Private Equity Funding

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Why discuss PE Funding?

PE in India: Investment Side

- Deal value of $ 16.8 billion in FY 2016
- No of deals = 1000 plus
- Average size deal is $ 17 million
- India focused funds are carrying $ 9 billion in dry powder
- Early & growth stage deals contribute 40% of total value
- New asset classes viz venture debt, distressed assets, etc.

Top PE Investments in 2016

Company	Industry	Funds / Investor	$ Mio
Mphasis	IT & ITES	Blackstone	1,100
Resurgent Power	Energy	CDPQ, OSGRF, KIA	500
Quest Global	IT & ITES	Advent, GIC, Bain Capital	350
GE Capital Services	BFSI	Aion India Invst Advisors & oth	330
Bangalore Intl Airport	Infra	Fairfax Financial	321
Eicher Motors	Manufacturing	Euro Pacific, Cartica Capital	310
Sanmar Chemicals	Manufacturing	Fairfax Financial	300
SBI Life Insurance	BFSI	KKR, Temasek	270
CARE Hospitals	Healthcare	Abraaj Group	255
Sigma Electric	Manufacturing	Argand Capital	250
Ibibo Group	Consumer Tec	Naspers	250
Edelweiss ARC	BFSI	CDPQ	250
Greenko	Energy	GIC, ADIA	230

PE in India: Exit Side

- Total Exits in 2016 is $ 9.6 billion
- There is $ 50 billion of investment overhang
- Public market sales continued as prominent exit mode
- Secondary and strategic sales improved
- Fund to fund deals gained attraction

Top 10 PE Exits in 2016

Target	Exit by	Sector	Mode	$ Mio
Alliance Tire Group	KKR	Mfg	Strategic Sale	1,200
Bharti Telecom	Temasek	Telecom	Strategic Sale	700
Gland Pharma	KKR	Healthcare	Strategic Sale	600
Minacs	Capital Square, CX Partners	IT & ITES	Strategic Sale	420
Sigma Electric	Goldman Sachs	Mfg	Secondary Sale	250
Sonalika Tractors	Blackstone	Mfg	Strategic Sale	250
Quest Global	Warburg Pincus	IT & ITES	Secondary Sale	250
Lodha Group	HDFC Property	Real Estate	Buyback	220
Equitas Holdings	IFC, Sequoia, FMO, Helion	BFSI	IPO	220
Idea	Providence Equity	Telecom	Market Sale	210

Funds raised by Indian PEs: 2016

Fund Name	$ Mio
Sequoia Capital India V Ltd	920
HDFC Capital Real Estate Fund I	405
Multiples PE Fund II	285
Godrej Residential Invst Fund	275
Kotak India Real Estate Intnl Fund III	250
Oman India JV Fund II	250
India Advantage Fund Series IV	190
Matrix Partners India III	110
Gaja Capital Fund III	110
ASK India Real Estate Fund	100

Major PE / VC Backed IPOs in 2016

Issuer	Rs. Bln	Offer Price Rs	Listing Price Rs.	MPS on 31-1-17	PE / VC Investors
Laurus Labs Ltd	13.31	428	490	475	Aptuit, Eight Roads Ventures, Warburg Pincus
Endurance Tech Ltd	11.62	472	570	611	Actis
RBL Bank	12.13	225	274	382	Elephant Capital, Beacon India, Gaja Capital, Capvent India PE Fund II
SP Apparels Ltd	2.39	268	305	375	New York Life Investment India Fund II
Dilip Buildcon	6.54	219	240	238	Banyan Tree Growth Capital
Advanced Enzyme Tech	4.12	896	1,210	1,809	Kotak India Venture Fund I
Parag Milk Foods Ltd	7.52	215	216	266	IDFC Pvt. Equity Fund III, India Business Excellence Fund I
Ujjivan Financial	8.88	210	227	363	India Financial Inclusion Fund, Unitue, Wolfensohn, Sarva, IFC, Elevar Adivosrs
Thyrocare	4.79	446	662	711	CX Partners Fund I
Equitas	21.75	110	144	165	Avishkar, Sequoia, Westbridge, Helion, IFC, Creation Invst, Sarva Capital
Health Care Global	6.50	218	210	242	Premjji Invest, India Build Out Fund I, Temasek

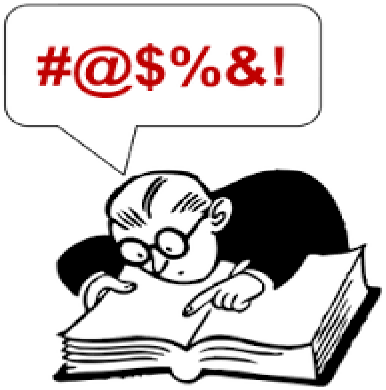
Opportunities for CS

- Due Diligence
- Instrument Structuring
- Transaction Negotiator
- Corporate Compliance
- Drafting Documents
- Valuation

- Training
- Consulting
- Investment Banking
- PE Fund Advisory
- Certifications
- Nominee Director

Request to Note - Disclaimer

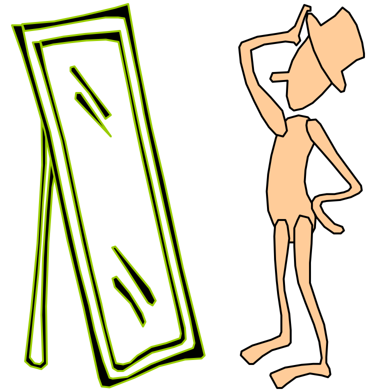
- None of the information or views relate to the organizations the presenter is presently or previously associated with.
- The numbers, examples, and information are all indicative.
- The summarized details are only to give a broad idea.
- These details are not meant for sharing in any way that would cause prejudice or that would take name of this resource person or the present or previous organizations he is associated with.



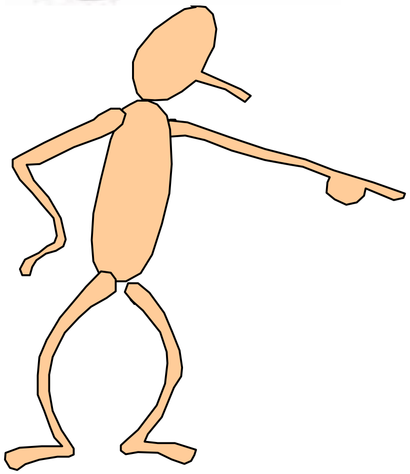
PE Jargon

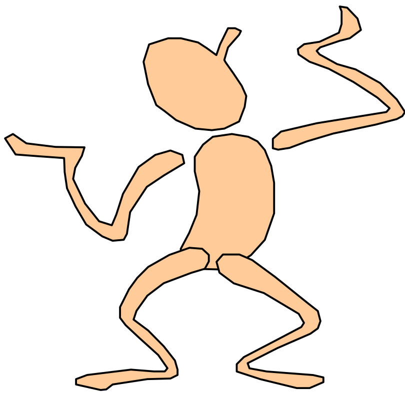
- Alpha & Beta Products
- Baggage
- Capital Call
- Carried Interest
- Catch-up
- Claw back
- Dry Powder
- Earn Out
- House Keeping
- Kicker
- Living Dead
- MBI & MBO
- Overhang
- PIPE
- Skin in the Game
- Vintage Year

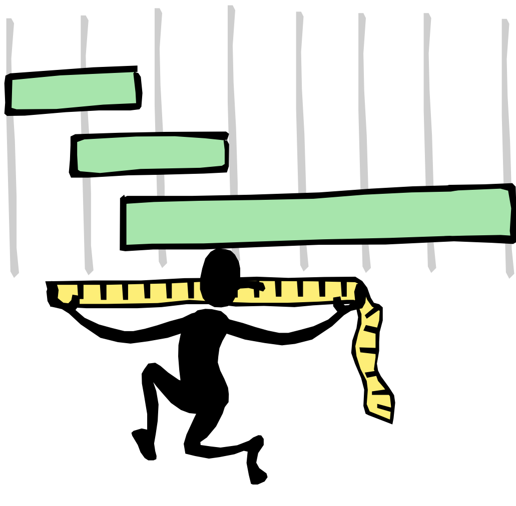
Scheme of discussion



- PE and related investments
- Investment strategies of PE
- Process of PE and Fund’s Life cycle
- Valuation Methodologies of PE
- Contractual Terms in PE Funding:
  - Liquidity Preference Rights
  - Equity Ratchet Rights
- Pre and Post Money valuation
- 20 Pressure Clauses of PE







PE and related investments

Private Equity – Broad Meaning

- Technically refers to any type of equity investment in an asset in which the equity is not freely tradable on a public market.

- Therefore, PE is:
  - Less liquid
  - Long Term in nature

Kinds of private equity

	"Angel"	"Venture Capital"		"Growth"	"Buyouts"		"Distressed Investing"		"Hedge Funds"
	Seed	**1st Round**	**2nd & 3rd Round**	**Emerging Growth**	**Leveraged Buyouts**	**Mezzanine Debt**	**Distressed Equity**	**Distressed Debt**	**Hedge Funds**
Age of Company	0 years	0-1 year	1-3 years	3-10 years	10-50 years	10-50 years	10-50 years	10-50 years	5+ years
Stage of Company	Idea	Prototype	1st generation product	2nd or 3rd generation product	Established, slow growth	Established, slow growth	Stressed	Stressed	Public
Public or Private?	Private	Private	Private	Private or Public	Private or Public	Private or Public	Private or Public	Private or Public	Public
Equity Requirement	$0.2-0.5m	$1-2m	$2-5m	$5-20m	$10 - 250m	$10 - 250m	$10 - 250m	$10 - 250m	N/A
Return Expectations	70%+	50-70%	50-60%	40-50%	25-40%	20-30%	30-50%	30-40%	20%

Investment strategies of PE

Private Equity strategies

<table>
<tr><th colspan="2">Private Equity</th><th rowspan="2">Private Debt</th></tr>
<tr><th>Corporate Finance</th><th>Venture Capital</th></tr>
<tr><td>Leveraged Buyout (LBO)</td><td>Early Stage</td><td>Mezzanine</td></tr>
<tr><td>Growth Capital</td><td rowspan="2">Late Stage</td><td>Distressed Debt</td></tr>
<tr><td>Turnaround</td><td>Infrastructure</td></tr>
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Private Equity – Corporate Finance Strategies

Finance type	Strategy
Leveraged Buyout	Acquisitions of operating companies that are financed with equity and debt
Growth Capital	Expanding companies in need of capital to finance high growth or acquisitions
Turnaround	Acquisitions of underperforming businesses or businesses in out-of-favor industries in need of either financial or operational restructuring

Private Equity – Venture Capital Strategies

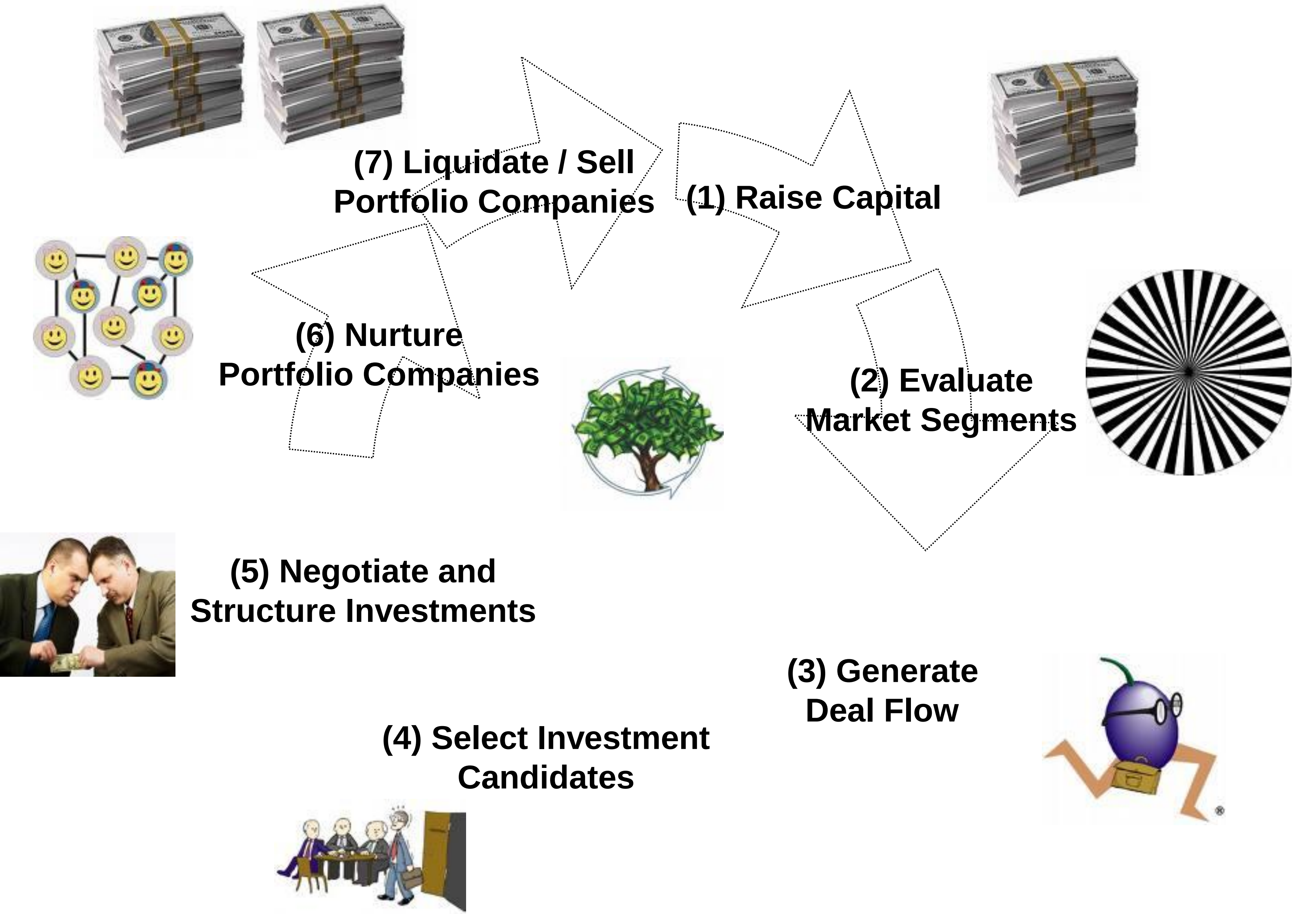
Finance type	Strategy
Early Stage	Companies that are in the process of developing business plans, products / services have been developed and are marketed to a limited number of customers
Late Stage	High growth companies, nearing profitability

Private Debt – Financing Strategies

Finance type	Strategy
Mezzanine	Investments in subordinated debt issued by operating companies; frequently issued in conjunction with a buyout acquisition and with equity kickers attached, such as warrants or options in order to enhance returns
Distressed Debt	Investments in public and private debt securities that are trading at discounts to par value due to financial stress of the underlying company
Infrastructure	Investments used to finance the construction or enhancement of distribution networks for electricity, water and gas, and certain transportation assets such as toll roads, bridges and tunnels

Process of PE & Fund's Life cycle

Process of PE fund

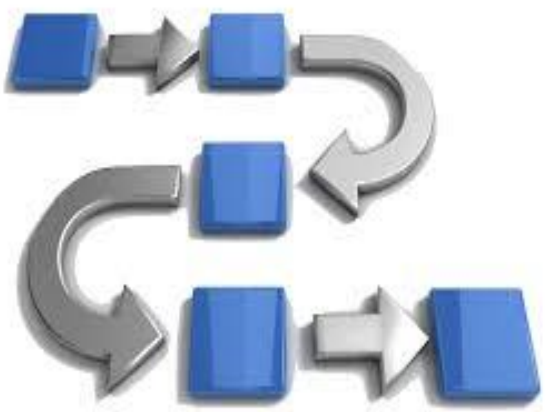


Private Equity Fund Lifecycle

Period	Activity
Fund raising (6 – 18 months)	The first phase of a fund's life cycle is the fundraising period, during which a fund is marketed to potential investors who commit capital. Capital commitments from investors are essentially promises to fund future investments as a fund manager identifies them.
Investment Period (5 – 6 years)	Once fundraising is complete, the fund closes and begins its investment period, which typically lasts five years. During the investment period the fund manager calls capital from commitments provided by investors to make investments
Realization Period (5 – 8 years)	After the investment period, the fund enters the realization period, which lasts five to eight years on average. During the realization period, investments are sold or liquidated, and proceeds are returned to the investors

PE: Process for Investees

- Configuring the Business
- Preparation and floating of Teaser
- Validation, Valuation & Negotiation
- Receipt of Term Sheets
- Responding to Due Diligence
- Structuring Instruments
- Finalization & Signing of Definitive Agreements
- Fulfilling Conditions Precedent
- Receipt of funds
- Fulfilling Conditions Subsequent



Valuation Methodologies of Private Equity

Valuation methodologies

- Price of recent investment
- Earnings multiple
- Net assets
- DCF or earnings (of business)
- DCF from investment
- Industry valuation benchmarks

Price of recent investment

- Since the previous investment was made recently, the same price may be adopted for the current investment as well

- The validity of the valuation obtained in this way is inevitably eroded over time.

- To adopt price as above, background to the previous transaction and investment must be evaluated (such as volume, rights, strategic considerations etc)

Evaluation of previous investment and business

- Performance and prospects of the business against the assumptions / terms of previous investment
- Extent of compliance with the terms and conditions of investment documents
- Present business environment, including technical, market, economic, legal and regulatory, in comparison with previous investment

Earnings multiple

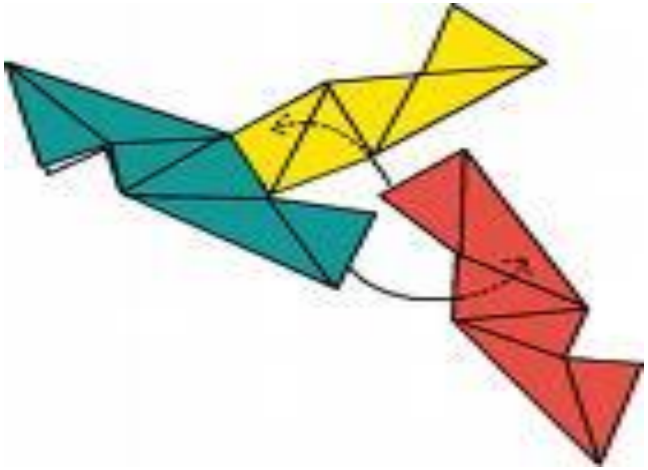
- Is applying an earnings multiple to the earnings of the business to derive the value of the business.

- This methodology is appropriate for investing in established businesses with identifiable stream of maintainable continuous earnings

- The earnings figures for a number of periods may be averaged using a forecast level of earnings or applying a sustainable profit margin to current or forecast revenues.

Essentials to apply earnings multiple

- Multiple should be appropriate, reasonable, and commensurate with the earnings growth prospects of the underlying company.
- Earnings should be adjusted for the surplus assets or excess liabilities and other relevant factors to derive enterprise value for the company
- This methodology may even be applied to companies with negative earnings if the losses are considered to be temporary and one can identify a level of normalized maintainable earnings



Various multiples

Multiple	Applicability
P/E	Price / Earnings of comparative company may be used. It signifies the price market is willing to pay for the Company based on its earnings (EPS). Theoretically the company can be purchased at the MPS on the stock exchange
EV / EBIT	EV, Enterprise Value, is the sum of net worth and net financial debt of the Company. EV / EBIT indicates the multiple of EV for the total earnings of the Company
EV / EBITDA	EBITDA is the total cash earnings of the Company. EV / EBITDA indicates the multiple of EV for the total cash earnings of the Company

Caution while applying multiples

Multiple	Caution
P/E	P / E is a market based approach. Market capitalization of a quoted company may not reflect the value of the Company but only the price at which ‘small parcels’ of shares are exchanged. The comparative companies should be similar in terms of business activities, markets served, size, geography and applicable tax rates.
EV / EBIT	This multiple ignores the benefit of depreciation, particularly in case of assets depreciated for accounting purpose over a limited period but practically have a longer economic usable value.
EV / EBITDA	This multiple removes the impact on the value of depreciation of fixed assets and amortization of goodwill and other tangibles. The need of replacement of highly depreciable assets, need for expending additional amounts to be amortized over a limited period have to be factored in.

Net assets

- This methodology involves deriving the value of business by reference to the value of its net assets

- This is likely to be appropriate for a business whose value derives mainly from the underlying value of its assets rather than its earnings. Ex., property holding companies and investment businesses.

- This may also be appropriate if return on assets is inadequate and greater value can be realized by liquidating the business and selling its assets

Caution required while applying Net assets method

- Contingent assets and liabilities may also be included while valuing assets and liabilities of the Company
- An appropriate marketability discount should be applied to arrive at a realistic value of the assets
- The value of the redeemable instruments, if any, should be deducted to arrive at the available value of the assets

DCF from underlying business

- Discounted Cash Flow (DCF) methodology involves deriving the value of a business by calculating the present value of expected future cash flows
- Is flexible as it can be applied to any stream of cash flows or earnings
- This methodology may be applied for businesses going through a period of great change, such as a rescue refinancing, turnaround, strategic repositioning, loss making, or is in its startup phase etc.

DCF from the investment

- Unlike the DCF from the business earnings, this methodology applies DCF technique to the expected cash flows from the investment itself.

- Where pricing for the return on the investment or floating Initial Public Offer (IPO) is / to be agreed at the time of making investment, this is the appropriate methodology.

- Is particularly suitable for valuing non-equity investment in instruments like debt, mezzanine debt etc since the value of such instruments derives mainly from the instrument-specific cash flows and risks than of the underlying business as a whole

Caution for DCF methodology

- Cash flow forecasts, estimation of terminal value, and selecting risk-adjusted discount rate should be appropriate

- Ideally DCF based valuations should be used as a cross-check of values estimated under market based methodologies and should be used in isolation of other methodologies only under extreme caution

Industry valuation benchmarks

- Industry specific valuation benchmarks are used as per the prevailing practice of the industry
- Examples: price paid per bed for hospitals, price per seater for BPO, price per head for schools, price per subscriber for cable-television, mobile, internet companies etc
- These industry norms are based on assumptions that investors are willing to pay for turnover or market share and that the normal profitability of business in the industry does not vary much
- This may be used as a sense-check of values produced using other methodologies

Duration of Private Equity/ Venture Capital Investment normally ranges from 3-7 years

EXIT OPTIONS:

- **IPOs**
- **Mergers & Acquisitions**
- **Management Buy-out**
- **Sale to Another Fund**
- **Buyback by Promoter/ Company**
- **Stock Market**

In case of Buyback by Promoter/Company , the value at which PE Fund would exit is IRR or market-based and is pre decided at the time of investment on a certain valuation

Popular Investment instruments of PE

(For issue to PE by investee companies)

Equity shares at a premium	Traditional pricing. Ratchet rights may not be involved
Optionally Convertible Preference Shares	ECB guidelines apply and foreign PE / VC may not find it attractive. Pricing can be in favour of PE. Ratchet rights may be stipulated.
Fewer no of equity shares (with disproportionately higher voting rights) and substantial portion in Preference shares	Market pricing. Deal in favour of PE. Voting control is provided to PE with the differential voting rights. (Present version of new Companies bill bans DVRs)
Cumulative Compulsory Convertible Preference Shares with participating rights	**Prospective pricing. Participating rights in residual income. Very popular instrument and widely used in the recent past.**
Mix of Equity + convertible equity warrants + preference shares	Multiple convertible instruments. Very complex to structure. Pricing can be manipulated as per the agreement between the parties.
Debentures convertible into equity shares at the time of IPO at the IPO price	Pricing can be fair and neutral. Comfort to PE with the periodical interest cash flows and comfort to Investee Company with the non-equity control by PE (till conversion into equity)

Pricing & Exits:

Contractual Terms

Liquidity Preferences

Liquidity Preference

- Liquidity preference right applies for liquidation, merger, acquisition, takeover, sale of asset of company, IPO, or any other exit

- If company is liquidated the PE investors (holding liquidity preference rights) will be entitled to get their money back in 1 or more multiples as per the liquidity preference right

(ex: Invst x 1; invst x 1.5; invst x 2)

Liquidity Preference distribution

Liquidity preference distribution if liquidity realization is Rs. 14000 lacs

PE Invst Rs lacs	PE % shareholding	Liquidity prefer X	Liquidity pref amt distributed#	Capital share distributed *	Total distributed
2500	5%	1	2500	575	3075
2500	5%	2	5000	450	5450
2500	11%	1	2500	1265	3765
2500	11%	2	5000	990	5990
2500	26%	1	2500	2990	5490
2500	26%	2	5000	2340	7340

PE invst x Liquidity Pref
* PE shareholding % x (Liquidity realization – Liquidity pref amt distributed)

Liquidity Preference distribution

Liquidity preference distribution if liquidity realization is Rs. 8000 lacs

PE Invst Rs lacs	PE % shareholding	Liquidity prefer X	Liquidity pref amt distributed#	Capital share distributed to PE*	Total distributed to PE
2500	5%	1	2500	275	2775
2500	5%	2	5000	150	5150
2500	11%	1	2500	605	3105
2500	11%	2	5000	330	5330
2500	26%	1	2500	1430	3930
2500	26%	2	5000	780	5780

PE invst x Liquidity Pref

* PE shareholding % x (Liquidity realization – Liquidity pref amt distributed)

Liquidity Preference distribution



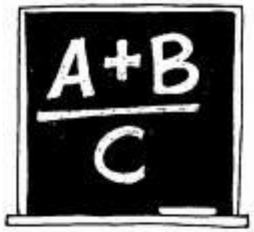
Liquidity preference distribution if liquidity realization is Rs. 4500 lacs

PE Invst Rs lacs	PE % shareholding	Liquidity prefer X	Liquidity pref amt distributed#	Capital share distributed *	Total distributed
2500	5%	1	2500	100	2600
2500	5%	2	4500	0	4500
2500	11%	1	2500	220	2720
2500	11%	2	4500	0	4500
2500	26%	1	2500	520	3020
2500	26%	2	4500	0	4500

PE invst x Liquidity Pref

* PE shareholding % x (Liquidity realization – Liquidity pref amt distributed)

Liquidity preference equations



Liquidity preference amount to PE	Liquidity realization amount x PE % shareholding x liquidity preference number
Capital share on liquidation	% PE shareholding x (Total liquidity realization – liquidity preference distribution amount)
Total distribution to PE on liquidation	Liquidity preference amount + capital share distribution
Amount available to other shareholders	Liquidity realization amount – total amount distributed to PE

Equity Ratchets

Anti-dilution price protection provision (Equity ratchets)

- Ratchet is the structure of resetting (adjustment) of equity price and shares allocations depending on subsequent equity allotment price, future performance of company or the rate of growth etc.
- Anti-dilution price protection gives PE the benefit of reduced effective price per share if the company issues its shares at a lower price in a later round (down round)
- Later round price is considered as lower if it is lower than the share value projected to prevail at the later round price

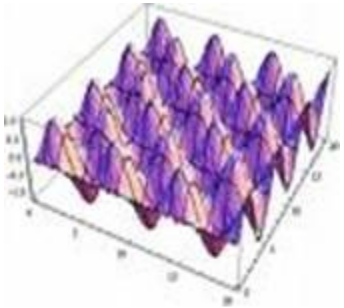
Types of equity ratchets

- Weighted ratchet anti-dilution price protection
  - Narrow based weighted average anti-dilution price protection provision
  - Broad based weighted average anti-dilution price protection provision
- Full ratchet anti-dilution price protection

Nature of ratchets

- Weighted ratchet: The resetting allotment price is lowered to a price that is a weighted average of the price at which the company issued shares valuing the company at the pre-adjusted price. It has two sub-types viz., narrow based weighted average ratchet and broad based weighted average ratchet

- Full ratchet: The resetting allotment price is lowered to the lowest price, that is lower than PE’s purchase price, regardless of the number of shares issued (but not weighted average price)



Kinds of weighted average ratchets

- Narrow based weighted ratchet: Narrow based weighted average anti-dilution price protection provision might include only equity share capital and convertible preferred shares then outstanding

- Broad based weighted ratchet: Broad based weighted average anti-dilution price protection provision includes equity shares outstanding and issuable upon conversion, warrants, convertible debt, options and any other contingent right to equity shares or equity share capital

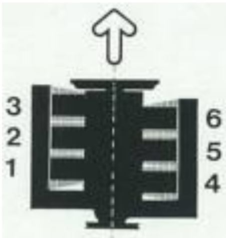
Ratchets & Share price adjustments

Share price adjustments with weighted average ratchets

Investor	**No of shares**	**Allot price**	**Invest amt**	**Before adj % shareholding**	**After adj no of shares**	**After adj % shareholding**
Promoters	10,00,000	80	8,00,00,000	64.52%	10,00,000	63.73%
Private Equity	***50,000***	125	***62,50,000***	3.23%	**69,095***	**4.40%**
New Invst - 1	***2,00,000***	**90**	***1,80,00,000***	12.90%	2,00,000	12.75%
New Invst - 2	***3,00,000***	**85**	***2,55,00,000***	19.35%	3,00,000	19.12%
Total	15,50,000		12,97,50,000	100.00%	15,69,095	100.00%

* Rs. 62,50,000/90.45; Rs. 90.45 = (Sum invst amt of PE + NI 1 & 2)/(Sum of no. of shares to PE, NI 1& 2)

Ratchets & Share price adjustments

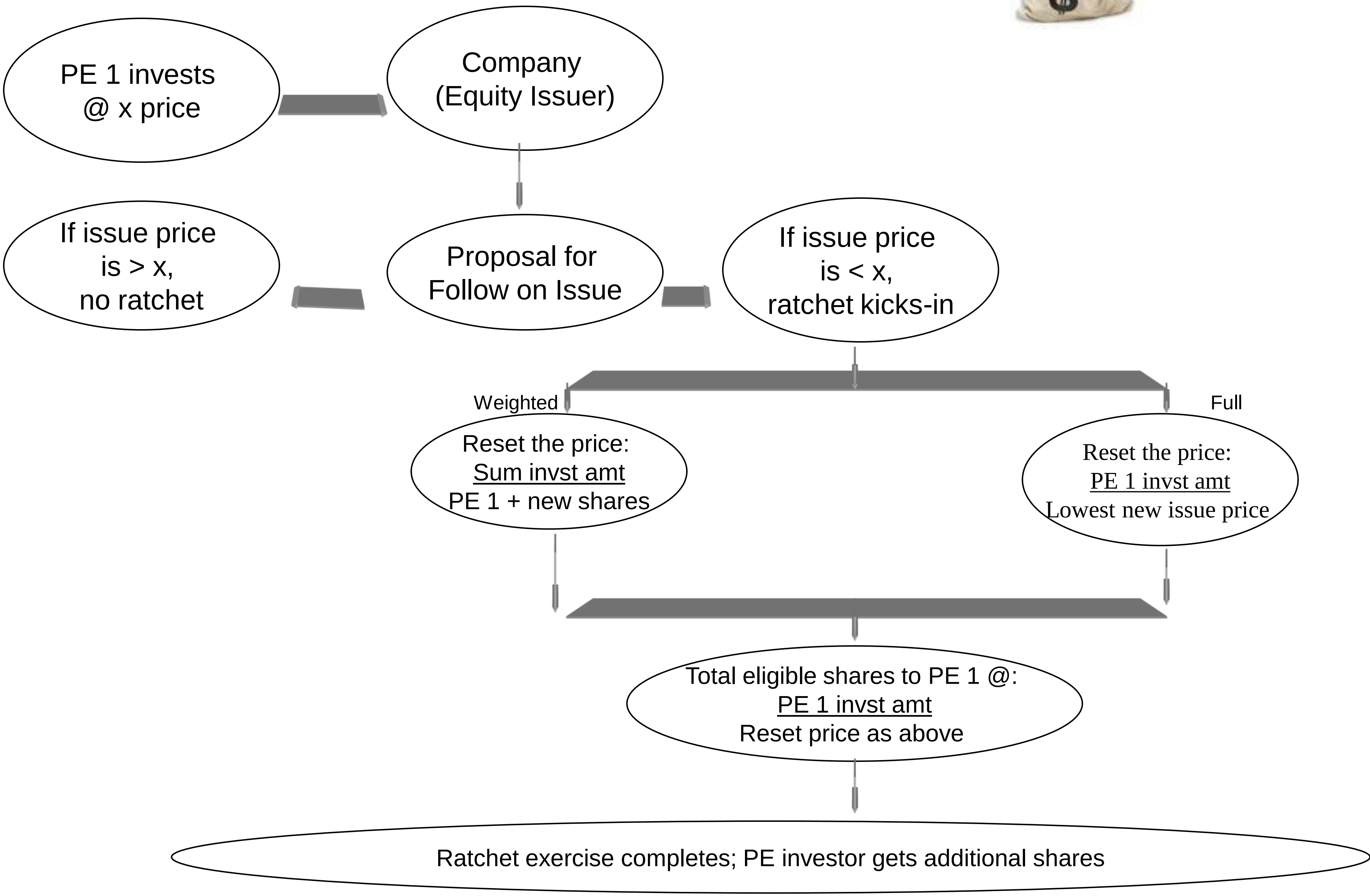


Share price adjustments with Full ratchets

Investor	No of shares	Allot price	Invest amt	Before adj % shareholding	After adj no of shares	After adj % shareholding
Promoters	10,00,000	80	8,00,00,000	64.52%	10,00,000	63.55%
Private Equity	50,000	125	62,50,000	3.23%	73,529*	**4.67%**
New Invst - 1	2,00,000	**90**	1,80,00,000	12.90%	2,00,000	12.71%
New Invst - 2	3,00,000	**85**	2,55,00,000	19.35%	3,00,000	19.07%
Total	15,50,000		12,97,50,000	100.00%	15,73,529	100.00%

* Rs. 62,50,000/85; Rs. 85 = Lower of Allot price to PE, NI 1 & 2)

Ratchet flow chart



Ratchets in connection with book value of equity shares

In addition to the ratchets connected with down-rounds, ratchets are also structured in connection with book value of equity shares. While ratchets of former type protect the control interests of PE investor, the latter protects the monetary interests of the PE investors even if no down-rounds are made. The following is one of the practices to structure these kinds of ratchets.

- Optionally convertible cumulative participating redeemable preference shares **(OCCPRPS)** will be issued at premium to equal the determined value at the time of PE investment for the equity shares of the Company.

- The intrinsically prevailing value of the equity share will be arrived at, at the end of each year

- If share value as in 2 is greater than in 1, no ratchet kicks-in; If share value as in 2 is lower than in 1, ratchet kicks-in.

- As per the ratchet, either of the following two or a mix of the following two will be effected at the option of the PE investor:

  i) **for the payable preference dividend amount, PE investors will have to be allotted equity shares at value that will compensate the PE investor in value terms for his total investment and this dividend receipt.**

  ii) **Convert the preference shares into equity shares at the relevant valuation as on the date of opting for conversion**

Pre-money and Post-money valuation

Pre-money and post-money valuation

- The following are the two valuation concepts in connection with computing the % of shareholding a PE gets for its investment in the company:

- Pre-money valuation

- Post-money valuation

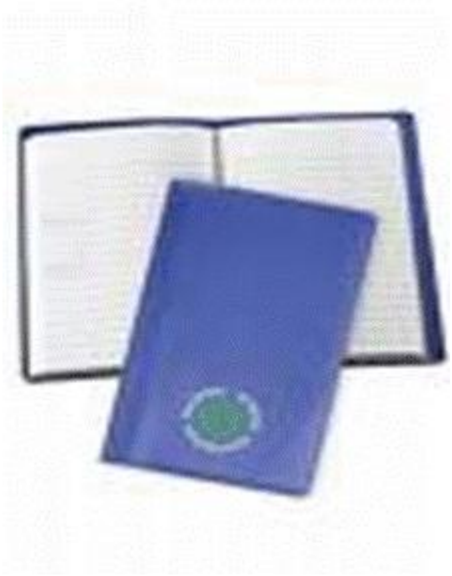
Pre & post money valuation equations

Pre-money valuation	Post money valuation – PE investment
Post money valuation	PE investment / PE ownership percentage or Pre-money valuation + PE investment
Share price	Pre money valuation / no of pre money shares; or Post money valuation / no of post money shares
New shares issued	PE investment / share price
Total outstanding shares	Pre money shares + new shares issued

Pre money and post money valuation - illustration - 1

Pre money valuation	Rs. 100 crores
Investment amount proposed	Rs. 25 crores
Post money valuation	Rs. 125 crores
PE’s percentage shares	Rs. 25 / 125 x 100 = 20%

Pre money and post money valuation - illustration - 2



Post money valuation	Rs. 100 crores
Investment amount of PE	Rs. 25 crores
Pre money valuation	Rs. 75 crores
PE’s percentage share	25 / 75 x 100 = 25%

20 Key Pressure-Clauses
in PE investments

1/20 Key pressure clauses of PE investment

Dividend Rights:

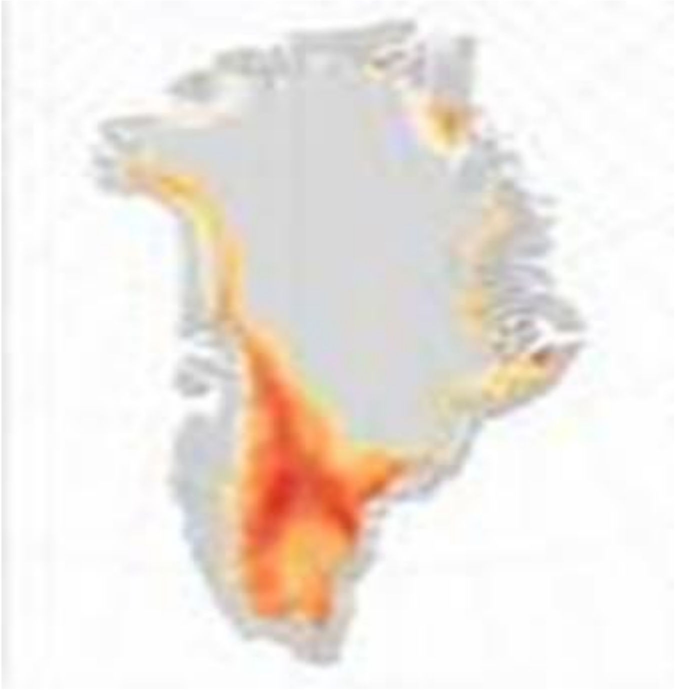
- Dividend policy of the investee company during the period of PE investment is influenced by PE.
- The dividend policy is formulated in a tax efficient way
- Usually, on account of taxation, PEs do not encourage periodical dividend payments
- PE investor holds an overriding right to veto the payment of any dividend.

2/20 Key pressure clauses of PE investment

Kind of shares for PE investors:

- PE investors usually invest in either Equity or preference depending on the legal provisions prevailing in the host country
- Since ratchet rights have to be accommodated, generally PE investors prefer convertible preference shares over equity shares. However, since veto rights are available only for equity shareholders, PEs prefer to hold a mix of preference and equity.
- PEs also prefer to hold golden shares (with additional rights).
- Differential Voting Right (DVR) shares are considered in India. However, the new companies bill prohibits issuance of DVR shares.

3/20 Key pressure clauses of PE investment



Liquidation Preference:

- Liquidation preference accords a right to the PE investors to receive certain amount of the realized amount out of liquidation of the Company in preference to other shareholders.
- This preference amount may be equal to the amount of the original amount invested by the PE investor or a multiple of it.
- In India liquidation preference rights may not be possible on equity shares and hence PE investors prefer 'cumulative participating preference shares'

4/20 Key pressure clauses of PE investment

Redemption Rights (Equivalent to sell-back right in India):

- PEs demand that the Company shall buy back its own shares from investors. PEs insist that the other shareholders (usually promoters) should not participate in the buy back scheme thereby facilitating their shares to be bought back by the Company.

- Valuation of the buy back of the shares is subject to the guidelines issued by the competent authorities.

- Alternately and / or simultaneously, as per the terms of the investment agreement, promoters will have the obligation to purchase the shares from PE investor at a price to yield the required rate of return

5/20 Key pressure clauses of PE investment

Anti dilution rights (ratchets / Price protection rights):

- PEs hold anti-dilution protection rights to protect the value of their stake in the Company if new shares are issued at a valuation which is lower than that at which they have originally invested. Such subsequent or follow on issue round is termed as ‘down round’.

- These rights are termed as ratchet rights. Ratchets could relate to price of follow on issue price or valuation of the equity share even in the absence of a subsequent equity issue.

6/20 Key pressure clauses of PE investment

Right of first refusal (ROFR):

- ROFR right provides that if any shareholder (usually promoter) intends to dispose of shares, such shares must be first offered to the PEs (if ROFR right is held) at the same terms and conditions the shares are intended to be sold.
- These rights ensure that the promoters do not sell their shares to persons whom PE would not like to be shareholders of the Company.
- These rights also ensure that the promoters do not sell their shares at unusual terms to their preferred persons

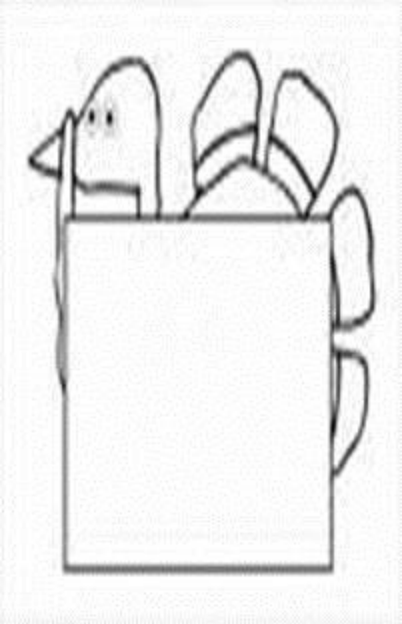
7/20 Key pressure clauses of PE investment

Drag along (Bring along) rights:

- A drag along provision creates an obligation on the other shareholders (usually promoters) of the Company to sell their shares to a potential purchaser if and when PE shareholder votes to sell its shares to the potential purchaser

- These rights will be useful in the context of a sale where potential purchasers intend to acquire substantial majority (usually 100%) of the shares of the Company in order to avoid having responsibilities towards minority shareholders after the acquisition.

8/20 Key pressure clauses of PE investment



Tag along (Co sale) rights:

- A tag along provision creates an obligation on the other shareholders (usually promoters) of the Company to ensure that the potential purchaser agrees to purchase an equivalent percentage of PE's shares at the same price and under the same terms and conditions.

- This right may have the effect of making the shares more difficult to sell.

9/20 Key pressure clauses of PE investment

Pre-emption rights:

- Preemption is the right of PE investor to participate in a financing to the extent necessary to ensure that, if exercised, its percentage ownership of the Company's shares will remain the same after the financing as it was before.

- In Indian term sheets, it could even mean rights of PE to decide whether certain items can be taken up by the Board or General Meeting in the agenda.

10/20 Key pressure clauses of PE investment

Representations:

PE investors insist on representations from the issuer Company (and from the Promoters) to be included in the investment agreement / term sheet confirming about the information disclosed and that the deal (investment by PE) is subject to the facts, information, statements furnished by way of representations.

Representations are also stated as recitals. Recitals usually form part of the agreement. PE investors prefer to include the representations in the agreement rather than in recitals since as per the legal interpretation, recitals are considered as jointly agreed upon statements / situations than a cover to the other party.

If any representation is found inaccurate subsequently, PE will have a right to initiate corrective action including accelerating the investment as per the terms of the investment.

11/20 Key pressure clauses of PE investment

Warranties:

PE investors insist on warranties from the issuer Company (and from the Promoters) to be included in the investment agreement / term sheet to provide the investors with a complete and accurate understanding of the current condition of the Company and the past history so that the investors can evaluate the risks of investing in the Company prior to investing in the Company.

The warranties typically cover areas such as legal existence of the Company, financial statements, business plan, assets, liabilities, material contracts, employees and litigation.

If any warranty is found inaccurate subsequently, such an event will be considered as breach of the agreement and the PE will have a right to be reimbursed for the loss / expenses etc with an additional right to rescind the investment agreement itself.

12/20 Key pressure clauses of PE investment

Consent Rights:

PE investors normally hold consent rights which provides that that certain actions cannot be taken by the Company without the consent of the PE investors or of a majority % (as specified)

These consent rights need not confine to only board agenda items

13/20 Key pressure clauses of PE investment

Board Seats:

PE investors will require a right to nominate one or more directors to be appointed on the Board of the investee Company.

PE investors may also require a right to appoint a Board Observer who can attend all Board Meetings but will not participate in any board decisions.

14/20 Key pressure clauses of PE investment

Information Rights:

PE investors will require right to receive information on a regular basis concerning the financial condition and budgets along with a general right to visit the company and examine its books and records.

15/20 Key pressure clauses of PE investment

Registration Rights:

These are specific only to USA since SEC requires the registration of the securities to be eligible for offering for public sale (Offer for Sale). The registration process involves the Company providing significant information about its operations and financial condition which can be time consuming and expensive.

In India this clause is non-existent. However a corresponding clause to this in India is that PE investors insist that the Company do not recognize PE investors under promoter group and also should endeavor to avoid PE investors being recognized as promoters under law. This will help PE investors not to be subject to the lock-in requirement of the promoters' shares at the time of IPO of the Company.

16/20 Key pressure clauses of PE investment

Conditions to be fulfilled in advance

Conditions Precedent:

Term Sheet / Investment agreement of PE investors will include a full list of conditions to be satisfied before investment will be disbursed.

Usually Conditions Precedent to signing of the investment agreement and Conditions precedent to releasing of the investment amount to the investee Company will be separately laid down clearly in the term sheet and the investment agreement respectively.

17/20 Key pressure clauses of PE investment

Tranche Disbursements:

PE investors will have a right to release the investment amount in one or more tranches (stages / phases) dependant on achievement of targets or milestones claimed to be achieved in the business plan of the Company.

While the investment price may be determined at the time of signing of the investment agreement itself, the investment amount is structured to be released in tranches (stages) to ensure that the Company is growing as per the growth guidance issued by the Company / Promoters.

18/20 Key pressure clauses of PE investment

Exit Options / Rights:

PE investors will reserve right to exist in various ways including:

- Initial Public Offer (IPO)
- Offer For Sale (OFS)
- Merger
- Take Over
- Strategic Sale

19/20 Key pressure clauses of PE investment

Non Compete Clause:

Cant

PE investors will require the promoters to sign non-compete agreements so that the promoters will not nurse their interests to promote and develop other companies which may eat in to the business of the investee Company or which may stand competition to the investee company.

Usually the Non-Compete agreements will carry a tenure of about 5 years from the date of investment.

20/20 Key pressure clauses of PE investment

Special Audit:

PE investors will require the Company's financials to be audited by a special auditor usually appointed by them in addition to the statutory auditor of the Company.

The costs of the audit and the audit fee for the special auditorr have to be borne by the Company.

Special Auditor submits his audit report to the PE investor with a copy of the audit report to the Company. In addition to the usual financial audit, he may also comment on the status of the compliance of the conditions of the terms and conditions of the investment agreement signed by the Company with the PE investor.

Pros and Cons of Private Equity

Advantages for Company	Disadvantages for Company
Faster Growth	More complex accounting and reporting
Unsecured Finance	Investor veto rights
Employee ownership (in the case of MBO)	Accountability to investor
Strengthens financial position	Investor's involvement in board decisions
Facilitates obtaining other forms of finance	Restrictive covenants for managers / operations
Funding is committed until exit (unlike bank loans)	Warranties to be given by promoters / company
Management and relationship advise	Investor's objective / motive is exit at good return

Challenges to PE in India

Area	Challenge
Value of Private Equity	-Important to be an active investor to understand the value add from PE -Must trade-off value, growth and risk -Analyzing the relative merits of a potential non-PE investment -No relevant experience to guide
Market conditions	-Developing business plans and best practices for privately held and family run Indian firms -Questions of global competitiveness -Discarding what is irrelevant and possibly damaging for Indian companies
Exit Strategy	-Market and business tolerance for public offerings -Family business reluctant to relinquish control -Inevitability of an Initial Public Offer (IPO)
Others	- PE sponsors more susceptible to volatility in the global debt market -Increased regulations -Lower IRR on existing PE portfolios

Discussion:

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