PRIVATE EQUITY - STRUCTURING AND DEAL NEGOTIATION

October 2009

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AGENDA

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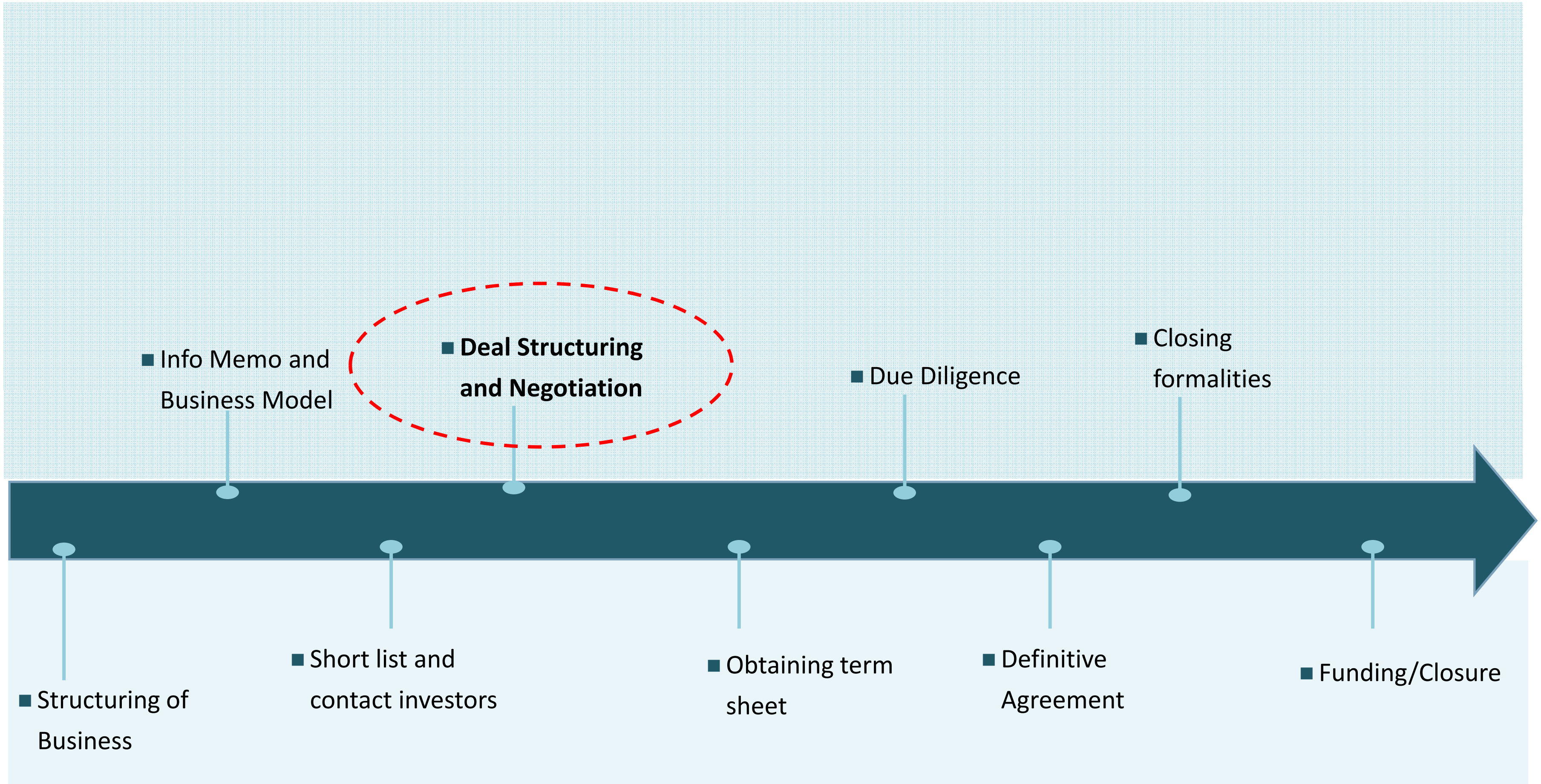
Private Equity – The Process



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Broad Investment Structure

- Involves fresh infusion of capital in the company against issue of fresh shares to augment future growth
- Ideal for early growth companies

Private Equity Investment

- Primary Investment
  - Instruments
    - Direct Equity
    - Convertible Preference Shares /Debentures
    - Warrants
- Secondary Investment
  - Instruments
    - Direct Equity

- Involves buying out the existing shareholders of the company
- Ideal when promoter wants to cash out (fully or partially) or Buyouts

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Case Study - Direct Equity

CASE A - Hotel Industry

- Chain of hotels running 4 properties
- Managing 600 rooms across properties
- Running at 80% occupancy
- Company intends to raise equity for setting-up 4 new Greenfield properties - (to be operational by FY13)

Transaction characteristics

- Highly capital intensive
- Low growth
- Low RoI, RoE and margins
- Long gestation period
- Stable business model

Projected P&L

Investment (FY 10) · Construction (FY 11) · Comm. Start (FY 13)

Particulars	FY 09	FY 10	FY 11	FY 12	FY 13
Revenue	100.00	110.00	124.30	144.19	209.07
Y-o-Y Growth		**10%**	**13%**	**16%**	**45%**
EBITDA	22.00	24.20	27.97	33.16	49.13
EBITDA Margin	**22%**	**22%**	**23%**	**23%**	**24%**
PAT	12.00	15.40	18.02	21.63	25.09
PAT Margin	**12%**	**14%**	**15%**	**15%**	**12%**

Why Direct Equity ?

- The state of business gives good visibility and to a certain extent confirms ability to scale up which can provide comfort to an investor
- Investor community prefers conversion within 18 to 24 months (stretched)
- Investment is into projects with long gestation cycle beyond 24 months horizon
- Thus direct equity makes sense…..

Future growth lower than expected discount by investor, early conversion on existing business or direct equity preferred

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Case Study - Convertible

CASE B - Education

- Chain of coaching classes operating in multiple locations
- Total enrollment for FY10 in excess of 23,000
- Expected enrollment for FY11 is 32,000
- Well established brand
- Company intends to raise equity for setting-up a dedicated residential campus
- By FY13, projected batch strength in excess of 80,000

Transaction characteristics

- Low capital intensive
- High growth
- High RoI, RoE and margins
- Small gestation period
- Proven business model

Projected P&L

Investment (FY 10) – Construction (FY 12) – Comm. Start (FY 13)

INR Crore	FY 09	FY 10	FY 11	FY 12	FY 13
Batch Strength	15,500	23,500	32,000	54,100	80,000
Revenue	55.00	77.00	115.50	161.70	242.55
Y-o-Y Growth		**40%**	**50%**	**40%**	**50%**
EBITDA	24.75	34.65	52.55	74.38	112.79
EBITDA Margin	**45%**	**45%**	**46%**	**46%**	**47%**
PAT	13.75	15.40	23.68	33.96	41.23
PAT Margin	**25%**	**20%**	**21%**	**21%**	**17%**

Why Convertible ?

- The business is growing, generates good cash flows and scale up from current levels can reap huge benefits – provides comfort to an investor
- There is lot of demand-pull, hence selling additional capacities would be easier
- Investor community prefers conversion within 18 to 24 months (stretched)
- Investment is into projects with gestation cycle of 12 to 24 months
- Thus convertible structure makes sense.....

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NEGOTIATIONS

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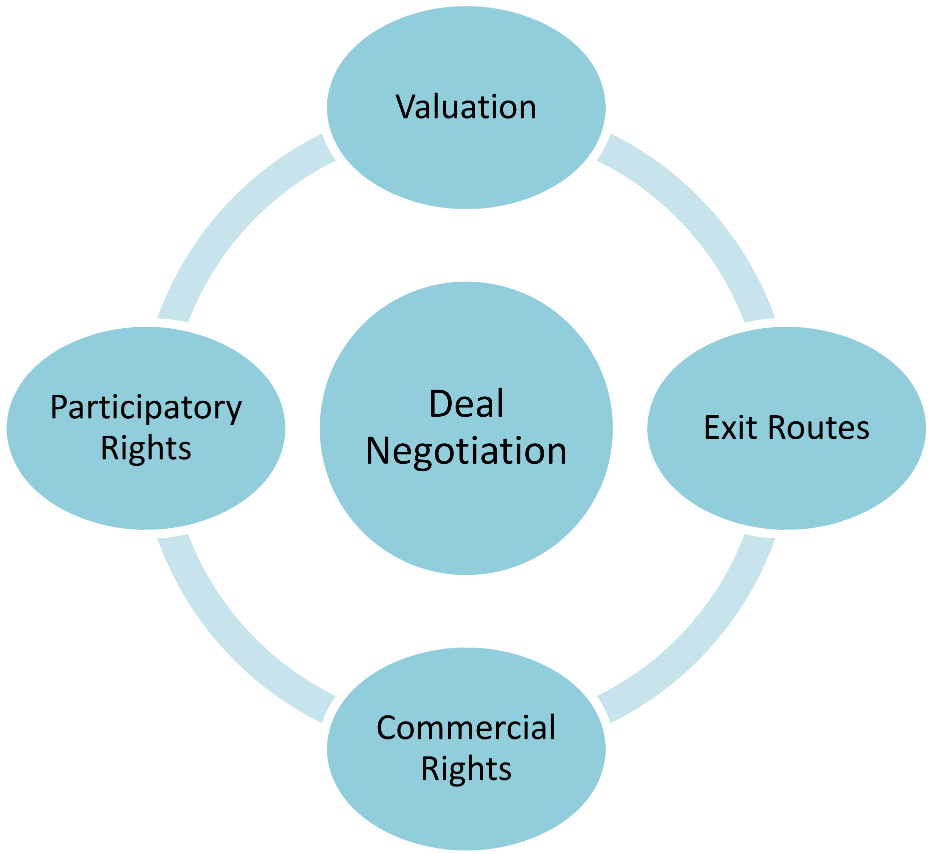
Key Aspects of Negotiations



Negotiation is ultimately a summation of "Give(s)" and "Take(s)"

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Valuation Negotiation

Hard Aspects

- Structure of proposed investment – Equity /Convertible
- Valuation benchmarking vis-à-vis comparable transactions, peer analysis, etc.
- Potential returns analysis in terms of RoCE, RoE, investor IRR
- Sector / company growth potential and other economic aspects
- Entry and Exit PE multiple as viewed by the investor
- Committed IRR in favor of investor

Soft Aspects

- Appetite for investment in the sector
- Comfort on the promoter pedigree
- Comfort on the promoter's integrity and the overall intent
- Hard negotiations should not give a negative impression – hence should be in a subtle and structured manner
- Investor's interest should be kept in mind during the process of negotiations which would clear the thought process to a large extent

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Exit Route Negotiations

Alternatives in the order of preference	Things to be taken care of……	Indicative Time-Lines
IRR	▪ IRR should be kept at the lowest possible level	
IPO	▪ Promoter's dilution at the time of IPO should not be significant ▪ In case of a potentially higher dilution, the promoter should seek part dilution by the investor or have an option to purchase additional equity before IPO ▪ Up to a minimum IRR the prerogative should be with the Promoter	0 – 12 months
Sale to Financial Investor	▪ Non-conflict alignment – the investor should not be aligned to a competitor ▪ The process cannot be completed without the involvement of the Promoters	12 – 15 months
Sale to Strategic Investor	▪ Should not offer more than controlling interest ▪ Should seek a window to purchase at the price offered by the strategic investor within reasonable time horizon	15 – 18 months
Put Option on Promoters	▪ Should ideally be set at rock-bottom IRR – ideally at a few basis points above debt-based IRR ▪ A predefined process for arriving at the fair market value ▪ Promoter should seek reasonable time horizon to make the payment ▪ Comfort on other cashflow entity would help reduce Put IRR and improve security comfort of the investor	18 – 24 months

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Commercial Rights Negotiations

Particulars	Things to be taken care of…….
Promoter's equity escrow to enable a strategic sale	▪ Should be avoided
Anti-dilution at a lower price along with RoFR	▪ Should be fine since investor would need to protect its level of investment as well as have an option to participate in the future capital requirements
Non-compete	▪ This is one of the key requirements of any investor to prevent the promoter having any window to do similar businesses elsewhere – which is quite fair
Related Party Transactions	▪ Should be avoided in most circumstances, however, if there is genuine benefit and comfort which could be derived out of any such situation then this would need to be handled in right perspective
Liquidation Preference	▪ Investor would seek first preference in terms of payment of capital in an event of liquidation / divestment / wind-up
Top-up For Minimum IRR	▪ Investor would seek protection of its minimum IRR which clause cannot be avoided ▪ To enable such a protection one can offer additional equity

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Participatory Rights Negotiations

Particulars	Description
Board Rights	▪ An investor would seek board seat in proportion to their equity holding subject to a minimum of one board seat – which should be fine
Affirmative Rights	▪ Key affirmative rights normally sought by investor would include – CAPEX, sale of unit/business/division/removal of key management/declaration of dividend etc. ▪ Care should be taken to keep a practical level at which these rights would trigger
Information Rights	▪ Investor would seek access to information and might even ask for an observer seat in certain circumstances – which should be fine

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Q&A Session

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