Pre Investment Stage
Preparatory work and Due Diligence

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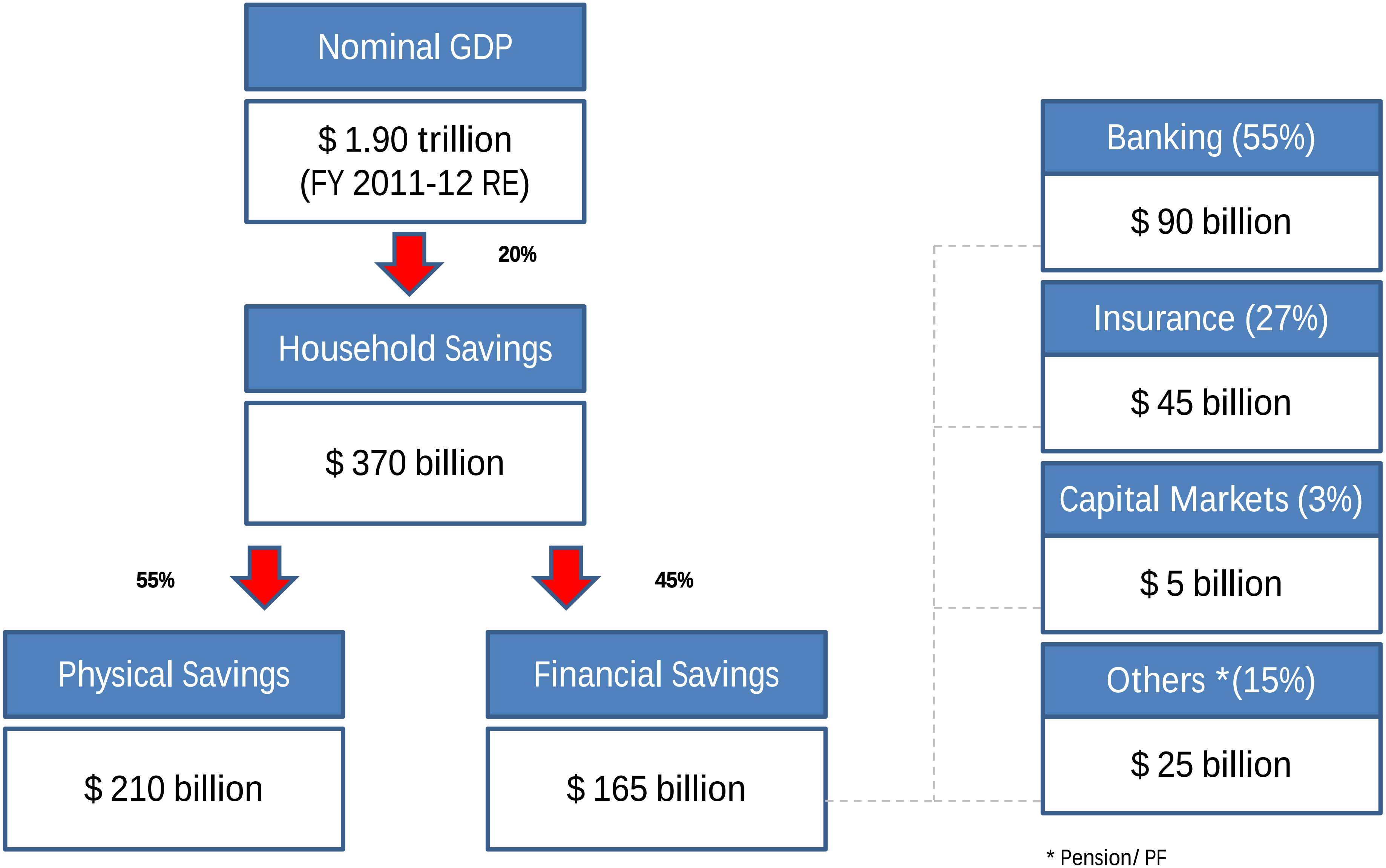
The macro perspective

The Indian Economy & the Banking Sector



The Indian Economy & the Banking Sector

Reserve Bank of India (RBI)

Public Sector (26)

- **Total Deposits: INR 43,724 Cr**
- **Advances: INR 38,783 Cr**
- **Capital & Reserves: INR 3,556 Cr**
- **Key Players:** State Bank of India

Private Sector (21)

- **Total Deposits: INR 11,745 Cr**
- **Advances: INR 9,664 Cr**
- **Capital & Reserves: INR 1,593 Cr**

Old (14)

- **Total Deposits: INR 3,158 Cr**
- **Advances: INR 2,300 Cr**
- **Capital & Reserves: INR 279 Cr**
- **Key Players:** Karur Vysya, J&K, ING Vysya

New (7)

- **Total Deposits: INR 8,587 Cr**
- **Advances: INR 7,363 Cr**
- **Capital & Reserves: INR 1,314**
- **Key Players:** HDFC, ICICI, Axis Bank

Foreign (41)

- **Total Deposits: INR 2,770 Cr**
- **Advances: INR 2,298 Cr**
- **Capital & Reserves: INR 937 Cr**
- **Key Players:** Citi Bank, HSBC, SCB

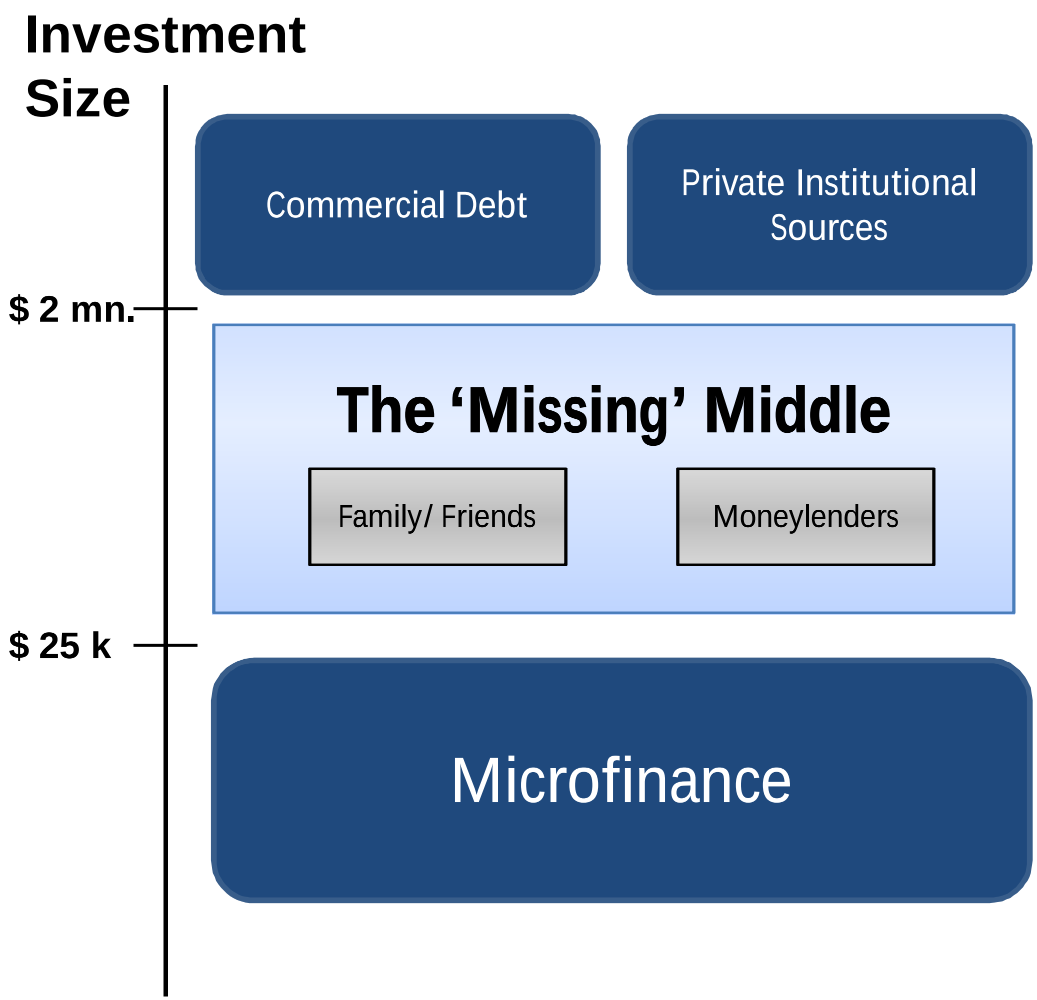
- The Indian Banking Sector consists of 88 Scheduled Commercial Banks as of March '2012 apart from Regional Rural Banks, Co-operative Banks and Local Area Banks.
- The Indian Banking Sector is dominated by Public Sector Banks (PSBs) with a combined market share of around 75% for both credit and deposit till March 2012.
- The total number of branches for Commercial Banking (including RRBs & LABs) as of March 2012 is 97,111 with 63% in rural and semi-urban areas, 37% in metro and urban areas.

In short, we have a well entrenched and fully functional Banking system. Debt is easily accessible to remote constituents of the economy.
The cost of the debt of course is dependent on the fiscal situation - crowding out effect

Is there a gap in project funding

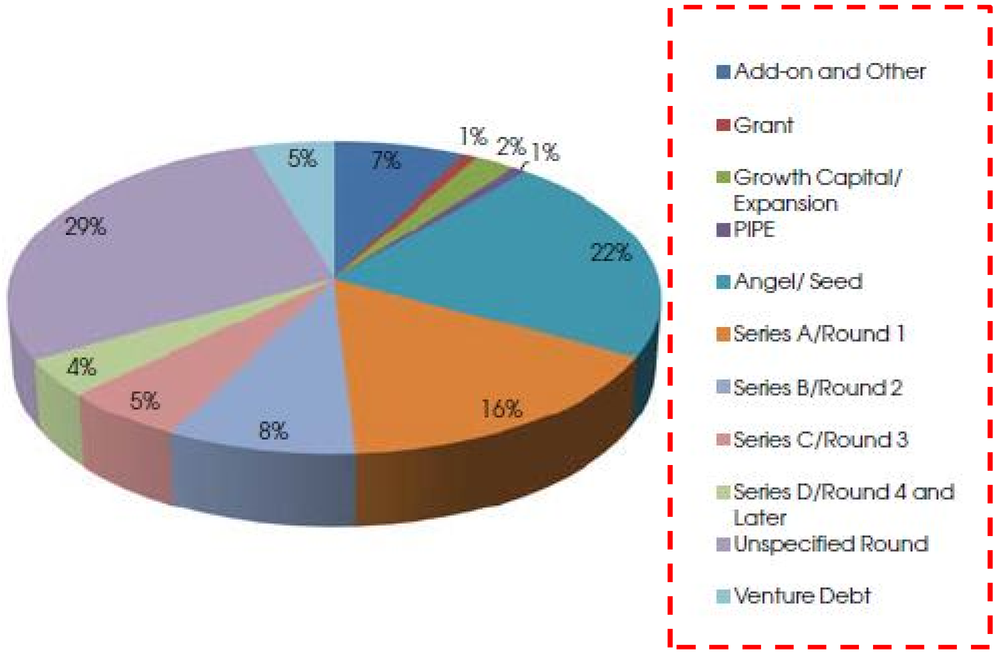
- The debt leverage presupposes an existing capital base
- This capital can be domestic or foreign
- Thus there is an ecosystem of capital seekers and capital providers
- The intermediaries that help arrange this capital and bring the two sides together are the investment bankers
- The PE/ VC/ Seed funds are a special breed of capital providers
  - they channel foreign capital into domestic companies
  - help channel capital into risky ventures and create business transformation stories (ecommerce)
  - also typically chase investment themes
  - operate on an 80:20 principle
  - and a 2/ 20 rule
  - with a low threshold return (12%) and a sharing mechanism with GPs over the threshold.
  - operate under existing regulatory guidelines (AIF)

The Missing 'Middle' of SME Financing



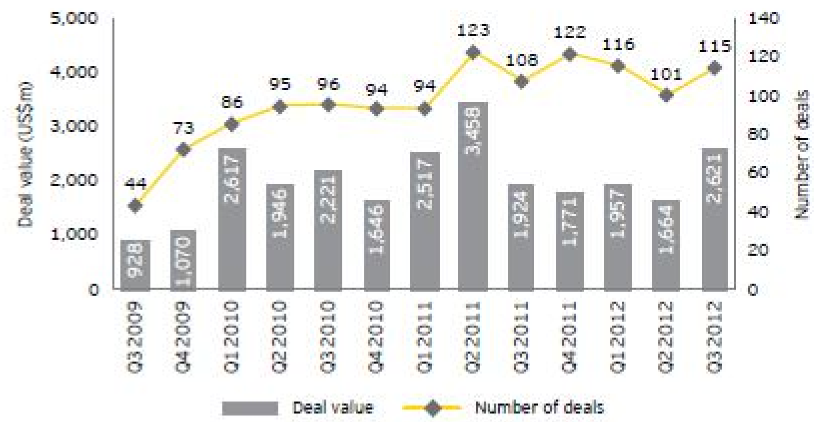
- MSMEs usually have small fund requirements. Dependence to fulfill these requirements is heavily on personal sources.
- While microfinance is not targeted to these companies, access to commercial debt and private institutional sources is usually tough.

Trends

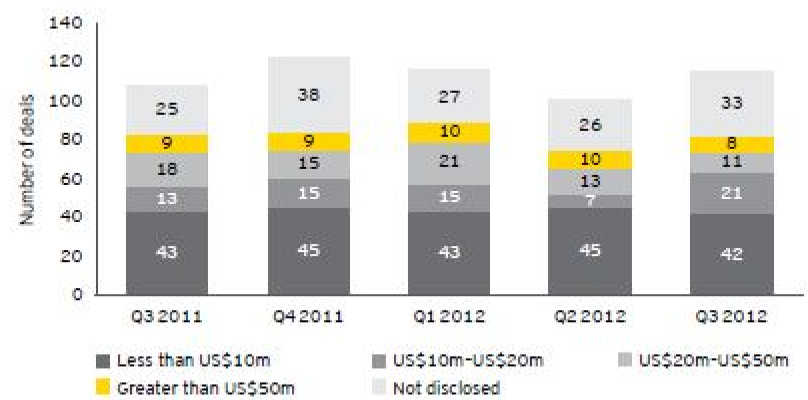


Seventy-eight venture capital deals valued at $610mn were announced in India during Q3 2012

Trend in PE investments



Composition of total PE deal volume by PE deal size



The AIF Regulations

AIF refers to any fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate which:

- is a privately pooled investment vehicle having investors (Indian or Foreign), for investing in accordance with the investment policy; and
- is not covered under MF Regulations, CIS Regulations or any other SEBI regulations regulating fund management activities

Under the AIFs Regulations, following shall not be considered as an AIF:

- Family Trust set up for the benefit of "relatives" as defined under the Co Act;
- ESOP Trust set up under the Employee Stock Option Guidelines or as permitted under the Co Act;
- Employee Welfare Trust or Gratuity Trust set up for the benefit of employees;
- Holding Companies as per section 4 of the Co Act;
- SPV not established by fund manager including securitization trusts, regulated under specific regulations;
- Funds managed by securitization company or reconstruction company which is registered with RBI under section 3 of SARFAESI Act; and
- Any such pool of funds which is directly regulated by any other regulator in India

AIFs Regulations seeks to cover all types of AIF broadly under 3 categories:

Category 1 AIF

Category 2 AIF

Category 3 AIF

AIF Categories

Categories	Key Requirements
Category 1 AIF	▪ Invests in start-up or early stage ventures or social ventures or SMEs or infrastructure or sectors which government considers socially or economically desirable. ▪ Leverage disallowed. ▪ E.g.: - Venture capital funds, SME Funds, social venture funds, infrastructure funds including VCC or VCF as specified under section 10(23FB) of the Income Tax Act.
Category 2 AIF	▪ Refers to those AIF which does not fall in Category I and III and for which no specific incentives or concessions are given by the government or any other Regulator. ▪ Leverage disallowed. ▪ E.g.: - Private equity funds, Debt funds, Fund of Funds.
Category 3 AIF	▪ Investment in listed or unlisted derivatives with a view to make short term returns. Employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. ▪ Can be open ended or close ended. ▪ E.g.: Hedge funds or funds which trade with a view to make short term returns.

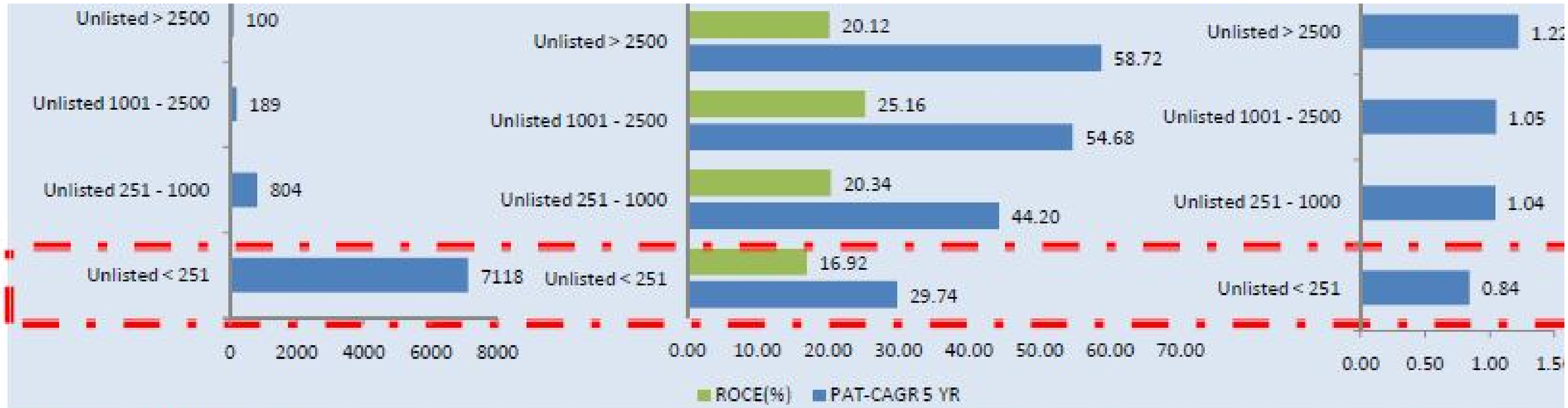
Alternative Investment Fund Regulations

Investment Guidelines: Investments by all categories of AIF shall be subject to the following conditions:

Particulars	Category I	Category II	Category III
Investment in companies incorporated outside India	Permitted (subject to RBI guidelines)		
Maximum investment in single Investee company[2]	25% of the corpus		10% of the corpus
Investment in associates[3]	Permitted only with approval of 75% of investor by value of their investment		
Investment of un-invested corpus	Into liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury bills, CBLOs, Commercial Papers, Certificates of Deposits, etc. till deployment of funds as per the investment objective		
Investment in other Category AIF	Only in Category I AIF of the same category	In Category I AIF and Category II AIF	Category I AIF and Category II AIF
Investment in other Fund of Funds	Not Permitted		
Leverage / Borrowings	Not permitted except for meeting temporary funding requirement subject to leverage of not more than 30 days, not more than 4 occasion in a year and not more than 10% of the corpus		Permitted subject to consent from the investors in the Fund and subject to maximum limit as may be specified by SEBI

Target Mid Segment – has large untapped scope

Large base of unlisted mid-market Cos | **With scope for operational improvement** | **And spare debt capacity**

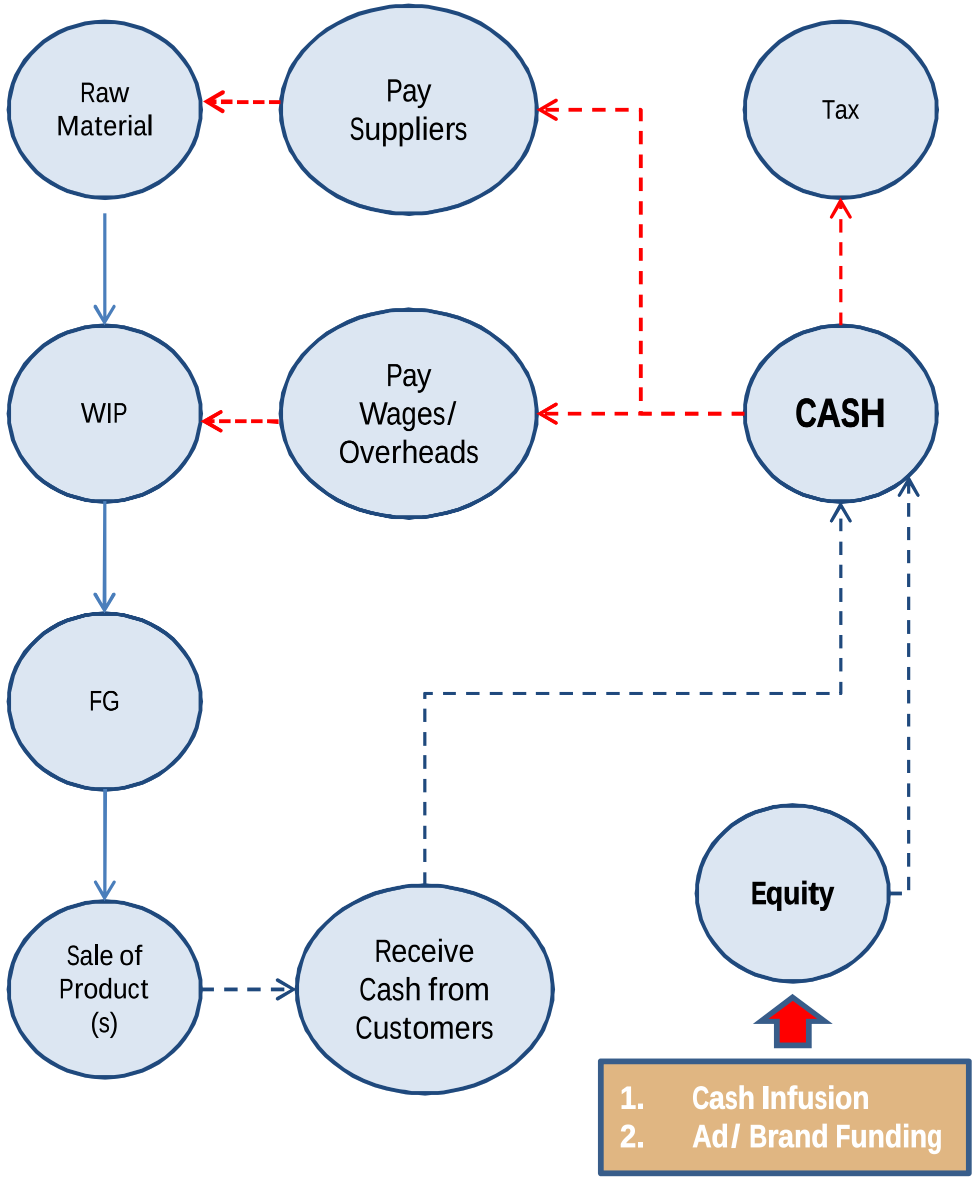


Source: Accord Fintech; CMIE

- A large base of over 7,000 companies which are unlisted an have a turnover < INR 2,500 million.
- These Companies have potential for improvement in operations and growth rates (with ROCE's and PAT CAGR lower than average)
- There is also spare debt capacity at these firms due to limited availability of Bank funding
- A large pool of mid market companies with turnover < INR 2,500 million with possible upsides from scale, operational improvement and spare debt capacity

Mid Segment 'Buyouts' have a larger target market and are easier to execute. On the flip side, the only problem alleviated is the 'comparatively' lower capital requirement. Difficulties remain.

Minority Growth & SME Control



Key Factors of Production

- Financial Capital
  - Owners Contribution
- Fixed Capital
  - Machinery/ Equipment
  - Factories, Technology
  - **Brand Spends**
- Working Capital
  - Inventory/ Stocks of Finished & Semi Finished Goods

Impact of Breakage in WC Chain

- Any breakage in the chain would impede cash flow through the system.
- Any disruption in the working capital cycle will also adversely impact the cash conversion cycle.
- Prolonged disruptions can damage the business significantly.

Pursuing co-investment opportunities with cash investors in select consumer demand verticals* with 'ad relevance' lets us pitch ad capital deals at a later stage – can be used as a market entry strategy.

Cash Inflow
Cash Outflow

** Identified Sectors in following slides*

How do Funds manage returns?

- **Identifying The right Business**
  - Growth Oriented
  - Scope for margin improvement
  - Leveraging
  - Strong Management

- **Generating Scale and Operations Improvement**
  - Sweat Equity. Incentivizing the professional management class.

- **Improvement in Exit Multiple**
  - Scale Rerating
  - Control premium

- **Challenges**
  - Restricted leveraging capability (robust corporate bond markets a pre-requisite).
  - Managers unwilling to commit much of own capital.
  - Sellers less concerned about quality of buyer, valuation sole criteria.
  - Issues around quality of information, legal compliances in businesses being bought.

What does a Private equity firm bring to the co

- Long-term capital, underpinning the company's growth aspirations;
- increased visibility within the ecosystem i.e. with bankers, suppliers and clients;
- alliances due to the investor's network of contacts and portfolio of investments;
- partnership model, one that entails sharing risks and the rewards;
- an investment within a pre determined framework of a negotiated contract/ set of terms;
- adoption of high-performance management standards/ corporate governance;
- strategic/ operational support and financial advice;
- assistance with subsequent financing rounds;
- partial or total exit strategy.

What is a Private investor looking for …

Key Imperatives for a private investor

- High growth, competitive products or services;
- scalable models, demographic advantage etc..
- a key imperative .. A quality and stable management team, one that's capable of turning the negotiated goals into reality;
- sound corporate governance practices/ solid management procedures, either already in place or able to be quickly put in place;
- a transparent legal structure where personal and professional assets are not entangled;
- an agreement on the investor's exit, with or without the head of the company.

Questions needed to be answered by the company - Implicitly or otherwise

- Does your company have the potential to achieve sustained growth?
- Does the management team have the necessary skills?
- Does the probable return on investment justify the risks taken?
- Does the investment match the fund's investment criteria?

What’s important..due diligence?

Understanding of the business's potential. It’s worth in three to five years?

Does target's competitor have cost advantages? Cost structure above/ below expectations given its relative market position? Optimal cost position?

Target's market? Size, growth rate, by geography, product and customer segment.

Compare target's customer segments - profitability, potential, disadvantages vis-à-vis competitors.

Fully penetrated some customer segments, neglected others? Can target continue to grow ahead of the market?

Examine capabilities of competitors

As also to companies seeking private investors.

- Funds Utilization
- Structure - Fixed/ Convertible/ straight equity or warrants
- Anti Dilution (Full ratchet/ weighted average) - Why Important ?
- Price Protection
- Promoter lock-in
- Liquidation preference
- Related party
- Conditions Precedent - What can it achieve
- Exits - Share buyback/ Tag along & Drag along Rights / Right of First offer
- Affirmative rights - what should it cover?
- Exclusivity

Full Ratchet - Exercise

Microsoft Office
xcel 2007 Workbool

The other important questions..

Company Valuation: Some questions

- Entry, Exit - Why/ How
- What to watch out for when valuing unlisted companies
- Peer Group Definition
- How much role do fundamentals play
- Macroeconomic Environment/ In vogue investment ideas influencing investment thesis

- Case Study
  - Normalize financials – why important
  - Determine entry valuation – why variable cases are important
  - Exit valuation – how to measure / predict value (multiple arbitrage, organic growth, capital structure optimization)

An example...

Lets take an example..

Consumerization
Industry is moving towards premium. Brands carry monetizable value.

Access to content
Viewership shifting from traditional TV viewing. Multiple ways to entice a consumer

Print Media
India to map the structural change underway globally. An Opportunity?

Spaces are undergoing structural shifts. Interplay between each will create newer opportunities.

Distribution
Collapsing Supply Chains. Online wave - a threat to brick-mortar distributors!

Intermediary Business
Yields will continue to be squeezed

The approach – primary filters

Identifying The right Business

- Growth oriented with a clear path to scalability and scope for ..
- .. margin improvement in a going concern and amenable to ..
- ..leveraging that can increase return for shareholders - A rupee invested can be levered by upto INR 2 of debt. And in doing so, partner with management that has ..
- ..strong domain competence and a proven track record.

Thus as part of the strategy

- Target the MSME Space since it would yield deal sizes that fit into the charter.
- Target low capex models since they obviate frequent equity dilution.
- Target consumer demand segments. These target a large demographic, ties in with the India economic growth model and leverages investor capabilities.

Consumer Discretionary Led Models	
Food Service	Apparel & Footwear
Small Home Appliances	Personal Care
Branded Foods	Home Automation
Medical Disposables	

The Consumer Discretionary Sub Spaces – WHY?

Small Home Appliances

- Consumer Durable segment has been growing at over 20-35% y-o-y. Premium appliances growing at a higher rate.
- Average penetration of Home appliances in India is 5-10% as against 75% in US.
- Prevalence of Asset light model resulting in high ROE. Average ROEs of 30%+

Food Service

- Restaurant/Food service market in India is growing at the rate of 20% annually
- Among the various formats, QSRs and cafes have had the maximum growth over the last few years.
- Valuations have been close to 2x sales

Branded Foods

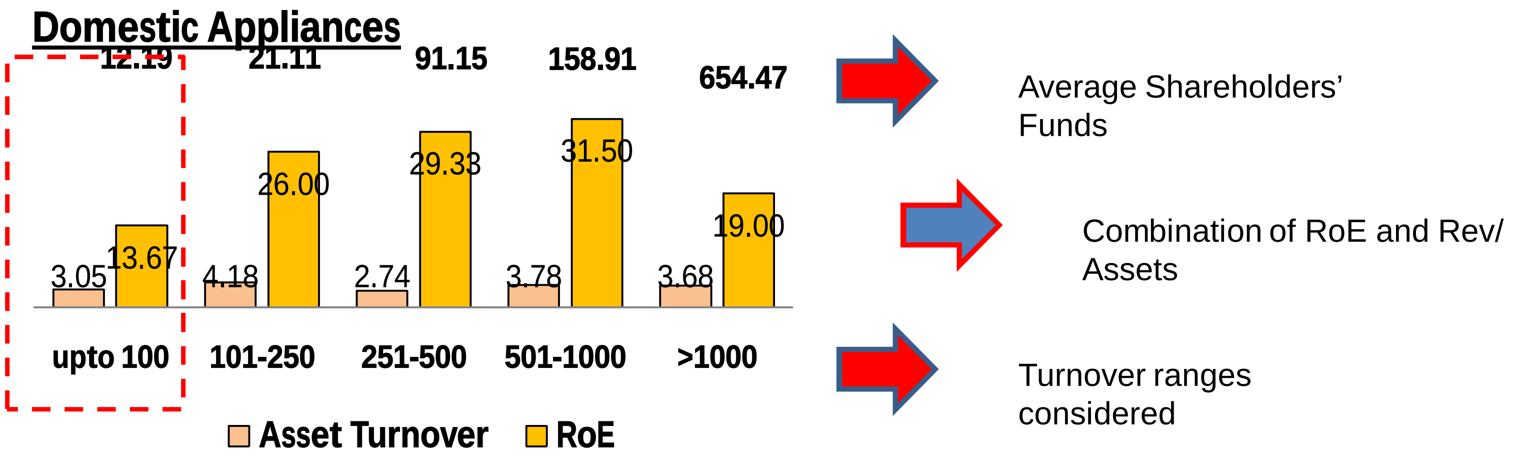
- Indian Health & Wellness Foods industry is over INR 1000 Crores in size and growing by over 25% CAGR. Yogurt, fruit juice, energy & sports drink are likely to be ~8x current size by 2015
- Ice Cream Industry is over INR 2700 Crores and is growing by over 16% CAGR.
- Snack food in India is estimated to be worth 12,000 Crores, with the branded snack market estimated to be around 5,000 Crores, growing at 15-20 per cent a year

Apparel & Footwear

- The branded apparel segment is estimated to be Rs 9,000 Crores. The women wear segment is growing at a rate faster than men's wear.
- Indian footwear market was valued at INR 16,000 Crores. The market is dominated by the men's footwear collection, accounting for 48% volume share

Personal Wear

- Indian personal care market is valued at INR 224 bn. in 2009 and is growing at 19% CAGR
- Market can be categorized as bath & shower, hair care, skin care, color cosmetics and fragrance
- Sector seeing a lot of M&A - Emami - Zandu, Dabur - Femcare India

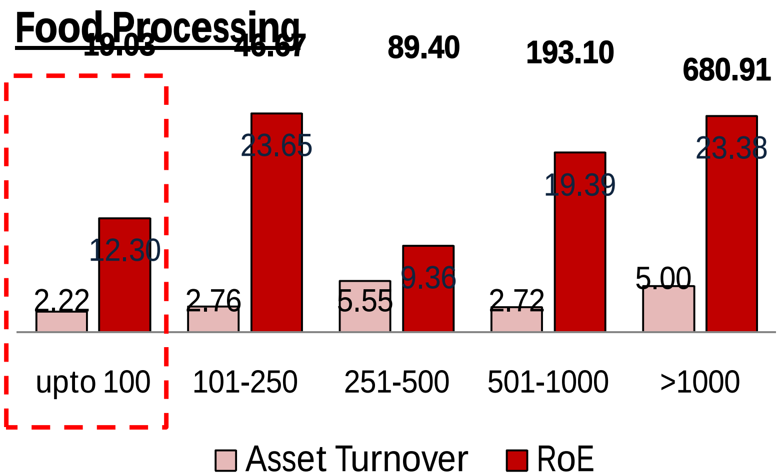


- Companies in the domestic appliances space were segregated into revenue buckets viz. upto INR 100 Crores, 101 Cr-250 Cr etc.

- Average shareholders' fund, Asset Turnover ratio and Return on equity plotted for each of the subcategory. It was found:
  - The average capital requirement ranges from INR 10 Crores (upto INR 100 Cr turnover) to over INR 150 Crores (turnover over INR 500 Crores)
  - There is clear evidence of improving turnover and return metrics with increasing scale. Thus a company transitioning to category II is expected to gain scale faster than otherwise.

Positive to explore
Investment opportunities

Food Processing



Average Shareholders' Funds

Combination of RoE and Rev/ Assets

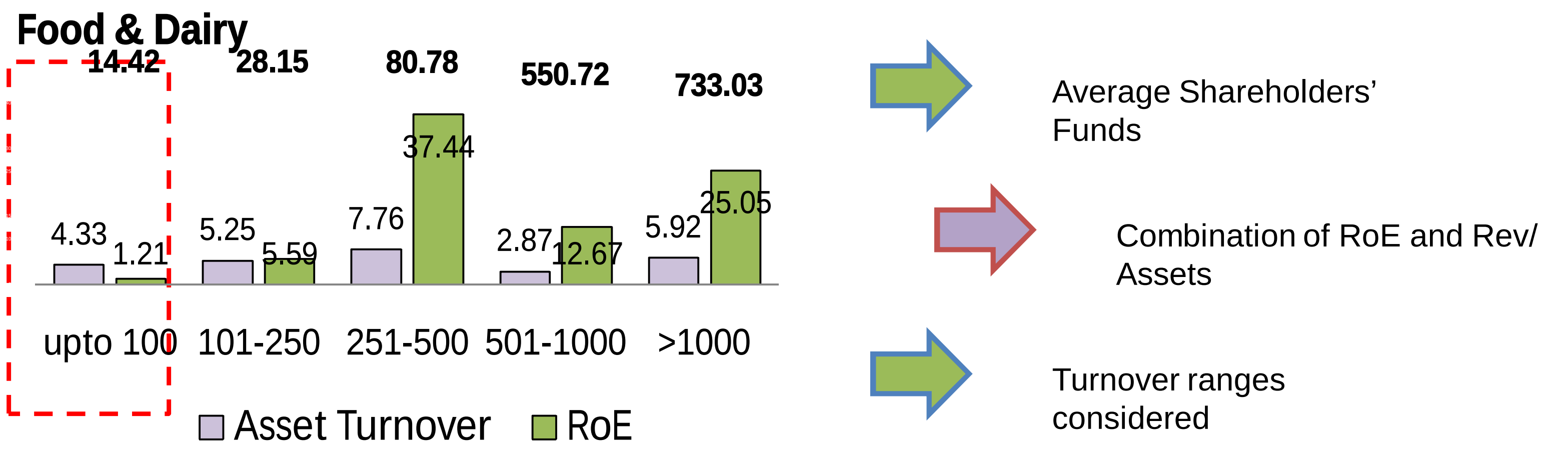
Turnover ranges considered

- Companies in the food processing space were segregated into revenue buckets viz. upto INR 100 Crores, 101 Cr-250 Cr etc.

- Key Findings:
  - The average capital requirement ranges from INR 20 Crores (upto INR 100 Cr turnover) to over INR 200 Crores (turnover over INR 500 Crores). Sectoral Asset turnover values are high, but require greater unit capital allocation.
  - Arbitrage available in case of both turnover and return metrics as scale increases. Thus a company transitioning to a higher category gains scale and improves shareholders' return faster than otherwise.

Positive to explore
Investment opportunities

Food & Dairy



- Companies in the Food & Dairy space were segregated into revenue buckets viz. upto INR 100 Crores, 101 Cr-250 Cr etc.

- Key Findings:
  - The average capital requirement ranges from INR 15 Crores (upto INR 100 Cr turnover) to over INR 550 Crores (turnover over INR 500 Crores). Average shareholder fund infusion remains on the higher side. Asset turnover ratios remain high on account of the high depreciation effect.
  - While scale tends to improve operational metrics the change is not as pronounced as with other categories.

Positive to explore
Investment opportunities

Food Segment – The Market Size

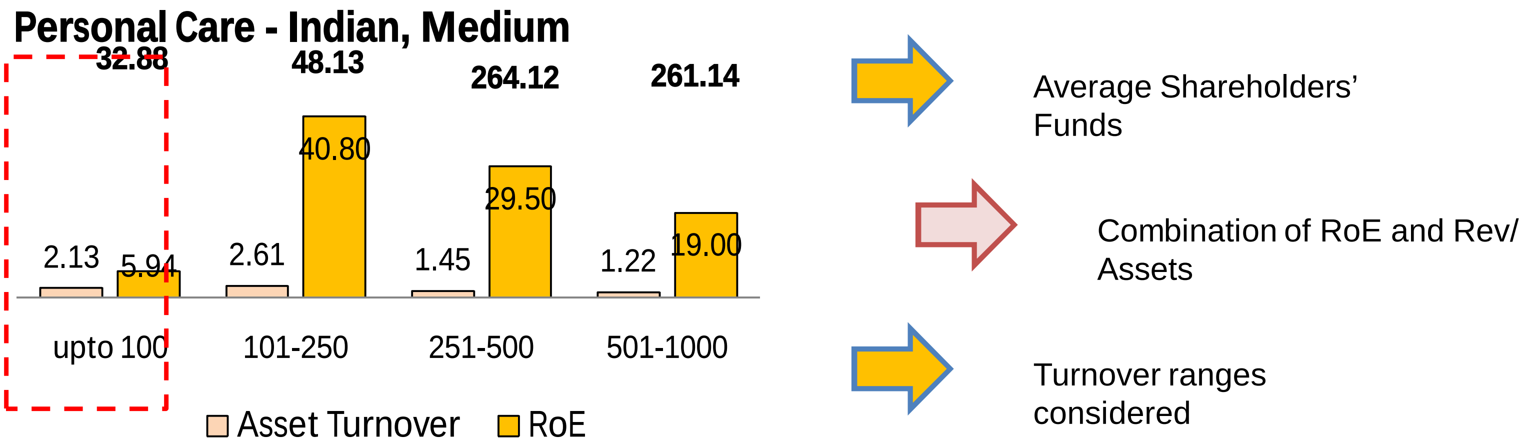
Segment (INR Bn.)	2011	2015E	CAGR (%)
Biscuits	120	210	15%
Branded Snacks	60	105	15%
Bottled Water	30	54	16%
Value Added Dairy	25	52	20%
Ready to Eat	5	14	30%
Total	**240**	**435**	

- Each of the above segments require a robust "distribution network" and will potentially require brand creation ability.

- The immediate opportunity in the above categories alone is more than two times HUL's current market size (HUL turnover of INR 22,000 Crores in FY 11-12)

Segment (INR Bn.)	2011	CAGR (%)
Chocolates	30	20%
Ice Cream	25	20%
Fruit Juices	12	20%
Total	**67**	

Personal Care Indian, Medium

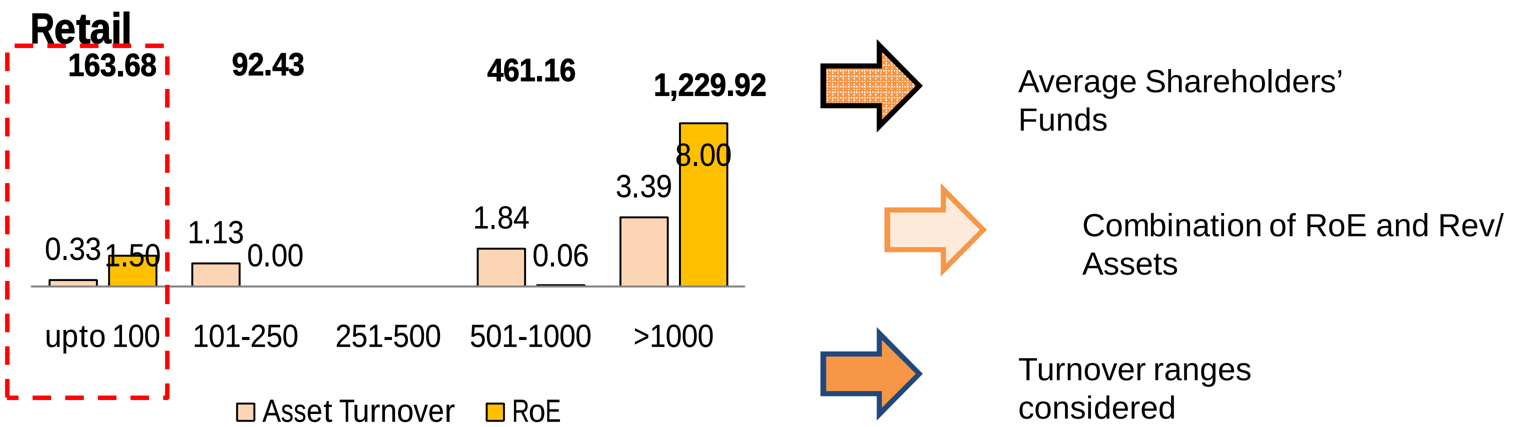


- Companies in the Personal Care space were segregated into revenue buckets viz. upto INR 100 Crores, 101 Cr-250 Cr etc.

- Key Findings:
  - Exhibited high median startup capital requirements ranging from over INR 30 Crores (upto INR 100 Cr turnover) to over INR 250 Crores (turnover over INR 500 Crores). However capital requirements cap out beyond a certain amount and returns tend to stabilize.
  - Scale does not seem to have significantly positive impact on the operational metrics.

High Consumer Connect. Reasonable returns on equity. Positive.

Indian Retail



- Companies in the Retail space were segregated into revenue buckets viz. upto INR 100 Crores, 101 Cr-250 Cr etc.

- Key Findings:
  - Very high capital requirements. Asset turnover ratios severely depressed on account of high current assets mainly high inventory. Very low to negative RoI.

Avoidable.

Thank You