

Summary of Events

At the "2 Days Extensive Workshop on Private Equity".

1st and 2nd August 2008, Hotel J W Marriot, Mumbai

**Committee for
Members in Industry
(CMI)**
&
**Committee on
Financial Markets and
Investors' Protection**



**Western India
Regional Council
Of
I.C.A.I.**

Dear Members,

1st and 2nd August 2008 were Great Days , in the history of PE education in India, with, almost 350 Chartered Accountants from the Industry and the Practice, met together and interacted on the hot topic of the day – "Private Equity".



Speakers on the podium



Juhu Tara Road, at which the Marriot hotel is situated



The Front of the J W Marriot Hotel



The Shivaji Statue at the Juhu Beach, just 200 m from the J W Marriot Hotel

Some Excerpts From the Seminar

Rs. 40000 Crores already invested in India, via Private Equity Route, in last 5 years. When Stock markets are not doing fine (as is the fact today), the PE route is even more important for the businessmen.



Income Tax Benefits

Advantage to the Venture Capitalist =

Zero income tax for the "fund", on the profits derived from the fund.

Key Words of Wisdom

- & Bringing business from 0 to 100 cr was possible
- & But taking from 100 to 1000cr is a different ballgame
- & One individual cannot do this
- & Two or three partners cannot do this.
- & One joint family cannot do this

You need more people

- & You reached Rs. 0 to Rs. 100 crores with 100 people
- & Now, next increase from Rs.100 Cr to Rs. 500 Cr needs 500 more people.
- & You cannot have a personal eye
- & You cannot have a personal rapport
- & You need corporate governance,
- & You need systems,



Key Words – Merits of PE

PE makes company more efficient
PE improves in method of management
PE brings better people, better systems
PE help you grow.

Key Words – Demerits of PE

PE are bad-mouthed as fair weather friends,
PE are asset strippers
PE can sell away the company
PE force labour layoffs

A Section of the Audience at the "**2 Days Extensive Workshop on Private Equity**". . It was attended by CA's, Directors of Corporates, and Country Heads of PE Funds, from locales like Abu Dhabi, Montreal, Dubai, Chennai, Kolkatta, Banglore, Hyderabad, Delhi, Faridabad, Gurgaon and so on.

Both are correct, but usually, PE never has time or inclination to disturb the apple cart. He wants to increase value, and exit like a gentleman. (usually !!!)

Session 2 : Birds Eye View on the Contemporary Indian Scenario

Mr Namit & Mr Utpal, CEO, Rare Enterprises.

4M – that the Private Equity Players sees?

- & Management
- & Market
- & Merchandise
- & Model

First M = Management

Core about Taking a bet on the management. And this is the main focus.

The Private Limited companies are in nature, illiquid assets, non-continuing, So, there is a big “illiquidity risk”.

Key aspects that a PE / VC sees = “What is the vision of Promoter ? “

- Is there a dream to make a larger company
 - Today, the Rs 100 cr co., PE owns 30% = 30 cr
 - Do the mgmt have a vision to become 1000 cr, so that PE's share gets Rs. 300Cr.
- Does he have the flexibility ?
 - Are they building company for just their children / grandchildren only ?
 - Or are they open to the larger picture ?
- Alignment of interest
 - value for all , or
 - Just benefits for himself ?
 - Corporate governance – Does he "manage tax", manage overheads, and
 - Is it “True and Fair “
- By its purpose, PE wants a IPO soon. So, wants a healthy discussion on all things on the BOD level

Second M = Market

The PE sees, the market .

Is there a great market ?

Pain killers sell, vitamins don't , even if vitamins is a good thing.

is it a luxury ? Or mass consumption ??

Can it be a big market ?

What is the SAM ? = Size of Addressable Market

What is the SHAM ? = Share of Addressable Market

Third M = Merchandise

The PE sees, the product itself,

Does it make sense ?

You get Premium if you are better than the competitive products.

Fourth M = Model

The PE sees, the Business Model.

The model and plan of generating the profit.

Does it make sense ?

What is the model to earn revenue ?
Compare with the 2000 dotcom era, and we had fancy models with, no money.
is it fully funded plan ?
must have fully funded for next 18 months
Should not have to worry for capital for 18 months



Can the promoter say ?

“Let me hire a CEO, who will work better than me. and I continue being 80% holder.”

Mr Utpal, Rare Enterprises

PE is happy to share on the "upside" but sometimes relations get bad during the "downside".

PE is not a winner
Company is the actual winner
He is just a participant in the winner

PE	=	Opportunity + capital + Management ..
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Target Company Must have a competitive advantage
If you don't have any of these 4 M's → it is a "no show"

Non-linear growth model required
with every 20% inc in Sales, must have 40%-80% inc in profits
and that is not just financial leverage
and that is also operating leverage

Who Creates value ? (PE or the company)

The speakers gave the example of "WIPRO Limited".
WIPRO is listed. Mr Azim Premji owns 80%
But his Net Worth is high, since, its shares value is high, "in the eyes of the stock market"
Stock market values its 20% (Owing Just 20%). And helps to increase the net worth of Premji's 80% too.

PE helps you create the future value

Mr Uppal commented that

- Some entrepreneurs, want highest first initial value
 - Have a bigger vision
 - Let him enter low
 - And exit high
 - He wins, and also giving a enormous value to your 80%
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Mentoring by VC

PE provides a different thought process that is the mentoring, "What company really wants?"
VC is not venture Capitalist alone, he is also a mentoring capitalist

VC helps management think through.
Better decisions, are made.

Even the Managements who are not articulate, traditional, transform themselves in the long run.

Importance of Long Term vision

Ideally, a PE should have a vision for 5 to 7 years
They are usually for shorter period.
Generating 100% in one year is easy
But 40% consistently for 5 year is good, but very difficult.

When we select the PE, we must see the no of years of future partnership. If there is a long term focus, the promoter and his company is not IRR focused, quarter to quarter, and instead is having a long term vision.

Other Advantages of the P.E. player

When you are head-hunting

Trying to convince a Top-Notch target employee
the PE can convince
This is an endorsement effect
helps attract talent

When You Are In an IPO

Trying to convince the Target Public
The PE Can Convince
This Is An Endorsement Effect
Helps Attract Money in an IPO

When you are doing your own product marketing

Trying to convince the customer
The name of the PE can convince the customer about your credibility.
This is an endorsement effect
Helps Attract Customer
Example : A PE arm of a particular Bank having taken a 5% stake in "Property Builder" BPTP has given a higher credence to it. Both for allotment of SEZ lands and the sale of towers and flats in its properties/cities.

Management Team Composition At P.E.

In India, they are usually CA/MBA - Finance / Marketing Only.
But, In USA, they are a combination of operating General Managers also
That adds even better value.

3 E's from the Promoters (What are they) ?

EGO's	of the promoter
Emotions	of the promoter
Expectations	of the promoter
but promoter must be realistic	

All these Ego, Emotion and Expectations of the promoter must be realistic. Extremities, don't help the case.

3 E's from the Private Equity Partner (What are they) ?

what PE can give – in form of 3E's

Enlarging the canvas	for the company
Escalating scalability	for the company
Enhancing the strategic framework	for the company

The promoters, usually working on "GUTS". The PE helps in making this more scientific. How? Due to his wider knowledge.

Example :

Whether cash flow is good or not ?

DE is correct or not ?

Risk is ok or not ?

Further expand or not ?

Sometimes the entrepreneur may get carried away - think fashionable, doing a big amalgamation → PE may guide, "Listen, this company is going bust, and market is not good in other parts of the world, so please think again".

PE gets involved in all Big, and Critical Business decisions.

Mode of Exit : (What is that) ?

Already part of the SHA= agreement

Logically, we must not "Plan to divorce, before marriage".

Some PE Funds, do not "force an exit clause" in the agreements.

if the company does well, multiple options will come in

if the company does NOT DO well, all options will be ZERO

Nobody can envisage, what will happen after 5 years / 10 years.

However generally the PE's keep a Exit option in the agreement.



Exit from a SME (Small & Medium Enterprise) : (How is that done) ?

"When we get in, we understand the company will do well."

In India, a Trade Sale, is considered a failure. & Selling co, is admitting defeat

But , in PE, this is a rule, PE has to come out of it, then and only then, PE manager has made any profit from the PE fund and PE stakeholders.

So, as a rule, PE manager, sees if the company can do an IPO in 5 years maximum.

And its current & future revenue, profit must be of that scale

Part Exit

Divorce / exit is sometimes not divorce

This is sometimes, reduction from 20% to 15% or say 5%.

so, take the capital out, for further market deals
balance continues to grow.

Next

Session of Mr C S Nanda and Mr Sanjeev Maheshwari

First message to the Practising CA's

CA Profession now wants us to be specialized.
"Attest function" CA's must also do management consultancies

Message to the CA's in the Industry

If you have to be on the top, be the best
Add value
Be different
Specialize

For Both practicing and industry, CFO's , Financial function, gives us the best limelight.
90% CA's on top are due to their finance-connected functions.

But remember, Finance, is not merely funds raising, But also strategy how to generate funds

Anecdote by Mr Nanda

Man to doctor = " I am down, with a strange illness"

Doctor = " What happened ? "

Man = "For 20 years, I see a dream, and it is the door to success, I am pulling, but it not opening up. I am getting mad. Help me."

Doctor = Today focus on the door

Next day, he came again

Man = Again, I dreamt same dream. Again Door appeared.

For 2 hours I pulled on the door, then, I remembered, to "Focus on the door"

When, I focused, I saw a small slip on which was written - "push"

I just gave a small push, and the "Door to opportunity opened"

Moral of the story :

We must know what is correct, and how it is to be done

If we don't know the intricacies of the Private Equity market, we will never know how to click a correct deal. So, prepare yourself

Next topic : Importance of "Pre-Due-Diligence"

Mr Nanda said, = "Due diligence(D.D., for short) is ok." But actual real, pre-due diligence is most important. When DD comes, and if it finds that everything that he wanted to find out is readily available and also is ok/as per industry standard norms, he is very happy. This will increase the confidence level .

If instead, the company calls the PE, before preparation, then it (may) create a bad word-of-mouth, of that company in the market.

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Next Case

Discussed a Case of a company → First PE happened at Rs.1500/share in Sep 2007. Then, the Stock Markets crashed.

Yet, after 6 month, when it wanted funding for the new project, it was able to sell further stake, (20% more of its equity), and this time not at lower, but at rate of Rs. 3500/Share.

Moral of the story : Yes it is possible . If your company credentials are good, and if intentions are good, you can win, even against the market tide.

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Suggestion to bring money into the company “in Phases”.

Understand the cost first.

Understand what you have to give.

Go for phased money coming in.

Eagerness of lumpsum hints of some eagerness or even greed.

Prefer to plan to get funds in small bullets, example : Dilute just 5% every year , in 4 tranches. This way, you will get better valuations, in every successive tranche.

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New Development : Basel II Norms – Risk Compliance Officer

From Apr-08 Basel II norms, have been made applicable in some aspects.

And thus, in all listed co, a compulsory post of Risk Compliance Officer is required.

They must calculate risks in the organization, and their mitigation steps being taken by the company.

Every organization , every business has some risks. There are Certain system risk

Some are calculated risk, anyway business runs on risk. And some are system risk, personal risks, Governmental risks, competition risks, the stakeholders want you to share the knowledge of those risks from you. So, that they can take an informed decision.

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Message to Chartered Accountants

Do, Activity based costing

Do Mergers

Do Networking

Build capacity

Be clear

Be fair

Do your own internal Due-Diligence First

Just as 1995 to 2005 was the period of Information Technology Revolution, come-on, let us work harder to be a part of the Financial Revolution in the World, and Indian Chartered Accountants must lead it.



Do Networking, with your colleagues

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Remember your own Children, your Spouse and your Parents

In the fag end of the deliberations, reminded all that after winning the world, you still have to go back to your family. They are the only people in the world, who worship you like their hero. Do, never-ever forget them. Give them time, Give them your love. Give them the affection.

He reminded of a story, when a child cries and offers his father, Rs. 500 for buying one hour of his father’s time, so that he could have dinner with his father.

Let this not happen to any of us. Give them time before even this becomes a commodity.

Next Session on Valuations

The Core message of this session was that there are numerous methods of valuation, but the “Perfect Right figure” is in the Eyes and Hearts of the Two parties.

Mr Lalit Chaudhary, Senior Vice President, & Head of Private Equity and Growth Capital at LEHMAN BROTHERS, India, shared the fancy and hugely varying price-tags people put, to the same company. For Example : in a case, the price bids could be so varying as follows :-

<u>Who thinks What ?</u>	<u>Rs/Share</u>
Promoters thinks	200
Initial Quote of Promoter to intermediary	500
Intermediary to market	400
Intermediary to promoter	300
PE to Promoter / intermediary(initial Quote)	100
PE to self	200

So, from as low as Rs. 100 per share to as high at Rs. 500 per share.

Different methods were discussed, like

- & Discounted cash flow
- & Discounted dividend flow
- & Net asset valuation
- & Relative valuation

Each has its own merits and demerits, so, actually a combination of all the above is made. If more than 26%, I get control, and in that case, a control premium is also paid up.

His Message to the Directors and CFO’s present in the meeting was

If you already have a PE on board, then, getting funds for the next round of Capex becomes very very comfortable. Especially, if your corporate governance parameters are good, ERP is running fine, and your cash flows are positive.

“Parta” System of Accounting

Today the PE’s calculate sustainability and valuations, much like the ancestral “Parta system” in Marwari Community in India. => if you got Cash in your “galla”, (positive cash flows), then you are good, else you are not.

Period.

Next Session on “How to close the Deal”

Mr Harjit Singh Sethi, Head-Institutional Sales, at Almonds Global Securities Ltd, and Mr Carlton Pereira had this to share :-

Keylines

There are very few "100% correct, or, 100% wrong answers"

There are so many shades of Grey, that this needs a proper planning, and gut feeling.

Just like a naïve may “keep waiting infinito to choosing your perfect wife/husband”, we must not be naïve in waiting for a perfect correct price.

If the price is good enough, go for it.

Let both parties win.



Bombay Stock Exchange Limited
BSE
The edge is efficiency

The implications of P-E- ratio

The speakers felt that even PE along is not any perfect barometer. For Example,

- & Last year
 - 30 times PE in engineering was average
 - 20 times was cheap
- & This year
 - 10 times PE in engineering is average
 - 12 times is also expensive (?????)



What are the pinpricks, in closing a deal ?

A big thing that happens is that , during due diligence, the skeletons may be discovered in the cupboards. Example,

- & Asset diversions, showing private assets in garb of guest houses,
- & Income Diversions to family members,
- & Illegal adjustments in the books



Mr Carlton remarked that if they find a company which is “showing” a Net profit (PBT) of just 1% over last 10 years, suddenly wants to claim that it earns 10% to 15% PBT, and actually hides the balance. This starts creating a major suspicion of “mis-trust”



The PE knows that , Greed factor becomes higher with more money coming in,
And if this Entrepreneur's Greed, if it is a part of his DNA, if the PE finds this, he usually, walks out.

Next Session on “International Fund Raising Options”

By Mr Sundeep Makar, Director, Citibank and Mr Pawan Bansal, Doyen of PE Industry

They discussed in detail about the International options. The talk was applauded. The options , the USD-INR rates, the LIBOR, the case studies discussed were well taken.

& DEBT

- External Commercial Borrowing (ECB)
- Foreign Currency Convertible Bonds (FCCB)
- Compulsory Convertible Debentures (CCD)

& EQUITY

- Global Depository Receipts (GDR's)/ American Depository Receipts (ADRs)
- AIM Listing
- REITs
- Special Purpose Acquisition Company (SPAC)

This session was one of the “**Hot & Interesting**” one for the audience.

Next Session on “Corporate Story Telling”

In this we had,
Chairman, Mr Bharat Banka, CEO, Aditya Birla(credited with deals of L & T, Ambuja, Idea Cellular) & Mr Naveen Jain, CEO, Deut India Hotels P Ltd, who was earlier at DLF hotels, and Leela group. We also had the “Young dynamic and talented”, Mr Jyoti Prakash Gadia, M.D. of Resurgent India Limited.

Mr Gadia, shared with us, some more “Deal-bongers” – the factors which throw away all the preparation and labour to the scrap.

Example : Fear of the Promoter

Promoter starts feeling "will PE start becoming the owner"
and I will become the employee of the PE house
Sometimes, they get scared , → and back out
So, the CA and intermediary, must properly guide them in advance.

Example : Non-education of the Technical / Back office Partners of the Lead Promoter

If one Promoter is the face of the company for this PE,
If PE fund forgets to talk to , and take the other partners in confidence, the other partners may feel giddy, or suspicious, and ditch the whole deal.
So, the CA and intermediary, must properly guide them in advance.

Next Session on “Interface between the PE and Stakeholders”

This session had Mr KK Rathi, Mr Abhishek and Mr Vijay Mantri,
In Lighter vein, Mr Abhishek shared the biggest concern of the main promoters-
*“Just like a "Saas" gets threatened from the entry of the "Bahu"
Promoters, think the same for the PE fund"*
And the proper education is the only solution.

Example : You were climbing one hill, Now you have reached the top. For further growth, yo have to now target climbing the next bigger hill. But for that, you have to first come down from the first. And this is the reality in the real life too. The promoter has to change his way of working from the “Traditional” family concern to the “Professional” corporate.

Valedictory Session & Presidential Address by CA. Ved Jain, President ICAI

Our Honoured President was here at Mumbai, chairing the Valedictory Session.
He Shared his personal experiences, His vision for CA-profession.
He also gave a brief of his plans to make CA the spearhead of the Financial Revolution .
He shared his plans through which the CA’s can attack and capture the major markets of the World, on the strength of their knowledge, fine-tuned communication skills, and the spirit of a Sportsman.



The August Conference Podium being decorated with the dignitaries, From left, Mr Kedia – PE player and consultant, Mr Tekchandani – Promoter of a PE Fund, Mr Ved Jain – President , ICAI, Mr C S Nanda -- Central Council Member, and Chairman of the CMII and Mr B M Aggarwal – Chairman , WIRC

The CMII of the ICAI wishes you all a Happy Independence Day, 15th August, 2008



May the New Year of Indian Independence, bring with it peace, prosperity and welfare for one and all. And may it give more and more strength to the Chartered Accountants to make their mark on this Planet Earth, more and more visible.

The Programme Organisers
Thank you for your kind participation

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