

Holding tight

CRISIL Research survey of private equity and venture capital



Research

CRISIL
An S&P Global Company

Feeling the pulse



What we know

Entire global economy is reeling under a pandemic-triggered recession. Various industries are struggling to find ways to survive this crisis



What we understand

Even in alternative funds space, the flow of money or investments is slow



What we tried to know

Through our coverage of the impact on various industries, we have tried to understand

- Whether investors will continue to put in money or stay away
- Where they will direct investments to



Questions we asked

We reached out to private equity and venture capital investors to understand

- How this space will look like in the next 1-2 years
- Which sectors the fund houses will focus on



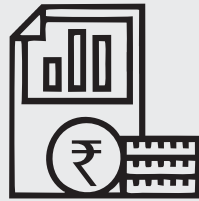
Answers we got

The views and expectations of investors obtained from the survey and interaction is presented in our report titled 'Holding tight'

Approach

The findings are based on survey and telephonic interactions with key stakeholders in private equity, venture capital and other alternative funds. The survey, conducted between May and June this year, received responses from 26 independent funds and respondents. It gathered insights to glean an outlook on private equity and venture capital funds through questions pertaining to investments, fundraising, exit, portfolio performance expectation over the next 6-12 month and 12-24 month timeframes, compared with 2019, and to identify the focus areas of investors in future.

Key messages



Over the next one year, private equity (PE) and venture capital (VC) players will focus on managing existing portfolios and will be less aggressive on new investments



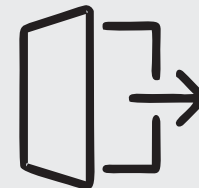
PE and VC investments, excluding Jio-platform, will decline this fiscal, but will log a quick, though moderate, recovery next fiscal



Digital economy will continue to attract investments, with healthcare garnering more attention than the financial sector



Investors have positive views on India being an attractive investment market in the APAC region even post-pandemic



Exit options will be limited. Merger and acquisition (M&A) exit route will provide some relief



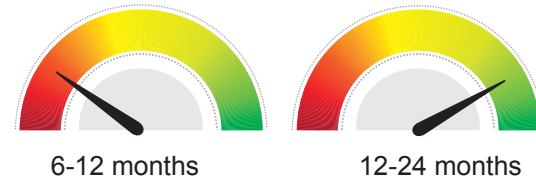
M&As will rise over the next two years

Pandemic slams the brakes on private equity and venture capital activity 1/2

CRISIL Research survey gauges investor mood as growth stalls after three strong years

More than half of the investors say investments will decline in the next 6-12 months. The negative expectations, however, drop sharply to just 15% for a longer-term view.

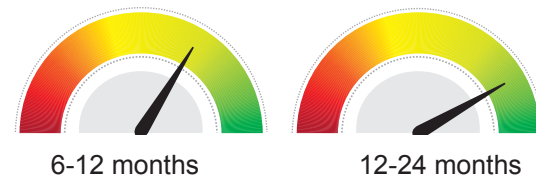
Quick recovery in PE and VC investments



Only **23%** of investors expect investments to rise in next 6-12 months; **69%** expect a rise in the next 12-24 months

With companies' performance declining, risk of investment loss increases. Good investment opportunities are rare and finding them becomes critical. On the other hand, disruptions like these trigger or hasten innovation, attracting investors to the market.

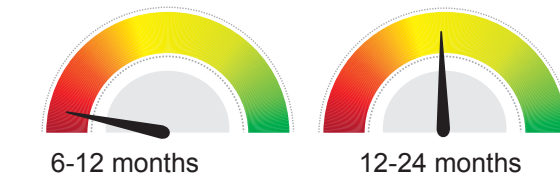
Rise expected in M&A activities



66% expect an uptick in M&A activity, only **28%** expect a decline in next 6-12 months

Mergers and acquisitions (M&As) for inorganic expansion and strategic exits will rise as firms put capex plans on hold.

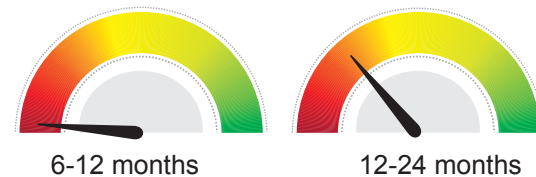
Prudent approach towards fundraising



Almost **90%** expect fundraising to decline in the next 6-12 months

With enough dry powder at the global and pan-India levels and few attractive opportunities for capital deployment, funds are not expected to raise money. New entrants may find it difficult to raise money as limited partners (LPs) would prefer to stay with experienced general partners (GPs) and funds.

Limited improvement in fund exits



A good **67%** expect a drastic reduction and **28%** a marginal decline in exits in next 6-12 months. This moderates to a total **44%** expecting only marginal decline in 12-24 months

Exit options were limited and would continue to be limited given the pandemic-led uncertainty in growth. PE and VC funds may opt to stay invested longer to achieve desired returns.

Pandemic slams the brakes on private equity and venture capital activity 2/2

A whopping 80% of the investors say portfolio companies will see contraction in performance this fiscal, although 54% are still bullish on certain key sectors

Portfolio firm performance expected to decline

In the next 6-12 months, 80% of investors expect portfolio performance to decline, particularly in terms of financial stability, making it imperative for them to focus on on existing investments.

Attention focused on managing existing portfolios

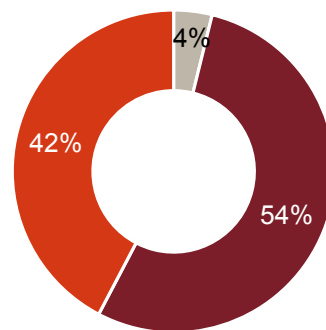
In the next 6-12 months, 43% of investors will focus on managing existing portfolios; 58% expect new investments to decline.

Investors eye innovation and/ or lower valuations

Differentiated solutions and a correction in valuations are key expectations as nearly 70% investors look for innovative business solutions and strategies and/ or lower valuations when making new investments.

Overall Indian PE and VC market cautious in near term, expects only marginal recovery going ahead

Investor sentiment



- Bearish across
- Sector selective bullish
- Wait and watch with caution

Around 42% of respondents are cautious of the changing environment and are taking a wait-and-watch approach.

Decline in investments expected to be short term with ~70% of investors expecting a marginal recovery next year.

PEs are expected to focus on segments minimally impacted by the pandemic.

Over a longer term, these segments will see a positive structural change that will drive stronger growth due to changing consumer behaviour.

Promising opportunities in emerging sectors such as technology, e-commerce and healthcare will keep investment activities humming.

Economic slowdown, pandemic make current fiscal challenging

Forecast of a 5% decline in GDP has raised red flags already. Worse may be in the offing if the pandemic scenario extends

Economic impact



-5.2%

Weaker global demand: Global gross domestic product (GDP) to contract by 5.2% in 2020
World Bank Global economic prospectus June 2020



-5.0%

India GDP expected to decline by 5.0% in FY21



7%

V-shaped recovery in GDP growth with average 7% CAGR over FY22-24

Corporate impact



India Inc to see more than 15% slide in revenue in FY21



Profitability: Ebitda to fall faster than revenue



Credit metrics weakening across sectors

Behavioural impact



Lower discretionary spending



Increased adoption of technology



Higher penetration of e-commerce services

Investments falling since fourth quarter of last fiscal



Uncertainty in economic growth



Impact on valuations due to change in assumptions



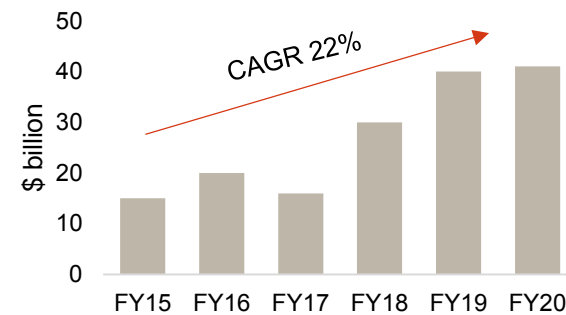
Investee focus on survival over business expansion



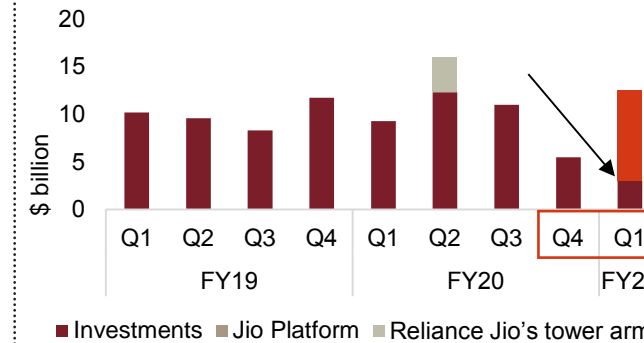
Drawn-out due diligence due to operational constraints

PE and VC investments grew significantly over the past five years, but have trended down since the fourth quarter of fiscal 2020

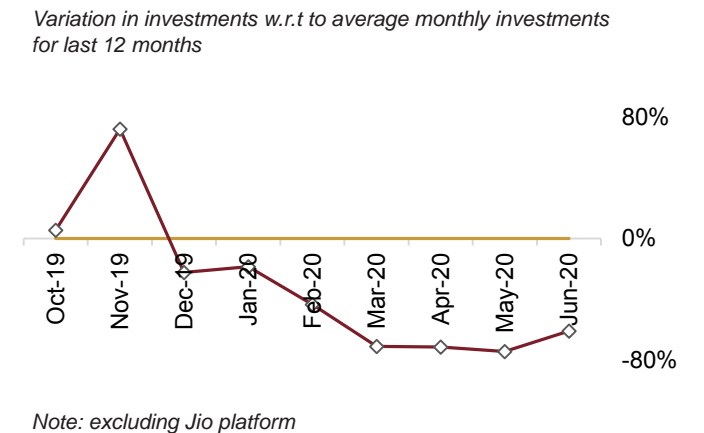
PE and VC investments clocked a robust 22% CAGR since fiscal 2015



Investments in first quarter of fiscal 2021 very low excluding outlier investments raised by Jio platforms



Monthly investments in the last four months, i.e. from March to June, were 60-70% lower than the monthly average of the last three years



Note: India-based AIFs and domestic funds, International funds, pension and sovereign funds investments are considered for total investments
Source: News articles, IVCA, CRISIL Research

Top sectors by investment deal volume

FY15	FY20
Technology and IT	Financial services
E-commerce	Technology and IT
Financial services	E-commerce
Real Estate	Foods and consumer (D)

Top sectors by investment value

FY15	FY20
Real estate	Infrastructure
Financial services	Financial services
Technology and IT	Real estate
E-commerce	E-commerce

Infrastructure and real estate sectors typically known for large transaction sizes aided rise in total investment value. Technology, E-commerce and Financial services have been attracting investments consistently.

Deployment of capital will be slow given the uncertainty in the economy

A quarter of investors expect drastic reduction in investments

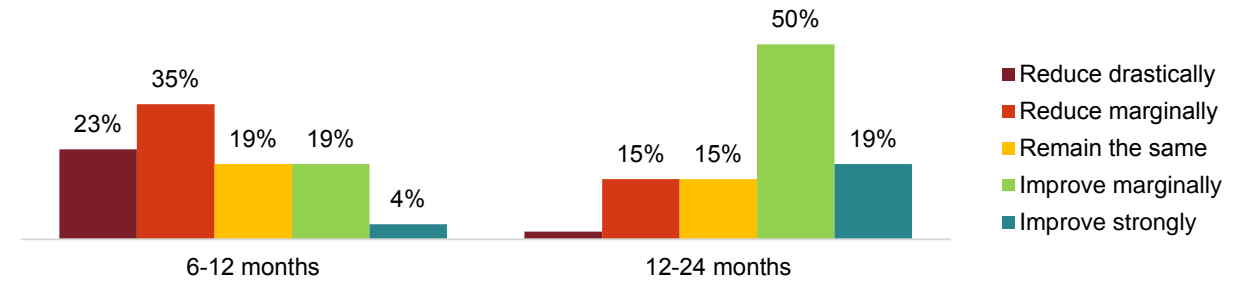
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58% of investors say investments will decline over the next one year; however, sentiment quickly turns positive over the next 12-24 months

Investments will decline in the short term over concerns and uncertainty over India Inc. performance

Outlook is expected to be more positive in the long run as 70% of respondents are hopeful of improvement, but largely with marginal growth as companies would struggle to regain post-Covid-19 growth trajectory

Q. How do you think investments will be impacted compared with 2019?



Short-term investments will decline as 43% of investors to focus solely on managing existing portfolios

46% of investors who are willing to look at new investments will have a sector-specific strategy or a balance between new and existing.

Overall investment climate will be muted as only 11% are focusing on new investments

Q. Do you agree that the pandemic will impact your firm's investment strategy and in next one year your firm will primarily focus on managing existing portfolio companies?

27%	Yes, focus on existing portfolios for initial two quarters
16%	Yes, focusing on existing portfolios for next one year
19%	Balance between existing and new investments
27%	Sector specific strategy for existing and new investments
11%	No, will largely focus on new investments

Pandemic casts a pall on portfolio performance

46% expect drastic reduction in revenue

38% expects drastic reduction in profitability

89% expect decline in financial stability

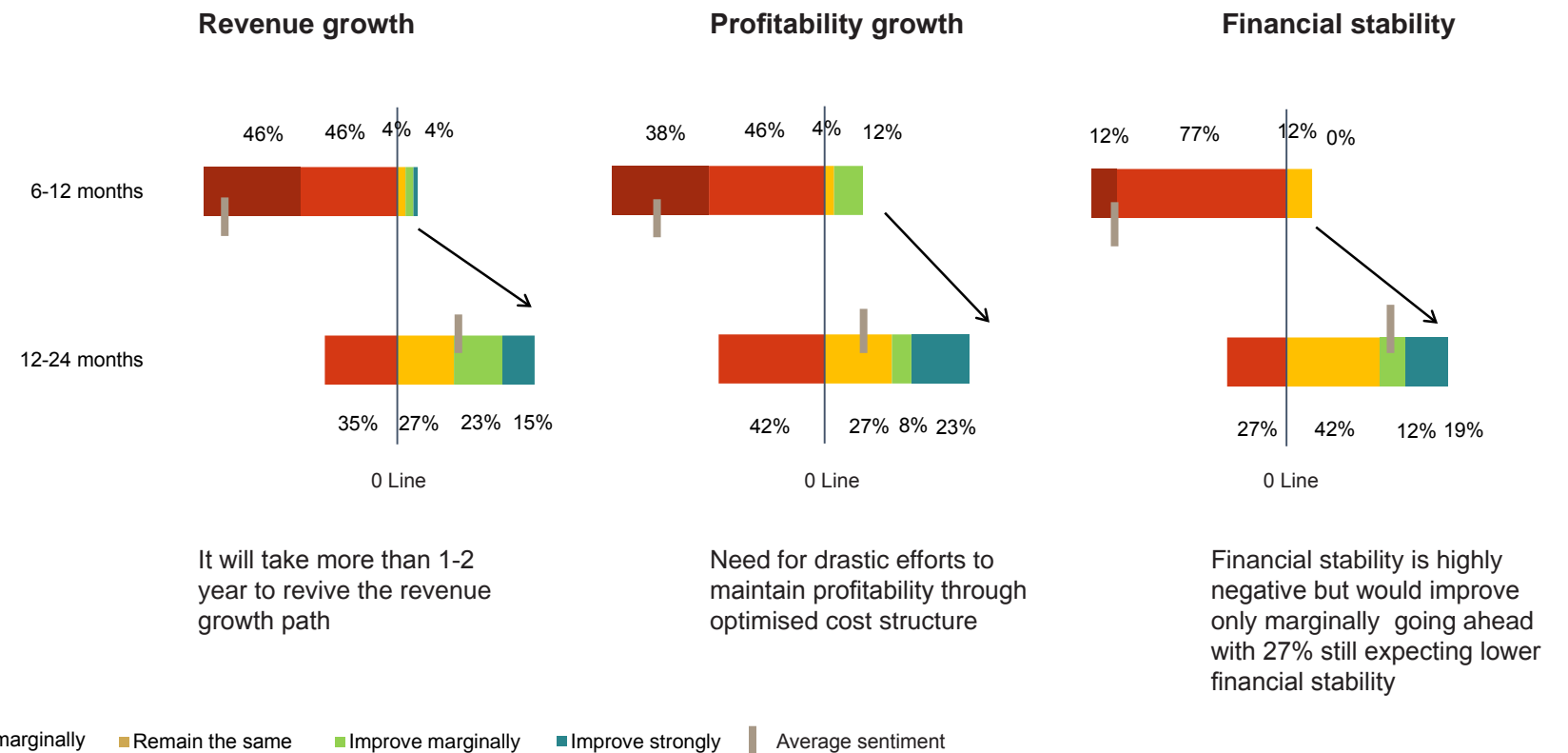
Investors have extreme negative growth outlook on revenue, profitability and financial stability of portfolio companies

In the short term, more than 80% investors expect a decline across all parameters

In the longer run, performance would not improve majorly but will be less negative. Long-term horizon will still be largely as-is or marginally decline

With negative outlook, there will be some write-offs and loss lingering around the corner for funds, impacting their overall returns. With portfolio growth performance impacted funds may stay invested longer for expected rate of return

Q. What is your firm's outlook on portfolio companies for the following parameters?



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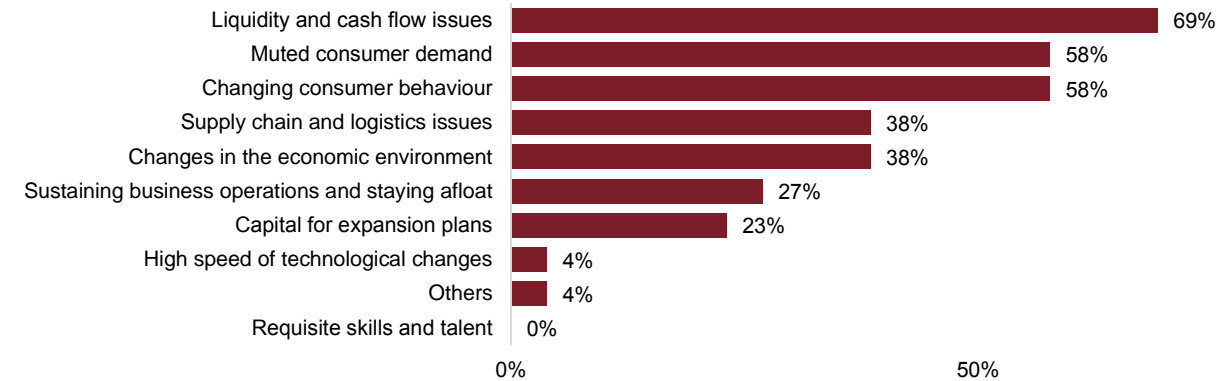
Managing cost in existing portfolio companies will be the key objective over the next one year

More than 75% of the investors expect firms to optimise manpower and limit opex

70% list liquidity as the top risk, followed by 58% for both muted consumer demand and change in consumer behaviour

Muted demand and liquidity issues are new entrants to top risk factors for portfolio companies, at least in the short run

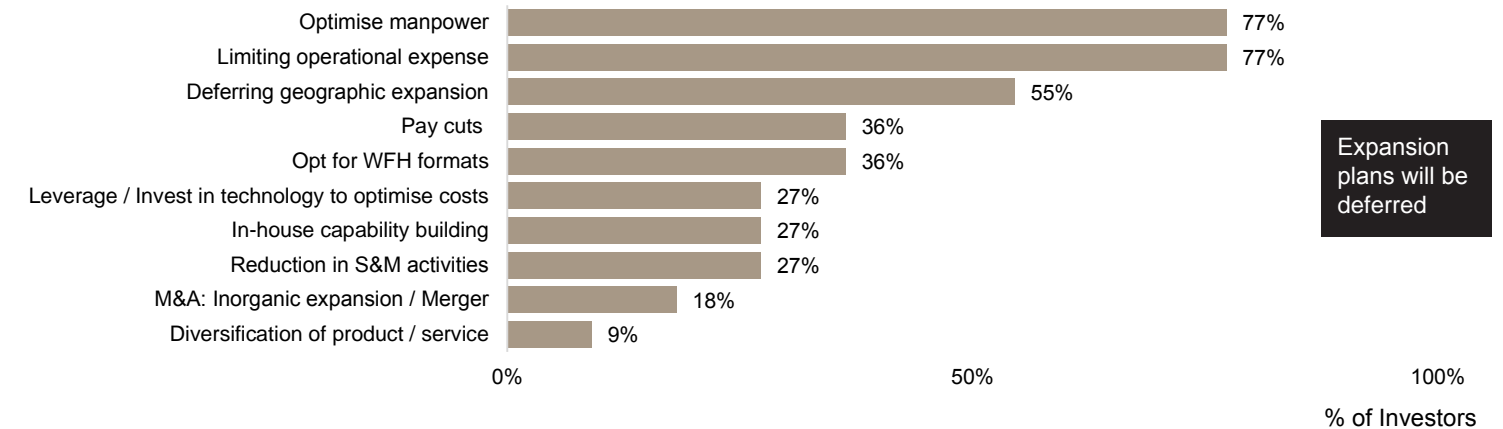
Q. Which factors do you believe will pose the greatest risk to your firm's portfolio companies over the next 12 months?



Over 75% investors look at optimising manpower and operational expenses for managing performance

GPs expect portfolio companies to manage cost structure by managing operational expense, optimising manpower and deferring geographic expansions

Q. What long-term strategies will portfolio companies most likely look at to tide the crisis?



Exit market to stay dull, but M&As to see traction

95% of investors expect a major decline in exits in the next 6-12 months

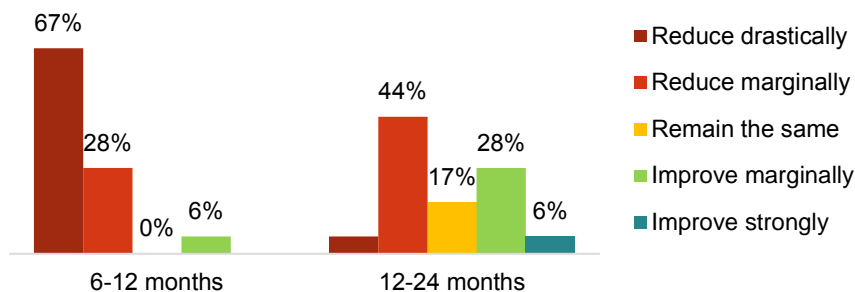
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Firms are expected to delay exits over the longer horizon for better returns

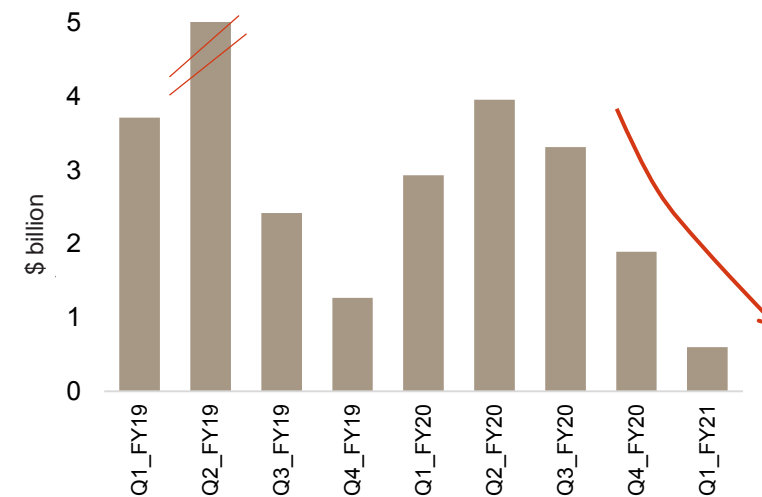
Exit options are likely to be limited. Funds would prefer to stay invested longer to achieve desired returns

A recovery in the exit market will be very slow, as 44% expect a decline even in the longer term and 28% expect a marginal improvement over 12-24 months with only 6% expecting a strong improvement

Q. How do you see exits to be impacted compared to 2019?



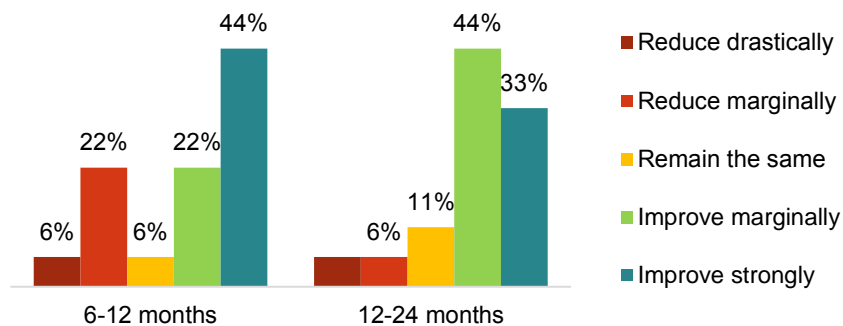
Exits have been declining and the past two fiscals have had a lower number of exit deals



M&As for expansion and as strategic exits will see increased traction post-Covid-19

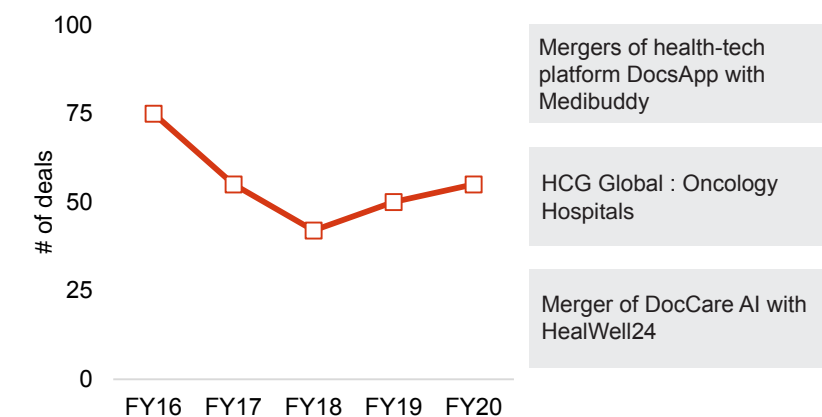
66% of investors have a positive outlook on M&A deals in the short term, but this rises to 77% in long term. M&As will see a moderation in the longer horizon, as more investors expect a marginal rise than strong growth

Q. How do you see M&A deals to fare compared to 2019?



Exits via M&A have been fairly good in the past few years, as the IPO market was dry

Exits via M&A deals would see an uptick in FY21



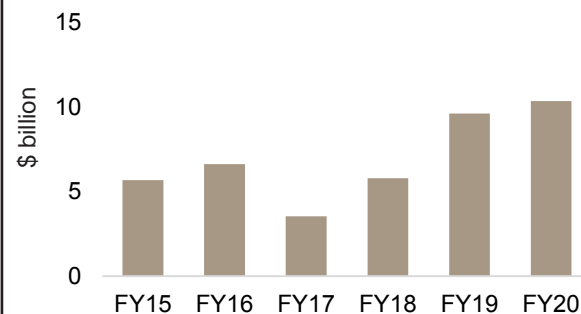
Indian funds saw limited fundraising in last two quarters

Fundraising was almost nil in first quarter this fiscal

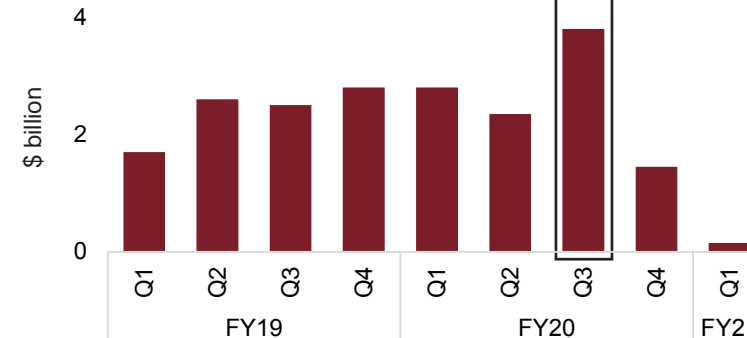
Indian funds are sitting on enough dry powder, which reduces the need for additional fundraising

GPs stayed away from fundraising in first quarter of fiscal 2021 due to a freeze in commitments from risk-averse LPs and adequate capital in hand for limited investment opportunities.

Over 30% growth in funds raised since FY18



Third quarter of fiscal 2020 saw highest funds raised / announced in a while, but April was zero, while May showed slight traction.



LPs freeze commitments
Overall lower risk appetite for LPs due to uncertainty in growth
LPs wary of backing new funds or GPs



Restriction on roadshows/ fundraising activities



Enough dry powder with PE and VC funds

Note: Indian funds are considered for amount of funds raised
Source: News articles, IVCA, CRISIL Research

Top sectors by investment value

Sectors in which India-focused funds raised / announced capital since FY20

Early stage/ start-ups	28%
Consumer, healthcare, financial services, manufacturing and technology	26%
Sector agnostic	14%
Venture debt and private credit	14%
Distressed assets	10%
Logistics	5%
Renewable energy	3%

Share have been calculated by excluding the investments towards stressed assets by Government and any financial institution's stressed asset fund as reflected in graphs above. Excludes Real estate and Infrastructure

Early stage/ start-ups drive most of the investments by Indian funds.

Traditional sectors such as consumer, healthcare, BFSI, manufacturing, and technology and IT attract over 40% of investments (including sector-agnostic funds).

Warbug Pincus raised up to \$1.5 billion for its first India-focused funds in third quarter of fiscal 2020 for consumer, financial and manufacturing segments.

Renewable energy and logistics are garnering special funds investments.

Fundraising to be minimal as there is ample capital available

Limited good opportunities for investment is expected to be a bigger challenge than availability of funds for deployment, but more than 60% of investors are positive India will attract international capital in the long run

CRISIL Research survey of private equity, and venture capital and funds

Funds have a surplus of uninvested capital. Plus fundraising is not major concern as investment opportunities will be limited

There is enough dry powder with India-focused funds for investments

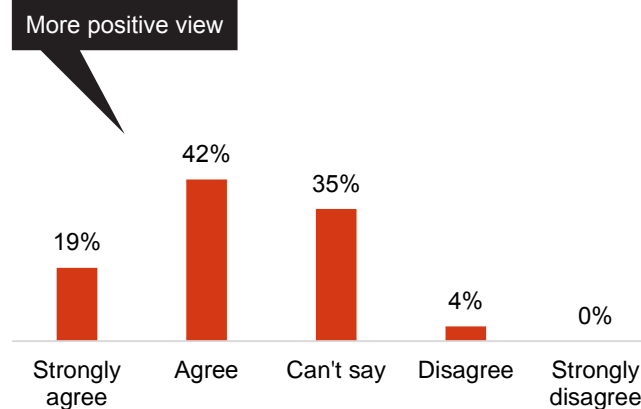
With an uptick in funds raised in the previous quarters, the available capital for deployment is sufficient

Sector-specific funds will not face issues with fundraising, if there are investment opportunities

India has the potential to attract international funds

Almost 60% of investors agree about India's potential for attracting investments in the APAC in the long run

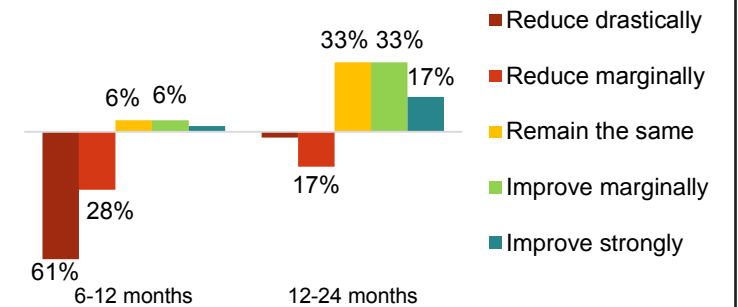
Q. Will India be a more attractive market for investments in APAC post the pandemic?



Fundraising is expected to be muted in fiscal 2021, as ~90% do not expect to raise funds during the year

Recovery in fundraising is expected after 12 months, with 50% having a positive outlook

Q. How do you see fundraising to fare compared with 2019?



India-focused fundraising activity has not stalled; there has been very slow movement in Q1 FY21

WestBridge in talks to raise fresh money from LPs for an evergreen fund (> \$500 million)

Gaja Capital initiated fundraising for \$400-500 million

Sixth Sense Ventures initiated fundraising for \$200 million

JM Financial group raises \$21 million for stressed-asset investments

Iron Pillar raised \$45 million for existing portfolio companies

Basis Vectors (\$50 million)

Water Bridge (\$10 million)

Note: Funds raised or initiated from April 2020; Source: News articles, CRISIL Research

Investors will evaluate options for new deployment of capital

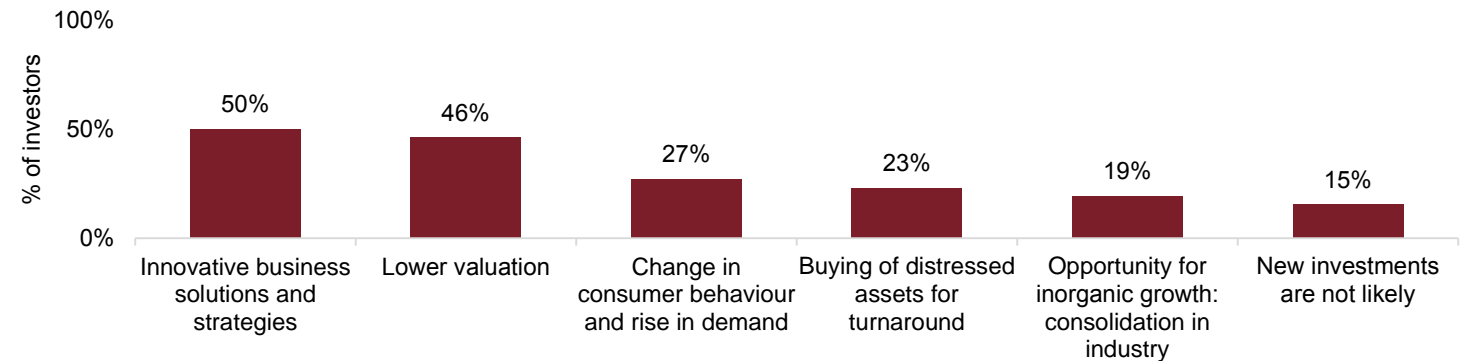
During periods of slow economic growth, good investment opportunities are expected to be limited. Funds will also take longer than usual to complete due diligence, further delaying investments

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50% of investors are looking for investments in innovative businesses that will perform well in the long run

Innovative business solutions / strategies, along with a correction in valuations, will attract investors to explore new portfolio firms.

Q. Which of the following reasons are more valid for you to invest in new portfolio companies?

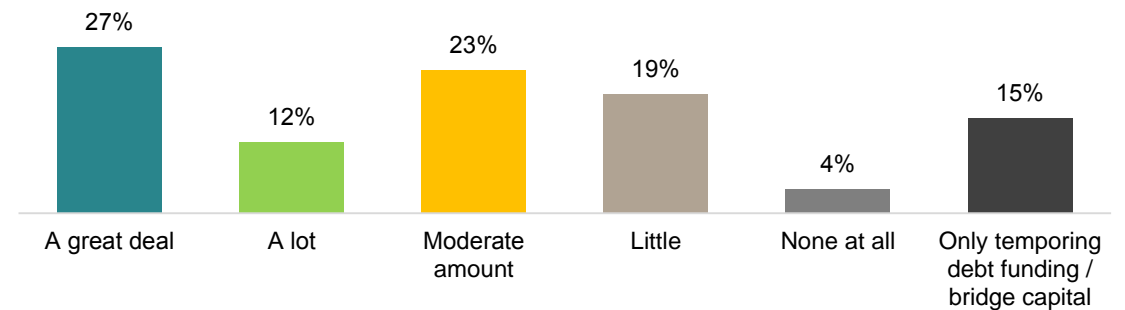


39% of investors expect debt funding to rise in current scenario

Sharp rise is expected in private debt funding. Private debt funding is at a nascent stage in India, and has been growing moderately.

Many funds such as CDPQ, along with Piramal Partners, Apollo global management, KKR, and Alteria capital have raised / announced capital for private credit / structured debt

Q. Will private debt / convertible debt instruments see more traction in current scenario?



Chunk of investments to flow into sectors that support digital economy

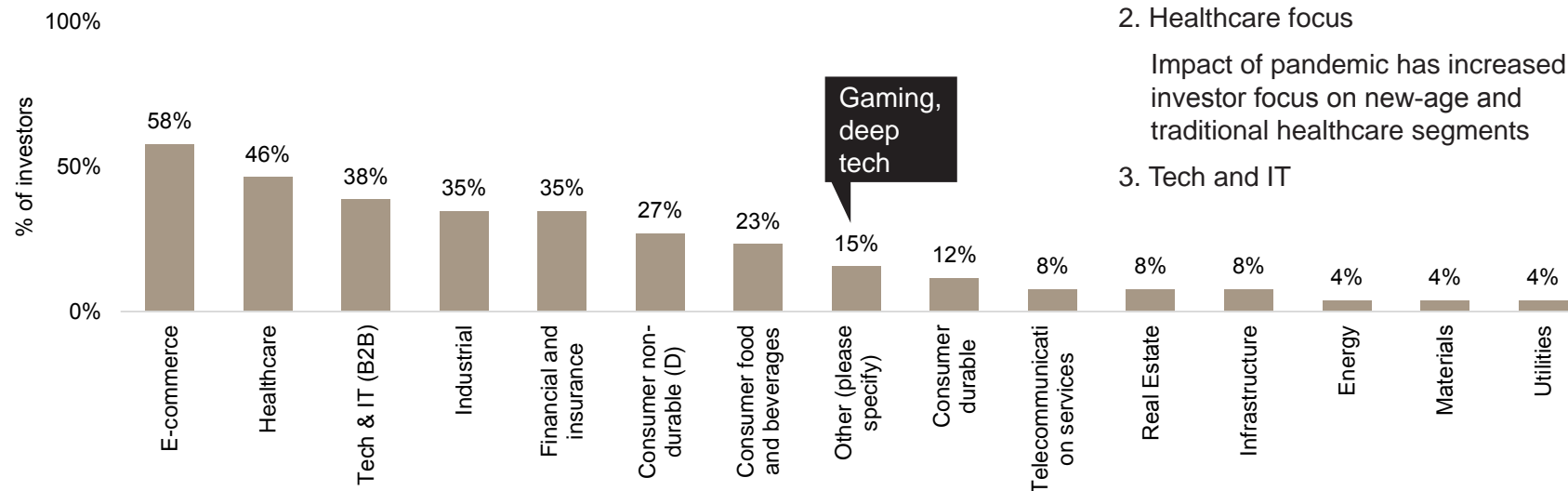
Healthcare sector is ranked 2 for investor interest above Tech and IT

CRISIL Research survey of private equity, and venture capital and funds

E-commerce will remain the sector of choice with investor interest of 58%, followed by healthcare with 46%

Healthcare has grown to be among the top-three sectors, along with e-commerce, technology and IT-enabled solutions. Gaming and deep tech are special mentions.

Q. In next 12 months, I expect my firm to focus on opportunities in following sectors



1. E-commerce
2. Healthcare focus
3. Tech and IT

Impact of pandemic has increased investor focus on new-age and traditional healthcare segments

Consumer and digital platform have been the theme for investments in 2020 till now

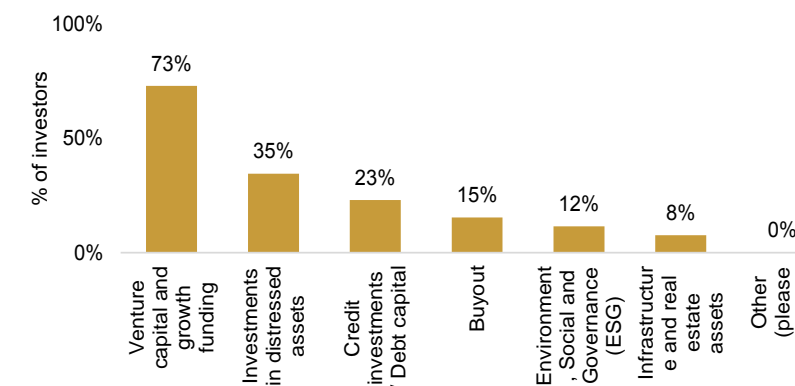
Top sectors in deal making since Jan'20 to May'20

Sectors	Themes
Consumer	Wellness and health
Technology	AI-powered, Machine learning
Healthcare	Tech-based solutions
E-commerce	Vertical segment e-commerce
BFSI	NBFCs and tech solution
Logistics	Logistics infra and management system
Enterprise SaaS	Support solutions for digital world

Venture capital and growth funding will largely be the strategy for PE and VC players in 2020

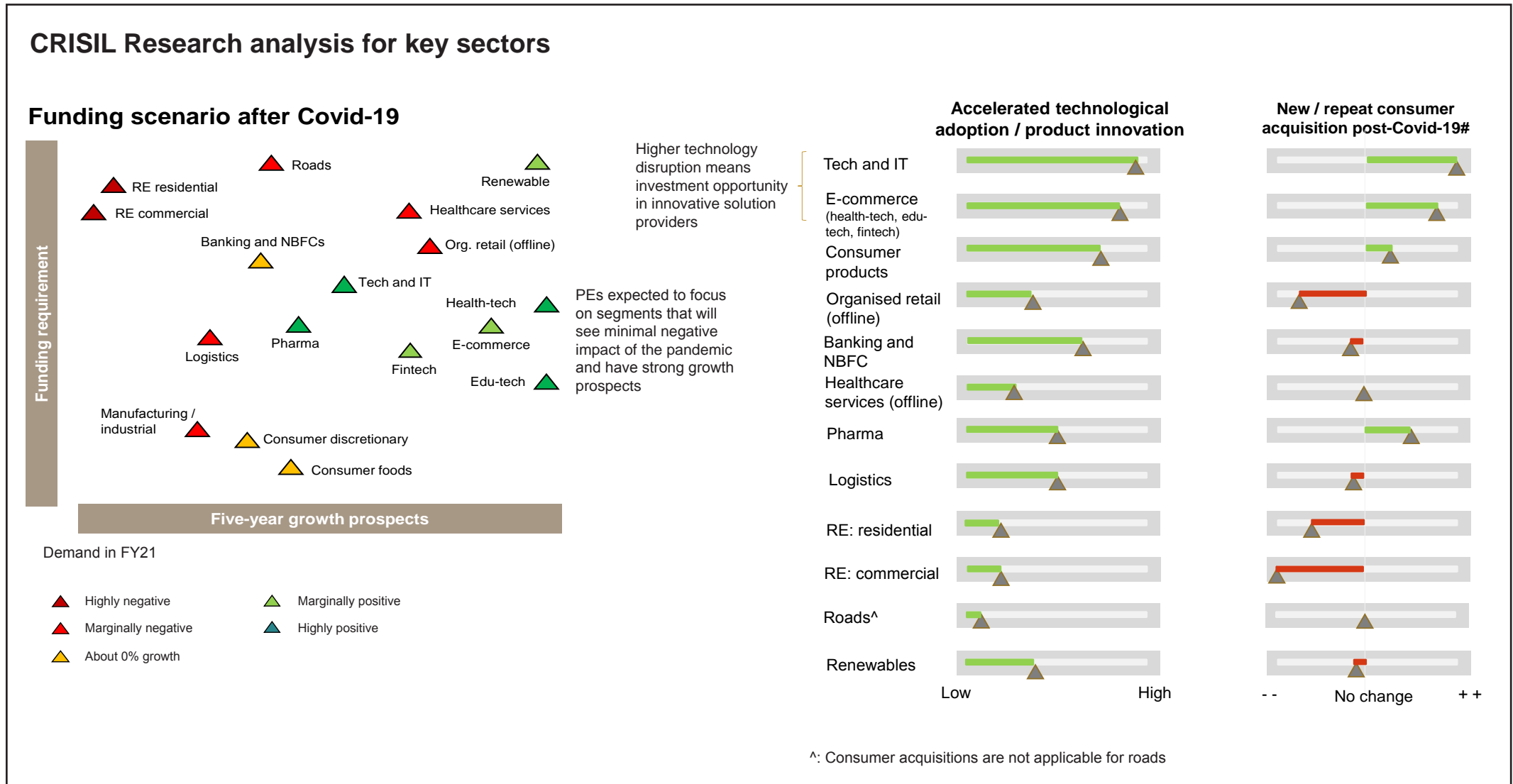
More than 70% of investors will look for venture capital and growth funding in key focus sectors; 35% of investors will look to invest in and revive distressed assets

Q. What will be the core element of your firm's investment strategy in 2020



PEs to focus on resilient segments with growth potential

Growth of e-commerce segment has not been impacted much and it is still expected to grow over 20% over the next five years



Within e-commerce, edu-tech and health-tech will perform better than fintech, as the financial sector and lending see slow movement in the current fiscal year

Consumer packaged foods and offerings related to health and wellness will see more demand from consumers







Real estate will see lesser interest, as the sector is already in a bad shape and demand will further deteriorate

Over the longer term, segments such as health-tech, edu-tech, technology and IT, and pharma will see a positive structural change, driving stronger growth amid changing consumer behavior





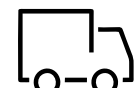

Tech and healthcare sector to focus on AI and digital solutions for efficiency

Tech (including IT and ITeS) and healthcare saw over 100 deals in the three months through Jun'20

In addition to pharma and medical devices, digital and tech-enabled healthcare segments are expected to gain due to higher health consciousness

 <p>5X e-consultation Increase in interest for online doctor consultation in India. Popularity above 50 for seven consecutive weeks#</p>	 <p>Digital Therapeutics Self-health management / monitoring tools for lifestyle disorders, such as managing blood sugar, weight care, heart health</p>	 <p>Medical IOT Connect all healthcare devices to apps, track progress and report health summary to doctors</p>	<ul style="list-style-type: none"> Specialised healthcare delivery Online pharmacy E-consultation/ telemedicine Mobile health Health-tech (B2B+B2C) Pharmaceuticals and biotech Medical devices
 <p>Point of care Diagnostics: Testing at clinic or on field immediately would help in increasing geographical access and better turnaround</p>	 <p>AI and machine learning Varied applications from screening and diagnostics to analytics data to help physicians provide proven consultation</p>	 <p>Forced adaptation Covid-19 has pushed consumers to try buying healthcare services digitally, aiding consumer acquisition in future</p>	

AI and Machine learning are new entrants among cloud, SaaS and data analytics

 <p>Artificial intelligence A Nasscom study reveals that 50% of tech start-ups consider AI as big technology opportunity</p>	 <p>Cloud computing The delivery servers, storage, databases, networking, software, analytics, intelligence and more over the Internet</p>	 <p>Digital economy The future of work will be co-existence of humans and technology-enabled devices</p>	<ul style="list-style-type: none"> Enterprise SaaS – Business solutions Ed-Tech, Fin-Tech, Health-Tech SCM and Logistics Agriculture focus AI, Data Analytics
 <p>Healthcare focus 40% of start-ups consider healthcare vertical as a big opportunity in the tech segment</p>	 <p>Logistics and SCM The segment is attracting investments for logistics management services. Agri-sector to be in focus</p>	 <p>BOTS Solutions powered by AI and machine learning are increasingly aiding efficiency and optimising human interaction for critical tasks</p>	

Tech offerings in consumer services to deepen penetration

E-commerce segments are expected to gain due to increased acceptability during the lockdown, resulting in deeper penetration over the longer period



Healthy foods

Health, fitness and wellness gaining consumer attention. Increase in consumer offerings around nutrition, nutraceuticals and healthy food



Offline to online

Deeper penetration on mobiles, interest, and convenience offered are pushing online commerce



Local brands

On-shelf/ local brands have seen a rise in sales due to availability/ supply-chain issues



Online content and gaming

Gaming and other online entertainment platforms such as OTT are on the rise



Personal care and hygiene

Beauty, personal care and hygiene are key themes for the consumer market



Fintech and B2C e-commerce

Discretionary consumer spending and digital financial services attracted investments in e-commerce. Health-tech and edu-tech to pace up

E-commerce

- Consumer shopping / delivery
- Fintech, health-tech, edu-tech

Renting / selling

Personal care and wellness

Consumer foods, beverages

Dietary supplements / nutraceuticals

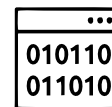
Gaming

Dissemination of financial service across segments, convenience and security of digital channels will drive industry growth



Fintech

Building robust and reliable digital infrastructure for the BSFI sector



Tokenisation

Enhanced system to ensure security in transactions and avoiding usage of consumer data



Digitisation

Digital solutions for tech-savvy customers and increasing market penetration



NBFCs / microfinance

Under-penetrated financial services in driving investments for last-mile financial inclusion



Alternative lending

P2P, invoice financing, mobile lending, crowd funding, are other tech-led models

NBFCs / microfinance

Online lending services

Banking

Insurance

Fintech / Mobile VAS

Others

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