GETTING THE DEAL THROUGH

# market intelligence

# Private Equity

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2018

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# market intelligence

Welcome to GTDT: *Market Intelligence*.

This is the 2018 edition of *Private Equity*.

**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.

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# PRIVATE EQUITY IN INDIA

Vineetha MG is the founding partner at Samvad Partners. She has extensive experience at Samvad Partners 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 Government of Singapore Investment Corporation, New Silk Route, Morgan Stanley Infrastructure Fund, ICICI Ventures, 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. Vineetha has also assisted in setting up various investment funds. *AI Global* recently awarded her Most Influential Women in Private Equity Investment 2018 – India. Vineetha has also completed an Executive Education Programme at the Harvard University, John F Kennedy School of Government.

Neela Badami is a partner at Samvad Partners. She has amassed over a decade of experience both in India and abroad. At the firm, she works extensively on private equity and venture capital transactions, mergers and acquisitions, corporate advisory, commercial contracts, including technology and intellectual property, and technology law. Neela has her master's in law from University of Michigan Law School, Ann Arbor, USA and she also served as a law clerk at the International Criminal Court in The Hague, the Netherlands. Neela has co-authored several publications, including 'Legal Issues in Negotiating Term Sheets', (VC Handbook, 2013).

Pooja M Shah is an associate at Samvad Partners. She joined Samvad Partners in 2017 and has represented the firm in various private equity investments and M&A transactions, including legal due diligence, drafting and negotiating transaction documents. She has also recently assisted the firm on a foreign investment transaction for a start-up fintech company as well as investments in several start-ups in the fintech sector. She has regularly worked on matters representing IDFC Ventures, Sequoia Capital and Axis Bank. She also assisted private equity funds such as Sixth Sense Ventures, IndiaNivesh Growth and Special Situations Fund and Mayfield India II for a US$13 million foreign as well as domestic private equity investment in an Indian supply chain solutions company.

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*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 and Pooja M Shah:* In 2017, India-focused funds grew by 48 per cent to an aggregate US$5.7 billion in funds raised. Despite a 23 per cent decline in volume, 2017 witnessed a nearly 50 per cent increase in deal value over 2016, which saw US$16.5 billion invested across 829 deals. Some of the largest private equity (PE) deals India during 2017 were seen in the technology, banking, agriculture, renewable energy and logistics sectors. The technology (including e-commerce) sector retained its dominant position, with US$11 billion invested across 346 deals, accounting for 45 per cent of the investment value this year. 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 2017, 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 PE investor.

*GTDT: Looking at types of investments and transactions, are private equity firms primarily pursuing straight buyouts, or are other opportunities, such as minority-stake investments, partnerships or add-on acquisitions, also being explored?*

*VMG, NB & PS:* A PE investor typically invests in a minority stake ranging between 10–25 per cent of the share capital of the company, either by means of subscribing to straight equity or convertible instruments. In such cases, the PE investor only has minority protection rights, such as affirmative rights and the right to appoint a director or an observer on the board of the investee company, and the majority control is exercised by the promoter group through a lead member or promoter. However, in 2017 we also saw several control deals by PE funds. In some cases, the existing shareholders exited fully and the PE investors acquired 100 per cent. In scenarios like these, the PE 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. Owing to the large size of these deals, a lot of control deals have been structured as co-investments between general partners and limited partners.

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

*VMG, NB & PS:* In 2017, the most notable was SoftBank Corp's investment of US$2.5 billion in the Indian e-commerce leader, Flipkart. Other important deals were SoftBank's investment of US$1.4 billion in PayTM, India's largest mobile wallet and SoftBank's US$1.1 billion investment in ANI Technologies Pvt Ltd, which operates Ola Cabs. The financial services sector saw a lot of private investment in public equity (PIPE) deals, the largest of which was Bain Capital's US$1.1 billion investment in Axis Bank and a US$338 million investment in Kotak Mahindra Bank Ltd by Caisse de Depot Quebec and the Canadian Pension Plan Investment Board. These deals marked increased investments from other Asian countries especially China and Japan and greater participation from sovereign wealth funds.

*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? How are those challenges evolving?*

*VMG, NB & PS:* Most PE M&A tends to be domestic and is targeted towards consolidation and economies of scale. In a multi-jurisdictional deal, the major aspect that needs to be addressed is compliance with the Indian exchange control regulations. Both inbound and outbound transactions are regulated under the Foreign Exchange Management Act 1999 and the regulations issued thereunder. In addition, the local law requirements also need to be complied with in such transactions, thus creating a need to engage a local counsel. 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, and to align the exchange control rules in India, the RBI has notified the Foreign Exchange Management (Cross Border Merger) Regulations 2018. In addition, M&A through asset transfers, as opposed to share transfers, can prove challenging to foreign-incorporated venture capital and PE funds. Liquidating companies and recovering proceeds can be particularly time-consuming and procedurally complex in India compared with other parts of the world.


Vineetha MG


Neela Badami

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

*VMG, NB & PS:* Indian laws do not permit banks to extend loans for funding an investment or acquisition of shares. Hence, it is not possible for PE 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 PE 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.

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

*VMG, NB & PS:* In 2017, India continued on its trajectory of introducing tax and business-related reforms to bolster investors' confidence in the economy. Changes such as the abolishing of the Foreign Investment Promotion Board in February 2017 are a positive indication of the government's efforts to attract foreign investment by removing a layer of red tape. Another important change is India's insurance watchdog, the Insurance Regulatory and Development Authority of India allowing PE firms to invest in unlisted insurance companies as promoters. PE investors have benefited from the introduction of the Insolvency and Bankruptcy Code. The government has set up the National Investment and Infrastructure Fund to enhance infrastructure investments in India and is also fast-tracking approvals for industry and infrastructure projects. The RBI on 7 November 2017 notified the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2017 to streamline the infusion of foreign direct investment into the Indian economy.

*GTDT: What are the current attitudes towards private equity among policymakers and the public? Does shareholder activism play a significant role in your jurisdiction?*

*VMG, NB & PS:* Almost all relevant corporate laws or regulations in India have been revamped in the past few years and are continually evolving with the needs of the market. This impacts both inbound and outbound investments, yet there has been a 'positive investment sentiment' over the past few years that can be attributed to various economic and political factors combined with structural reforms promoted by the government.

Furthermore, 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 multitude of business interests do not struggle with as many 'control issues' or emotional attachments to their business, as compared with their older counterparts.

Shareholder activism is at a relatively nascent stage and is yet to pick up as much steam in India as it has globally – but law enforcement agencies and authorities have recently questioned proxy advisory firms for the structuring advice given by them 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 & PS:* 2017 turned out to be a landmark year for PE exits with a record 259 exits valued at US$12.5 billion, exceeding the exits, ie, 2015 (previous best year for exits) by nearly 40 per cent in terms of value. The technology sector witnessed the highest exit activity, with 60 exits aggregating US$5.8 billion, followed by the financial services sector (US$2.3 billion)


Pooja M Shah

*"In India, most private equity funds are set up as trusts, which are preferred as fund entities over companies or limited liability partnerships."*

and the healthcare and life science sector (US$1.3 billion). Both public market sales and secondary sales were the preferred modes of exit. PE-backed initial public offerings (IPOs) alone amounted to US$1.2 billion in 2017 and it is expected that IPOs shall become a preferred exit route for investors. The number of exits in 2017 increased only marginally as compared with 2016, but big-ticket deals added to the value of exits. The notable exits for 2017 include Qatar Foundation Endowment's exit from Bharti Airtel Ltd by means of an open market transaction for US$1.486 billion. Tiger Global exited from Flipkart for US$800 million and from Ola in a secondary sale for US$500 million. Among the big IPO sales, Fairfax Financial Holdings Ltd exited ICICI Lombard for US$558 million.

*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 & PS:* India has been making a concentrated effort to be pro-investors, 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. They want to ensure that the deal allocation policy is transparent, robust and equitable.

The fundraising market in India has seen immense growth with liberalisation of regulatory reforms in exchange control laws and tax laws with respect to funds in India. 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).

*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 & PS:* 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 PE 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

## 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 recent matters?*

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 Pooja M Shah**
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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 & PS:* 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 effect has the AIFMD had on fundraising in your jurisdiction?*

*VMG, NB & PS:* The AIFMD seeks to regulate managers of funds outside the European Union 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 & PS:* Previously, Indian tax avoidance principles were based on judicial principles, which were crystallised on a case-by-case basis. The government has tried to rein in tax avoidance and on 1 April 2017 implemented the General Anti-Avoidance Rules to ensure that complex and multi-layered structures cannot be used to obtain illicit tax benefits.

The rules provide that an arrangement whose main purpose is to obtain a tax benefit and which also satisfies at least one of the four specified tests – (i) arrangement is not at arm's length, (ii) misuse or abuse of tax laws, (iii) lacks or is deemed to lack commercial substance or (iv) not carried out for bona fide purpose – can be deemed to be 'impermissible avoidance agreements'. Once an arrangement is held to be an impermissible avoidance arrangement, the Indian tax authorities have been given powers to disregard entities in a structure, reallocate income and expenditure

between parties to the arrangement, alter the tax residence of such entities and the legal situs of assets involved, treat debt as equity and vice versa, deny double taxation avoidance agreements, benefits, etc.

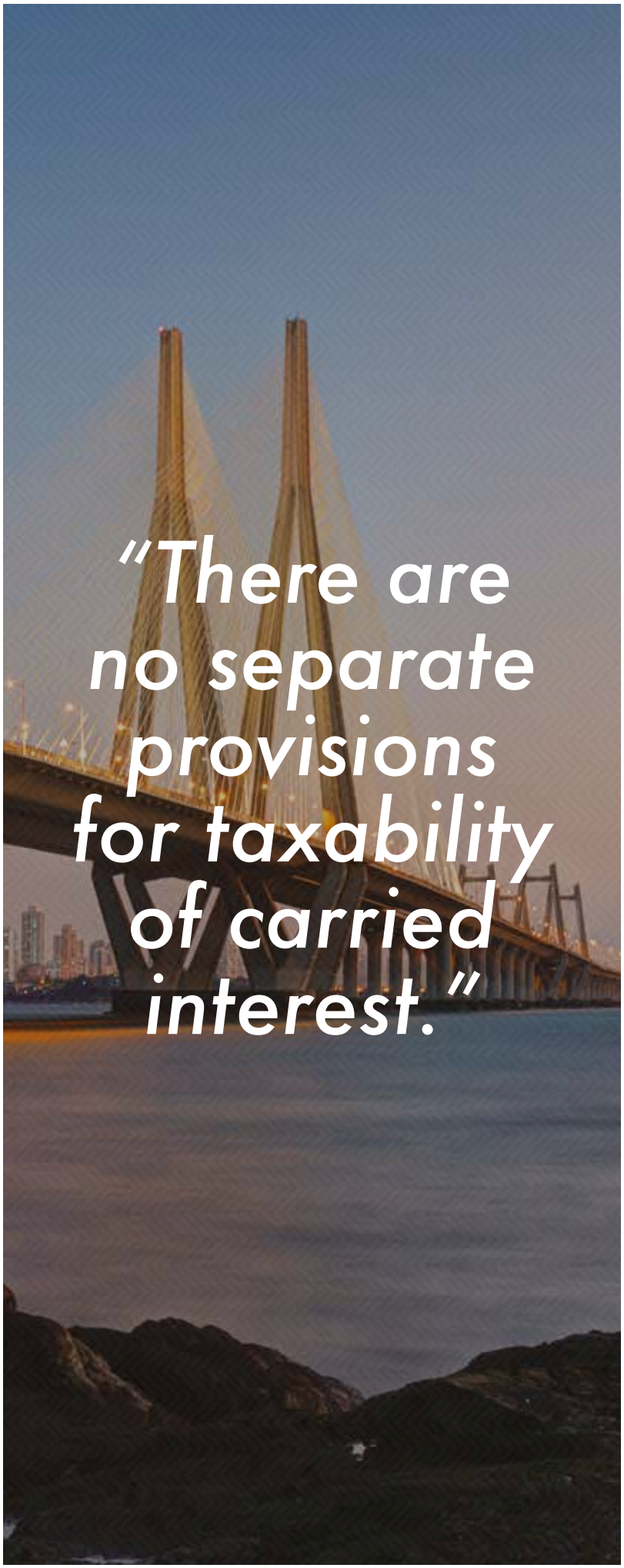
There are no separate provisions for taxability of carried interest. The tax levied depends on how the income is structured. However, the POEM guidelines could have an impact on some of the carried interest structures, such as personal holding companies set outside India.

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

*VMG, NB & PS:* The persistent optimism of the past few years is expected to continue in the next 12 months. 2017 has been the biggest year for private equity and venture capital (PE/VC) investments in the past decade, and even though the volume of deals reduced when compared with 2016, the value of the deals done increased by almost 50 per cent when compared with 2016. This indicates investor confidence in the consumer-driven growth story of India.

2018 is expected to be a strong year for the Indian PE/VC industry in both investment activity and exits. Over the past few years, deals have been becoming larger in scale, and should two to three mega-deals materialise, PE/VC investment activity in 2018 could very well surpass the record highs seen in 2017. Exits are expected to remain buoyant, backed by strong capital markets and good interest from both domestic as well as overseas strategic investors, and this will be helped by a positive macro-economic factors and expected reforms to the economy.

The Indian PE landscape has developed significantly over the last 10 years, and is in a considerably mature phase now with two full investment cycles behind it. A large part of the deal activity in 2017 was due to consolidation across key sectors, including consumer internet, telecom towers and infrastructure or EPC businesses. It was expected that some of the consolidation play would continue in 2018, which would be an opportunity for PE investors. Likewise, there is a significant opportunity for PE players to support the potential resolution applicants under the IBC.

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