Background

India has been one of the largest recipients of Private Equity/Venture Capital (PE/VC) funds in the last few years. In CY2019, PE/VC Investments totalled US$48 billion, equating to 1.7% of the Gross Domestic Product. Private capital investments in India have grown at a compound annual growth rate (CAGR) of almost 44% for the past three years.

The driving factor behind the increasing trend of these investments is the attractive return expectations for these investments. However, there has not been enough analysis to understand the historical returns that funds have made in India, and the underlying drivers for these returns.

Underlying growth in investee companies accounts for more than three-fourth of the total returns that PE/VC Funds make in India in case of IPOs.

1 Growth
This represents the underlying growth in the performance of the investee companies, from the time of the entry of the PE/VC fund to the time of their post IPO exit. The growth is measured in financial measures appropriate for the industry of the investee company e.g. Revenue, EBITDA, or, in case of financial companies, net worth.

2 Alpha
This represents the returns attributable to the difference in valuation multiple at the time of exit as compared to entry. This return is driven by the arbitrage in valuation multiples prevailing in the private market vs. public market. The appropriate category of multiple for each company was considered based on the usual multiples used in the industry or based on the specific situation of the Company. The default multiple used was EV/EBITDA multiple; however, in cases where the company was loss making (or only marginally profitable) at entry/exit, revenue multiples were also used. The Enterprise Value multiples were appropriately adjusted for net debt to factor equity values. For financial companies, the price to book value multiples were used.

*EY Study assumes the returns hypothetically earned by PE/VC funds if they exit their entire stake held in investee companies post the completion of one year mandatory lock-in.
Methodology

- All the IPOs that took place between 1 January 2015 to 31 March 2020 were analysed to check for the ones that had shareholding of PE/VC funds. 60 such IPOs were identified. However, in case of 20 companies, the transaction data at the time of entry of the PE/VC Fund was not available. Hence, these cases were discarded, and only 40 cases were analysed, of the companies which had shareholdings of PE/VC Funds, and which completed a successful IPO. (Annexure 1: List of IPOs considered for analysis).

- To consider a meaningful investment and holding period for the calculation of IRR, only those cases were analysed where the PE/VC Fund invested at least INR10 million and 1% of stake in the company, and the investment was made at least 18 months prior to the IPO.

- The 40 IPO Companies had investments by 96 PE/VC Funds. The financials of the companies and the transaction multiples (EV/Revenue, EV/EBITDA, P/BV (Price to Book value) multiple) were calculated both at the time of the entry of the Fund, and as implied by the post IPO exit valuation.

- 31 March 2020 was considered as exit date for the Companies which had their IPOs after 31 March 2019.

- While transactions/listing valuations are, many a times, based on forward multiples, it is not practicable to find forward financials especially at the time of investment by the PE/VC fund. In a growing company, the use of trailing financial data will lead to over-statement of transaction multiples. However, considering that this is uniformly applied to both entry and exit of PE Fund, the impact would hopefully cancel out.

- The data for the above analysis was sourced from public sources (Draft Red Herring Prospectus / Red Herring Prospectus, financials from Ministry of Company Affairs website) or from databases subscribed to by EY (Capital IQ, VCC Edge, Privatecircle etc.)

- This study measures the returns earned by PE/VC funds only for cases where the exit was through IPOs. As against 96 investments by PE/VC Funds analysed in this study, the total number of investments made by PE/VC Funds in the period 1 January 2015 to 31 December 2019 were 3,755. Thus, this study is restricted to only a very small part of the PE/VC Funds’ investments. It does not make any inferences about the overall return earned by PE/VC Funds Industry in India.

**EY Study assumes the returns earned (hypothetically) by PE/VC Funds if they exit their entire stake held in investee companies through IPOs.**
Return computation

- The IRR earned by the PE/VC Investors was computed on the basis of implied valuation of PE/VC’s stake on the basis of closing share price as on date of post IPO exit (exit value), the investment made by the PE/VC at the time of entry (entry value) and the time period the stake was held.
- This return was broken into growth and alpha, as mentioned earlier.
- Growth was computed as the return in the financial performance of the investee company from the time of entry to time of exit. The financial indicator considered was Net worth for companies in the financial sector and EBITDA in case of companies in sectors other than the financial sector. In a few cases, where EBITDA/net worth of the investee company was negative (or negligible) at the time of investment by PE/VC Fund, revenue growth was the metric considered.
- Alpha was computed as difference between the PE/VC IPO return and Growth. This represents the ability of the PE/VC Fund to invest at a valuation multiple lower than the multiple at which they are able to exit from the investee company.

The break-up of Returns earned into Growth and Alpha is graphically represented below

![Diagram showing the break-up of Returns into Growth and Alpha]

Value increase due to multiple expansion

Value increase due to profitability growth

Financial Metric (Revenue, EBITDA, Net Worth)
Conclusion

- For the 40 IPOs for which returns were calculated, the weighted average\(^1\) IRR earned by 96 PE/VC investments' was 38.0% per annum (p.a.)
- Total IRR\(^*\) on account of growth in underlying financials metrics of the companies was 31.3% per annum (i.e. about 86% of total IRR\(^**\))
- The expansion in multiples between entry and exit accounted for only 5.1% IRR. (i.e. 14% of the total IRR\(^***\))
- Thus, most of the returns earned by PE/VC Funds can be attributed to their ability to spot and invest in fast growing companies.
- Globally, transactions in private markets are usually at a discount to public markets. Various studies measure this difference between valuations in public and private markets\(^2\). However, this analysis indicates that this is a not a major cause for the returns that PE/VC Investors have made in IPOs.

Returns earned by PE/VC Funds - IPOs

Returns made by PE/VC Funds in India through IPOs in the period between 1 January 2015 to 31 March 2020

\[
\text{Total IRR\%} = [(1 + \text{growth\%}) \times (1 + \text{alpha\%}) - 1]
\]

*total IRR is taken as multiplication of return from growth and return from alpha.

** EY Study assumes the returns earned (hypothetically) by PE/VC Funds if they exit their entire stake held in investee companies through IPOs.

---

\(^1\) The amount of initial investment made by the the PE/VC Fund were the weights used for averaging.

\(^2\) For instance, Williamette Management Associates indicated discounts in private markets ranging from 18% to 56% (http://www.willamette.com/insights_journal/16/winter_2016_5.pdf)
### Annexure 1 -
List of IPOs considered for the Analysis

<table>
<thead>
<tr>
<th>S.no</th>
<th>Year of IPO</th>
<th>Company name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>CY2015</td>
<td>Dr. Lal PathLabs Limited</td>
</tr>
<tr>
<td>2</td>
<td>CY2015</td>
<td>Narayana Hrudayalaya Limited</td>
</tr>
<tr>
<td>3</td>
<td>CY2015</td>
<td>Ortel Communications Limited</td>
</tr>
<tr>
<td>4</td>
<td>CY2015</td>
<td>PNC Infratech Limited</td>
</tr>
<tr>
<td>5</td>
<td>CY2015</td>
<td>Power Mech Projects Limited</td>
</tr>
<tr>
<td>6</td>
<td>CY2015</td>
<td>Shree Pushkar Chemicals &amp; Fertilisers Limited</td>
</tr>
<tr>
<td>7</td>
<td>CY2015</td>
<td>UFO Moviez India Limited</td>
</tr>
<tr>
<td>8</td>
<td>CY2015</td>
<td>VRL Logistics Limited</td>
</tr>
<tr>
<td>9</td>
<td>CY2016</td>
<td>Advanced Enzyme Technologies Limited</td>
</tr>
<tr>
<td>10</td>
<td>CY2016</td>
<td>Endurance Technologies Limited</td>
</tr>
<tr>
<td>11</td>
<td>CY2016</td>
<td>Equitas Holdings Limited</td>
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<tr>
<td>12</td>
<td>CY2016</td>
<td>HealthCare Global Enterprises Limited</td>
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<tr>
<td>13</td>
<td>CY2016</td>
<td>Parag Milk Foods Limited</td>
</tr>
<tr>
<td>14</td>
<td>CY2016</td>
<td>Quick Heal Technologies Limited</td>
</tr>
<tr>
<td>15</td>
<td>CY2016</td>
<td>RBL Bank Limited</td>
</tr>
<tr>
<td>16</td>
<td>CY2016</td>
<td>S.P. Apparels Limited</td>
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<tr>
<td>17</td>
<td>CY2016</td>
<td>TeamLease Services Limited</td>
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<tr>
<td>18</td>
<td>CY2017</td>
<td>AU Small Finance Bank Limited</td>
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<tr>
<td>19</td>
<td>CY2017</td>
<td>BSE Ltd</td>
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<td>20</td>
<td>CY2017</td>
<td>CL Educate Limited</td>
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<td>21</td>
<td>CY2017</td>
<td>Eris Lifesciences Limited</td>
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<td>22</td>
<td>CY2017</td>
<td>Godrej Agrovet Limited</td>
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<tr>
<td>23</td>
<td>CY2017</td>
<td>ICICI Lombard General Insurance Company Limited</td>
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<td>24</td>
<td>CY2017</td>
<td>Khadim India Limited</td>
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<td>25</td>
<td>CY2017</td>
<td>Mahindra Logistics Limited</td>
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<td>26</td>
<td>CY2017</td>
<td>S Chand and Company Limited</td>
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<tr>
<td>27</td>
<td>CY2017</td>
<td>Shankara Building Products Limited</td>
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<td>28</td>
<td>CY2018</td>
<td>Aavas Financiers Limited</td>
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<td>29</td>
<td>CY2018</td>
<td>Bandhan Bank Limited</td>
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<td>30</td>
<td>CY2018</td>
<td>CreditAccess Grameen Limited</td>
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<td>31</td>
<td>CY2018</td>
<td>EZE Networks Limited</td>
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<td>32</td>
<td>CY2018</td>
<td>Newgen Software Technologies Limited</td>
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<tr>
<td>33</td>
<td>CY2018</td>
<td>Sandhar Technologies Limited</td>
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<tr>
<td>34</td>
<td>CY2018</td>
<td>SoftTech Engineers Limited</td>
</tr>
<tr>
<td>35</td>
<td>CY2018</td>
<td>TCNS Clothing Co. Limited</td>
</tr>
<tr>
<td>36</td>
<td>CY2018</td>
<td>Varroc Engineering Limited</td>
</tr>
<tr>
<td>37</td>
<td>CY2019</td>
<td>CSB Bank Ltd.</td>
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<tr>
<td>38</td>
<td>CY2019</td>
<td>IndiaMART InterMESH Limited</td>
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<tr>
<td>39</td>
<td>CY2019</td>
<td>Metropolis Healthcare Limited</td>
</tr>
<tr>
<td>40</td>
<td>CY2019</td>
<td>Polycab India Limited</td>
</tr>
</tbody>
</table>

Source: VCCEdge

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R8