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Private Equity: An Alternative Asset Class

- Capital is invested in **private market**, NOT on a public market.

- The Capital is raised from **Institutional** or **Ultra/High Net Worth** Investors who can contribute substantial amounts and are able to commit an average Investment period of 7-10 years.

- Private Equity is an asset class delivering **beating the market** investment returns.

- The opportunity to **nurture companies**, ability to have alignment of interest with Management & PE investors being the shareholder with long term **patient capital** are the **hallmarks** of PE.

“Private Equity is Building Value over the Long-Term”

Henry R. Kravis, Co-Chairman and Co-CEO of KKR
Typical Private Equity Structure

**Limited Partners (LPs):** LPs are passive investors – purely financial investors. They commit legally to providing capital for investment and contribute on receiving capital call from GP. They receive distributions of capital – including a share of profit upon successful exit of fund’s investments.

**General Partners (GPs):** Responsible for managing the fund and has the fiduciary duty to act solely in the interest of the fund’s investors. The GP stake typically ranges from 1-5% of the total capital raised.

**Investment Manager:** The Investment Manager conducts day-to-day activities of a PE fund, evaluates potential investment opportunities, provides advisory services to the fund’s portfolio companies, and manages the fund’s audit and reporting processes. The management fee is typically set at around 1.5-2% of committed capital during the investment period.

Firm with the expertise in executing a venture, growth or buyout investment strategy. Funds are raised from LP. GP and Investment Manager is responsible for deployment of these funds.
**Fundraising:** PE firms raise capital for a fund by securing capital commitments from investors (LPs). Once initial threshold of capital commitments is met, fund’s GP holds a First Closing.

**Investment:** Rather than receiving committed capital on day one, a GP draws down LP commitments over the course of the investment. Once the investment period is over, the fund cannot invest in new companies.

**Value Creation:** Funds GP works closely with portfolio company to create value and prepare the company for exit. The holding period can last for 4-7 years or can be more for underperforming companies.

**Exit:** Success of PE firm depends largely on its ability to exit an investment profitably. Following a full or partial exit, invested capital and profits are distributed to LPs and GPs.
TYPES OF PRIVATE EQUITY

Venture Capital

Growth Equity

Leverage Buyouts
Types of Private Equity

**Venture Capital (VC)** funds are minority investors betting on the future growth of early-stage companies defined as pre-profit, sometimes pre-revenue and at times even pre-product start-ups. VCs may invest in specific areas, such as technological or geographic, and often specialize in a distinct sub-stage of investment, such as early-stage, mid-stage or late-stage VC funding.

**Growth Equity** funds invest in fast-growing businesses (which have moved beyond the start-up stage) in exchange for a minority equity stake. Given the lack of control, a strong working relationship and trust-based partnership between the investors, existing owners and management are required to achieve the desired outcome: advancing the company to a new stage of development. At times they buy these shares from outgoing VC.

**Buyout** funds acquire controlling equity stakes in companies that allow them to restructure the targets’ financial, governance, and operational characteristics. However, despite this control element, buyout investors must work proactively with a wide range of stakeholders - from management to debt providers - to execute on their investment thesis by driving value creation in their portfolio companies.
Venture Capital

Defining Characteristics of Venture Capital

Start-up Development and Funding
Value Creation in Growth Equity

STAGES OF DEVELOPMENT

OPERATING PROFIT

VENTURE CAPITAL

BUYOUTS

New Initiatives
- Market Equity
- New Product Roll-out
- Cash Flow Optimization
- Acquisition & Divestments

Professionalization
- Systems and Processes
- Governance & Reporting
- Succession Planning
- Mentoring
Management Buyout (MBO): The incumbent management team initiates the buyout of a company or corporate division with the financial backing of a buyout fund.

Institutional Buyout (IBO): The buyout is initiated by a PE firm without the support of the incumbent or external management team. There is little or no support from any management team until the acquisition terms have been agreed.
Total PE Capital Deployed by Strategy

Source: Prequin
Alternative Strategies

**Distressed Private Equity**
- Distressed PE funds invest in mature companies in need of **substantial restructuring** in the face of imminent failure or bankruptcy.
- Distressed investing requires a specific **skillset** geared either towards **operational improvement** or **balance sheet optimization**.
- Many times **loss making government company** get acquired by PE funds under this structure.

**Real Assets**
- Funds investing in industries such as **real estate, infrastructure** and **natural resources** are regularly classified as a subset of the PE asset class and are referred to as real asset investors. Generally they are called **REIT trust**.
- Long holding periods, low correlation with traditional asset classes and the stable cash generation of mature projects have made them attractive investments to certain type of institutional investors.
Fund Theme Selection

### COUNTRY SPECIFIC FOCUS

1. **Emerging Markets**: India, China, Brazil, Indonesia, Thailand etc.

2. **Frontier Market**: Bangladesh, Sri Lanka, Kenya, Tanzania, Ghana

### SEGMENT SPECIFIC FOCUS

1. TECHNOLOGY
2. FMCG
3. REAL ESTATE
4. HEALTHCARE
5. EDUCATION
6. FINANCIAL SERVICES
7. OIL GAS

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[Image](image)
**THE FUND STRATEGY**

<table>
<thead>
<tr>
<th><strong>Fund Vision</strong></th>
<th>Enabling Financial Inclusion</th>
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<tbody>
<tr>
<td><strong>Fund Size</strong></td>
<td>USD 150 Million</td>
</tr>
<tr>
<td><strong>Hurdle Rate</strong></td>
<td>8%</td>
</tr>
<tr>
<td><strong>Average Investment Size</strong></td>
<td>USD 10 Million</td>
</tr>
<tr>
<td><strong>Investment Theme</strong></td>
<td>Riding on the potential frontier market growth</td>
</tr>
<tr>
<td><strong>Target Sectors</strong></td>
<td>Financial Services</td>
</tr>
<tr>
<td><strong>Target Markets</strong></td>
<td>Africa &amp; South Asia</td>
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<tr>
<td><strong>Market Opportunity</strong></td>
<td>The Financial Services sector is undergoing massive transformation</td>
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<th><strong>AFRICA FOCUSSED FUND STRATEGY</strong></th>
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<td><strong>Average Investment Size</strong></td>
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**Case Study- FUND STRATEGY**
Fund Focus

- Global Fund
- Regional Fund
- Country Specific Fund
TYPICAL PE FUND STRUCTURE
Rights and Duties of the LP

- **Types of LPs** - Insurance companies, pension funds, banks, and high net worth individuals
- Investors commit a certain amount to the fund
- They have no other active role in the fund and no liability beyond their commitments
- To provide the Capital at the time of Capital Call
- **ILPA** - Institutional LP Association focus on making sure that LP have greater access into underlying details of the companies in which they are investing.
Deal Flow

• Deal sourcing is the first step in a PE firm’s investment process, when potential investment opportunities are identified and screened.

• Two main ways to deal flow:

1) **Proprietary deal flow**: These are sourced directly by a PE firm through personal and business relationships. They are often more tailored to Fund size and sector requirement and often cheaper and faster to execute once they mature.

2) **Intermediated deal flow**: Paid intermediaries such as investment banks, M&A boutiques and corporate advisory arm of accounting firms play key role in deal sourcing for larger growth equity and buyout funds.

• In Emerging Markets, investment opportunities rarely come in well documented form or there maybe no credible validation of the bona fides of the investment opportunity.

• In Emerging Markets, the key for revealed opportunities is to keep the dialogue bilateral.
Due Diligence

- Due Diligence (DD) is a critical process for investment process.

**PE Due Diligence Process**

1. **DEAL SOURCING**
2. **PRELIMINARY DD**
   - NDA
   - CIM
   - Management Presentation
3. **FORMAL DD**
   - Deal Team
   - DD Questionnaire
   - Data Room
   - Site Visit
4. **CONFIRMATORY DD**

**DUE DILIGENCE AREAS**

- **COMMERCIAL** - Management Strategic Advisors (Consultants, Banks)
- **FINANCIAL** - CFO Accountants
- **LEGAL** - General counsel Legal Advisors (lawyers)
- **HUMAN RESOURCES** - Key employees HR advisors (Consultants, Headhunters)
Target Valuation

- For Growth Equity and Buyout Investments in mature companies, valuation is typically based on target’s profit and cash flow and corresponding multiples of comparable businesses.

- Strategic Investors favor Discounted cash Flow valuation method, which uses future cash flow projections and discounts them to arrive at an estimate of present value.

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<tr>
<th>EBITDA-1 × EBITDA Multiple-2</th>
<th>Net Debt -2</th>
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<tr>
<td>Enterprise Value</td>
<td>Equity Value</td>
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1- Business Plan or Financial Statements 2- Industry Comparable
Key-Transaction Documentation

DEAL SOURCING
- Non Disclosure Agreement (NDA)

PRELIMINARY DUE DILIGENCE
- Letter of Intent (First Round Bid)

FORMAL DUE DILIGENCE
- Letter of Intent (Second Round Bid)

NEGOTIATION & DOCUMENTATION
- Sale and Purchase Agreement (SPA)
- Debt Documentation

CLOSING PERIOD
- Equity Documentation

INVESTMENT PERIOD
Investments: Annual PE Deal Funnel

- Opportunities Reviewed in a Year: 500
- Preliminary DD: 100
- Investment Committee Review: 25
- Formal DD: 12

INVESTMENTS MADE: 4
Exit Strategies

- Exists in PE are crucial; they validate the GP’s investment strategy and prove its value add during the holding period.
# Exit Alternatives and Considerations

<table>
<thead>
<tr>
<th>PATH</th>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
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<tbody>
<tr>
<td>SALE TO STRATEGIC</td>
<td>i) Full Exit</td>
<td>i) Less sophisticated buyers prolonging process</td>
</tr>
<tr>
<td></td>
<td>ii) Often pay a premium (synergies)</td>
<td>ii) Strategic require a majority stake</td>
</tr>
<tr>
<td></td>
<td>iii) Pay in cash</td>
<td></td>
</tr>
<tr>
<td>SALE TO PE FUND</td>
<td>i) Ample dry powder in market</td>
<td>i) Sophisticated &amp; demanding buyers</td>
</tr>
<tr>
<td></td>
<td>ii) Can “warehouse” company until eventual IPO</td>
<td>ii) Minority stake may reduce pool of potential investors</td>
</tr>
<tr>
<td>IPO</td>
<td>i) Potential for high returns</td>
<td>i) Lock-up</td>
</tr>
<tr>
<td></td>
<td>ii) Access to future liquidity</td>
<td>ii) Risks of going to market</td>
</tr>
<tr>
<td></td>
<td>iii) Often preferred by management</td>
<td>iii) Uncertainty of returns</td>
</tr>
<tr>
<td></td>
<td>iv) High Profile exit</td>
<td>iv) Strain on management time</td>
</tr>
<tr>
<td>DIVIDEND RECAP</td>
<td>i) Return cash to LPs</td>
<td>i) Partial exit</td>
</tr>
<tr>
<td></td>
<td>ii) No new shareholders</td>
<td>ii) Value of investments unknown</td>
</tr>
<tr>
<td></td>
<td>iii) Does not dilute equity stake</td>
<td>iii) Not a high profile exit</td>
</tr>
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Do you Know?

- Globally there are 7800 PE firms.
- 50% of Global PE deals was priced at 11X.
- Private Equity funds have outperformed public markets in all major regions over the long term. Asia Pacific Funds generated 12% over 5 years tenure v/s 9% in Listed equity markets.
- 96% of Limited Partners (Investors) plan to raise or maintain their long-term PE allocations.
- Sales to strategic buyers dominated exits.

Source: Prequin
• 5 years is the Average holding period of investments in 2017 though close to 15% of exits was in less than 3 years.

• Global PE Funds raised USD 701 Billion in 2017 v/s USD 302 Billion in 2010

• USD 2.1 Trillion of Dry Powder to be deployed

• Average time taken to Final Close in 2017 – 24 Months

Source: Prequin
First-time private equity fund managers typically outperform non-first-time funds

**The first time fund Managers are:**
- Often more entrepreneurial
- Highly motivated
- More focused in their strategy
- More innovative in the deals they source and structure
- Hungry for success

Source: Prequin
Conclusion

• PE as an asset class continues to grow and evolve, both in developed and emerging markets.

• Business operators around the world - from entrepreneurs looking for start-up funding, to SME business owners with global ambitions, to management teams interested in buying out a corporate division - often find the right partner in PE funds in their ambitions.

• As a result, PE is deeply entrenched in the economic model and will remain an important driver of business transformation globally.
Q&A

Which are the Firms Funded by VC-Funds?

Apple

Google

Exxon Mobil

JP Morgan Chase

Amazon

Johnson & Johnson

Facebook

Microsoft

Bershire Hathaway

General Electric
Answer

Apple
Google
Microsoft
Facebook
Amazon
Which is the Largest PE Firm Globally?

- Blackstone Group
- Carlyle Group
- Apollo Global Management LLC
- KKR and Company LP
Answer

Carlyle Group
Thank You