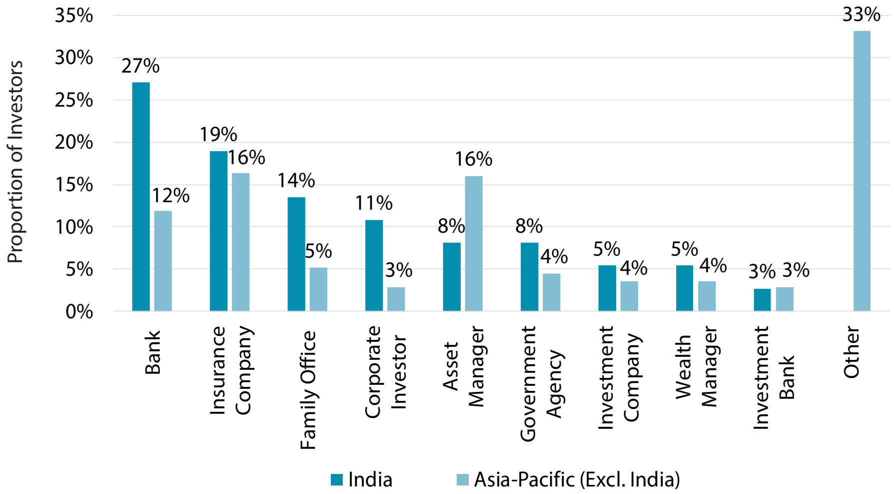
### STRATEGY PREFERENCES

As seen in Fig. 6.7, special situations is the most targeted strategy among both India- and rest of Asia-Pacific-based investors in private debt. A larger proportion (58%) of Asia-Pacific-based investors look to invest in mezzanine funds than those in India; conversely, a greater proportion (23%) of India-based investors have a preference for distressed debt strategies. No institutions in India invest in fund of funds vehicles, in comparison with 3% of institutions elsewhere in Asia-Pacific.

### ASSETS UNDER MANAGEMENT

Investors in India and the rest of Asia-Pacific share a similar make-up in terms of AUM (Fig. 6.8). The largest proportion (40%) of private debt investors in India hold $10-49bn in AUM, compared to 25% of investors based elsewhere in Asia-Pacific. However, the largest investors (more than $50bn in AUM) represent a greater proportion (33%) of the investor pool in the wider Asia-Pacific region than in India (18%).

Fig. 6.6: Asia-Pacific-Based Private Debt Investors by Type and Location




*Source: Preqin Private Debt Online*

NO. OF ACTIVE INDIA-BASED PRIVATE DEBT INVESTORS

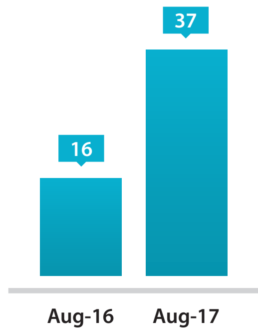
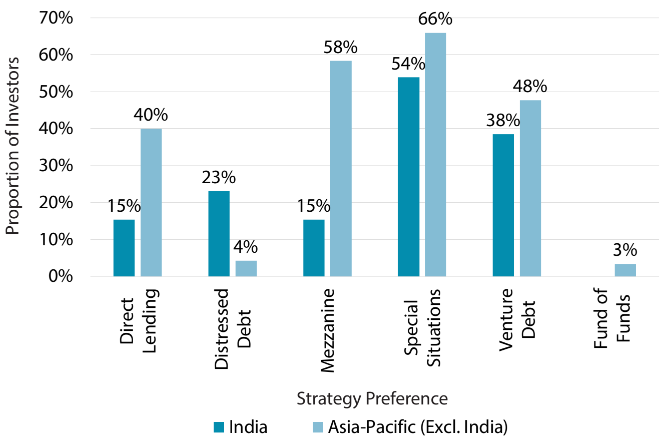
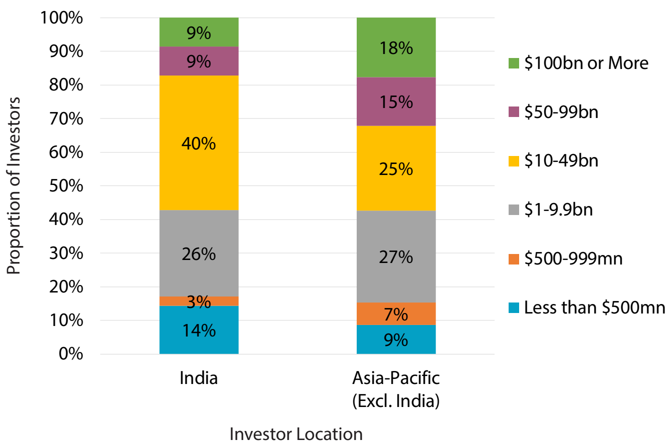



Fig. 6.7: Strategy Preferences of Asia-Pacific-Based Private Debt Investors by Location




*Source: Preqin Private Debt Online*

Fig. 6.8: Asia-Pacific-Based Private Debt Investors by Assets under Management and Location




*Source: Preqin Private Debt Online*