GETTING THE DEAL THROUGH

market intelligence

Volume 4 • Issue 6

Private Equity

Post-Brexit investor confidence returning

Simpson Thacher & Bartlett lead the global interview panel

North America • Asia-Pacific • Europe • Latin America
Investment hotspots • Cross-border challenges • Keynote deals • Shareholder activism

Publisher: Gideon Roberton
Senior business development manager:
Adam Sargent
adam.sargent@gettingthedealthrough.com
Business development manager:
Dan Brennan
dan.brennan@gettingthedealthrough.com
Readership development manager:
Rosie Oliver
rose.oliver@gettingthedealthrough.com
Product marketing manager: Kieran Hansen
subscriptions@gettingthedealthrough.com

Head of production: Adam Myers
Editorial coordinator: Teya Humphris
Subeditor: Janina Godowska
Designer/production editor: Tessa Brummitt

Cover: iStock.com/dynasoar

Law
Business
Research

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3780 4104
Fax: +44 20 7229 6910

ISSN: 2056-9025

GETTING THE DEAL THROUGH

Strategic Research Sponsor of the ABA Section of International Law

THE QUEEN'S AWARDS FOR ENTERPRISE: 2012

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

market intelligence

Welcome to GTDT: *Market Intelligence*.

This is the fourth annual issue focusing on global private equity markets.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

Market Intelligence is available in print and online at www.gettingthedealthrough.com/intelligence.

Getting the Deal Through
London
October 2017

In this issue

PRIVATE EQUITY IN INDIA

Vineetha MG is a partner at Samvad Partners. She has extensive experience in advising clients on private equity investments, cross-border and domestic M&A, and banking and financing transactions. Vineetha represents and advises various private equity investors, including GIC, New Silk Route, Morgan Stanley Infrastructure Fund, Cerestra Advisors and Sequoia Capital in relation to investments in India, in both listed and unlisted companies, as well as on exits from such investments.

Neela Badami is a partner at Samvad Partners. She has amassed over a decade of experience both in India and abroad. At Samvad, she works extensively on private equity and venture capital transactions, M&A, corporate advisory, commercial contracts, including technology and intellectual property, and technology law. Neela has a master's degree in law from University of Michigan Law School and she also served as a law clerk at the International Criminal Court in the Hague, the Netherlands.

Niruti Pangotra is a senior associate at Samvad Partners. She joined the firm after obtaining a master's degree in law from Kellogg School of Business and Northwestern School of Law, Chicago. She handles matters relating to M&A, private equity transactions and structuring, media and entertainment law, general corporate and commercial matters, commercial litigation and dispute resolution.

GTDT: What trends are you seeing in overall activity levels for private equity buyouts and investments in your jurisdiction during the past year or so?

Vineetha MG, Neela Badami & Niruti Pangotra: Private equity transactions in India in 2016 amounted to approximately US$16.3 billion across 652 deals. While there were fewer private equity deals compared to 2015, the dry powder earmarked for India was still fairly substantial. As the markets continue to grow in the coming years, India will attract significant private equity investments. The banking and financial services sector received the most investment and continues to be attractive for investors. In 2016, few large deals dominated the market. The top 15 deals accounted for 30 per cent of total investment value in 2016.

Buoyancy in the stock market affects a target's valuation, and typically strategic investors have always favoured 100 per cent acquisitions as opposed to financial or other investors who prefer investing in equity linked instruments. Under Indian exchange control laws, the minimum price at which a foreign investor can invest cannot be below the fair market value of the target company as determined by an internationally acceptable pricing method. Further, under the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations 2000, the consideration payable for any sale of securities by a foreign investor to a resident buyer, whether strategic or financial, is capped at the fair market valuation of the target company. Therefore, valuation plays an important role in determining the mode of entry and exit by a foreign private equity investor.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or add-on acquisitions, also being considered?

VMG, NB & NP: In 2016, private equity investors focused heavily on financial services, renewable energy, real estate, technology, insurance and fintech.

Generally, a private equity investor invests in a minority stake ranging between 10–25 per cent of the equity share capital of the company, either by subscribing to straight equity or convertible instruments, while the controlling equity stake is held by individual promoters or members of the same family. In such cases, the private equity investor only has minority protection rights, such as affirmative rights and the right to appoint a director, and the majority control is exercised by the promoter group through a lead member or promoter.

We also saw several control deals by private equity funds in 2016. In some cases,


Vineetha MG

the existing shareholders exited fully and the private equity investors acquired 100 per cent. In such a situation, the private equity investor hires professional management and takes over the company in controlled tranches, to aid the transition of management control and to align the interests of the acquirer and the target. Given their size, a lot of control deals have been structured as co-investments between general partners and limited partners. We believe this trend will continue in 2017. We are also seeing an increase in participation by sovereign wealth funds in such deals.

GTDT: What were the recent keynote deals? And what made them stand out?

VMG, NB & NP: In 2016, the largest investment in the private equity and venture capital space in India was received by start-ups, in light of recent government incentives to encourage this type of investment. The sectors that received the most private equity investments included telecoms, real estate, banking and financial services, IT and IT enabled services (ITES) and e-commerce. The acquisition of shares in Reliance Infratel Ltd, a telecoms tower firm, and the private equity transactions involving Janalakshmi Finance, Ibibo and Snapdeal were discussed widely in the market.

Another important deal was the acquisition of a controlling stake in IT services firm Mphasis by Blackstone Group and its co-investors from Hewlett Packard Enterprise. This deal was one of the largest buyouts of the year.

The other big-ticket transactions in 2016 were the US$1.65 billion investment by Canada's Brookfield Asset Management in Reliance Infratel, and the acquisition of GE Capital Services by Aion Capital Partners.


Neela Badami


Niruti Pangotra

GTDT: Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal? Are those challenges evolving?

VMG, NB & NP: Most private equity M&A tends to be domestic and is driven by a consolidation objective. Mergers and acquisitions through offshore subsidiaries of Indian entities have been few and far between.

In a multi-jurisdictional deal, the major aspect that needs to be addressed is compliance with the exchange control regulations. Both inbound and outbound transactions are regulated under the Foreign Exchange Management Act 1999 (FEMA) and the regulations issued thereunder. In addition, the local law requirements also need to be complied with in such transactions. Very often, a local counsel is engaged to address these issues.

Foreign investors have always faced hurdles under FEMA guidelines while contemplating any structures that involve cross-border mergers. While the Companies Act 2013 has permitted Indian companies to enter into cross-border mergers after obtaining approval from the Reserve Bank of India (RBI) , under the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules 2017, corresponding amendments have not been made to the FEMA regulations. The RBI has recently proposed draft regulations in relation to mergers, demergers, amalgamations or rearrangement structures involving an Indian company and a foreign company.

In addition, M&A through asset transfers, as opposed to share transfers, can prove challenging to foreign-incorporated venture capital and private equity funds. Liquidating companies and recovering proceeds can be particularly time-consuming and procedurally complex in India compared to other parts of the world. India has recently unveiled a new insolvency and bankruptcy code that also deals with voluntary liquidations. This code is a progressive piece of legislation, which should help in improving the timelines and procedures involved in liquidation.

Further, taxation laws are still a bottleneck in many of these deals.

GTDT: What are some of the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

VMG, NB & NP: Indian laws do not permit banks to extend loans for funding an investment or acquisition of shares. Hence, it is not possible for private equity funds to raise debt finance from banks for their investments in India. We understand that non-banking financial companies do extend loans to promoters or their companies during an exit for acquisition financing on the strength of secured assets, to enable the promoters or the companies to buy out venture capital or private equity investors.

The RBI is currently considering relaxing restrictions on financial institutions, especially to enable leveraged buyouts of distressed assets. Additionally, public companies are also prevented from providing financial assistance for the purchase of their own shares.

iStock.com/Noppasin

GTDT: How has the legal, regulatory and policy landscape changed during the past few years in your jurisdiction?

VMG, NB & NP: The Companies Act 2013 has codified the duties of directors of a company, and significantly expanded the duties and liabilities of all directors (including non-executive directors who do not take part in a company's day-to-day activities). As a result, the nominee directors of the private equity investor on the board of a portfolio company could be exposed to liabilities. In light of this, private equity investors are insisting on strong directors' and officers' liability insurance policies. Another trend followed by private equity funds is nominating a 'board observer' to exercise oversight over portfolio companies and foregoing the board seat altogether.

With regard to exchange control, more than 90 per cent of foreign investments are now made through the automatic route.

Examining every deal from an antitrust perspective and obtaining consent from the Indian antitrust regulator, the Competition Commission of India (CCI), is now crucial in private equity deals. While the competition regulations do provide for certain exemptions from notifying the CCI, the Commission's decisions in the past have tended towards narrowing these exemptions.

Another area of concern for private equity funds is the threat of facing enforcement actions under the Foreign Corrupt Practices Act 1997 and the UK Bribery Act 2010. These laws essentially expose funds to liabilities in the event that their associates and affiliates in foreign countries engage in corrupt practices. Despite a vast legislative framework, India ranks 79 out of 176 countries in Transparency International's Corruption Perceptions Index, reinforcing that corruption in the country compromises corporate governance, heightens reputational risk and increases the costs of doing business. Consequently, thoroughly vetting the target company and promoters from an anti-corruption perspective at the due diligence stage has become a priority.

GTDT: What are the current attitudes towards private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your jurisdiction, and if so, how has it impacted private equity M&A?

VMG, NB & NP: There has been investor-friendly sentiment over the past few years in India, which can be attributed to various economic and political factors combined with structural reforms

promoted by the government. Almost all relevant corporate laws and regulations in India have been revamped in the past few years and are continually evolving with the needs of the market. This has had an impact on both inbound and outbound investments.

Further, Indian companies seem more willing to provide buyout opportunities by selling their non-core assets or giving up control. Also, younger promoters and business owners exploring a multitude of business interests do not struggle with as many 'control issues' or emotional attachments to their business, as compared to their older counterparts.

Further, shareholder activism is in a relatively nascent stage and is yet to gather as much traction in India as it has globally – but law enforcement agencies and authorities have recently questioned proxy advisory firms about the structuring advice they have given during acquisition and investment transactions.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

VMG, NB & NP: Secondary sales continue to be the popular exit route for most private equity firms and there were close to 200 exits in 2016 worth approximately US$7.2 billion. Initial public offerings (IPOs) remain another form of exit. Upon execution of a binding contract, exiting a transaction involves a reasonable amount of regulatory compliance. Exit mechanisms are usually negotiated upfront at the time of investment, including tax indemnities at the time of exit, and details of this are set forth in the transaction documents. Private equity investors typically opt for an IPO as a method for exit and prefer the liquidity offered by way of listed shares. Consequently, private equity investors invest approximately three to five years before the target company is proposing to list, and exit the target company at the time of listing or shortly thereafter. Ascent Capital recently exited its investment in Citrus Pay through an all-cash buyout of Citrus by PayU for US$130 million. This was the largest ever all-cash deal in India's financial technology sector and the second-largest in the fintech sector. This deal will help merged entities to process more than 150 million transactions in a year, which is worth US$4.2 billion. Another big exit was the US$1.05 billion exit of KKR from Alliance Tire Group.

Dual-track exit processes are quite common, as private equity investors tend to pursue several exit channels in parallel, and continue to prepare for an IPO even as they negotiate terms for a direct sale to a third party. The IPO process is fairly lengthy and often contingent on market conditions. In light of regulatory processes and uncertainties on the return involved, IPO is not a preferred exit mechanism for private equity funds in India.

While considering a sale to a third party, private equity investors consider structures involving a distress or slump sale because of the tax breaks offered to the sellers. Another exit method used by private equity investors is a court-approved demerger or arrangement; however, this process is lengthy and uncertain because of the current backlog of cases in the National Company Law Tribunal.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

VMG, NB & NP: For the past two years, India has been making a concentrated effort to be investor-friendly, with increased disclosure requirements and answerability of the managers to the Securities and Exchange Board of India (SEBI) as well as the investors. Investors are being selective in their allocation and are concerned about the sponsor's investment allocation policy, which they want to ensure is transparent, robust and equitable.

The fundraising market in India has seen immense growth in the past year with the liberalisation of regulatory reforms in exchange control laws and tax laws with respect to funds. The government is actively taking steps to create a fund regime in India that is favourable for raising investments from foreign investors by notifying regulatory policies permitting non-resident Indians, persons resident outside India and registered foreign portfolio investors to invest in alternative investment funds (AIFs).

Registered AIFs in India have more than doubled over the past two years and stood at approximately 270 in 2016. They have also been a significant contributor to overall fundraising in the Indian market and accounted for 41 per cent of the total India-focused funds raised in 2016, compared to only 11 per cent in 2014. This growth is evident from the data released by SEBI, which reveals that total commitments raised at the end of June 2017 amounted to 580 billion rupees – an increase of 254 billion from total commitments raised in 2016.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your jurisdiction?

VMG, NB & NP: A fundraising exercise begins with structuring the fund. Key considerations for ascertaining the best structure include the jurisdictions of target investors, tax efficiency for the fund and the investors. In India, most

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Foreign exchange management laws and regulatory controls pose a big challenge to private equity investors. Practising private equity law in India involves an understanding of complex and changing regulations, and the ability to evaluate the feasibility of various investment structures. The constant evolution of laws in India, stemming from the need to remain relevant in a complex environment, necessitates that transaction lawyers must liaise with various regulators and sometimes manage deals involving the application of laws that have not been tested before. Scrutinising the plausible risks and underlining this to private equity investor clients is of vast importance. There has also been a steep rise in the number of Indian private equity investors over the years, which, combined with continuing investment from all the global private equity giants, means that the industry is underserved and lawyers' roles are more demanding as a result.

What should a client consider when choosing counsel for a complex private equity transaction in your jurisdiction?

Any counsel who advises on transactional law is required to be meticulous and patient, and must be able to achieve a speedy turnaround of documents. Owing to the ever-changing landscape in India with respect to private equity and venture capital transactions, it is advisable to choose a firm that has experience in a vast array of deals and is business-savvy. It is crucial that the counsel is able to take a solution-oriented approach, where they not only evaluate the issue from a legal perspective but are also able to address all practical concerns that may arise.

What interesting or unusual issues have you come across in matters that you have recently worked on?

There have been a lot of unconventional and unique issues in our practice that have required out-of-the-box solutions. We have worked on complicated and creative structures with even more complex documentation and negotiation. Further, after the process of mergers has become more streamlined and brought under the purview of the National Company Law Tribunal rather than the High Courts, there has been an increase in interest in adopting a court-approved arrangement of mergers and demergers to limit the tax and regulatory costs involved in a transaction.

Vineetha MG, Neela Badami and Niruti Pangotra
Samvad Partners
Mumbai
www.samvadpartners.com

private equity funds are set up as trusts, which are preferred as fund entities over companies or limited liability partnerships because of the simplicity with respect to incorporation and governance, and the rules of taxation applicable to them.

Once the structure is finalised, fund documents are prepared, setting out the investment strategy, investment purpose, its investment methodology, key terms of the fund and also information about the key stakeholders of the fund (ie, sponsor and manager). The fund is then registered with SEBI and once capital commitments have been obtained from the investors, the fund holds the initial closing for receiving contributions from the investors. The entire cycle can vary for each fund depending on the jurisdictions of the investors, the corpus size and the stakeholders involved, but typically takes between six and eight months. Historically, funds have been structured on unified or co-investment models, however, of late, with the liberalisation of foreign direct investment norms, unified structures have gained popularity with both domestic and foreign investors, and have emerged as the preferred choice for structuring India-focused funds.

Key contractual points in the fund documents will typically include distribution waterfall, management fees, hurdle rate, carried interest, equalisation amount, contributor giveback, tax structuring provisions and provisions relating to transfer and withdrawal of units, co-investment arrangements and allocations of expenses. In unified structures, typically, the Indian law is the governing law. The governing law with respect to offshore documents at the feeder fund and master fund level is usually that of Singapore, Mauritius or New York.

GTDT: How closely are private equity sponsors supervised in your jurisdiction? Does this supervision impact the day-to-day business?

VMG, NB & NP: More accountability has been given to the sponsors and managers with increased disclosures and periodical compliances. It is mandatory for the manager's key investment team

to have adequate experience in advising and in the business of buying and selling. It is also imperative for the trustee, sponsor and manager to be fit and proper persons based on the criteria specified by SEBI. Any change in control of the sponsor or manager of the fund requires prior approval from SEBI. However, SEBI supervision does not have an impact on the day-to-day business of the fund and the regulatory environment is generally conducive to business.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

VMG, NB & NP: The AIFMD seeks to regulate managers of funds outside the EU raising investment from the EU. It raises the level of regulatory supervision and funds are conscious of the cost of compliance; however, this is not known to have adversely impacted the fundraising efforts of AIFs in India that are raising investments from the EU. The standing committee set up by SEBI has also made recommendations for the adoption of certain rules from the AIFMD for bringing positive reforms to the AIF industry in India.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment potentially changing in the near future?

VMG, NB & NP: Uncertainty surrounding tax treatment has been a major issue for a while, and a lack of clarity relating to the General Anti-Abuse Rule has been an issue for the private equity and venture capital community. The implications of the place of effective management (POEM) guidelines issued in January 2017 are also uncertain at this stage and how it plays out will have profound implications on private equity and venture capital players.

Funds registered as Category I or Category II AIFs have been accorded a pass-through status, which provides that any income accruing or arising to, or received by, a unit holder of a Category I AIF or Category II AIF will be chargeable to income tax in the hands of the investor in the same manner as if it were the income accruing or arising to, or received by such investor, had the investments made by the fund been made directly by the investor. However, the income credited or paid by the fund to the investors will be subject to a withholding tax. Pass-through status has not yet been accorded to Category III AIFs.

SEBI has constituted the Alternative Investment Policy Advisory Committee, which has recommended certain reforms in the funds space including extending the pass-through status to Category III AIFs. We hope to get more clarity from the government on the taxability of funds, which would address the tax concerns of the funds industry.

There are no separate provisions for taxability of carried interest. However, the POEM guidelines could have an impact on some of the carried interest structures, such as personal holding companies set outside India.

GTDT: Looking ahead, what can we expect? What might be the main themes in the next 12 months for both private equity M&A and fundraising?

VMG, NB & NP: There was persistent optimism around private equity investments in India in 2016, which has continued into the first half of 2017. In the latter period, private equity and venture capital investments in India exceeded US$11.2 billion according to a report by audit and consultancy firm EY. These investments also accounted for over a third of the total investments made in the 2016–2017 financial year, which indicates positive investor sentiments towards the Indian economy for the 2017–2018 financial year.

In addition, the report stated that India sees incremental capital from regional allocations from global and Asia-Pacific-focused funds. With the Digital India programme and the plan to build 'smart cities', the ITES, fintech, banking and financial services (including peer-to-peer lending platforms), retail, telecoms and logistics sectors may provide more opportunities to the investors for investment. The liberalisation of the foreign direct investment regulations in the financial services space is a step in that direction. Health services (including diagnostics), the renewable energy sector (which has a strong focus in the government's 'Make in India' initiative), infrastructure services, and education and certain consumer derivative sectors, may also attract considerable foreign investment.

The rising volume of non-performing assets in the banking system could result in a large number of deals in the stressed assets space as well (both strategic and financial), aided by the strategic debt restructuring norms, including the bankruptcy code. A number of global private equity funds already have, or are looking to tie up with, local partners to set up asset reconstruction companies to tap into this opportunity. Simultaneously, many distressed asset funds have been looking at India as a potential market.

Based on the pro-investor stance of the regulators, fundraising is also expected to be a high priority for funds in 2017. We hope that funds are able to leverage the advantages posed by the Indian markets and surpass the potential investments expected in 2017.

Also available online

www.gettingthedealthrough.com

Law Business Research

LACCA
LATIN AMERICAN CORPORATE COUNSEL ASSOCIATION

Official Partner of the Latin American Corporate Counsel Association

Strategic Research Sponsor of the ABA Section of International Law