

PLAYING FOR CONSOLIDATION & DISRUPTIONS

PEs will do bigger deals and more buyouts while VCs will only back start-ups that look viable and disruptive, fund managers tell Ranju Sarkar

Return of discipline

The venture capital sector in India has been around for a decade-and-a-half, and VC firms offering risk capital have been the dominant sources of funding and impetus to the rapid growth of start-up ecosystem. A staggering \$11 billion-plus has been invested in the Indian start-up ecosystem. Over the years, venture capital as an industry (like all capital markets) is subject to funding ebb and flow. In the US, the years 2000 and 2008 saw venture funding retrench. China experienced its own funding crunch. It should be no surprise, then, that India had to go through a correction cycle; 2016 was the year.



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tum was not loss in confidence of Indian start-ups. The loss was the inevitable correction of irrational exuberance or 'frothiness' in the funding ecosystem and also the lack of exits in the industry.

Corrections, though painful at times, bring a cleaning that is good, like the forest fire that spurs new growth. It was not uncommon for founders to submit business plans with irrelevance to any thoughts of monetisation. Start-ups chasing growth at all costs have been chastised, shifted focus to unit economics with an eye on path to profitable growth has become the new norm. Understanding that top-line

growth devoid of any bottom-line impact is irrelevant. Start-ups without sound business models saw fund-raise to be more difficult than previous years. This trend is likely to continue in 2017. But, sound business models with a strong focus on unit economics and disruptive ideas will continue to see strong investor interest.

Rise in non-VC funding

We have seen a steady number of seed/angel deals — 400 investments in 2016. This indicates the continuing attractiveness of start-ups as an asset class to non-VC entities and high networth individuals. These seed investments are critical in promotion of entrepreneurship. Tier-2 and tier-3 towns in India now have robust ecosystems, attributable to rise in early-stage funding in the smaller towns — Jaipur has emerged as a start-up hub!

Interestingly, corporate investments through balance sheets have also started to play a role. Mahindra's acquisition of BabyOye, Caratlane acquisition by Titan are some of the prominent examples. Foreign companies foraying into the Indian market to find the next acquisition target or simply investing in start-ups will continue the momentum in 2017; we saw a trickle of that in the 2016 acquisition of Tuple by Apple.

Digital Bharat

The Indian start-up growth story was largely limited to urban areas. But, increasingly, start-ups have started making inroads into the hinterlands. From e-commerce companies strengthening their distribution networks in small towns to entrepreneurs (and even large companies such as Google) tapping the vernacular speakers, rural India holds tremendous potential with 120 million

connected users growing at 30 per cent a year, driven by lower smartphones costs, digital infrastructure, increasing in purchasing power and awareness. Bharat, or the hinterlands, in 2017 will see increasing adoption of tech, which is confirmed by emergence of start-ups such as StoreKing, Sharechat, CultureAlley. Given the increasing depth of the Indian market, we expect more investment momentum in India.

As 2016 comes to an end, capital ready to deployed (dry-powder) for start-ups by funds already established in India is quite significant at \$3.1 billion. Driven by strong discipline (sustainable business models), interest from angel investors and increased potential of the Indian market, funding environment is favour of the entrepreneurs. Venture capital in India, in its decade-and-a-half history, will continue to back and grow strong entrepreneurs in 2017.

All this good news for entrepreneurs doesn't mean building a company has gotten any easier. Entrepreneurship is still a hard row to hoe, and there are no shortcuts. The success rates are still single digits. But, if you have a disruptive idea and you are truly committed to building a great business, 2017 is a great time to take a plunge. May the force be with each of you who dare to venture forth to build the next generation companies putting India on the global map.

There is scope for consolidation

2016 was a year of radical changes in corporate mindset driven by conducive policy changes taking effect. With the GDP (gross domestic product) per capita growing at high single digits or better in India, manufacturing across sectors has witnessed a meaningful upside. The government is spending in a very systematic way. There are well laid-out plans of how they are saving on oil subsidy and allocating towards rural infrastructure, highways, ports and railways. This will gradually start showing growth across sectors and it has already shown green shoots in cement and steel. This has had a multiplier effect in employment, construction equipment, taxation and revenues.

We now see a very clear path to realising returns in India and sending money back to investors. This is conceptually a huge sign of confidence and will help us bring in a lot more money into the country. There is an increasing sense of confidence with the pickup in capital markets and interest by strategic investors. There has been a lot more activity than we anticipated this year in our industry.

Broadly, the approach for private equity players in the coming year should move towards strategic solutions that involve partnering with promoters to help them find ways that can help them grow, de-consolidate and go global where there is scope. Investments in 2017



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should strongly focus on these than on sectors that are broadly considered to be fashionable.

The current period is highly opportune for private equity players. There is immense scope to focus on deals that are beyond the purview of banks. This can be done by shifting the focus towards operational value add, larger deals and break away from thematic play and cheaper sectors.

With regard to sectors, manufacturing is looking exciting and there is operational ease thanks to the government's concerted efforts to develop a conducive environment. We are also inclined towards the financial services sector. If there is a buyout opportunity or the scope for a significant majority or demerger of a certain unit of a conglomerate, we will certainly be interested.

The focus is shifting towards return on economic capital, return to shareholders, total shareholder return and these are opening a whole new array of opportunities. Investors are more comfortable with governance, transparency, opportunity and private equity is expected to bridge the requirement for growth capital. The challenge now is to find opportunities where the market is big enough, there is scope for consolidation and investors are looking at reduction in cost of capital. Overall, consolidation is key and an intellectual approach towards investment will accelerate success in 2017.

Year of maturing



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If one were to go by the headlines, the real estate sector in 2016 has been characterised by many trials and tribulations ranging from a slump in sales, to an overhang in inventory, slowdown in tier-1 markets and financial stress among the developer community.

While we cannot deny that the past 12 months have been difficult, we believe the entire industry cannot be painted with the same brush. In fact, there have been many pockets of opportunity which define the market environment today: 1) End user demand has been brand elastic rather than price elastic (tier-1 developers, where the buyer is assured of quality, execution and delivery timelines will continue to sell well). 2) The industry has witnessed some degree of consolidation with smaller developers entering into reverse joint development agreements with larger brand

names in order to drive sales. 3) Pricing and velocity have, therefore, remained largely stable / range-bound assuming the basics (location, approvals, flat size, master plan etc are in place). 4) Most tier-1 developers have been able to access appropriate forms of financing from banks, PE and non-banking financial companies alike, with funding structures now more customised than before; and lastly. 5) The industry has seen an emergence of newer verticals such as commercial, logistics and even retail being actively funded by institutional and retail investors alike.

As the year turns to herald in 2017, we should factor in the dual impact of both demonetisation as well as Real Estate Regulatory Authority. We feel that 2017 will witness a further maturing of the sector even as developers and fund managers will be forced to institutionalise themselves. Assuming that buyer sentiment is also given a boost with an inevitable fall in interest rates as well as widely anticipated concessions in tax, demand for

real estate is likely to return with those that have been waiting on the sidelines willing to transact again. Developers, too, are waiting for this turn in sentiment and have been focused on creating an execution and delivery track record for the past couple of years. At the same time, offshore institutional investor interest and appetite for India is at its highest and aided by the move towards more stringent governance standards, 2017 is likely to witness more participation by such investors across asset class (residential equity, logistics, commercial etc) and in multiple structures (joint venture, fund, foldco etc). In conclusion, 2017 could turn out to be a very interesting year for real estate investments. Those developers that have established brands are likely to emerge stronger and perform even better as sentiment turns positive. On the flip side, the rest of the developer community will find it harder to survive as all stakeholders, including buyers and finance providers, adjust to operating in a more regulated environment.