LIMITED PARTNERS REPORT

FEBRUARY 2021

VCC EDGE

www.vccedge.com

01 Market Sentiment

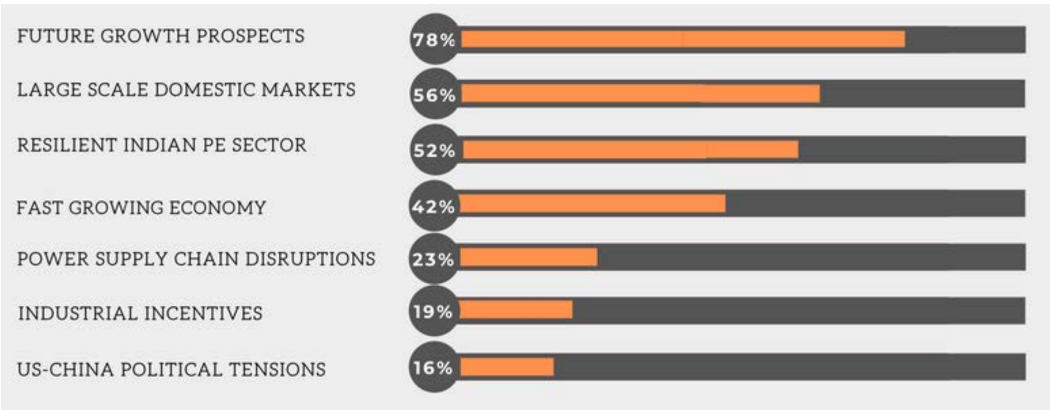
THE VERDICT

100%

INDIA REMAINS A PREFERRED INVESTMENT DESTINATION.

Insights from the VCCEdge Insights Research Programme have confirmed that **100% of Limited Partners** continue to regard India as a preferred investment destination in spite of the challenges brought on by the COVID pandemic and the global slowdown.

Key factors contributing to India's status as a preferred investment destination:



Market Sentiment

ADDITIONAL INFLUENCERS

3RD LARGEST ECOSYSTEM

- As per estimates shared by Government of India, the start-up ecosystem in India experiences an **Y-O-Y growth rate of 12-15%.**
- Out of more than 20 unicorns in India, which are valued at $73.2 billion, **11 were added in 2020** and despite challenges faced , the total amount of **funding raised was $11.5 billion.**
- Currently, US with 242 unicorns has the largest start up ecosystem followed by China with 119 unicorns.

"It is estimated that by 2025, the unicorn tally in India will touch 100, directly creating 15-16 lacs jobs."

Youth Power

Considering that 66% of India's population is below 35 years, it's not surprising that the **median age of Indian start up founders is 29yrs.** These young entrepreneurs are pioneering multiple tech start-ups with sustainable business models and choose to seek PE/VC funding rather than taking loans. This evolving mindset of entrepreneurs has led to increase of funding opportunities in India.

Dexterity Of Fund Managers

Past experiences at a national and global level have taught Indian fund managers to turn adversity into opportunity and take **advantage of investment opportunities** that emerge during economic instability.

Reflecting back to the fund crisis of 2008, fund managers had safeguarded themselves by investing in **Exchange- Traded Funds** because in addition to mimicking basic indices, they were cost effective as well.

During the demonetisation crisis, a **supportive domestic stock market** encouraged them to continue to invest in stocks keeping Indiabulls Housing Finance, Maruti Suzuki India and ITC in their portfolios. This was aided by the fact that India has lower credit penetrations levels.

Initiatives led by the government like Make In India have thrown a positive spotlight on us globally. FDI inflow as part of the Make In India initiative has contributed 46.94% to the total FDI of India, valued at $286 billion as of 2019 (source GOI's Make In India portal).

02 RISE IN CAPTAL CALLS

Two main causes for increase in capital calls are **the rapidly changing market conditions due to COVID 19** and the **triage effect** as cited by **40% and 33% LPs** respectively. While 4% LPS maintained that despite the increase in capital calls, there was no reason provided to them.

Triage Mode

Given the rapidly changing market conditions in 2020, capital calls have been used partly for new strategic investments but majorly as a **triage method**. Funds raised through capital calls have been pumped into portfolio companies in an attempt to support and keep them afloat as businesses took a severe hit. These funds have also been used for **top up investments** in portfolio winners.

Operational Costs

Raw materials and service costs have increased causing an overall increase in operational and production costs. This translated to **higher fixed costs** which led to funds from capital calls being utilised to **maintain existing portfolio companies.**

Opportunistic Play

The drastic fall in valuations and undervaluation of assets, generated plenty of buyout opportunities causing a substantial opportunistic play from larger funds to benefit from the situation.

However pricing corrections can rise concerns related to the "denominator effect."

Covid Impact

52% *Increased Slightly*

29% *No Change*

13% *Increased Substantially*

6% *Decreased*

03 Denominator Effect

EXHIBITED A LIMITED CONCERN TO LPs

Denominator effect was only a concerning factor during the lockdown -

During the lockdown period, seeing the rapidly dropping valuations of the unlisted companies caused investors to **shift their focus to listed companies**. The BSE index which started out at 36,144 in March 2020 rapidly fell to 25,981 by the end of the month drastically reducing valuations.

Once the public markets started stabilising, the denominator effect became less of a concern to the LPs and by end of June 2020 the BSE index touched 34,915 showing a **34% improvement.**

In the midst of all this, the technology space continued to attract positive interest from investment managers and was further aided by **corrections in pricing** as well.

Denominator Effect

LPS AFFIRM THAT THE DENOMINATOR EFFECT NEEDS CONSTANT MONITORING

Most portfolio companies have managed to balance out on their own with a few exceptions of those who were gravely impacted. On the other hand, the pandemic had a positive impact on some companies as well which overall created a **neutralising factor**. However, this varied impact and its long term effects need to be **monitored constantly.**

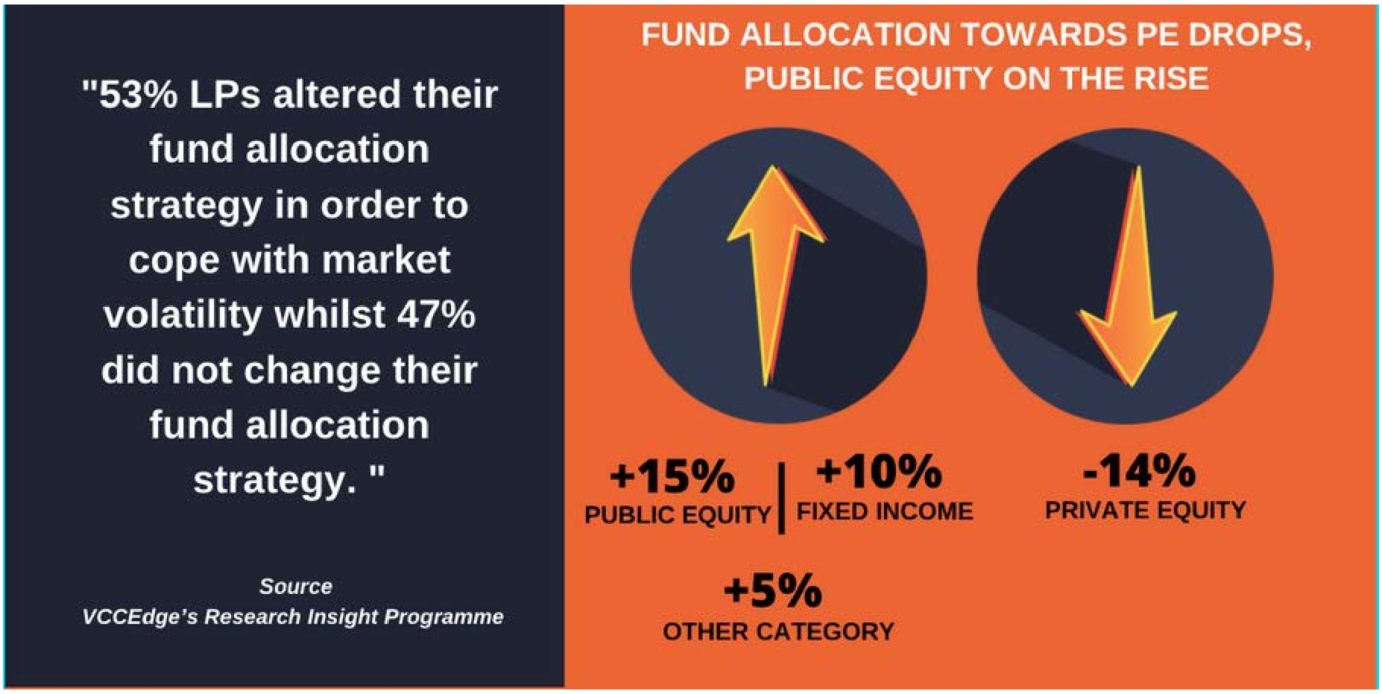
INCREMENTAL HOLDING PERIODS

Inspite of the neutralising effect, the holding period of assets has **increased by a few years,** especially in terms of distribution. The markets are currently mid-way to recovery due to the expeditious development of the vaccine and any over allocations of funds towards PE investments are also easing out. The situation will continue to improve as long as there is constant monitoring.

Fund Allocation

Divergence from Private Equity

04



PUBLIC EQUITY

Concerned investors shifted their fund allocations from private equity to public equity not only because listed company valuations dropped rapidly but also because public equity would be easier to monitor in constantly evolving market conditions.

FIXED INCOME SECURITIES

Investors have shown preference towards fixed deposits, government bonds and corporate bonds. Despite the returns being much lower, due to less risk associated with this category, LPs and some funds preferred to invest unallocated capital rather than keep it idle.

OTHERS- GOLD & MUTUAL FUNDS

During the initial phase of the pandemic when the Sensex dropped, other liquid investments like mutual funds also came into the limelight. Reputation of Gold in India as a safe haven, promoted investments in both physical form of Gold or Gold ETFs.

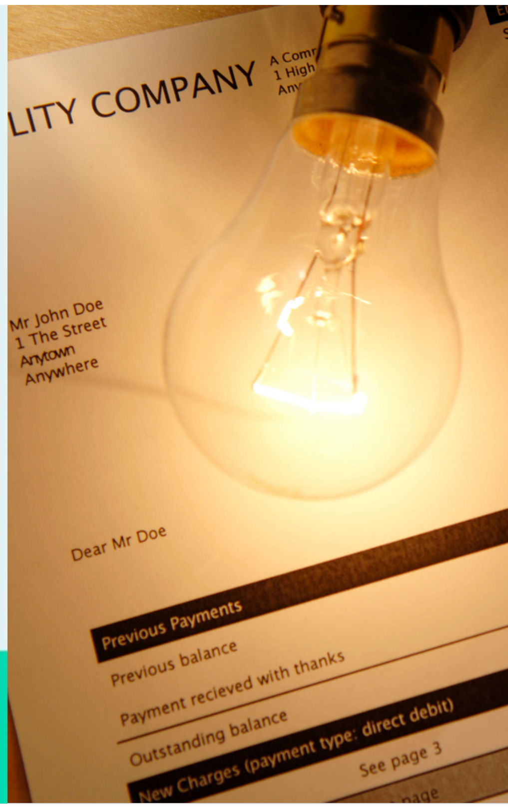
Transposition Of Investment Focus

05

55% CHANGED INVESTMENT
45% DID NOT CHANGE INVESTMENT

61% Healthcare
48% Pharma
42% IT
45% FMCG
39% Education

16% Real Estate
10% Sector Agnostic
6% Utilities
6% Materials
3% Tourism



Causes For Change In Investment Focus

Rapid Rise in COVID Cases

- Demand in healthcare sector has grown constantly at **19% CAGR**, however the supply has not matched the growth rate.
- The World Health Organisation recommends 1 doctor and 3.5 beds per 1,000 patients, however the bed density in India is 0.65 doctors and 1.3 beds per 1,000 patients indicating a **huge supply deficit.**
- In addition, till 2024, every year **3,00,000 nurses** need to be added to be able to fulfil demand.
- This gap in supply and demand has been further magnified by the rapid rise in cases and hospitalisations.
- Due to this, investment opportunities have **increased exponentially** in all facets of healthcare and pharma sector.

Technology as a Facilitator

- Shutting down of establishments like education institutes, cinemas, malls etc during the pandemic, facilitated the **use of e-learning and video consultation** software to enable establishments to continue to provide services seamlessly.
- The Information Technology sector in India is expected to grow at an annual compounded **growth rate of 7.6% till 2024,** once again providing a multitude of investment opportunities.
- In addition to health-tech, **digital transformation of businesses** have led to an increase in interest in areas like e-commerce, ed-tech, online F&B, OTT and others.

CHANGE IN INVESTMENT COMMITMENTS

55% *LPs focus on new investments with strategic advantages.*

32% *No change in commitment.*

10% *Completely paused new commitments.*

6% *Focussed on new investments nearing an exit with no focus on new investments.*

3% *Undecided - currently under evaluation.*

06

Increased Vigilance For New Investments

Focus is on investments with strategic advantages such as healthcare, pharma, education, etc. Increased caution among LPs have made them either pause new investments completely for the next 1-2 years or pay greater attention to investments nearing a close with exit opportunities.

Current Sentiment

"Wait and watch."

As the prevailing situation is highly uncertain and future timelines cannot be ascertained with surety.

Delay In Fund Launches

COVID IMPACT

07

87%

FUND LAUNCHES HAVE BEEN DELAYED

The year 2020 has been overall detrimental for funds as both fund launches and fund raising has been delayed significantly.

LPs HAVE BECOME RISK AVERSE!

Due to delay in closures, the willingness to invest in fresh capital has reduced substantially and a large number of LPs have **moved back from the market.** As there is lack of capital, fund managers have delayed conversations of new fund launches. In addition, the LPs **remain concerned** with taking long term positions because of the COVID impact

STRICTER DUE DILIGENCE

LPs are exercising an extra layer of caution and preference is being given to well established fund managers who have delivered in the past and will be able to provide a certain level of confidence to the investors. Due to this, new fund managers are **taking longer** to reach their targets or are **revising their target fund raise** to lower levels. Use of funds is also being channelled towards portfolios that require immediate attention.

Dry powder to the rescue!

Increase in use of dry powder

08

Private Equity firms are sitting on a large volume of unutilised capital which bodes well during times of economic distress.

2020 |$1.48 trillion	**2018/19 |$2 trillion**
2017|$1.80 trillion	**2016|$1.50 trillion**

71% LPs have claimed to have witnessed a substantial increase in the use of dry powder, as indicated by the Research Insights Programme of VCCEdge.

Key Influencing Factors

55% **To strengthen existing portfolios and enable them to sustain existing marketing condistions.**

29% **To make new investments.**

23% **Investments in companies that can pick up in the near future.**

Increase in use of dry powder

Key Influencing Factors

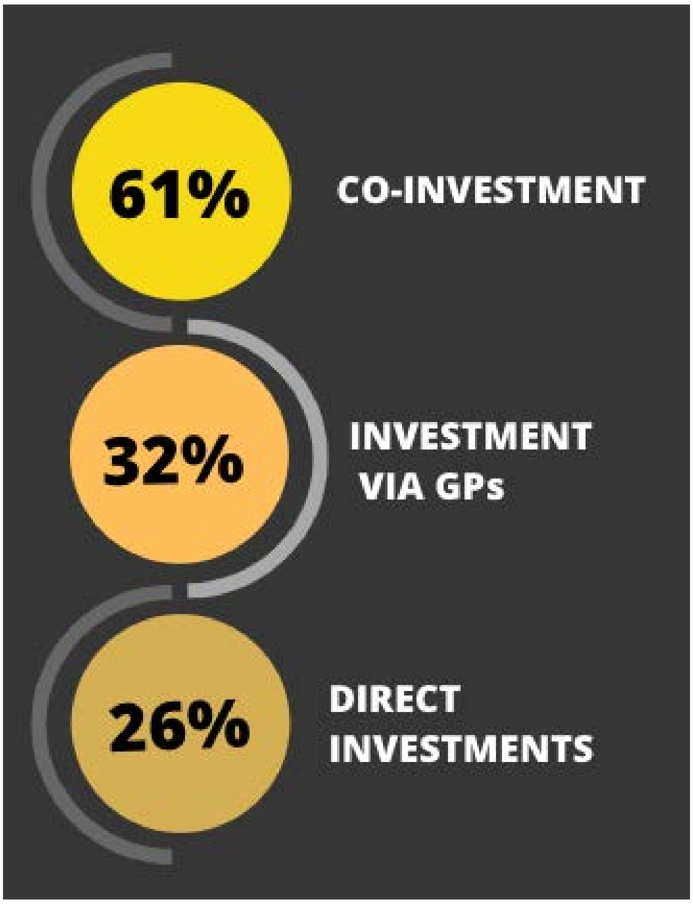
At times of economic distress and delayed fund launches, the capital being used by funds - whether their dry powder or funds collected through capital calls was majorly utilised to **balance their portfolio via top up investments.** These investments are geared towards increasing stakes in their **portfolio winners**.

Funds have also pumped capital in their portfolio companies to **support their operations** as innumerable business were going bankrupt and shutting down due to their inability to meet basic operational costs.

Investments in stressed assets and the NBFC sector also increased, although they were very popular even before the pandemic. Due to significantly lower valuations and the fact that acquiring these assets allows investors to **skip over long gestation periods,** they remain an attractive investment focus.

09

Co-investment- A Preferred Investment Strategy



As per research by VCCEdge, during the last 5 years $73.15 billion were invested by LPs and their co-investors in over 1130 deals.

Out of these, 210 deals worth $15.61 billion were in 2020.

Primary Influencers

Risk Diversification

As confirmed by **35% LPs,** co-investment gives them an advantage of spreading the risk. In adverse scenarios, when market conditions are unresolved and there is a lack of clarity with regard to the future, investors tend to become risk averse. At this time it becomes imperative for them to **spread their risk** by investing in **diverse asset classes** and also increasing the **number of investors i**n the investment pool.

Co-investment
Primary Influencers

Enables Larger Transactions

In addition, **35% LPs** also confirmed that co-investments gives them the **flexibility of executing larger deals** as opposed to them investing individually. Higher number of investors results in increased knowledge resources, greater professionalism along with **availability of more capital.**

Higher Return Generation

Complementing the above reasons, **23% LPs** perceived co investment to be an attractive strategy **yielding in higher returns.** Moving hand in hand, higher capital commitments warranted higher returns on investment.

Benefits LPs with Limited Investment Knowledge

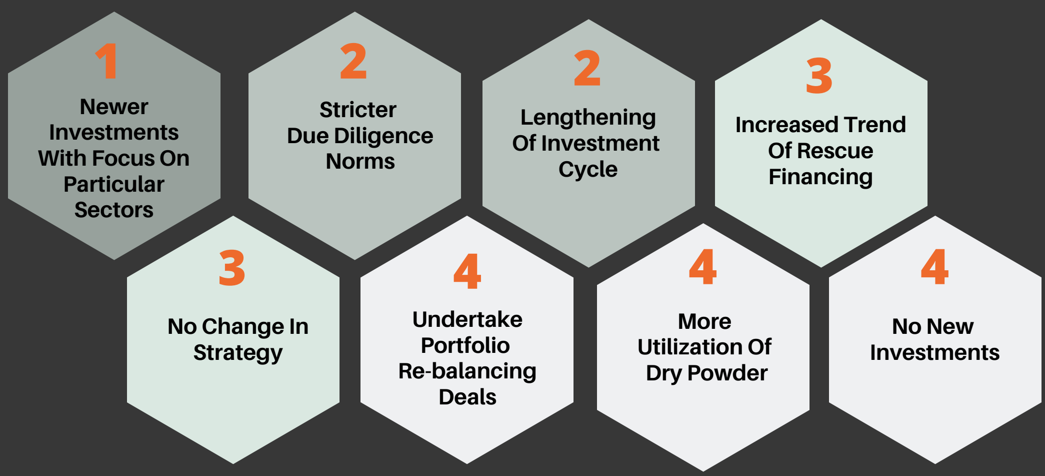
Collaborations between LPs greatly **enhances the knowledge pool,** helping less well versed LPs benefit from the past experience of those who have already dealt in the Indian markets, an observation stated by 23% LPs. Having said that, co-investing as a strategy was primarily preferred by investors with past experience in the Indian markets and those who could effectively **drive investment decisions.** New investors continue to prefer to invest through GPs.

Added Control over Capital Deployment

Co-investment allowed LPs to be directly **involved in the decision making process** and focus investments in specific areas of interest. **19% LPs** voted that it gave them an additional control over **deployment of capital.**

10 Future Investment Strategies- Way Forward

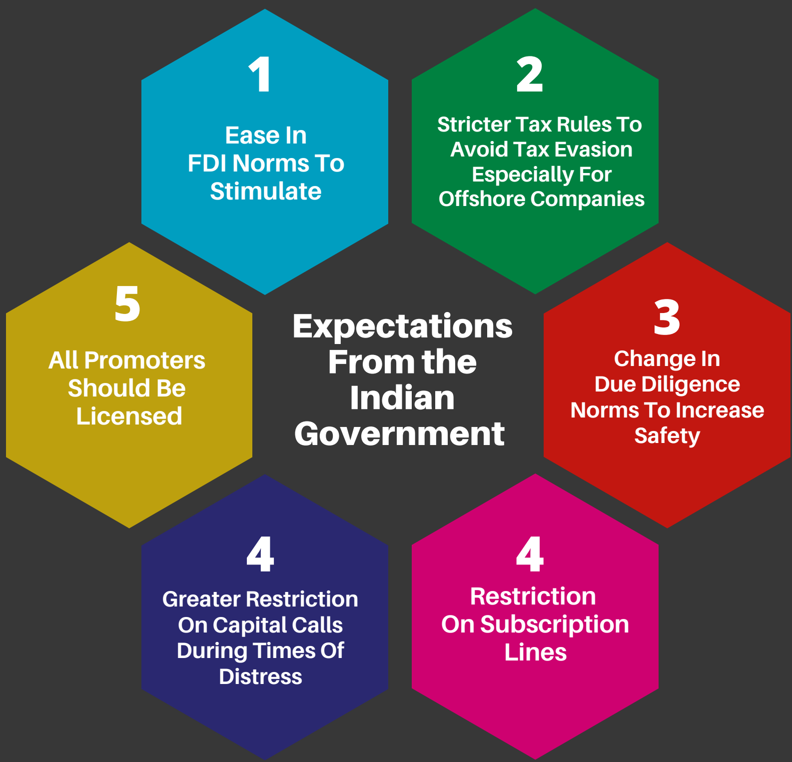
Investors by nature are primarily **risk averse.** In addition to tightening due diligence norms, they want to partner with **experienced fund managers**. They are now looking more favourably at avenues which have had a **consistent track record** over the last decade, and those who have sustained other economically volatile situations like the financial crisis of 2008, demonetization, etc.



Post 2020, **investment lifecycles have been extended** by an average of 1-2 years, depending on the extent of value erosion and the liquidity status of investors. However, as the average lifecycle of a private equity fund is between 10-12 years, investments which are approaching this time period have **limited choices** to increase their investment life cycle.

Although fund managers have provisions in the LPA to make extensions, in most cases this is subject to the approval of the investees. While some would like to hold their investments for another 2 years, most investors would prefer **cutting their losses and exiting** to try and benefit from new and **more lucrative investment opportunities.** This will allow them to make up for lost capital and value.

11 Future Investor Expectations- From Goverment of India



FEWER REGULATORY HURDLES

LPs are of the consensus that despite of greenfield routes of investments being open and the pass through status being approved by the government, the **numerous regulatory hurdles** which are faced by overseas investors acts as a huge **barrier and deterrent.**

Future Investment Expectations, From Goverment Of India

INCREASED TRANSPARENCY

Even though the issue of **lack of transparency** has been frequently raised, there continues to be grey area in terms of taxation in the private equity space. The channels of communication with government agencies are also not forthcoming with **limited points of interaction** , due to processes being highly automated.

ERADICATING BUREAUCRACY

Investors strongly believe that the Indian government needs to work on **long term strategic reforms** to remove bureaucracy and **ease the levels of harassment** faced by new entrepreneurs. While they are able to rise to the challenge of fund raising, the **multiple confusing laws and legalities** imposed by the Indian government acts as a **serious deterrent** in businesses starting up and fostering innovation.

STREAMLINING LAWS

The survival of new businesses will depend on how soon the legal system in the country can be **streamlined and simplified** for young entrepreneurs to be able to move forward. **Lack of clarity** in understanding the existing laws due to their ambiguous nature leaves them baffled and unclear on how to proceed.

IMPROVING TAX PARITY & STABLIZING INTEREST RATES

Investors can be helped by **avoiding rigorous fluctuations in interest rates** if they are working well. In addition, **better tax parity** for venture capital and private equity as compared to public investments can benefit as well.

12 Investment Sentiment

THE VERDICT

Are we at Pre COVID Levels?

64% Near future

36% Yes

0% No

Steady Improvements In the Market

Majority of the LPs are of the opinion that a sneak peek of pre COVID levels in current investments can already be witnessed with an increase in deal activity, complemented by a super bounce back by the Sensex.

Pre COVID Levels: June 2021 Onwards

The current belief is that in the next quarter the markets will continue to pick up and the investment sentiment will further reflect pre COVID levels from June 2021 to January 2022. The approved pass through status has also helped boost deal activity.

Dependencies:

The sentiments of the market will be greatly influenced by the news and developments with relation to the COVID vaccine.

The VCCEdge Research Programme clearly indicates that any unfavourable news associated with the vaccine and the virus, such as the new COVID strains, efficacy/recall issues can unfortunately cause the market to plummet with unfavourable volatility again.

13 Silver Lining

Resilient Indian PE Ecosystem

Events in the past have effectively proven that **Indian private equity markets are resilient** and can handle volatility and adverse economic conditions. Investors have found innovative ways to make their investments work in these trying times, not withstanding any negative news related to COVID 19 virus and its effects.

Though investors are being presented with many **new investment opportunities,** the sentiment is to continue to **wait and watch** for the next few months, which has been their mantra last year as well. They do not believe that this will impact them negatively.

News related to the **speedy deployment of the vaccine**, which under normal circumstances would take 8-10 years has given a great **boost of confidence** to the investors, which is reflected positively in the market as well.

AUTHORS:

Shalil Gupta
Chief Business Officer
Mosaic Digital, an HT Media Group Company

Ruby Dobriyal
Manager Research

Jyotsna Singh
Research Analyst

For media enquiries, reach out to us at mediaqueries@vccircle.com

ABOUT VCCEdge

VCCEdge is a leading capital market deals, directories and financials data repository which helps facilitate the investment ecosystem in India.An online subscription-based service, VCCEdge allows users to track detailed information on LPs, IPOs, M&As, venture and listed debt, PE/VC, angel/seed funds and their deals and transactions. The platform also tracks financial summary of listed as well as unlisted companies. It enables investors and advisors to make informed decisions, manage risk and achieve market-beating returns.VCCEdge is part of Mosaic Digital, a 100% subsidiary of HT Media Limited and India's leading news, data & research company catering to the growing needs of investors, entrepreneurs, enterprise tech companies, startups and more. We provide advanced research and insights coupled with credible journalism and innovative brand solutions which moves markets, helps our partners and users make informed critical decisions and powers top companies and careers.

MOSAIC MEDIA VENTURES PVT. LTD.

DELHI: 17, Okhla Industrial Estate, Phase 3, New Delhi - 110020, Phone: +91- 011-49711180, +91- 011-68132900

MUMBAI: 61-A, 6th Floor, 2 North Ave., Maker Maxity, BKC, Bandra (East), Mumbai - 400051, Switch Board Number - 022-61456100

BENGALURU: No.43 Residency Road, Shanthala Nagar, Ashok Nagar, Near Gateway Hotel, Bengaluru - 560025