

Private Equity roundup

Foreword

Deal momentum built in 2010 continues in the first quarter of 2011

Private Equity roundup is a quarterly newsletter on trends and perspectives related to private equity (PE) activity in India.

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While Indian PE activity in the first two months of 2011 got off to a slow start with only US\$0.8b in recorded deals, activity picked up in March. The first quarter of 2011 (Q111) ended with more than US\$1.5b in total deal value. However, because there were only five large deals (greater than US\$50m) announced in the quarter, the average deal size dropped to US\$20m.

Fund-raising also gathered momentum with five announcements of successful fund closings, totaling more than US\$900m during Q111. Another six new India-focused PE/venture capital (VC) funds were also announced. These six funds are targeting a total of US\$1.5b.

Q111 also saw an increase in exits compared with the previous quarter. The majority of the exits were non-IPO, with only two PE-backed IPOs.

With GDP growth pegged at 8.7% in fiscal 2011 (April 2010 to March 2011), India is moving swiftly along its growth trajectory. Investor confidence in sustainable Indian economic growth was reflected in foreign institutional investors (FIIs) making a net investment of US\$32b in fiscal 2011. However, corruption-related cases, unrest in the Middle East/North Africa region, rising crude prices and inflationary concerns could affect investor sentiment. On balance though, with India's strong economic fundamentals and growing appeal for the global PE community expected to continue, our outlook for PE activity in India remains cautiously optimistic.

Overview

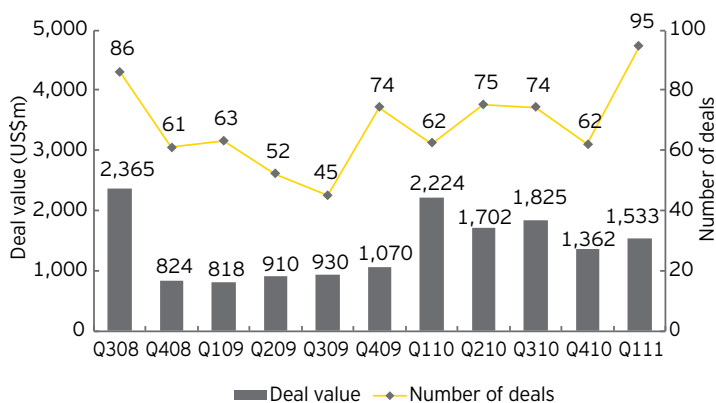
PE deal momentum continues in 2011

There were 95 PE deals in Q111 compared with 62 deals in Q410, representing a 53% growth in deal volume. The total deal value in the current quarter stood at US\$1.5b, a 13% growth compared with the previous quarter.

However, a year-on-year comparison indicates a slightly different trend. The deal volume in Q111 was more than 50% higher than that in the corresponding period in 2010 (Q110), while the deal value was approximately 31% lower than in Q110. The high deal value in Q110 was due to large deals in the Infrastructure sector.

Global PE firms continued to be involved in the majority of the top 10 PE deals in Q111, similar to the trend seen in 2010. However, this quarter witnessed a slowdown in large deals (greater than US\$50m). Consequently, the average deal size of the top 10 deals in Q111 declined to US\$92m, compared with US\$99m in Q410 and US\$173m in Q110.

Figure 1: Trend in PE investments



Sources: VCCEdge, Asian Venture Capital Journal (AVCJ); Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.
Note: All deal values and volumes have been revised in accordance with updated data from AVCJ for periods prior to Q111.

Figure 2: Top 10 PE deals announced in Q111

| Month | Target | Investor(s) | Value (US\$m) | Sector |
|---------------|--|--|---------------|---|
| March 2011 | GMR Airports Holding | Macquarie SBI Infrastructure Fund | 200 | Infrastructure |
| February 2011 | Ratnakar Bank* | HDFC, Beacon India Private Equity Fund, Cartica Capital, India Evolving Fund, Gaja Capital Partners, Norwest Venture Partners, Samara Capital, TVS Shriram, Elephant Capital Growth Fund | 163 | Financial services |
| January 2011 | MB Power Madhya Pradesh | Macquarie SBI Infrastructure Fund | 130 | Infrastructure |
| March 2011 | KMC Constructions road projects | 3i India Infrastructure Fund | 112 | Infrastructure |
| March 2011 | MedPlus Health Services | TVS Capital Funds, India Venture Advisors, Mount Kellett Capital Management | 90 | Health care |
| January 2011 | Ybrant Digital | Oak Investment Partners, Asia Pacific Capital, ICICI Bank | 48 | Media and entertainment |
| March 2011 | Roots Corporation | Omega TC Holdings | 48 | Real estate, hospitality and construction |
| March 2011 | Ind-Barath Energy Uktal | 3i India Infrastructure Fund | 45 | Infrastructure |
| January 2011 | Integrated Health and Healthcare Services India | Halcyon Finance and Capital Advisors | 44 | Health care |
| February 2011 | Ansal Properties & Infrastructure's residential township | Red Fort Capital | 44 | Real estate, hospitality and construction |

Sources: VCCEdge; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

* The investors acquired stakes in Ratnakar Bank at different points in time over the last 12 months, but the deal was announced during Q111.

Special feature

PE interest in financial services upbeat

PE deal activity in financial services improved two-fold in Q111 compared with the previous quarter. The sector recorded eight deals with a total deal value of US\$192m. Continuing with its historical trend, the majority of the deals in this sector involved growth-stage financing. Deals in this sector have been recorded across sub-segments – banks, stock exchanges, microfinance institutions and non-banking finance companies.

Growing interest for banks

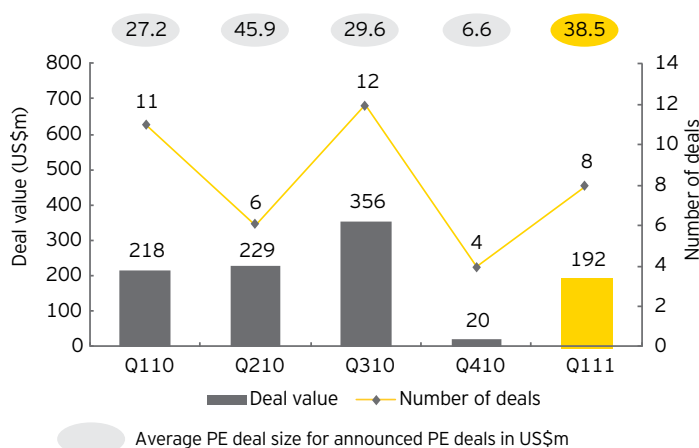
During Q111, three out of eight PE deals were recorded in the banking sub-segment. The most notable of these was investment in Ratnakar Bank by various investors including HDFC, Beacon India Private Equity Fund, Cartica Capital, India Evolving Fund, Gaja Capital Partners, Norwest Venture Partners, Samara Capital, TVS Shriram Growth Fund and Elephant Capital. Investments were received over a 12-month period and the deal, with a collective investment of US\$163m, was announced in Q111 – the second-largest deal of the quarter. Ratnakar Bank operates nearly 100 branches across the states of Karnataka, Goa, Maharashtra, Gujarat and Delhi. The bank had deposits worth INR15.1b (c. US\$335b) and total income of INR1.5b (US\$33m) for fiscal 2010.¹ The bank's vast regional setup, a new management team and its thrust on providing services to emerging small and medium enterprises and retail banking are the factors making it attractive for investment.

Banks remain attractive to PE as their growth is correlated to the overall growth of the economy. Also, as the sub-segment is relatively fragmented, with more than 25 government-owned commercial banks and over 20 Indian private-sector banks,² the opportunity for consolidation is also attracting PEs to invest. There has been wide expectation of consolidation in the banking industry and already some consolidation has happened among

the private banks. For instance, in the last two years, the private sector banks saw two large mergers and acquisitions (M&A) deals, namely, ICICI Bank's acquisition of Bank of Rajasthan for US\$608m in May 2010 (it previously also acquired Sangli Bank and Bank of Madura), and HDFC Bank's acquisition of Centurion Bank of Punjab for US\$2.3b in February 2008.³

However, it is not easy for PE to make large investments in banks due to regulations in India. According to current regulations, foreign investment is restricted to a maximum of 74% of the paid-up capital in the case of Indian private banks and 20% in the case of public sector banks.⁴ By contrast, prior to 2008, China recorded substantial foreign PE investments in its domestic banks. For instance, Industrial and Commercial Bank of China received US\$3.8b funding from Goldman Sachs, American Express and some other investors, while Bank of China received investments of US\$1.5b from Temasek Holdings, and Shenzhen Development Bank raised US\$145m from TPG.

Figure 3: PE investment trends in financial services



Sources: VCCEdge; AVCJ; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

1 "A Profile of Banks," Reserve Bank of India publication, www.rbi.org.in/scripts/AnnualPublications.aspx?head=A%20Profile%20of%20Banks, 23 September 2010.
 2 "Report on Trend and Progress of banking in India 2009-10," Reserve Bank of India website, rbidocs.rbi.org.in/rdocs/Publications/PDFs/RTP081110FL.pdf, 4 November 2010.
 3 "Advanced M&A Analysis," Thomson ONE Banker, accessed 1 April 2011.
 4 "Consolidated FDI Policy, Circular 1 of 2011" Department of Industrial Policy & Promotion, 31 March 2011.

Figure 4: Top five PE deals in financial services sector (January 2010-March 2011)

| Month | Target | Investor(s) | Value (US\$m) |
|-------------|--|--|---------------|
| July 10 | Infrastructure Development Finance Company | Actis; Khazanah Nasional | 180 |
| May 10 | National Stock Exchange of India | Temasek Holdings | 176 |
| February 11 | Ratnakar Bank* | HDFC, Beacon India Private Equity Fund, Cartica Capital, India Evolving Fund, Gaja Capital Partners, Norwest Venture Partners, Samara Capital, TVS Shriram Growth Fund, Elephant Capital | 163 |
| March 10 | Star Health and Allied Insurance | ICICI Venture Funds Management; Sequoia Capital; some undisclosed investor(s) | 70 |
| August 10 | Bombay Stock Exchange | Soros Private Equity Partners | 35 |

Sources: VCCEdge; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

* The investors acquired stakes in Ratnakar Bank at different points in time over the last 12 months, but the deal was announced during Q111.

Investment analysis

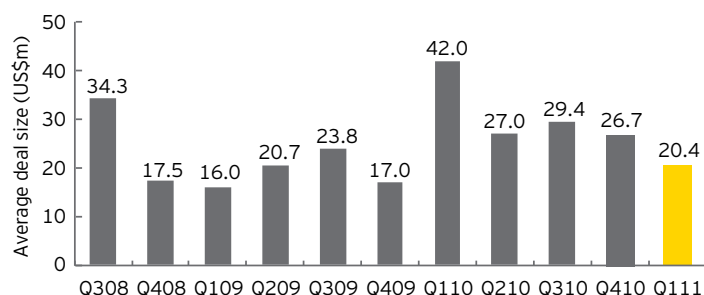
Analysis by deal size

Trend of small deals continues

Fewer large deals (greater than US\$50m) were recorded in Q111 compared with previous quarters, with only five large deals announced. The previous five quarters recorded an average of around eight deals. Further, the share of such deals in the total deal volume dropped significantly from 10% in Q410 to nearly 5% in Q111.

This resulted in a decline in the average deal size during Q111, which, at just US\$20m, was the lowest recorded in the last five quarters. This is a decline of nearly 23% compared with the average size in the previous quarter, and a decline of 51% compared with Q110. Small deals (less than US\$10m) continued to dominate deal activity in Q111.

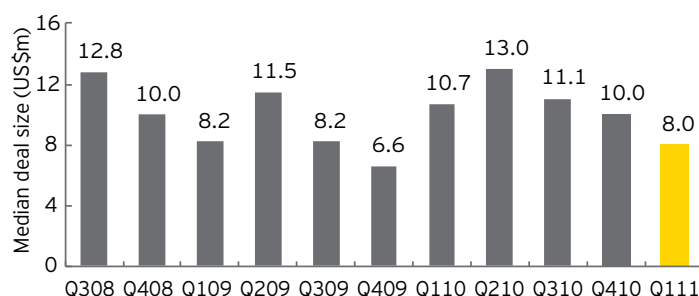
Figure 5: Trend of average PE deal size of announced PE deals



Sources: VCCEdge; AVCJ; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

Note: Only deals with disclosed values have been considered.

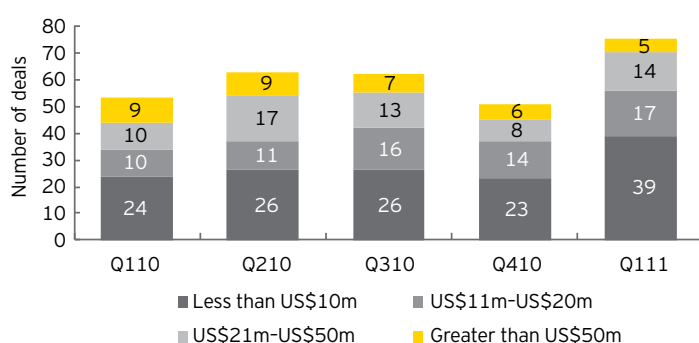
Figure 6: Trend of median PE deal size of announced PE deals



Sources: VCCEdge; AVCJ; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

Note: Only deals with disclosed values have been considered.

Figure 7: Composition of total PE deal volume by PE deal size



Sources: VCCEdge; AVCJ; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

Note: Only deals with disclosed values have been considered.

Analysis based on sector

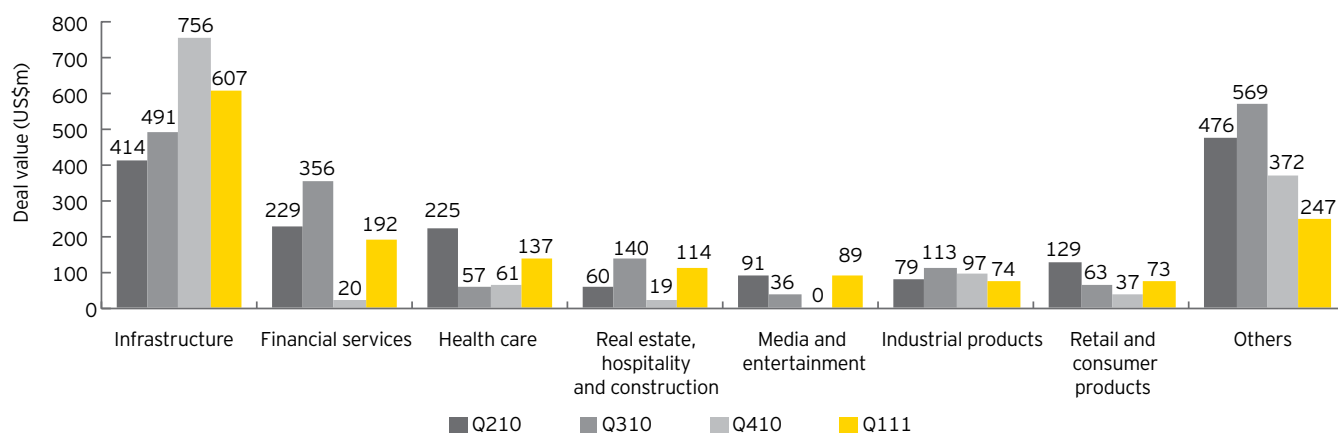
Infrastructure attracted highest amount of PE investment; retail and consumer products recorded maximum number of deals

The infrastructure sector continued to attract significant PE investments, with Q111 being the fifth consecutive quarter where the sector attracted the highest level of investment. The

sector accounted for 40% of the announced PE deal value in Q111. Financial services accounted for 13% of the total deal value in the quarter, which was the second-largest after infrastructure.

In terms of PE deal volume, the retail and consumer products sector (RCP) witnessed the highest number of PE deals (17) in the quarter, closely followed by infrastructure (15) and technology (12).

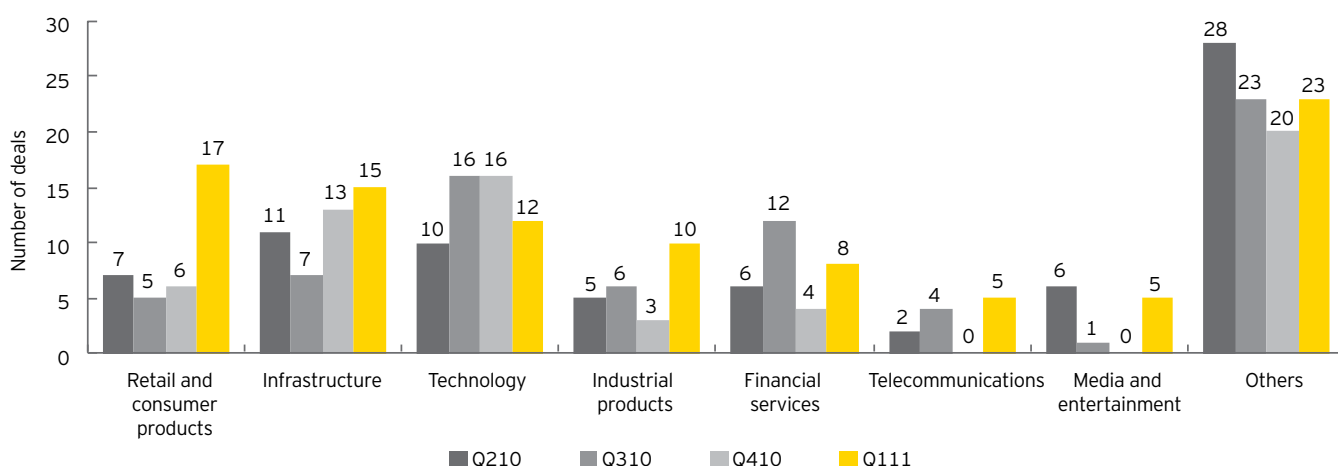
Figure 8: Composition of aggregate PE deal value by sector (US\$m)



Sources: VCCEdge; AVCJ; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

"Others" includes technology, telecommunications, logistics, automotive, chemicals, education, oil and gas, professional services, pharmaceuticals, textiles, cement and building products, biotechnology, travel, metals and mining and miscellaneous.

Figure 9: Composition of total PE deal volume by sector



Sources: VCCEdge; AVCJ; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

"Others" includes logistics, automotive, chemicals, education, oil and gas, professional services, pharmaceuticals, textiles, cement and building products, biotechnology, travel, metals and mining and miscellaneous.

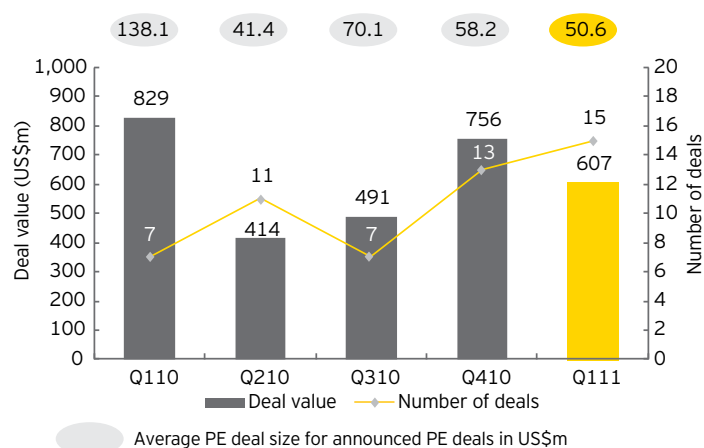
Infrastructure

Power sector continues to dominate with renewable energy also gaining traction

The infrastructure sector witnessed 15 PE deals during Q111, totaling US\$607m. The largest PE deal of the quarter saw Macquarie-SBI Infrastructure Fund investing US\$200m in GMR Airports Holding. Macquarie-SBI also invested US\$130m in MB Power, a step-down subsidiary of Moser Baer Projects, engaged in the development of thermal power plant in Madhya Pradesh. Moser Baer had received US\$290m funding from Blackstone in August 2010 and previously, in September 2008, it attracted a joint investment of US\$93m from players such as Nomura Holdings, Morgan Stanley Alternative Investments and IDFC Private Equity.

Within the infrastructure sector, players in the power sector attracted the majority of the PE funding in Q111, similar to the trend witnessed over the last few quarters. However, unlike the previous quarters where thermal power accounted for most of the deals, the renewable energy segment attracted the highest number of PE deals in Q111, registering 5 out of the total 15 deals. Deals were registered in almost all forms of renewable resources, including wind, solar, hydro and biomass.

Figure 10: PE investment trends in infrastructure



Sources: VCCEdge; AVCJ; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

Private investments in clean energy on the rise

Globally, clean energy investment stood at US\$243b in 2010, reflecting growth of approximately 30% from 2009. Asia also witnessed growth in such investments, which stood at approximately US\$83b during 2010, nearly 33% higher than in 2009. While China led the world with private investment of approximately US\$54b, which is nearly equal to the world investment in 2005, India also emerged as a significant favored destination, ranking 10th with nearly US\$4b worth of private investments in clean energy.⁵

India holds significant potential in renewable energy

In India, approximately 14,700 MW, or nearly 10%, of the country's installed power-generation capacity, is in the form of renewable sources of energy, excluding large hydropower projects.⁶ According to the Government of India (GoI)'s Ministry of New & Renewable Energy, the country has abundant renewable resources, of which only 14% has been tapped so far, which signifies major potential.⁷ Further, according to Ernst & Young's *Renewable energy country attractiveness indices*, which rank countries based on regulatory environment, fiscal support and unexploited resources, among other factors, India has consistently ranked among the top four countries in renewable energy globally. Additionally, the GoI has launched the Jawaharlal Nehru National Solar Mission to give India's solar energy market a major impetus, as the mission envisages an ambitious target of 20 GW of installed solar capacity by 2020. This provides independent power producers with significant untapped market potential and makes the sector attractive for PE/VC players.⁸

5 "India entered top 10 Clean Energy Investment list for first time," Economic Times website, http://articles.economicstimes.indiatimes.com/2011-03-29/news/29358044_1_renewable-energy-capacity-clean-energy-investment-solar-sector, accessed 29 March 2011.

6 "Conquering the Sun," Ernst & Young - Indian Chambers of Commerce report, August 2010.

7 "Renewable energy sector to attract more private equity investments," Hindu Business Line, 20 November 2010, via Dow Jones Factiva.

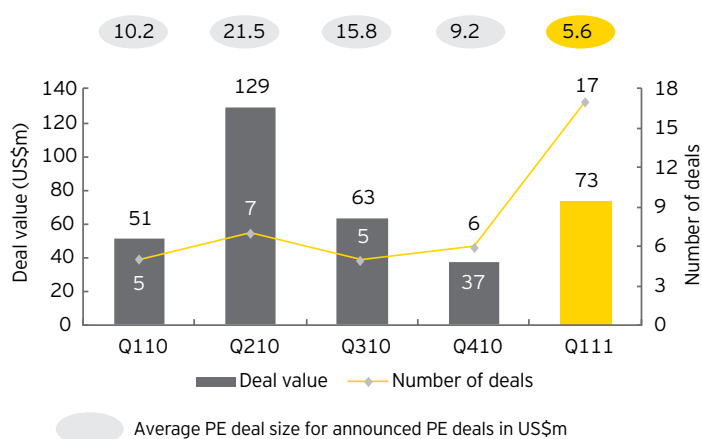
8 "Conquering the Sun," Ernst & Young - Indian Chambers of Commerce report, August 2010.

Retail and consumer products

E-commerce segment garnered lion's share

The RCP sector attracted the largest number of PE deals during Q111, with 17 deals totaling US\$73m. Most of the deals registered in the sector are for growth-stage companies that are small in size, leading to a low average deal size of nearly US\$6m. This trend is similar to previous quarters. The most notable deal in Q111 was a joint investment of US\$14m in e-retail firm Myntra Designs by NEA-IndoUS Ventures, IDG Ventures India Advisors and Tiger Global. In another deal, Sequoia Capital invested US\$4m in Lovable Lingerie, whose IPO subsequently acquired an impressive market response, being oversubscribed more than 35 times.⁹

Figure 11: PE investment trends in retail and consumer products



Sources: VCCEdge; AVCJ; Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

E-commerce attracting interest

E-retail firms witnessed significant PE investor interest in Q111, with five such deals closed with an aggregate deal value of US\$37m including Myntra (as mentioned earlier), Snapdeal.com (NEA-IndoUS Ventures and Nexus India Capital Advisors), Letsbuy.com (Helion Advisors and Tiger Global Management LLC and Accel Partners), Bigshoebazaar.com (Nexus India Capital Advisors) and Inkfruit.com (SAIF Partners).

According to a recent report by the Internet and Mobile Association of India (IAMAI), the Indian e-commerce market has significant potential and is expected to grow by 47% in 2011 to reach a value of INR460b (US\$10b). Of this estimated value, online travel is expected to be the biggest segment, followed by e-retailing.¹⁰ The immense potential that India's e-commerce market holds can also be judged by observing the market size and growth witnessed in China. China's e-commerce market was valued at an estimated US\$39b in 2009 and registered year-on-year growth of nearly 105%. It is expected that the country had more than 145m online shoppers at the end of 2010.¹¹

While deals in the Indian e-retail space mainly involved PE/VC firms investing small amounts (typically between US\$2m and US\$10m), growth in the number of internet users, rising income levels and growing confidence among Indian customers in online purchasing may provide broad business opportunities for e-retail firms. Further, the recent trend of e-retail firms offering customers the option of "cash on delivery" is spurring online purchasing. Moreover, the international success witnessed in similar formats such as pure online retail (companies such as eBay and Amazon) and group buying (Groupon) has also spurred business activity in this segment.

⁹ "Lovable Lingerie IPO covered 35 times on final day," *Reuters website*, in.reuters.com/article/2011/03/11/idINIndia-55504820110311, 3 March 2011.

¹⁰ "VC inflows into e-commerce zoom," *The Times of India*, 23 March 2011, via Dow Jones Factiva.

¹¹ "Chinese E-Commerce Tops \$38.5 Billion; What Comes Next?" *ReadWriteWeb website*, www.readwriteweb.com/archives/chinese_e-commerce_tops_385_billion_what_comes_next.php#, accessed 19 April 2010.

Fund focus

Resurgence of fund-raising activity

In contrast to the previous quarter, fund-raising activity gathered momentum during Q111. A total of six India-focused PE/VC funds aggregating US\$1.5b were announced, while the quarter witnessed five funds with a total of US\$908m being raised. This was unlike Q410 where only one successful fund closure announcement by Peepul Capital (US\$312m).

Everstone Capital Partners announced the largest successful fund closure of the quarter, worth US\$550m. This is the second fund that Everstone Capital has raised and, as reported, there was oversubscription from the institutional investors.¹² Such successful activity is a positive sign indicating building momentum in the fund-raising environment.

Figure 12: India-focused PE funds either announced or raised during Q111

| Name | Status | Focus sector | Fund size (US\$m) |
|---------------------------------------|-----------|---|-------------------|
| Everstone Capital Partners II | Raised | Sector agnostic | 550 |
| Nomura Securities | Announced | Roads, ports and power utilities | 500 |
| Accel Partners | Announced | NA | 400 |
| Kotak Mahindra Group | Announced | Infrastructure and power | 300 |
| Motilal Oswal Private Equity Advisors | Announced | Sector agnostic | 200 |
| Tata Capital Growth | Raised | Sector agnostic | 200 |
| Milestone Capital Advisors | Announced | Real estate | 108 |
| Morpheus Capital Advisors | Raised | FMCG, home and personal care, consumer services such as education and health care, and specialized retail | 93 |
| Seedfund | Raised | NA | 54 |
| India Education Fund | Raised | Education | 11 |
| BlackBerry Partners Fund for India | Announced | Wireless communications | NA |

Sources: Dow Jones Factiva; ISI Emerging Markets and Ernst & Young research.

¹² Everstone Capital Partners to Close Second Fund Everstone Capital Partners II at US\$550 million," *India Investment News*, 24 February 2011, via Dow Jones Factiva.

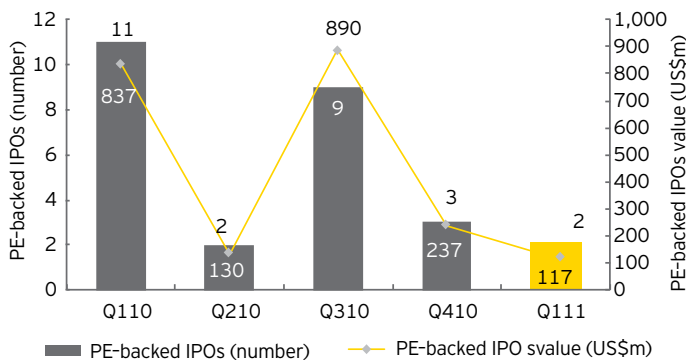
PE-backed IPOs

Low activity in Q111

Similar to the trend in the previous quarter, PE-backed IPO activity remained sluggish in Q111, with the quarter witnessing only two PE-backed IPOs – Lovable Lingerie’s US\$21m IPO (backed by Sequoia Capital India Growth Fund II) and PTC India Financial Services’ US\$96m IPO (backed by Macquarie and Goldman Sachs). However, not only PE-backed firms shied away from capital markets; IPO activity was generally sluggish during the quarter. While 16 IPOs hit the market in Q410, the current quarter only saw 6 IPOs. This indicates that market liquidity possibly continued to be low due to the vast number of successful IPOs and FPOs that hit the market in Q410.

However, upcoming quarters may see a greater number of PE-backed IPOs as several PE-backed companies have filed draft red herring prospectuses (DRHPs) with the Securities and Exchange Board of India (SEBI) in the current quarter. Some of these firms include Intas Pharmaceuticals (backed by ChrysCapital), ORTEL Communications (backed by New Silk Route Partners), Powerica Ltd. (backed up Standard Chartered Private Equity) and Arch Pharmaceuticals (backed by India Advantage Fund, Swiss Technology Venture Capital Fund and Leverage India Fund).

Figure 13: Trend of PE-backed IPOs



Sources: Dow Jones Factiva; ISI Emerging Markets; company filings; Prowess and Ernst & Young research.

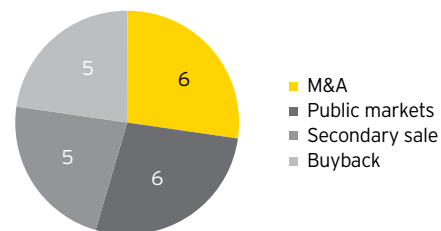
PE exits (excluding IPOs)

Increase in non-IPO exits

A total of 22 non-IPO PE exits were registered during Q111, a significant rise over the previous quarter. Exit activity, in terms of volume, was almost evenly distributed around M&A, secondary sales and the public markets. However, by value, M&A exits accounted for the main share of the overall exit value. Interestingly, the top two exits during the quarter were M&A exits.

The most significant PE exit of the quarter was Sequoia Capital India and Lightspeed Ventures exiting TutorVista Global, the online education services company, in which UK-based publishing firm Pearson Plc acquired a majority stake. Media reports indicate that the exit provided the two PE firms with a return of nearly 7 times the return on their initial investment, making it one of the most successful seed investments in India.¹³

Figure 14: Number of non-IPO exits by type (Q111)



Sources: VCCEdge; Dow Jones Factiva; Thomson ONE Banker; mergermarket and Ernst & Young research.

¹³ "Pearson buys majority stake in TutorVista," *The Economic Times*, 20 January 2011, via Dow Jones Factiva.

Figure 15: Top five non-IPO exits (Q111)

| Target company | Acquirer | Seller | Amount (US\$m) | Sector | Exit type |
|------------------------------|---|--|----------------|---|----------------|
| TutorVista Global | Pearson Plc | Lightspeed Venture Partners; Sequoia Capital India | 127 | Education | M&A |
| Commercial project in Mumbai | Undisclosed acquirers | Indiareit Offshore Fund I; Indiareit Domestic Fund Scheme I | 100 | Real estate, hospitality and construction | M&A |
| MedPlus Health Services | Mount Kellett Capital Management; TVS Capital Funds; India Venture Advisors | Peepul Capital Fund II LLC; NEA-IndoUS Ventures; Arcapita Private Equity | 90 | Health care | Secondary sale |
| Peepul Tree Properties | Tata Realty Initiatives Fund-I | Kotak India Real Estate Fund I | 84 | Infrastructure | Secondary sale |
| VA Tech Wabag | Undisclosed acquirers | India Advantage Fund Series I | 36 | Professional services | Open market |

Sources: VCCEdge; Dow Jones Factiva; Thomson ONE Banker; mergermarket and Ernst & Young research.

Tax update

This quarter saw the Union Budget for 2011-12 being presented in Parliament. From a PE perspective, the budget saw changes in minimum alternate tax (MAT) rates, removal of certain incentives to units in special economic zones (SEZs) and certain changes in the transfer pricing regime. Overall, the Govt appears to have adopted a balanced approach while framing budget proposals.

Highlights of Union Budget 2011-12

The changes the Union Budget has proposed are not expected to have any material impact on the companies in which PE investors have, or propose to make, investments. Some of the changes are as follows:

- ▶ Surcharge on income tax for domestic companies with total income exceeding INR10m has been reduced from 7.5% to 5% and for foreign companies, from 2.5% to 2%.
- ▶ It has been proposed that the MAT rate is increased from 18% to 18.5% effective 1 April 2012.
- ▶ The tax on dividends that Indian companies receive from overseas subsidiaries (in which the Indian company holds a stake of at least 26%) is proposed to be reduced from the existing rate of 30% to 15%. This shall apply only for fiscal 2012. The change comes as a relief to globalized Indian companies seeking to repatriate profits earned outside India. The tax payable by the Indian entity may further reduce on account of taxes paid in the other country, the credit of which may be available under beneficial provisions of an available tax treaty.

- ▶ Currently, an exemption from MAT payment is allowed with respect to income earned from any business conducted by a unit set up in a SEZ or income earned by a developer of a SEZ. However, it has been proposed in the budget that MAT at 18.5% be levied on the book profits of a unit set up in a SEZ or a person developing a SEZ. Another tax benefit developers of SEZs enjoy that has been withdrawn pertains to the levy of dividend distribution tax at 15% on profits distributed as a dividend by a developer of a SEZ. The removal of such benefits is being viewed as a major disincentive to developing or setting up a unit in an SEZ.
- ▶ Current transfer pricing provisions require the most appropriate method to be selected to compute the arm's length price. Further, a 5% variation between the actual price charged by the taxpayer and the arm's length price determined is currently allowed. The latest budget attempts to peg the percentage of this variation to a number that the Central Board of Direct Taxes (CBDT) will determine based on individual cases.
- ▶ The budget has proposed a two-pronged strategy to deal with the issue of "black money" outside India – firstly, increased cooperation with the international community and secondly, laying down an anti-avoidance regime specific to jurisdictions that are hesitant to exchange information. The budget has proposed the introduction of certain "Toolbox" provisions that could help the Central Government to notify any territory outside India, with regard to which there is a lack of effective exchange of information.

CBDT's clarification on the tax scrutiny of M&A cases

The CBDT has clarified that the tax authority is currently scrutinizing only a handful of cases related to takeovers and M&A. The selection of cases for scrutiny is risk-based and non-intrusive. The CBDT has further clarified that the mere incidence of takeovers and M&A does not qualify a case for tax scrutiny. The overall scrutiny level by the tax authority has not been exceeded 1.5% in the past decade.

After certain media reports that the tax authority was scrutinizing several M&A cases, this clarification will bring relief to investors looking to enter India via the M&A space.

Mumbai Income Tax Appellate Tribunal's (ITAT) decision in the case of Bharat Bijlee Ltd. on taxability under Indian tax laws of a transaction involving a slump exchange

In a recent decision, the ITAT held that the transfer of an undertaking on a going concern basis, in relation to the allotment of preference shares or bonds, is a case of a slump exchange and not a slump sale. Consequently, special provisions of Indian tax laws governing the slump sale are not applicable. The ITAT further held that such a transfer is also not liable to capital gains tax under the general provisions of Indian tax laws, since the slump consideration cannot be allocated to individual items of assets and liabilities forming part of the undertaking, and the cost of acquisition or improvement of the undertaking cannot be ascertained.

Regulatory update

Notification of the provisions of the Competition Act, 2002 relating to M&A

The GoI notified the provisions of the Competition Act, 2002 relating to "combinations," i.e., M&A, on 4 March 2011 to take effect from 1 June 2011. All M&A and amalgamations that meet the thresholds prescribed under the Competition Act will require a mandatory prenotification to the Competition Commission of India (CCI) and will not come into effect until 210 days from the date of notification or by the CCI's order, whichever is earlier.

The thresholds of assets and turnover stipulated are as follows:

Parties (i.e., acquirer and target jointly)

| | Assets | Turnover |
|-----------|--|---|
| INDIA | > INR 15b | > INR 45b |
| WORLDWIDE | > US\$750m (with at least INR 7.5b in India) | > US\$2.25b (with at least INR 22.50b in India) |

Combined group (i.e., acquirer group and target combined)

| | Assets | Turnover |
|-----------|---|--|
| INDIA | > INR 60b | > INR 180b |
| WORLDWIDE | > US\$3b (with at least INR7.5b in India) | > US\$9b (with at least INR 22.50b in India) |

All the above criteria are mutually exclusive, i.e., trigger of any of the above limits would require prior approval of the CCI. The asset size referred to above shall be the book value of assets to the audited financial statements of the preceding financial year.

These companies need to obtain approval of the CCI for mergers, acquisitions and amalgamations by intimating the CCI within 30 days of board approval or entering into the agreement. Such mergers, acquisitions and amalgamations shall not come into effect until a period of 210 days has passed from the day on which the notice was given to the CCI or CCI has passed an order, whichever is earlier.

Exemptions from approval of the CCI

The approval requirement is not applicable to share subscriptions or financing facilities or any acquisition by a public financial institution, FII, bank or VC/PE fund pursuant to any covenant of a loan or investment agreement subject to reporting of prescribed information to the CCI.

Exemption is also provided for a period of five years to a target enterprise being acquired, which has assets not exceeding INR 2.5b or turnover not exceeding INR 7.5b.

The provisions also exempt enterprises for a period of five years from being considered as part of the group if one enterprise exercises less than 50% voting power (earlier 26%) in the other enterprise.

Way forward

The CCI has recently also released draft regulations – The Competition Commission of India (Procedure in regard to the transaction of business relating to combination) Regulations – that would be finalized in due course.

Apart from the procedures, these regulations mandate the CCI to form a prima facie opinion within 30 days. This may be helpful in the case of simple routine transactions.

Further, these regulations also provide for voluntary pre-merger consultation on a specific request made by the parties to the CCI, though the views expressed by the CCI during such consultations will not be binding. This is in the nature of an “Informal Guidance” and would be very helpful for transaction planning.

New Consolidated FDI Policy

The Govt's Department of Industrial Policy and Promotion (DIPP) has issued the New Consolidated FDI Policy under Circular 1 of 2011, effective 1 April 2011. The policy may impact the deal activity of PE players on account of changes in the pricing of convertible instruments.

The new policy allows Indian companies to issue fully, compulsorily and mandatorily convertible instruments to non-resident investors with either the “price” or “conversion formula” determined upfront. In a scenario where the instrument is issued with “conversion formula” determined, the actual conversion price should not be lower than the price worked out in accordance with relevant guidelines (i.e., price determined in line with the discounted cash flow (DCF) guidelines for unlisted companies and price as per SEBI (ICDR) regulations for listed companies) at the time of the “issuance of the instrument.”

According to last year's policy, the conversion ratio had to be specified up front, which led to a delay in the flow of PE deals involving convertible instruments. As a result of the new policy, an upside in the business performance is expected to enable Indian companies to issue shares at a higher conversion price, therefore benefiting the company/promoters. On the other hand, if there is a decrease in the valuation, the foreign investor will not benefit as much because the conversion price will be locked at the minimum price determined, based on the DCF at the time when the convertible instrument is issued.

SEBI reported to regulate PE in India

As stated in certain news reports, PE funds, hitherto unregulated, may come under the SEBI purview. It has also been reported that the capital markets regulator has already started work in this respect and guidelines are expected shortly. As per the Economics Affairs Secretary, the regulations could be on the lines of venture capital funds, which are also regulated by SEBI.

Outlook

A number of factors are expected to support increased PE deal activity in India. Strong economic fundamentals provide growing appeal for the global PE community. Sluggish capital markets will drive companies looking to raise funds through IPOs to PE. And the improving global PE environment should also result in greater activity in India.

In terms of sector focus, domestic consumption is the central investment theme. Sectors such as infrastructure and its ancillaries, retail and consumer products, including e-commerce and restaurants, financial services, education and health care are likely to account for majority of the activity.

Recent announcements suggest a resurgence of fund-raising activity. This momentum is expected to continue for the next few quarters on the back of increased confidence among global investors. Although some of the firms witnessed a decline in dry powder in 2010, sufficient funds continue to be available for investment. In addition, a host of global firms have indicated a buoyant attitude toward emerging markets such as India as their favored investment destination.

Exit activity is also expected to remain high, as several funds are nearing the exit stage with a number of their investments. India's strong position on the world map as a growth market is driving the inbound activity and these inbound corporates may provide an interesting potential exit avenue for the PE firms. Finally, uncertainty in the stock market is likely to limit the number of PE-backed IPOs in the near future, though there is a good pipeline of PE-backed firms filing DRHPs.

However, there are a few things that may impact the overall positive sentiment – anxiety in the political system due to numerous corruption cases that have surfaced over the last few months, domestic inflation concerns, ongoing trouble in the Middle East and North Africa and rising crude prices.

On balance, we are cautiously optimistic about PE activity in India, since the theme of macroeconomic cross-sector growth in the country still remains intact.

Methodology

- ▶ Private Equity roundup is based on Ernst & Young's analysis of announced PE deals, as well as other PE-related news and information reported in secondary sources, *AVCJ* and *VCCEdge*.
- ▶ PE deal values used in this document are based on those provided in press releases pertaining to deal announcements. The conversion rate (INR to US\$) is based on the exchange rates prevalent on the dates of the deal announcements.
- ▶ We have not considered open market deals to analyze PE exits or investments.
- ▶ The deals have been reclassified, wherever required, based on Ernst & Young's sector-classification policy.
- ▶ The figures have been rounded off to the nearest whole number.

About Ernst & Young

Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

In India

Ernst & Young India has offices in Ahmedabad, Bangalore, Chennai, Gurgaon, Hyderabad, Kolkata, Mumbai, New Delhi, NOIDA and Pune. Its workforce of over 9,900* people work toward the organization's vision of being a trusted business advisor that contributes to the success of its clients by creating confidence and value. We help our clients achieve their potential through our leading approach, which incorporates various service dynamics, including:

- ▶ An industry-aligned delivery model that harnesses our broad range. Practices focused on specific industries draw on knowledge, skills and our experiences of that industry in India and around the world. This helps us customize our approach to the unique needs of each client.
- ▶ Our services are broadly classified as four service lines: Assurance, Tax, Transactions and Advisory. Each service line is further streamlined into niche competencies and focused groups, which enable us to strengthen our outreach and offer a compelling portfolio of broad and well-defined services.
- ▶ Each team is built as a multi-dimensional group of professionals from diverse backgrounds, with a range of perspectives. They understand and address our clients' concerns from a variety of standpoints while using highly

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- ▶ Values and ethics unite us, ensuring we work cohesively toward the shared goal of making a difference. A special energy that we bring to each assignment defines the way we work and is our key characteristic.

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- ▶ India's tier-one tax firm for the eighth consecutive year – Euromoney ITR, World Tax Guide 2010
- ▶ Ranked #1 Financial Advisor in India for nine consecutive years for most number of deals – Bloomberg
- ▶ The most reputed Tax Firm in India – TNS Global Tax Survey Monitor, 2009
- ▶ Asia-Pacific M&A Investment Bank of the Year and Asia-Pacific M&A Deal of the Year – 2009 Asia M&A Atlas Award
- ▶ Most Active Transaction Advisor Award, PE and M&A for 2010 & 2009 – Venture Intelligence
- ▶ Financial Advisor of the Year M&A Award – India, 2008 and 2009 – Financial Times & Mergermarket
- ▶ Overall winner – consultancy rankings, in survey of risk and compliance professionals – OpRisk and Compliance magazine
- ▶ Risk & business advisory relationship with 160 of the BSE300 companies
- ▶ “Excellence in Training” award in the Employer Branding Awards consecutively for the last three years
- ▶ “Continuous Innovation in HR strategy at work” award in the Employer Branding Awards 2010

* (The numbers include personnel from other member firms of Ernst & Young Global based in India)

Ernst & Young's Private Equity practice

At Ernst & Young, our Private Equity practice offers a broad range of services to assist you and your investee companies every step of the way – from your fund setup to the transaction life cycle.

Our teams work closely with you, offering incisive and proven industry experience coupled with integrated, objective practical advice and support to help you meet your needs. It's how Ernst & Young makes a difference.

Partners

- ▶ Personal tax

Fund-raising

- ▶ Audit of fund performance

Sellside advisory

- ▶ Mergers and acquisitions
- ▶ Valuations

Exit readiness

- ▶ IPO readiness
- ▶ Sale mandates

Assurance

- ▶ Assurance
- ▶ Tax compliance
- ▶ Risk management
- ▶ Internal audits and fraud reviews
- ▶ Valuations

Fund assurance

- ▶ Assurance
- ▶ Tax structuring

Buy-side support

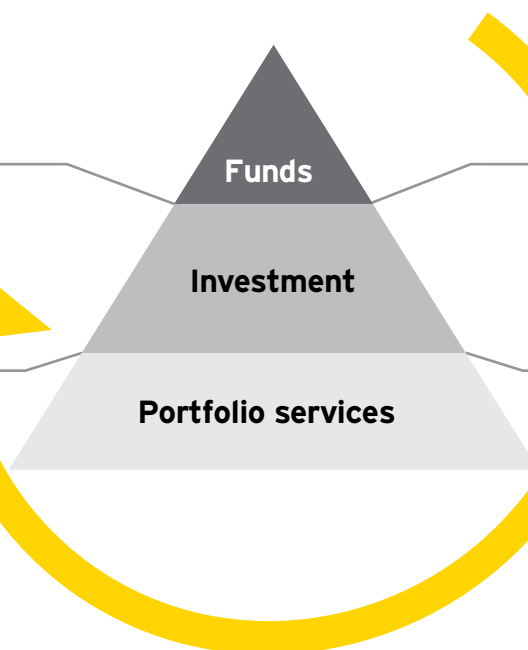
- ▶ Due diligence
- ▶ Tax structuring
- ▶ Environmental compliance
- ▶ Human capital
- ▶ Valuations

Transition

- ▶ Transaction integration
- ▶ Governance
- ▶ MIS development
- ▶ Process advisory
- ▶ Standard operating procedures

Growth

- ▶ Technology security
- ▶ IT strategy
- ▶ Operational improvement
- ▶ Market entry options
- ▶ Working capital management



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