Date : 08-Jan-2007 Edition : National Page No.: 42 Page Name: n.a. Size: 423.98 sq. cm

Sector: Banking and Finance Circulation: 139019 AVE: Rs.332826.58 Frequency: Weekly

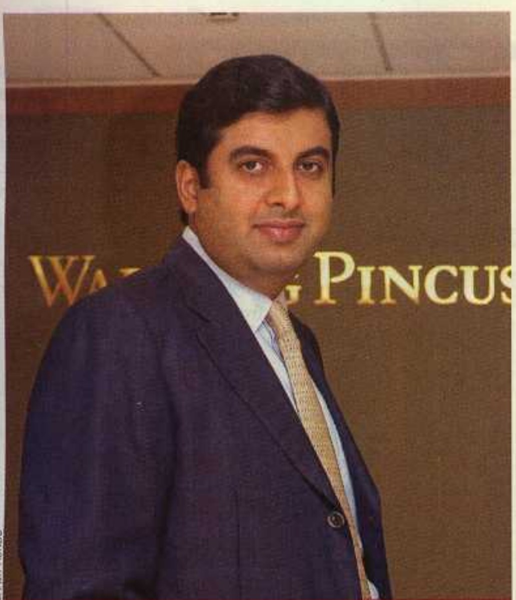
Businessworld

cover story

Small is BIG

India's $8-billion private equity business owes much of its success to small and medium enterprises. And this is just the beginning.

By Snigdha Sengupta



SANJIT KUNDU

Rajesh Khanna, managing director, Warburg Pincus India, has invested over $1.5 billion in India in the past seven years and half of it is SME-focused

HEMANT MISHRA

Donald Peck, managing partner, Actis India, has invested over $400 million in India. Peck believes the best opportunities are still in mid-market companies

Ashish Dhawan, senior managing director, ChrysCapital, has invested $449 million in 32 companies. More than half are in the SME segment

Date : 08-Jan-2007 Edition : National Page No.: 43 Page Name: n.a. Size: 436.76 sq. cm

Sector: Banking and Finance Circulation: 139019 AVE: Rs.342860.07 Frequency: Weekly

Businessworld

SMEs

AT $8 billion and counting, India's private equity (PE) market has achieved a certain critical mass in the past seven years. Various industry estimates put PE investments for 2006 alone between $3 billion and $7 billion. What's interesting is that over 70 per cent of this money has been pulled in by the mid-market segment or what is commonly known as small and medium enterprise (SME). Experts reckon that this trend will continue well into the next five years, as the Indian PE market matures.

One of the best indicators for how well the SME card has worked for PE in India is the market's track record with exits. Notably, most of the big exits have come from SME investments. Take some of the marquee exits over the past two years. In August 2005, Citigroup sold 41 per cent of its stake in i-flex Solutions to Oracle for $593 million. Then, in June 2006, Baring Private Equity sold its 34.73 per cent stake in MphasiS BFL to EDS for $380 million. And in August, Temasek Holdings and Newbridge Capital sold their 40 per cent stake in Matrix Labs for $736 million. "Growth continues to be the overriding opportunity in the Indian private equity market and we have just uncovered the tip of the iceberg," says Rajesh Khanna, managing director, Warburg Pincus India. Warburg has already invested over $300 million this year out of its $8-billion global fund and the portfolio has stuck to the SME formula.

For purposes of clarity, let us first define the term SME in the PE context. From a private equity perspective, companies below the Rs 300-crore revenue mark have been categorised as SMEs. Most of the PE exits mentioned in this story involve companies that were well over the Rs 300-crore mark at the time of exit. They would still qualify as SME exits because the investments were made at a time when their revenues were well under Rs 300 crore. Also, in mature PE markets like the US and Europe, SMEs would have typically been venture capital (VC) — seed to early-stage funding — targets rather than PE portfolio targets. In the absence of a vibrant VC industry in India (until now), PE firms have, in many cases, taken on the role of VCs. Consider Warburg Pincus' 1999 bet on Bharti TeleVentures. At that time, Bharti was one of the smallest telecom companies and India's telecom market was waiting to be discovered. In the US, Bharti would have been ideal picking for a venture capital firm — early opportunity, high long-term returns, etc. Warburg eventually invested $292 million over multiple tranches. When it exited in October 2005, it made $1.9 billion. Like telecom, PE investors in India have found early-to-growth stage opportunities across a spectrum of emerging sectors — healthcare, retail, auto components, IT services, and even infrastructure. "Most high-growth sectors in India are still fairly nascent and that requires a different investment approach," explains Donald Peck, managing partner, Actis India, which has been investing in India since the early 1990s. Some of its key investments include Jyothy Labs, Tavant Technologies, Daksh eServices and Glenmark Pharma.

Another factor that has influenced investments in SMEs is the availability of a large repository of mid-market listed companies. While in mature markets a company usually has to turn in $200 million-300 million revenues before it can list, in India the bar is much lower — $20 million-30 million. Investing in listed companies means exits are easier and that has been a big lure for PE investors. Also, since most of these companies, despite being listed, are relatively young in their businesses, they make attractive long-term bets. Delhi-based ChrysCapital is an example of a PE investor that has used this advantage to great success by doing what in PE terms is known as PIPEs (private investment in public enterprise). Out of some 32 investments till date, 14 have been PIPE deals.

Some recent deals in the Indian market illustrate the point. ChrysCapital picked up stakes in Shriram Holdings in 2006 at Rs 35 per share (it is now at Rs 100-110 per share). It also entered Gammon India at Rs 100 per share and exited the company at Rs 400. Recently, Warburg has invested in Vaibhav Gems at Rs 230 per share while Citigroup and Henderson have invested $50 million in Jubilant Organosys.

PE's close ties with SMEs have perhaps been most evident in the IT sector, which has had more than its fair share of deals. Some of the key VC exits in recent years — such as Intel Capital's exit from Pune-based Sasken through a $30.2-million IPO — have happened in this space. In terms of strategic sales, Infinity sold its stake in online gaming company Indiagames to the Chinese firm Tom Online for $17 million in 2005. There have been a clutch of non-IT exits as well — PVR Cinema's $39.5-million IPO, which gave ICICI Venture an exit route and, again, ICICI Venture's $5.3-million strategic exit from clothing company Indus League in favour of Pantaloon.

ChrysCapital, Actis and Warburg Pincus see India continuing to be a growth market led by SMEs for the next five years. This is something that later entrants such as Temasek Holdings, Blackstone, Henderson Advisors and even Carlyle are beginning to realise. Of the later entrants, Temasek has been the most prolific in terms of building an SME portfolio. Big business will also have a major part to play as India's PE market matures. PE firms teaming up with Reliance Communications to bid for Hutchison Whampoa's stake in Hutch-Essar is an indication of things to come. Till such deals become the norm, SMEs are the order of the day. ■

Exit record Some of the key SME exits in the past seven years.

Company	Seller	Buyer	Deal value ($mn)	Exit type
Bharti Tele-Ventures	Warburg Pincus	Vodafone	847.5*	Strategic sale
Suzlon	Citigroup, ChrysCapital	Public shareholders	340.0	IPO
Daksh eServices	Actis, Citigroup, General Atlantic	IBM	160.0	Strategic sale
Blue Dart	Schroder Capital	DHL	126.0	Strategic sale
Biocon	GW Capital, AIG	Public shareholders	72.0	IPO
Sasken	Intel Capital	Public shareholders	30.2	IPO
Indiagames	Infinity Ventures	Tom Online	17.0	Strategic sale
Indus League	ICICI Venture	Pantaloon	5.3	Strategic sale

*Warburg sold 5.65% stake for $847.5 billion. It earned $1.9 billion from Bharti. Source: Venture Intelligence