



# A PRIMER ON ALTERNATIVE INVESTMENTS

AUGUST 2018



## ALTERNATIVE INVESTMENTS

## WHAT ARE ALTERNATIVE INVESTMENTS?

- Alternative Investments includes wide range of investments from traditional rare coins to Bitcoins and from investing in farm lands to investing in start-ups

### Alternative Investments

Private  
Equity

Venture  
Capital

Hedge  
Fund

Real  
Estate

Others

- Art and Paintings
- Natural Resources
- Horse Breeding



# PRIVATE EQUITY

## WHAT IS PRIVATE EQUITY?

- Investment made in non-public companies through privately negotiated transactions
- For long term
- To enhance value of the companies through operational improvement and financial restructuring
- Through Illiquid investments
- Continuous Acquisition and Disposal of Investments
- Relatively, a new industry, came in forefront in US in 1970s in Europe in 1980s

# EXAMPLES - GLOBAL

## Private Equity Funds



## Private Held Companies



Note: Logos are intellectual property of respective companies, used only for educational purpose

# EXAMPLES - INDIA

## Private Equity Funds

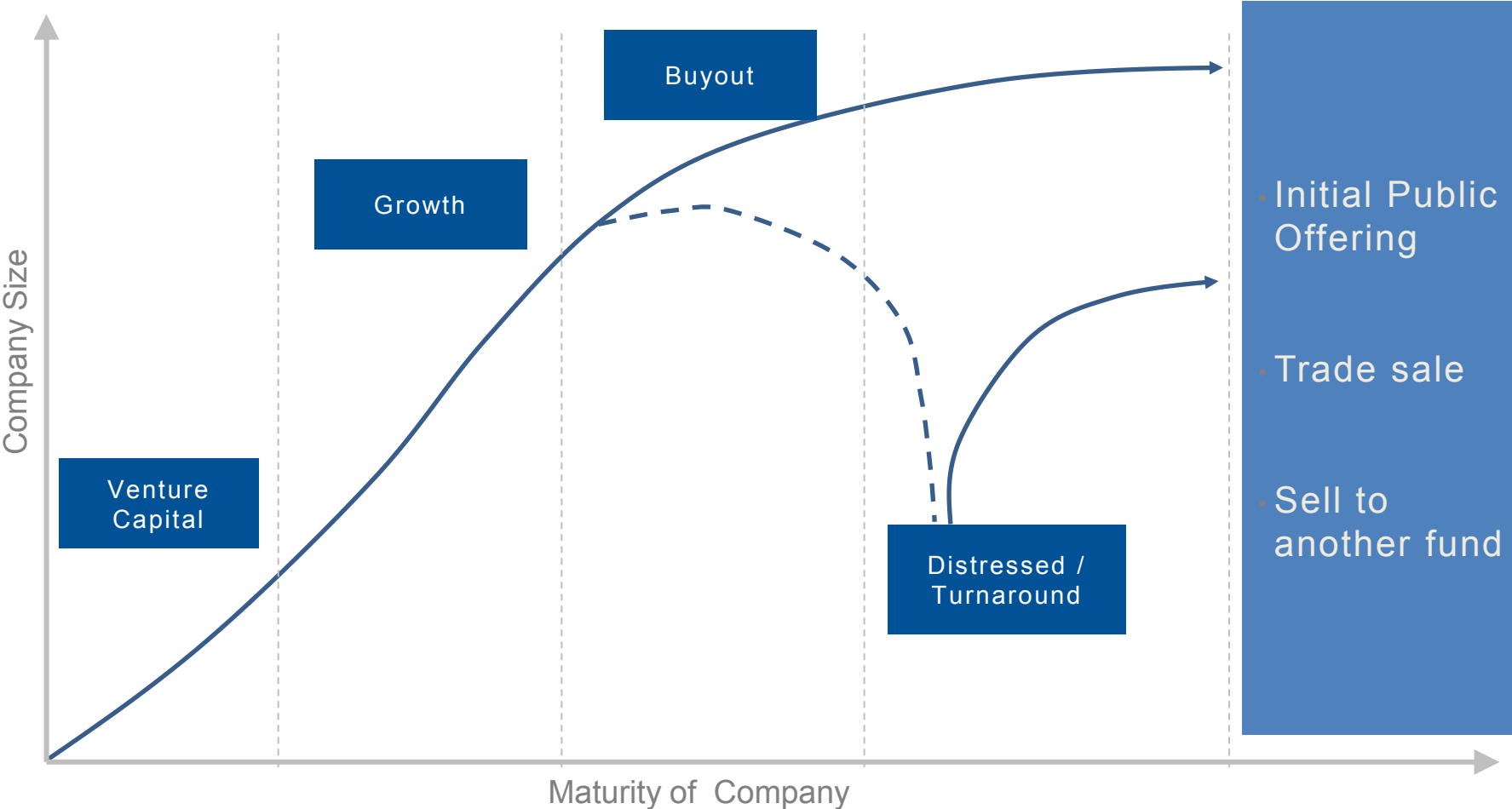
MULTIPL**E**S



## Private Held Companies



# TYPES OF PRIVATE EQUITY



Note: Chart is for representative purpose



## DIFFERENT CHARACTERISTICS

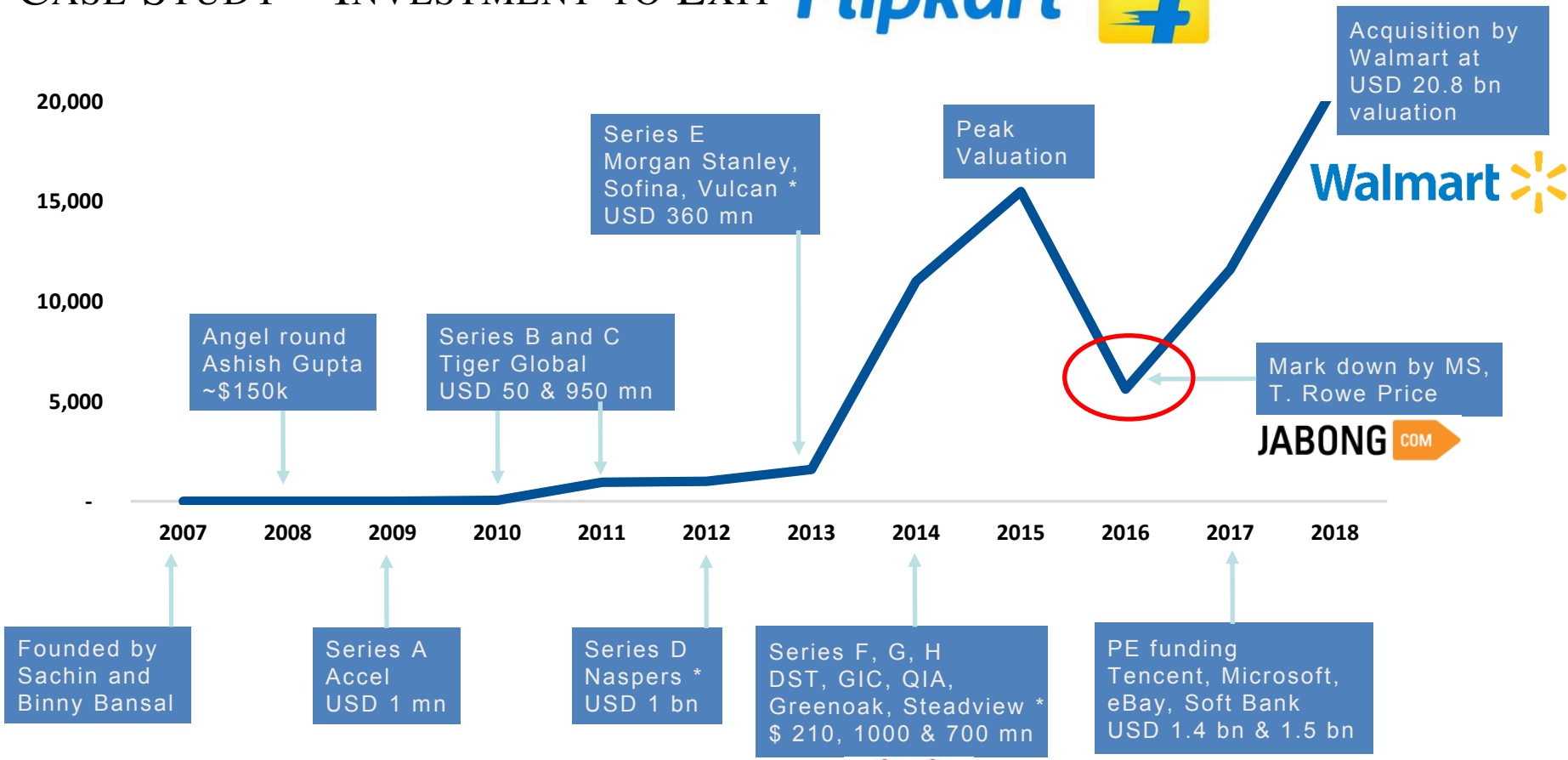
	Venture capital	Growth equity	Buyouts
Portfolio company stage	Early Stage	Expansion	Mature
Revenue	Negligible	Growing	Self-sustaining
Management involvement	Moderate - Heavy	Moderate	Heavy
Financing rounds	3-5	1-3	Often 1
Use of leverage	Rarely	Can be done	Almost always
Valuation	New financing rounds	Comparables	Comparables
Failure rate	Significant	Sometimes	Infrequent

## PRIVATE EQUITY VIS-À-VIS PUBLIC MARKETS

Public equity	Private equity
Investing in listed companies	Investing in companies not trading on stock exchanges
Information limited to regulatory disclosures	Full access to information
No active value creation	Active value creation
More efficient markets	Inefficient markets with little regulatory oversight
Liquid investments	Illiquid investments

**Fundamentally different investment model and access to inefficient markets generates attractive long-term returns compared to public equities**

# CASE STUDY – INVESTMENT TO EXIT *Flipkart*



\* Funded also by some of the existing investors  
All information from public sources

## OTHER STRATEGIES

### MEZZANINE FUNDS

- Provides mezzanine financing to growing medium sized companies
- Combination of debt and equity instruments combines current yield with high return potential

### REAL ESTATE FUNDS

- Investments in real estate property
- PE Real Estate funds generally follow core, core-plus, value added or opportunistic strategies when making investments

### INFRASTRUCTURE FUNDS

- Investments in Infrastructure projects like roads, toll bridges, renewable energy plants etc
- Lower risk and predictable stable annual yields

### PRIVATE DEBT FUNDS

- Provide private debt to fast growing, medium sized companies
- Private Debt Funds generally provide senior debt, subordinated debt, mezzanine, unitranche or distressed debt

### SECONDARIES FUNDS

- Investments in pre-existing investor commitments to PE funds
- More matured portfolio, lower investment cycle and earlier returns to investor (smaller J-curve or no J-curve)

## FEW JARGONS USED IN PRIVATE EQUITY

### General Partner

Firm/Individual who manage the investments of the Private Equity Fund and are responsible for performance of the fund

### Limited Partner

Investors who invest in the Private Equity Fund. Mainly these are institutions such as pension funds, insurance companies etc.

### Vintage

Refers to the year in which the firm raised capital and started investing

### Hurdle Rate

Refers to the minimum IRR over which General Partner earns a share in the profit made through investments (known as Carry)

### Multiples

Returns are generally measured as multiple of capital invested (MoIC)

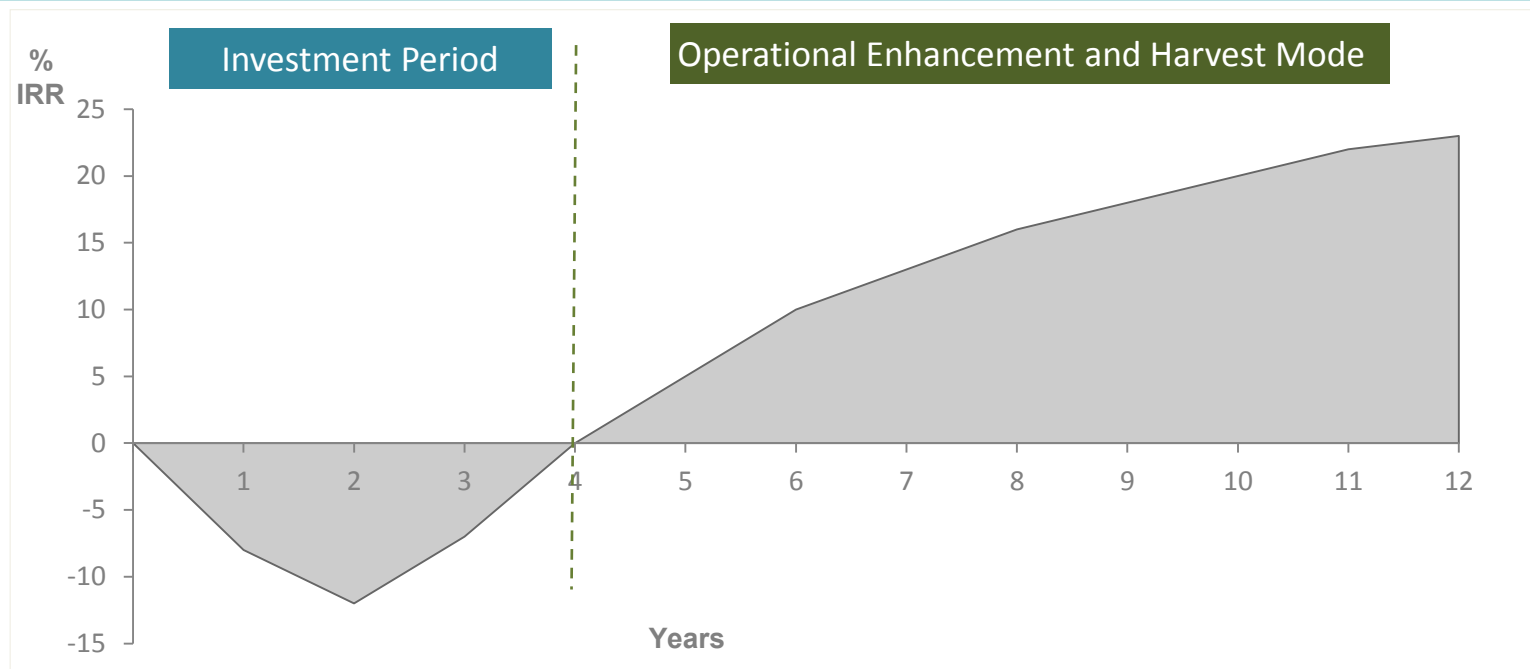
### Dry Powder

Originated from the term "Gun Powder". Refers to the capital which is committed but is yet to be invested

## J-CURVE IN PRIVATE EQUITY

- Private Equity returns typically follow a “J-Curve” over the investment period
- Funds tend to experience negative returns in first few years due to write downs and costs
- Liquidity events are around the end of the fund life cycle

### LIFECYCLE OF A PRIVATE EQUITY FUND



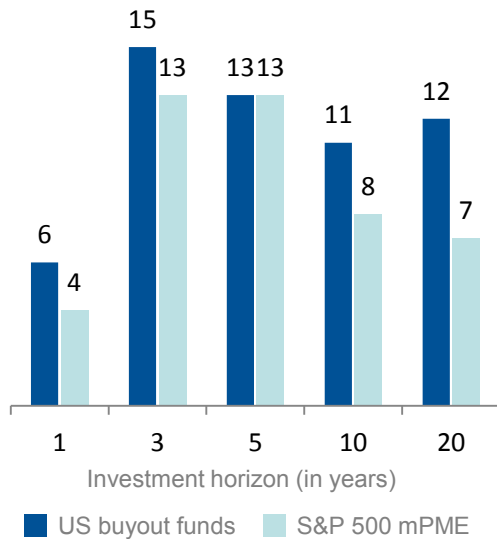
Note: Chart is for representative purpose

# PRIVATE EQUITY HAS GENERATED HIGHER RETURNS

- Private equity as an asset class has generated better returns, net of all fees and expenses, compared to public market investments over range of time periods
- Private equity investments provide access to industries, companies and products which are not easily available in public markets

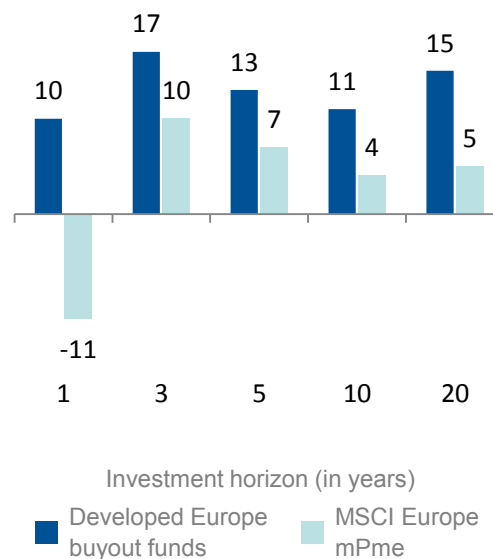
## US

End-to-end pooled IRR % (as of June 2016)



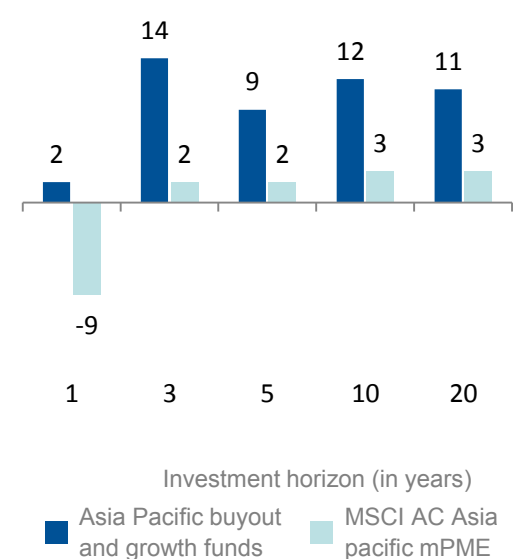
## Europe

End-to-end pooled IRR % (as of June 2016)



## Asia Pacific

End-to-end pooled IRR % (as of June 2016)

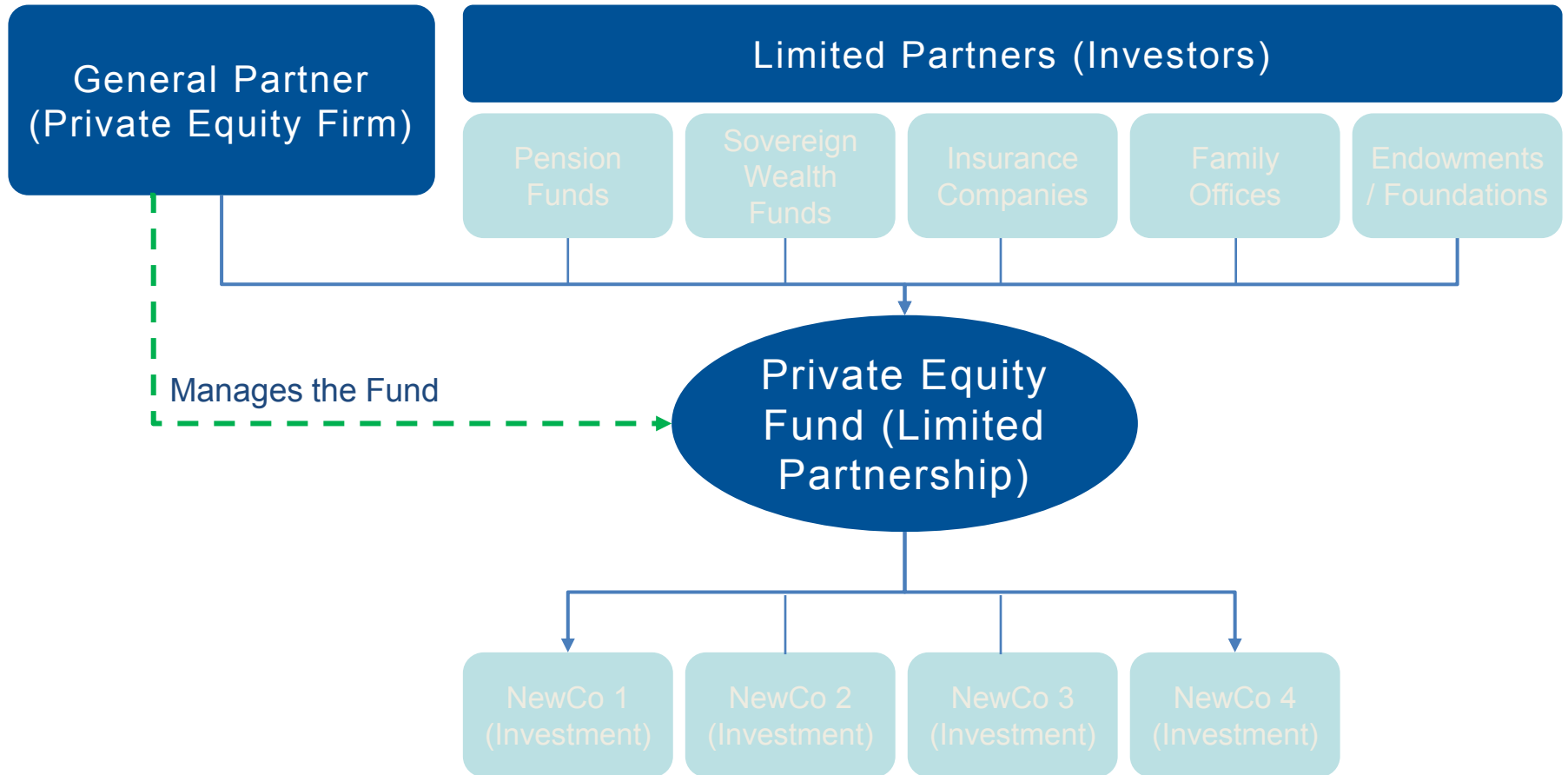


## WHY INVEST IN PRIVATE EQUITY

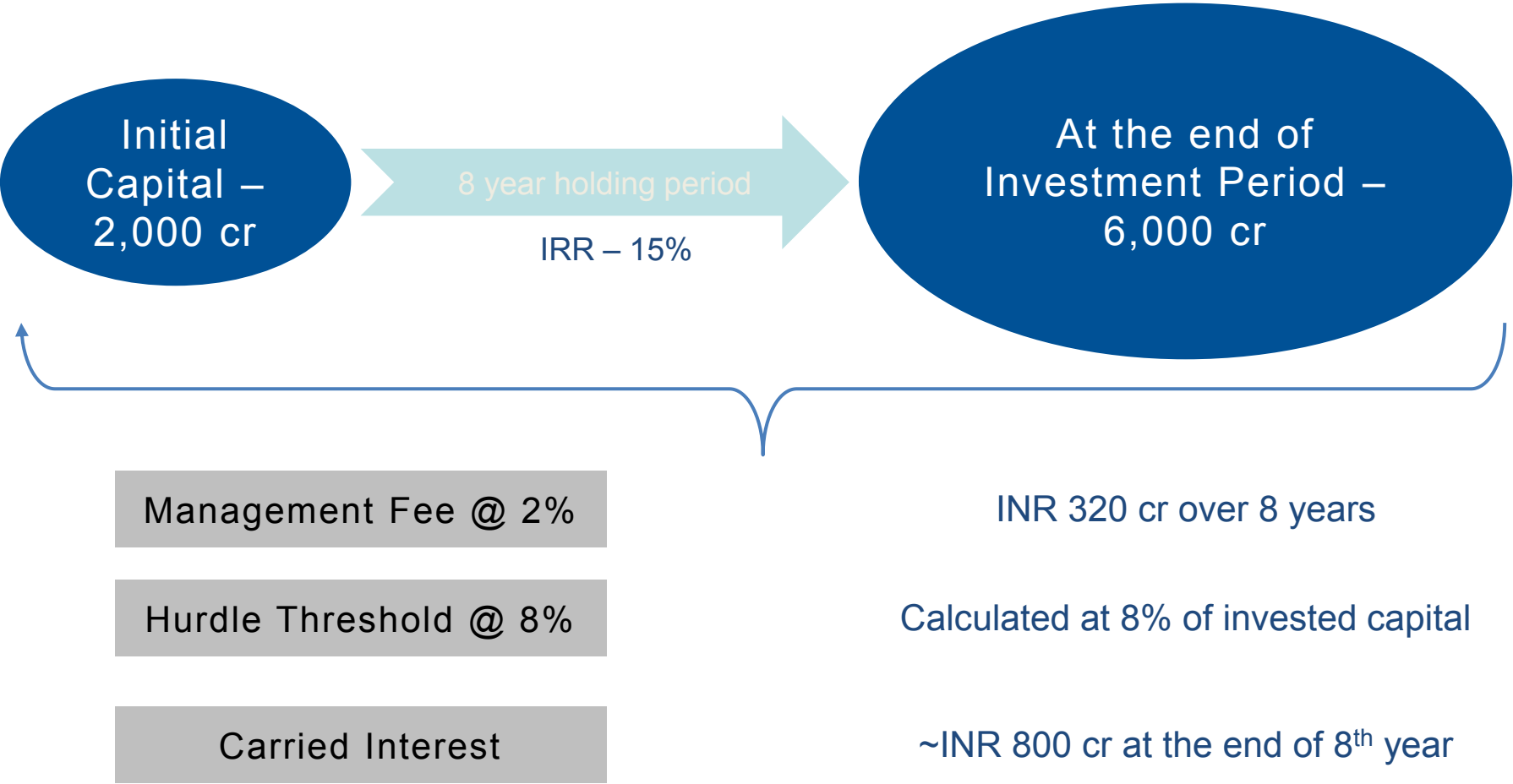
- The impact of private equity on portfolio efficiency and the ability to generate sustainable alpha has been proven
- Private equity portfolio can generate higher and more consistent returns
- Low Correlation with the broader indices
- Access to private companies which are not yet listed in public domain
- Corporate strategic purpose



# STRUCTURE OF PRIVATE EQUITY

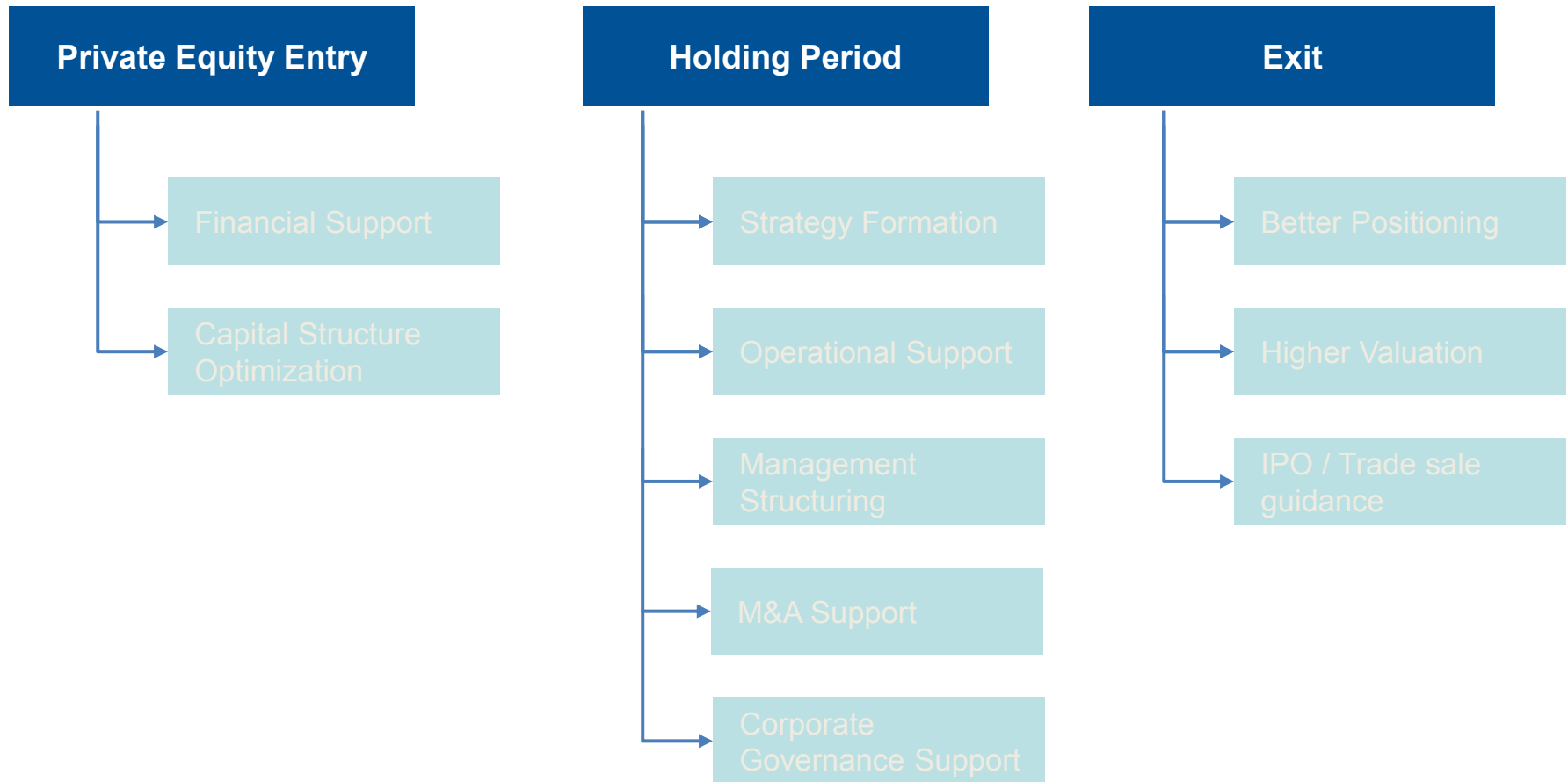


# PRIVATE EQUITY FEE STRUCTURE



Note: Calculation is for representative purpose

# WHY COMPANIES SEEK PRIVATE EQUITY CAPITAL



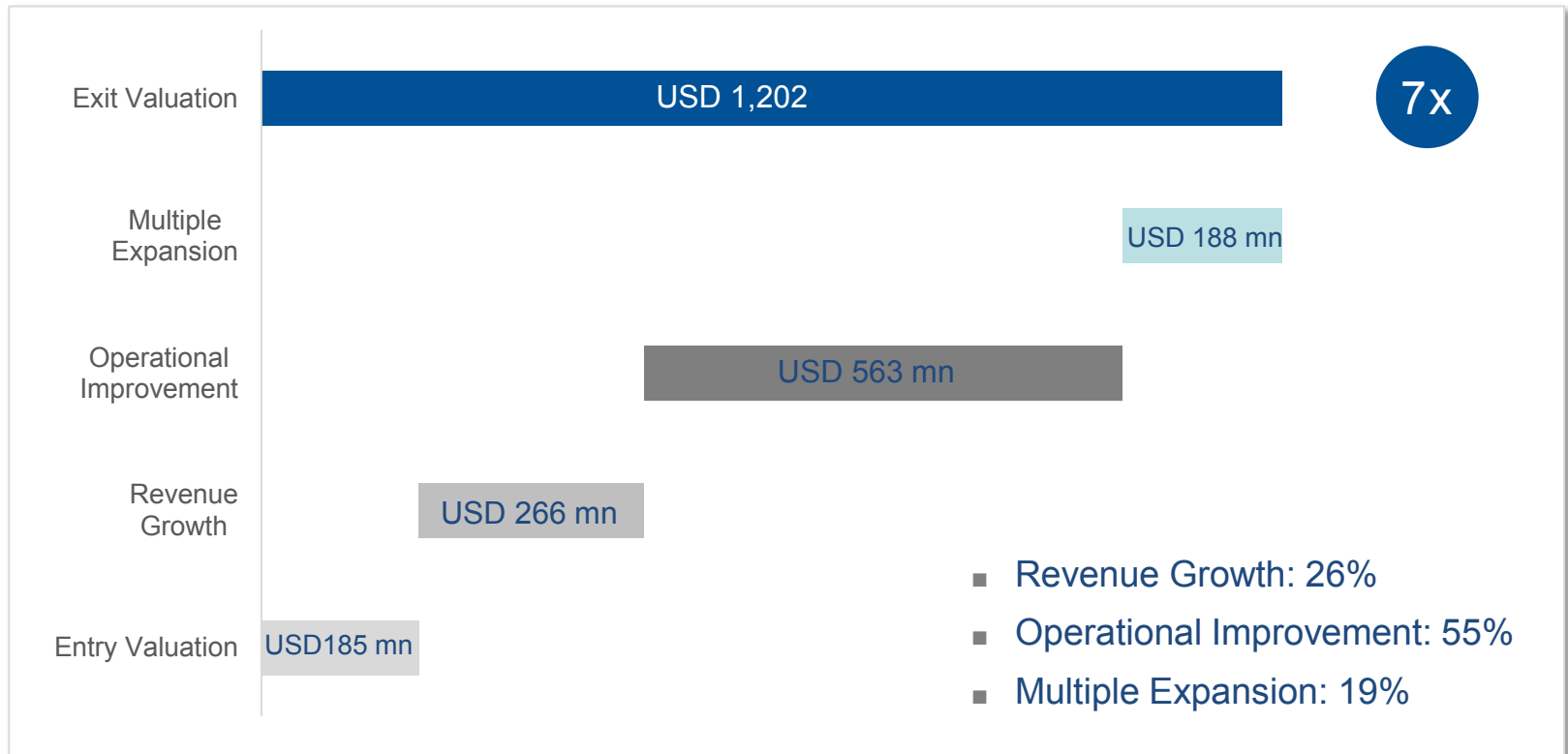
## HOW DOES A PRIVATE EQUITY FIRM CREATE VALUE?



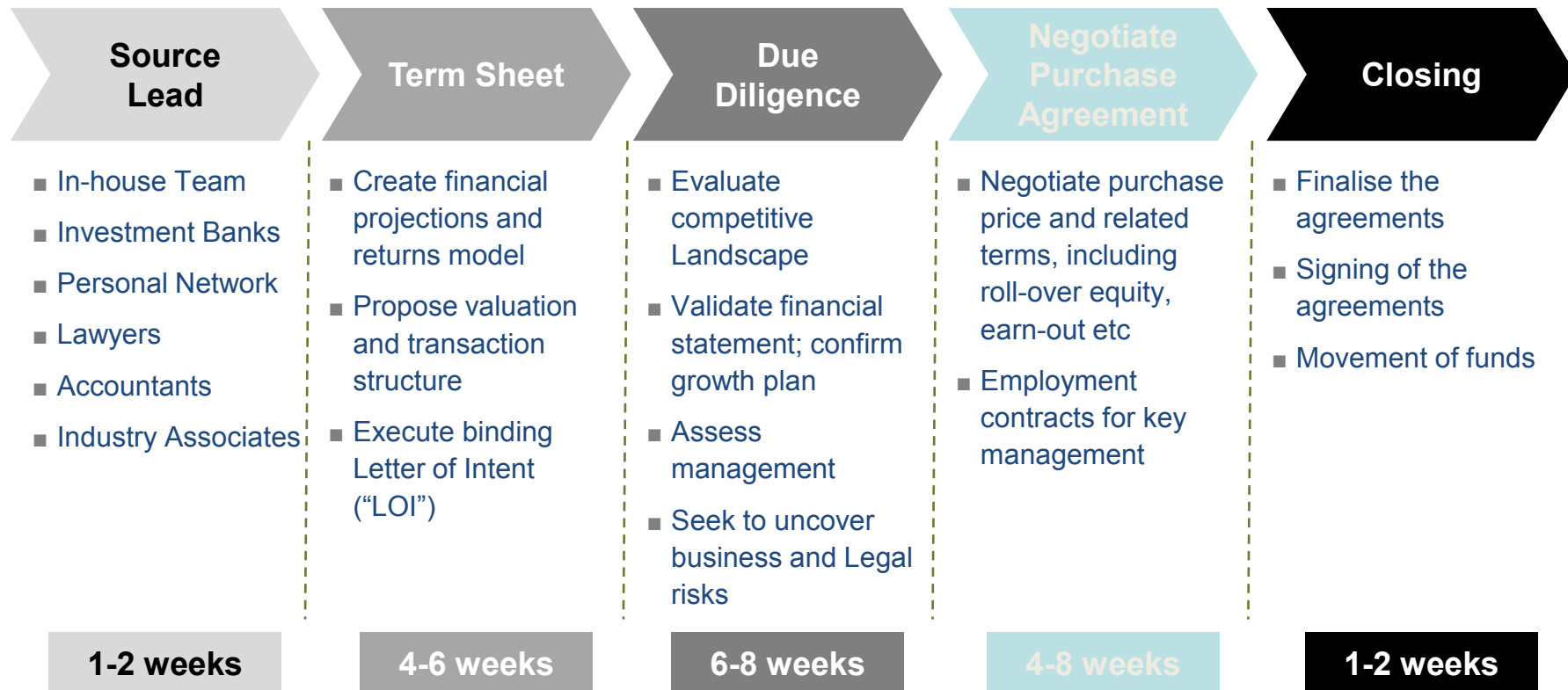
- Alignment of interest between management and business owners
- Upside sharing with the management
- Strengthening top management of the company
- Cost rationalization initiatives
- Long term focus without distraction of quarterly performance
- Assistance in entering newer markets and products
- Inorganic growth via acquisition

## VALUE ADDITION BY PE FUND – ERIS LIFESCIENCES

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



# INVESTMENT PROCESS OF PRIVATE EQUITY

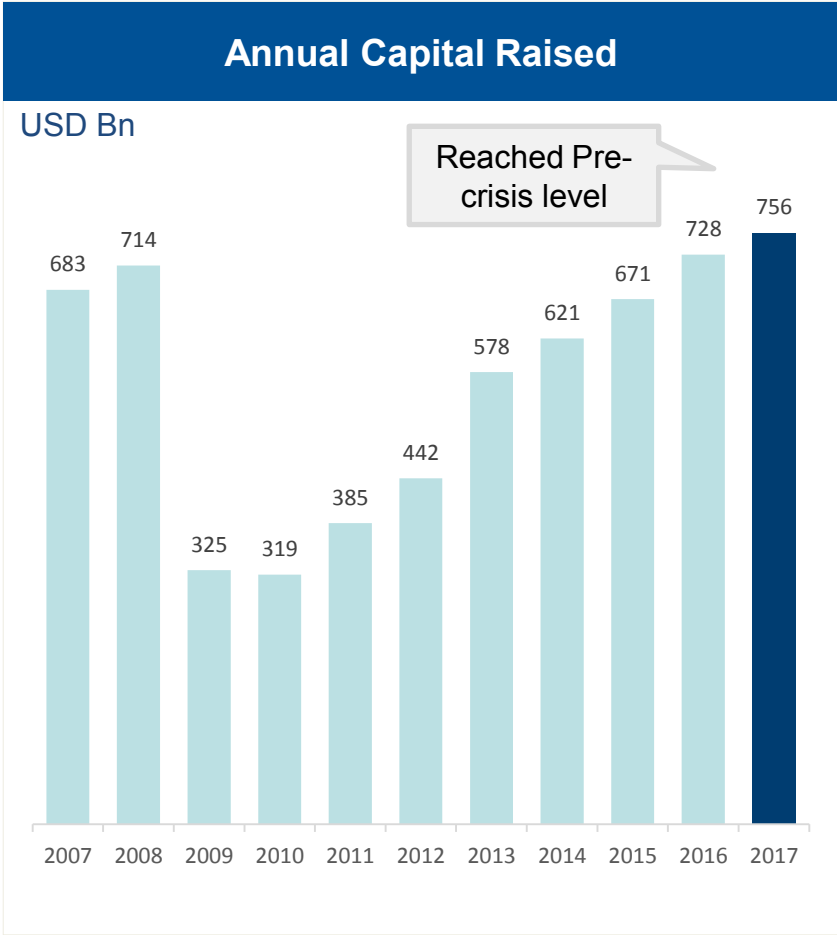
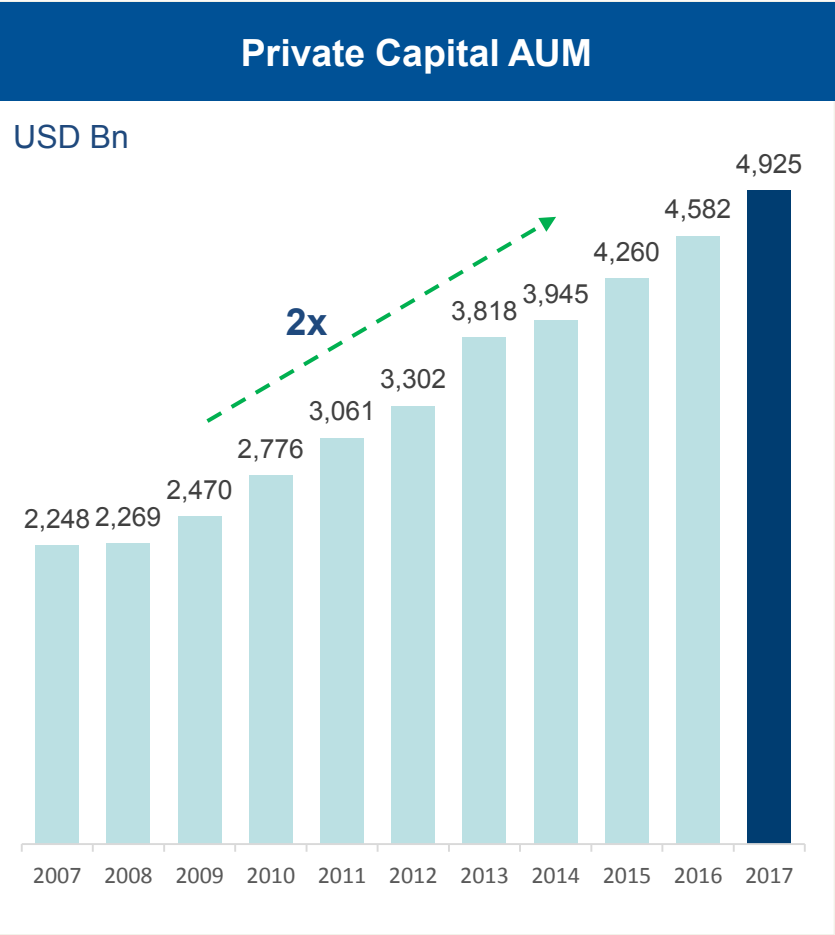


An investment cycle is 4 months to 6 months long from inception to final close



# PRIVATE EQUITY GLOBAL INDUSTRY LANDSCAPE

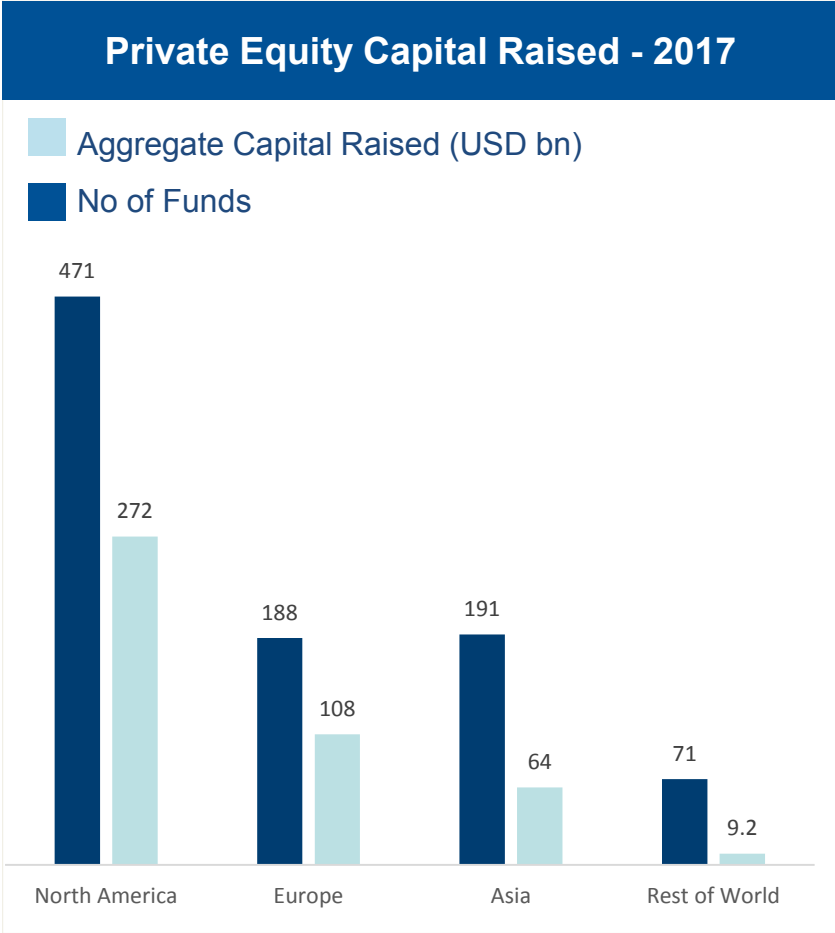
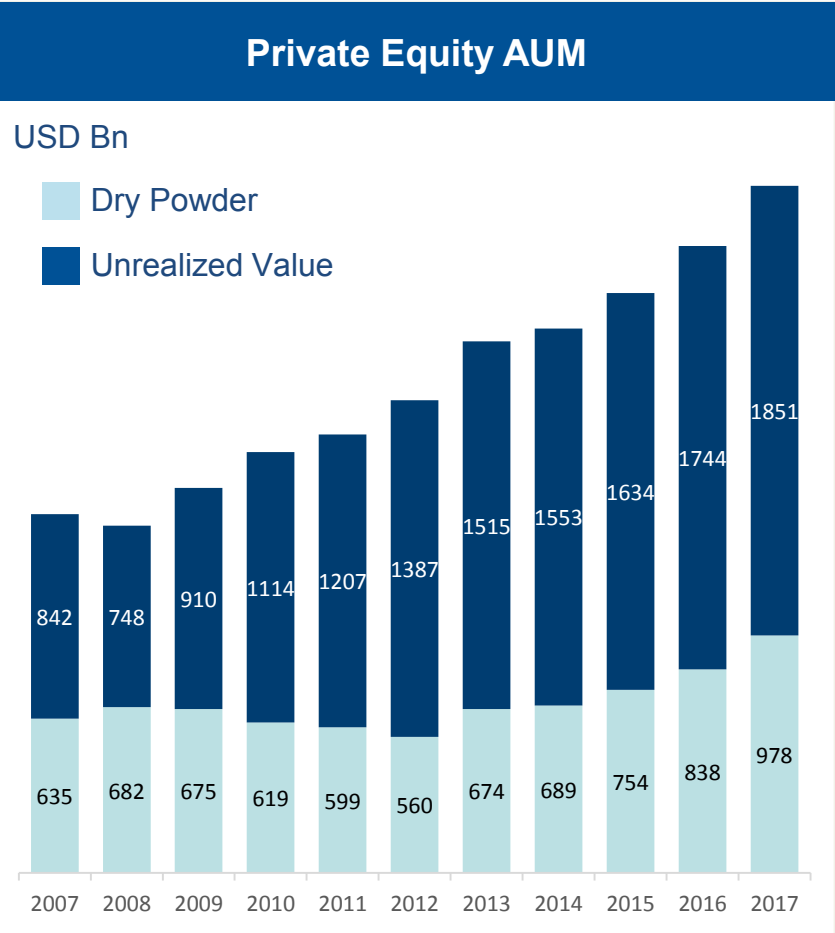
# INDUSTRY SIZE



Source: 2018 Preqin Global Private Equity and Venture Capital Report



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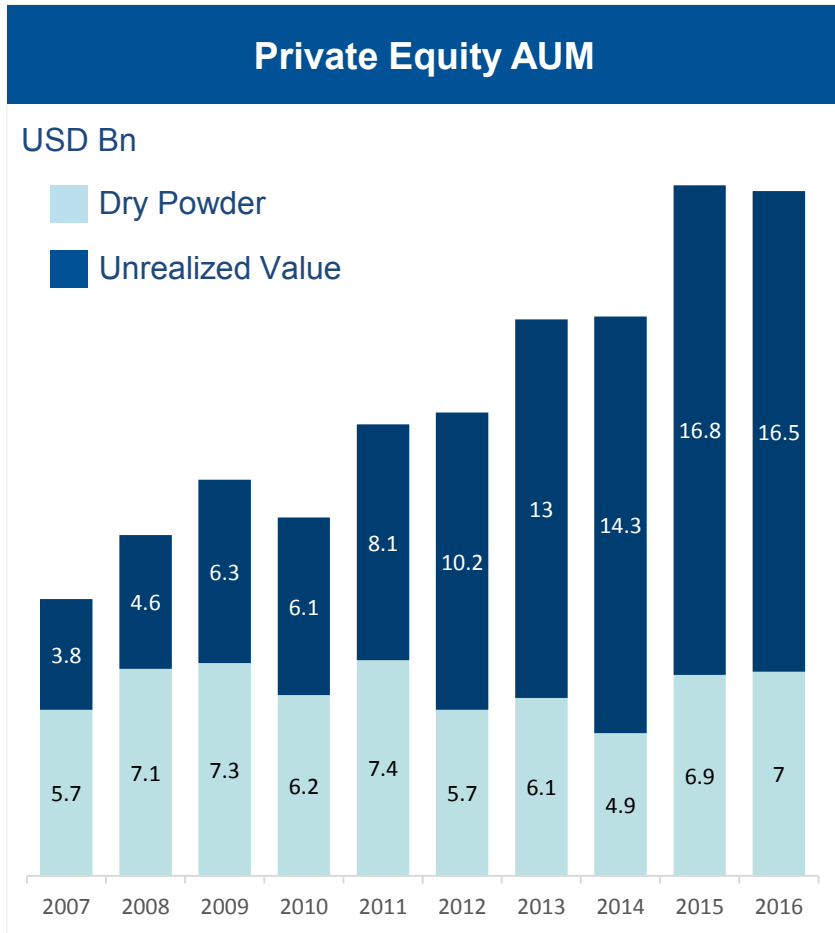
## LARGEST PRIVATE EQUITY FUNDS CLOSED IN 2017

Fund	Fund Size (bn)	Geographic Focus
Apollo Investment Fund IX	24.7 USD	Europe, North America
CVC Capital Partners Fund VII	16.0 EUR	Europe, North America
Silver Lake Partners V	15.0 USD	North America
KKR Americas Fund XII	13.9 USD	North America, Central America, South America
Vista Equity Partners Fund VI	11.0 USD	North America
Clayton Dubilier & Rice X	9.4 USD	Europe, North America
KKR Asian Fund III	9.3 USD	Asia, Australasia
BC European Cap X	7.0 EUR	Europe, North America
Bain Capital Fund XII	8.0 USD	Global
Strategic Partners VII	7.5 USD	Europe, North America



# PRIVATE EQUITY INDIAN INDUSTRY LANDSCAPE

# ASSET UNDER MANAGEMENT IN INDIA



Strategy	AUM (USD Bn)
Private Equity	23.5
Hedge Funds	1.4
Real Estate	10.2
Infrastructure	4.4
Private Debt	3.3
<b>Total AUM</b>	<b>42.8</b>

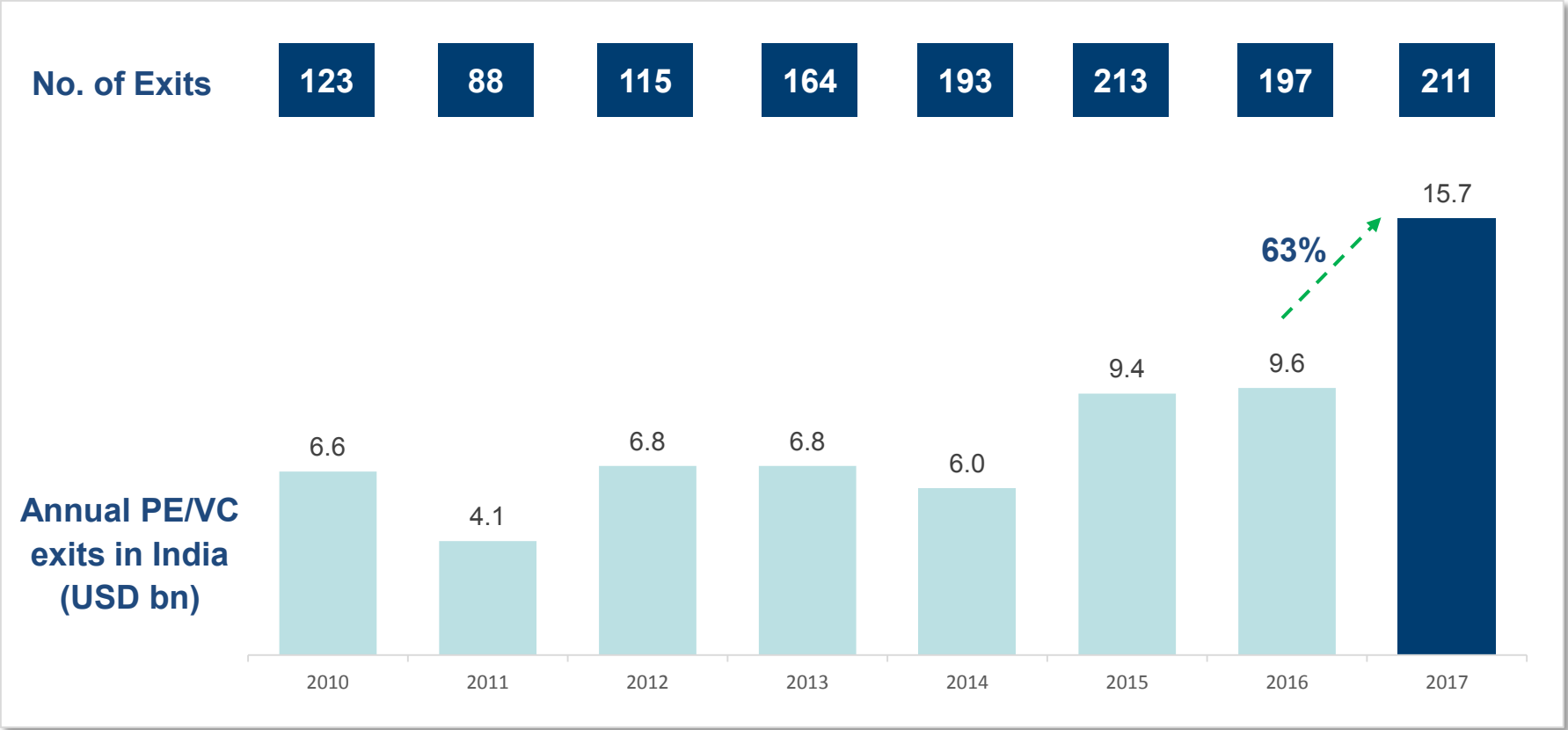
## PRIVATE EQUITY RETURNS IN INDIAN CONTEXT

- Historically, India has suffered due to below average returns when compared to global average

Vintage	Median USD net IRR (%)	Max USD net IRR (%)	Min USD net IRR (%)
Pre 2003	18.2%	39.7%	7.0%
2003 - 05	11.9%	89.2%	-5.6%
2005 - 09	8.0%	16.1%	-11.2%
2010 - 14	6.3%	147%	15.7%%

# INCREASE IN LIQUIDITY EVENTS FOR FUNDS

- However, Private Equity exits in India have increased significantly



Source: Indian Private Equity Report 2018

# INDIAN PRIVATE EQUITY LANDSCAPE



- New funds and asset types have emerged in market: AIFs, Venture Debt, Distressed Asset Fund

## Main Participants include:

- **Global PE Firms** include Apax Partners, Bain Capital, Carlyle, KKR, Soft Bank

## Investors in Private Equity

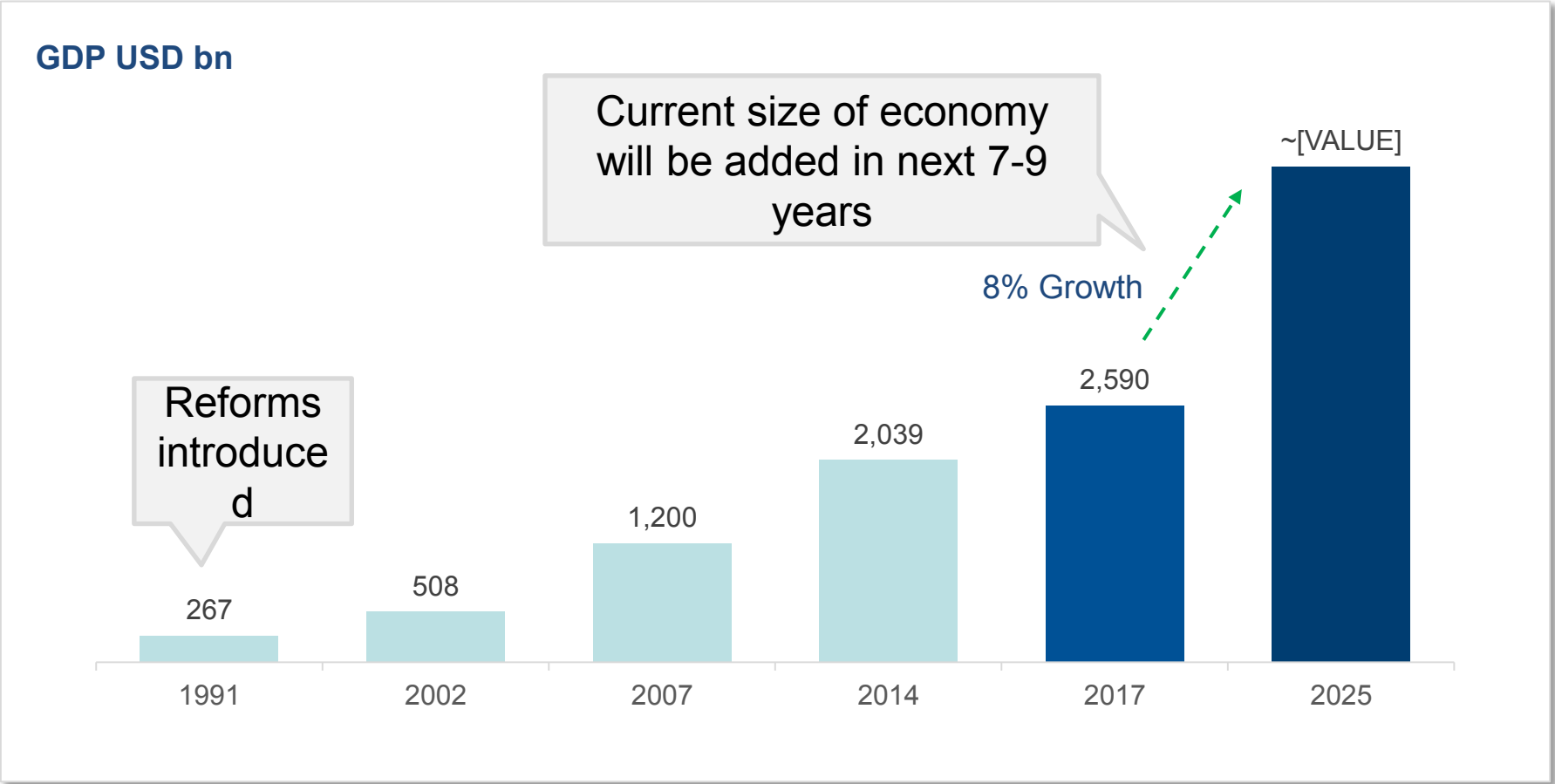
- **SWFs** including ADIA, GIC, Temasek
- **Pension Funds** including CDPQ, CPPIB, OTPPB etc.
- **Other players** such as family offices, smaller local funds, hedge funds



## OUTLOOK ON PRIVATE EQUITY IN INDIA



# INDIAN ECONOMY IS AN ELEPHANT WHICH HAS STARTED RUNNING



Source: statista.com

# PRIVATE EQUITY IS EVOLVING IN INDIA

## Past Trends

Minority Stakes

Early Stage Investments

Selective Investments

Mostly Primary infusion

PE/VCs playing the role of financial advisor



## Emerging Trends

Majority, Buyouts, Large Strategic Deals

Across Cycle, Pre-IPO Stage

Stiff competition, Bidding Process

Open to primary + secondary to match larger ticket sizes

Strategic roles, large investments and stakes creating sector platforms

## PRIVATE CAPITAL AUM BY GEOGRAPHY

### Private Capital AUM (USD Bn)



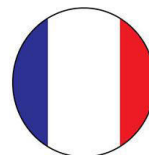
**US**  
2,759



**UK**  
495



**CHINA**  
265



**FRANCE**  
138



**CANADA**  
118



**HONG KONG**  
108



**INDIA**  
42



## ROLE FOR CHARTERED ACCOUNTANTS IN PRIVATE EQUITY

# CHARTERED ACCOUNTANTS CAN HELP THE INDUSTRY IN NEXT STAGE OF GROWTH

**Setting up of an  
Alternative  
Investment Fund**

Conceptualization

Structuring

Implementation

**Operations of PE  
Fund**

Sourcing Deals  
/ Due Diligence

Valuation /  
Taxation  
Advisory

Operations  
improvement of  
portfolio  
companies

# DUE DILIGENCE

## Accounting

- Verifying accounting controls
- Validate historical financials

## Market

- Evaluate market size and projected growth
- Assess competition

## Business

- Review product / service offering
- Understand customers, profitability, and overall business drivers

## Legal / Tax

- Diligence for identifying legal liabilities
- Assessing past and current taxation issues