Privcap/ Context for Private Capital Investment TRANSCRIPT

The Outlook For India
With Parag Saxena of New Silk Route Partners

David Snow, Privcap:

We are joined today by Parag Saxena from New Silk Route Partners. Parag welcome to Privcap, thanks for being here today.

Parag Saxena, New Silk Route:

Great to be here David.

Snow: You invest in India and South Asia, but most of your capital is being put to work in India a major market in any regard but also a place that has attracted a lot of attention from global private equity investors. I'd love to get your insider's perspective on what has been going on in India. I think your average LP, probably someone based in the west who is, maybe has been deploying capital in the emerging markets including India for a while has come to the conclusion that in general the data shows that average performance of private equity in India, again average has not been spectacular, in fact has been somewhat disappointing over the recent years. I'd love to get your perspective on why you think that is, and maybe what the future might hold for the Indian private equity opportunity?

Saxena: I agree that the data does show underperformance, and the promise that drew a great deal of money to India, particularly in the 2006 or 2008 period, is one that has not been met. That promise has failed to meet expectations, and that's an industry, an industry wide comment. So some things worked some things didn't work. The demographics of India are attractive, the consumer, the rising growth domestic product per capita and all the things that, that leads people to ask for better food, better healthcare, better education, better communications, all of those things. The companies essentially have grown demand for those businesses has grown. And when I look across our portfolio we have two companies in education, both have grown extremely well we have 600,000 students that are being taken through K through 12 schools. And they are growing well, and the underlying companies are growing extremely well. What has not happened is we haven't had exits, and there have been two reasons for this.

Snow: When you say we, you mean in general GPs in India.

Saxena: Across the country so we've pieced together pieces of data that encompass about 50 funds that are operating there. And we are aware that to, to give you a sense of it less, a single digit percentage, less than 10% of capital has been returned that was invested in the 2006 to 2008 period by growth capital or larger firms. There has been the occasional success in venture firms, very early stage companies where they may have been a large success on a percentage basis and you see some capital back. In fact that's the source of the small single digit return, but otherwise there have been modest number of exits. And I think the biggest reason for that is a very large amount of capital, so I think of it like I think of 1999 and 2000 in U.S. venture markets. Normally you would have 25 to 35 billion dollars invested a year, in 1999 and 2000 a $100 billion, three times the normal sum to four times the normal sum, was invested in the market.

What happens when money is quickly invested is people make poorer judgments than they might if capital is scarce, so that's reason why things have happened. The second is that people often don't know what to do if there is a problem with a company. The skill set both in investing and operations in aggregate across the industry is modest compared to the challenges that exist over there. So one of the things we did right in the beginning was get a very deep operating team knowing that if there are challenges we could run those companies ourselves.

Snow: To what extent do you think the let's call it interim underperformance in Indian private equity been the fault of macroeconomic factors beyond the control of the managers? And to what extent has it been the managers themselves lacking the wherewithal to extract value from their portfolio companies?

Saxena: I think that there are two really important macroeconomic factors. One deals with the past and it has been overwhelming. It's not a factor that managers can control, and the fact that it's been overwhelming has been the currency, so Indian currency a little bit like Brazilian has dropped very steeply in the last year. And this happened with a backdrop of for about 15 years you saw the Indian rupee at a very stable level, roughly 45 rupees to a dollar. And the range it certainly varied it was between 40 and 50, 45 being the midpoint but for 15 years that's the level that you saw. So you knew that generally the performance of a company was greater in its impact than the ten percent on either side that this mattered, right. What has actually happened, what's actually happened is that the rupee has fallen at one time almost getting to 70 rupees to the dollar. So in dollar terms that's a huge headwind against you, right. And so that macro factor has been a big headwind and it's not clear that it's going to go away. It's unclear it's going to go away because the biggest factor that has exacerbated this problem is it, over long periods of time currency problems are very straightforward. The US dollar has declined over long periods of time because we are importing much more than we sell, right. Same issue in India except it got very exacerbated in a short period of time because a number of power plants came up, a good thing by itself because of the shortage of energy.

Saxena: What we have seen is that since coal licenses were handed out with great paucity coal has been imported, a very unexpected situation. People set up these power plants fully expecting and signing agreements to get coal, and the central government is where that problem has occurred. They've not handed out licenses at the speed that they were expected to, so coal has come in from Indonesia, coal has come in from Australia. This has put a huge amount of pressure, when you have a growing economy one of the things you can correlate that to is energy, right. Use of energy is a great proxy for how well growth is actually doing, so you have growth but you have to fuel that growth with energy.

Snow: Let's talk briefly about the capital markets, obviously a very important source of exits and value creation, value monetization in private equity. I think a lot of the capital that went into India in this more enthusiastic time like 2006 to 2008 was expected a more robust IPO market for many of these private equity investments. That has not happened, and I wonder if you see over the next two years how the IPO markets might evolve, hopefully grow depending on a number of factors including possibly even political?

Saxena: Okay, so since the, the new year was over the weekend and the market hit new high I think that's an auspicious beginning to the new year. But importantly we are at new highs, and we've recovered fully from the drop that occurred after 2008, these are now highs compared to 2008 as they are in most of the world. And typically what follows then is the best companies start to get listed or go public, so I think that you should start seeing that activity. We have had a couple of very meaningful IPOs in terms of size. One of the biggest cellular tower companies, I say this with some closed interest because we have a cellular tower company in our portfolio but there are billion dollar offerings, a very substantial offering for a small market like India. And this is a total market value of $1.1- $1.2 trillion, so a billion dollars is a big deal.

Snow: Very briefly why don't you talk about next year's elections and what to look for?

Saxena: As I said, there was one other cloud on the market, and that cloud is what will happen in next year's election. Normally elections are not a huge deal. They matter, of course, but the difference between the two leading parties, the BJP (Bharatiya Janata Party) and the Congress and the coalitions that they form in policy is not massive. A little coloration on one side or the other, but they are just different shades of purple. This time, however, a number of regional parties have come up that are strong in one state or another, and they look like they may, there is some chance that they would actually have enough of a critical mass that they could come together all these regional parties could come together and say we want to form the government.

And that certainly is uncertainty, and the one thing that markets do not like is uncertainty. The implication I think for the PE market is that investments will still continue to be slow till that card is seen. And we'll know that by May, we'll have a new government that is in place by that point in time at which point I think people will deal where the issues are, make assessments and then you've got to go back to the positives because it is one, it is the second largest country in the world by population. The reforms that have been coming in since 1991 are things that are pro-business and should lead to continuation of five percent plus growth in GDP terms, and that will attract people.