Houlihan Lokey

Portfolio Valuation and Fund Advisory Services

India PE and VC Exit Landscape: A Tale of Two Halves

Market Update—2024

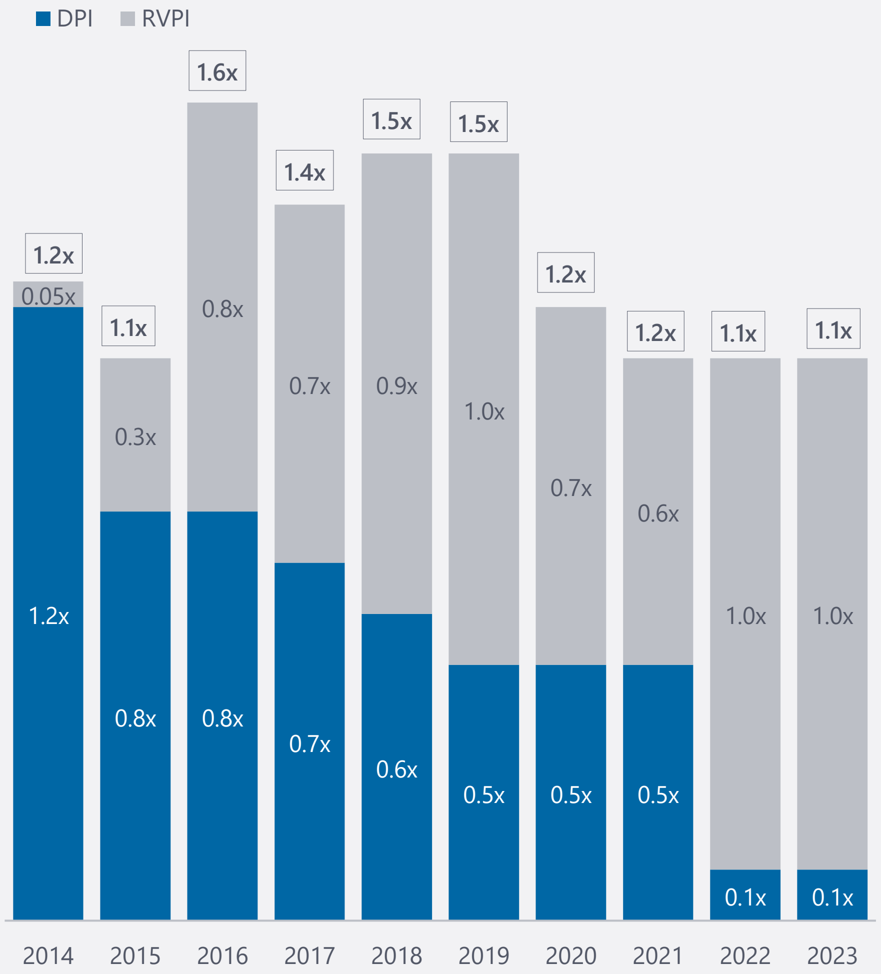
India PE and VC Exit Landscape:
A Tale of Two Halves

Indian Alternative Investment Funds (AIFs) surpassed $146 billion in lifetime commitments in September 2024, with Category II AIFs making up roughly 80% of the total. A buoyant economy, soaring valuations, an increase in participation from domestic investors, and an aversion of global investors to invest in China since the pandemic have contributed to the growth of AIFs, but how have the Indian AIFs fared in terms of returning capital to investors?

IPO markets in India have bucked the global trend and have been on a tear over the past year providing juicy exits to investors. However, these distributions represent a small fraction of the total capital invested, and most of the investors in AIFs continue to have an acute problem of converting their paper returns into cash. The distributions to paid-in capital (DPI)[(1)] metric captures the essence of the problem plaguing investors. The average DPI for Category II AIFs launched in 2015 and 2020 stands at a paltry 0.8x and 0.5x, respectively, whereas the average total value to paid-in (TVPI)[(2)] metric for these vintages is 1.1x and 1.2x, respectively. PE and buyout funds have fared much better on the DPI metric relative to VC and growth funds benefitting from strong public market activity. However, the overall DPI generated by Indian funds is lower than North American and European funds and has been trailing across vintages.

A basic tenet for LPs to reinvest in managers or an ecosystem is that they need cash distributions to recycle them into new funds. With the enhanced focus on distributions in the current environment, DPI is the "new IRR" for LPs. Traditional exit paths—IPOs, strategic sales, and sponsor-to-sponsor transactions—have not generated the desired liquidity for the LPs. With the limits of these traditional exit avenues, GPs are struggling to fully exit their maturing assets, and LPs are left with capital stuck in aging funds.

Category II Indian AIFs' Return Across Vintages[(3)(4)]

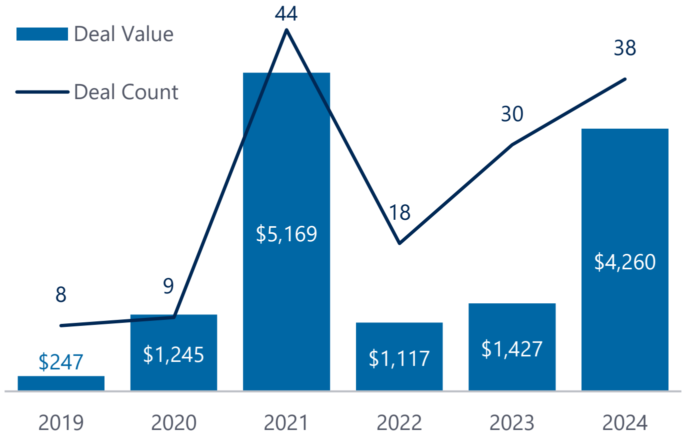


(1) DPI represents the ratio of (i) capital returned by investment manager to (ii) total investments made by the LPs.
(2) TVPI represents the ratio of (i) sum of total value of realised distributions and fund's residual value to (ii) total investments made by the LPs.
(3) RVPI represents the ratio of (i) fund's residual value to (ii) total investments made by the LPs.
(4) Category II AIFs include equity funds (listed and unlisted), real estate funds (including residential debt-oriented), debt funds, and distressed asset funds.
Source for Category II Indian AIFs' Return Across Vintages: CRISIL Alternative Investment Funds Benchmarks (India—2024). Returns are calculated on a post-expense, pre-carry, pre-tax basis and in U.S. dollars for the period April 1 to March 31.

Exit Landscape for Sponsor-Backed Indian Companies(1)

Initial Public Offerings (IPOs)

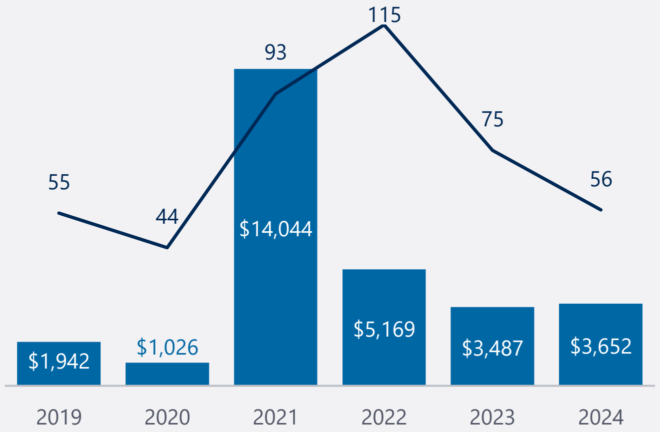
($ in Millions)



In CY 2024, the value of IPO exits for financial sponsors nearly tripled over the previous year. Supported by stronger macroeconomic tailwinds and high investor appetite for new-age tech businesses, PE funds were able to bring their marquee assets to the IPO market as evidenced by the successful listing of Swiggy, Ola Electric, FirstCry, GoDigit Insurance, Emcure Pharmaceuticals, and ixigo, among others. In 2025, more sponsor-backed companies, including Meesho, Zepto, Ofbusiness, Fractal Analytics, Smartworks, boAt, and PayU, are expected to tap the primary markets. While the current IPO environment provides a more desirable exit option for scaled profitable new-age businesses, IPOs alone may not be the magic bullet to solve the DPI challenges faced by sponsors.

Strategic Exits

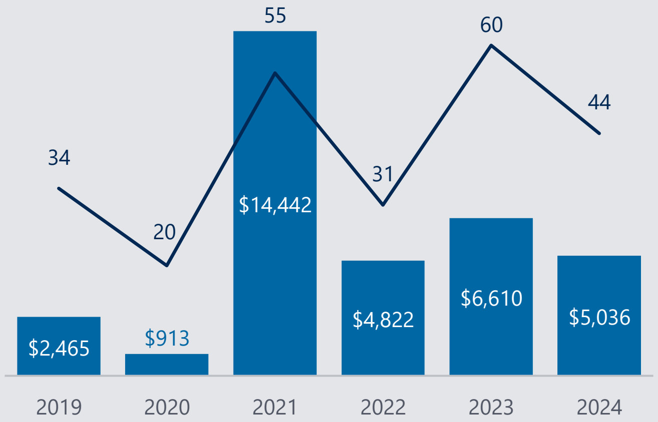
($ in millions)



Strategic exits for sponsor-backed portfolio companies in CY 2024 have been a mixed bag, with a decline in the number of deals but a significant increase in the average deal size. Cross-border M&A activity has been tepid due to higher interest rates, geopolitical issues, and valuation matches stemming from elevated public market multiples. With the re-election of the incumbent government and continuity in policy, Indian corporates have been active in the domestic M&A market. Notable strategic exits by sponsor-backed companies include Mankind Pharma's $1.6 billion acquisition of Bharat Serums & Vaccines providing an exit to Advent; Tata Consumer's $600 million acquisition of Capital Foods, which provided an exit to General Atlantic; and Gentari's (clean energy arm of Petronas Group) $900 billion acquisition of Brookfield's renewables portfolio in India.

Secondary Deals

($ in millions)



Secondary markets for private assets in India are evolving, with GPs looking beyond traditional sponsor-to-sponsor exit routes and embracing innovative exit strategies such as GP-led secondaries. ChrysCapital's $700 million single-asset continuation fund transaction for its stake in NSE is a case in point. Lightbox also announced a $100 million continuation fund for its mature portfolio companies. Global PE funds looking to increase their allocation to India are acquiring minority stakes in growth-stage and late-stage companies from existing investors. Temasek and Fidelity's $200 million stake purchase in Lenskart from existing investors is an example of this trend. Meanwhile, sponsor-to-sponsor exit activity continues to be robust; notable transactions for this year include Blackstone's $950 million stake sale in VFS Global to Temasek, ChrysCapital's $860 million stake sale in GeBBS to EQT, Apax Partner's sale of Healthium to KKR for $830 million, Advent's sale of Manjushree Technopak to PAG for $1 billion, and Chiratae's $70 million portfolio sale to Madison India.

(1) Sources for exits: EY IVCA – India Trend Book 2021-24, EY IVCA – H1 2024 half-yearly, Q3 2024, October 2024 and November 2024 roundups, and public sources. Exits data is based on calendar year.

Paths to Navigating Private Secondary Exits

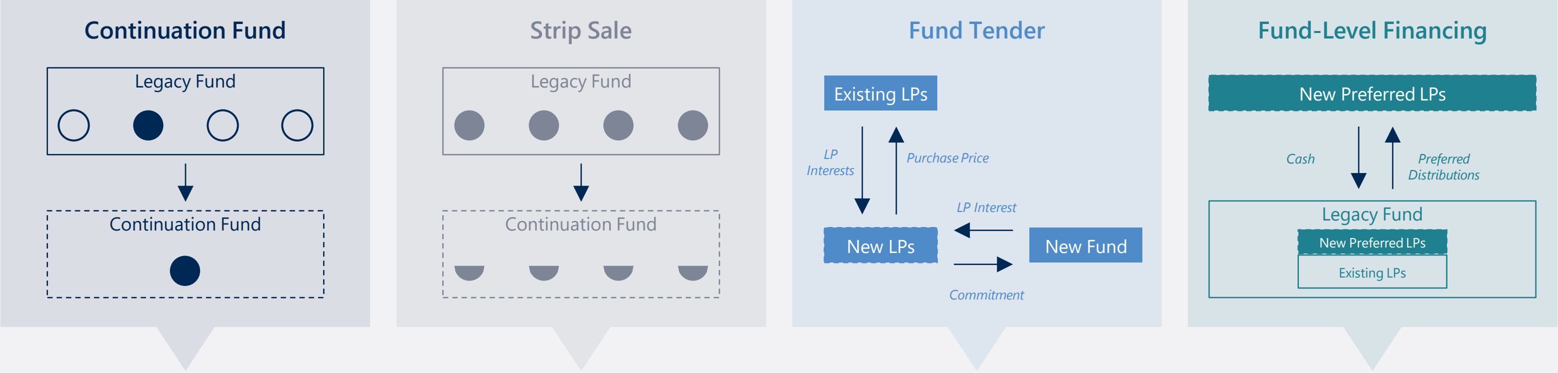
Evolution of the Secondary Market

Secondary funds gained popularity around the Global Financial Crisis to provide liquidity for LPs needing to rotate out of and rebalance their exposure to certain GPs. These early transactions were often stigmatised, as selling an interest was perceived as a signal of distress. However, as the private equity industry expanded, the demand for innovative liquidity solutions accelerated the evolution of secondary markets.

Over the past decade, GPs have been increasingly turning to the secondary markets to find creative solutions for tail-end assets and hold on to their winners, in each case generating DPI for their LPs. GPs are also taking advantage of the secondary market to catalyse fundraising through LP tender + staple processes in a challenging fundraising environment.

Secondary Transaction Alternatives for GPs

There are several innovative solutions available through the secondary market that can be used to help GPs achieve critical strategic objectives. These secondary solutions can be applied to a single asset, multiple assets, or even across multiple funds depending on the situation and the GP's goal.



Continuation Fund	Strip Sale	Fund Tender	Fund-Level Financing
Extend Hold Period/Retain One or More Trophy Asset(s) Raise New Unfunded Capital for Growth Lock in a Strong Return for Fund Reset GP Economics	Accelerate Distributions to LPs	Provide Full Liquidity Option to Legacy Fund LPs Catalyse Fundraising Activity	Generate Liquidity for Existing LPs and/or Dry Powder for Additional Investments

Paths to Navigating Private Secondary Exits

Deep Dive Into Continuation Funds

Globally, continuation funds have witnessed increasing adoption by GPs and have played a significant role in driving the volume of secondary transactions. Continuation funds provide liquidity to existing LPs while allowing the GP to continue managing select assets over a longer duration.

Following the close of ChrysCapital's $700 million continuation fund for NSE, which was one of the largest single-asset CV transactions in Asia, we observe that other Indian GPs are evaluating similar solutions for their trophy assets.

Benefits and Rationale

- Extend hold period to keep a trophy asset with attractive upside potential over the next three or more years.
- Create an exit for the legacy fund for a successful investment and increase the legacy fund's DPI.
- Raise new unfunded capital that can be used for accretive acquisitions or to invest in growth initiatives.
- Crystallise and compound GP economics pertaining to a trophy asset.
- Increase ownership of a trophy asset by buying out co-investors/minority shareholders.
- Continue partnership with a strong management team.

Paths to Navigating Private Secondary Exits

Deep Dive Into Continuation Funds (cont.)

Typical Transaction Structure

1. Legacy Fund:

Legacy fund’s interest in the asset(s) is contributed to the continuation fund.

2. Legacy LPs:

Existing LPs are given two options:

- Sell indirect interest in asset(s) for cash at a price determined through the secondary process.
- Roll their investment into the continuation fund, retaining exposure to the asset(s) for a new investment period.

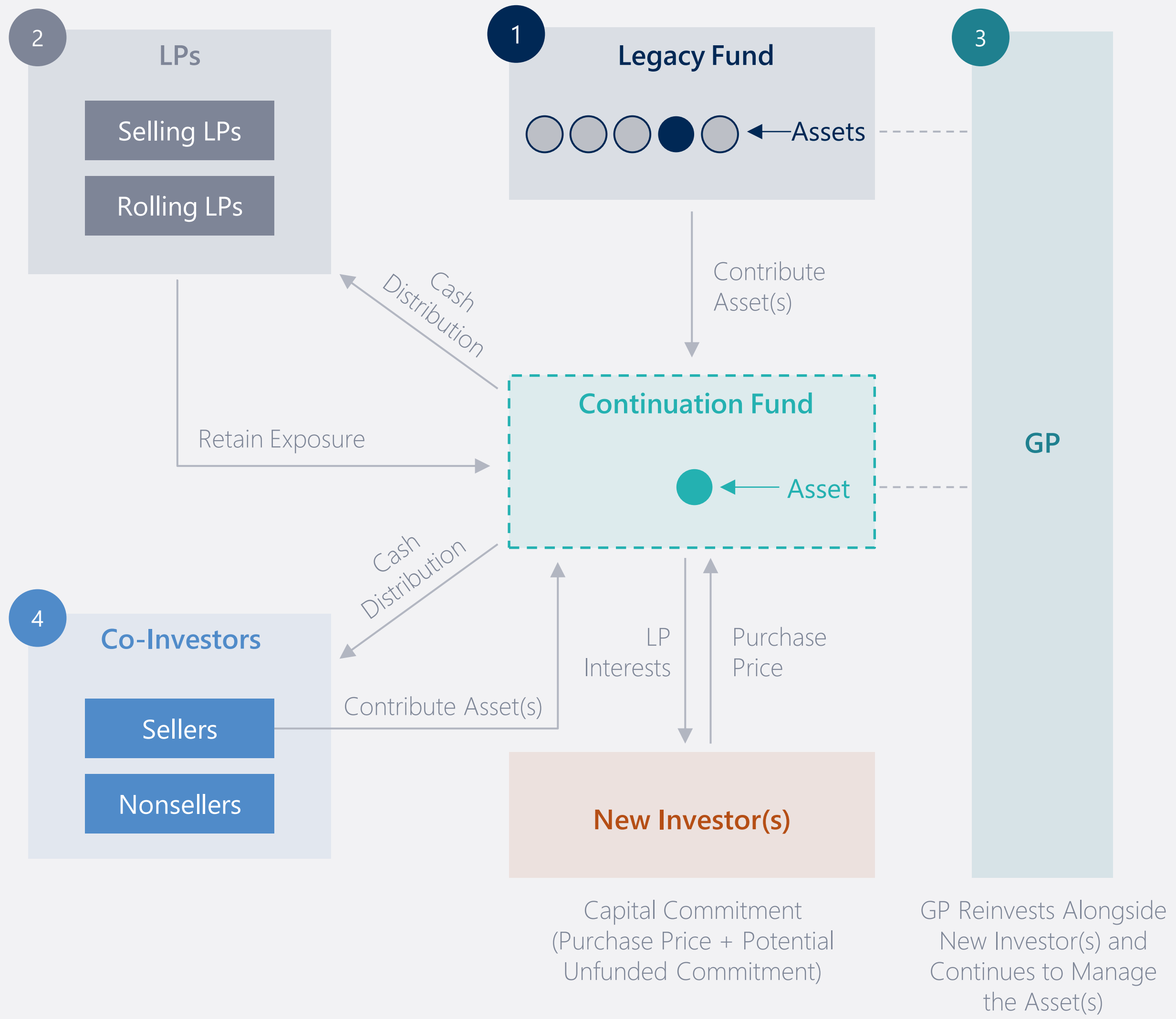
Purchase price that the new investors will contribute to the continuation fund will be used to cash out the “nonrolling” LPs.

3. GP:

GP continues to manage the investment, and economics (e.g. carried interest) will be reset at the purchase price set through the secondary process. GP receives management fees on net invested capital in the continuation fund.

4. Co-Investors:

Co-investors can be given the option to sell their interests to the continuation fund, thereby increasing fee paying AUM for the GP; typically, co-investors cannot be forced to sell.



Paths to Navigating Private Secondary Exits

Secondary Market Key Considerations

GP Evaluation

- Secondary transactions require navigating complex governance, alignment, and fee arrangements, which are often challenging due to potential conflicts of interest among involved parties.
- For continuation funds, GP diligence is as important as asset diligence, underscoring the significance of thoroughly evaluating the GP's past performance and ongoing capabilities.

Asset Underwriting

- Secondary investors typically underwrite an opportunity on a bottom-up basis solving for 2.1x–2.5x net MOIC, implying a net IRR above 20% over a four- to five-year hold period. This often necessitates a discount to the NAV to provide the expected return to the secondary investors over a shorter hold period.

Valuation and Pricing

- Secondary investors typically reference the most recent GP mark when pricing a transaction, applying a discount, or applying an uplift to the reference date NAV based on their underwriting.
- Private market valuations tend to be opaque. Not only is there a lag in private market valuations, as they are computed periodically, but there are also different market practices on what is a "fair NAV." Some GPs tend to rely on the last round of funding and do not consider the latest performance and market risk in computing the NAV, whereas other GPs have a robust mark-to-market process.
- NAV staleness limits the volatility and provides return stability for private investments but is problematic in a secondary process as it often leads to wide bid-ask spreads.
- Independent assessment of the NAV by a third-party valuation agent provides transparency and improves the efficiency and quality of execution of the transaction.
- Secondary transaction pricing is impacted by numerous factors, including (i) expected time frame for distribution and exits, (ii) available dry powder, (iii) developments in the asset's operational profile, and (iv) volatility and perceived riskiness of the fund strategy. VC discounts typically tend to be higher than discounts for buyout or infrastructure strategies.

Paths to Navigating Private Secondary Exits

Secondary Market Key Considerations (cont.)

GP Alignment

- In GP-led transactions, strong alignment between the GP and secondary investors is imperative for successful outcomes.
- GPs are often required to "roll over" their entire stake in the legacy fund (including any crystallised carried interest from selling LPs) into the continuation fund and may be required to make a further investment in terms of new money.
- LPs tend to favour continuation fund transactions where GPs offer a status quo option, allowing legacy LPs to retain their existing distribution waterfall, thereby ensuring continuity without requiring new commitments.

Fiduciary Considerations

- Continuation fund transactions present potential conflicts of interest, valuation complexities, and enhanced execution risk. Globally, these transactions have come under heightened scrutiny in recent years from both regulators and investors.
- To address LP concerns, the Institutional Limited Partners Association (ILPA) issued guidance requiring a fairness or valuation opinion by the GP to manage the actual or perceived conflicts of interest. The U.S. Securities and Exchange Commission also proposed similar regulations under the Private Funds Adviser rules, which were eventually overturned by the U.S. Courts. This is not expected to impact LPs' expectations for enhanced disclosures and transparency from GPs on conflict-prone transactions such as continuation funds.
- The fairness or valuation opinion requirement (i) provides an important check against a GP's conflicts of interest in structuring and leading a transaction from which it may stand to profit at the expense of private fund investors and (ii) helps ensure that investors receive the benefit of an independent price assessment, which will improve their decision-making abilities and overall confidence in the transaction.

Paths to Navigating Private Secondary Exits

Outlook for the Secondary Market in India

Globally, the secondary market is primed for a record-breaking year, with deal volumes expected to be around $146 billion in 2024,[1] driven by decreased distributions to LPs, aging VC/PE portfolios, and secondaries fundraising at all-time highs.

In India, many PE funds are currently evaluating continuation fund transactions for their trophy and scaled-up assets. Assets managed by top-tier sponsors with clear paths to IPO can achieve near-par pricing.

There is also a lot of interest from VC and growth funds approaching end-of-tenure for a portfolio solution for their tail-end assets. However, valuation mismatches have been the primary impediment to closing these transactions. Tail-end portfolios with assets that have not scaled up or do not have a clear path to exit are getting priced at a deep discount of 30%–40% of NAV.

Smaller VC portfolios are seeing interest from Asian secondary buyers. Appreciation of public equity markets along with the IPO boom is expected to drive pricing higher, which should help in narrowing the bid-ask spread for secondary transactions and, in turn, lead to higher volumes.

(1) Source: Secondaries Investor.

Paths to Navigating Private Secondary Exits

Recent Continuation Fund Transactions in India

Samara Capital

Date:	January 2023
Deal Size:	$150 Million
Investors:	TR Capital, Axiom Asia, Stepstone, and Unigestion
Transaction Type:	Multi-Asset CV

- In January 2023, Samara Capital transferred its stakes in three firms to a TR Capital-led investor consortium in a $150 million continuation fund transaction.
- This transaction provided liquidity to Samara Fund II's LPs.
- Investments transferred to the CV include:
  - Sahajanand Medical Technologies.
  - First Meridian Business Services.
  - Paradise Food Court.

ChrysCapital

Date:	April 2024
Deal Size:	$700 Million
Investors:	HarbourVest, LGT Capital, and Pantheon Ventures
Transaction Type:	Single-Asset CV

- In April 2024, ChrysCapital successfully closed a $700 million continuation fund to acquire the stake in the National Stock Exchange (NSE) previously held by one of its own funds.
- ChrysCapital initially acquired approximately 5.0% of NSE in 2016 and retained a 3.93% stake as of March 31, 2024.
- This is one of the largest single-asset continuation vehicle transactions across APAC.

Multiples

Date:	Transaction in Progress
Deal Size:	$300 Million (E)(1)
Investors:	NA
Transaction Type:	Multi-Asset CV

- Multiples is planning to raise approximately $300 million for a multi-asset continuation fund to retain a stake in at least two of its investments, including Vastu Housing and APAC Financial Services.
- This transaction is yet to be finalised and is subject to change, depending on investor interest.

(1) Source for Multiples' continuation fund transaction: Bloomberg, "CPPIB-Backed Multiples Seeks $300 Million for Continuation Fund," August 22, 2024.

Houlihan Lokey's Secondaries and Valuation Experience

Houlihan Lokey has a successful track record and robust experience in assisting its clients—including private equity, venture capital, hedge fund, sovereign wealth fund, and family office—with placement and valuation of GP-led secondary transactions.

Our Private Funds Group is a long-term partner to GPs, offering an integrated solution through a 60+ person global team to address their most important strategic practices.

We seamlessly engage the most relevant parts of the firm to deliver superior results to our clients, given the cross-disciplinary experience required to successfully execute complex GP-led secondaries transactions. Our team has $17+ billion of GP-led secondary transaction experience across transaction structures.

We have deep valuation expertise in investment, NAV reporting, and fund-related transaction matters.

We advise boards of directors and valuation committees as they navigate audit review, regulatory challenges, and new fund formations, including valuation policy and procedures.

We value large portfolios of highly structured, venture-backed "unicorn" investments for various investors across the globe.

Our industry-leading Fund Opinions practice provides valuation and fairness opinions to many financial sponsors annually in connection with cross-fund, spin-out, and other conflict-of-interest transactions.

Our Capital Markets team has substantive private placement experience in structuring and raising capital with leading industry participants in growth and structured equity.

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