Business Standard

Delhi - Oct 19, 2017

Page No:	4	Type:	Newspaper
Page Name:	Private Equity	Language:	English
Size:	405 sq. cm	Circulation:	18,817
AVE:	INR 300,871	Frequency:	Daily

News monitored for: Baring Private Equity Partners

'Key is to deliver returns over a 20-year period'

Private equity (PE) firm Barings India recently made three exits —Muthoot Finance, Marico India and Godrej Consumer — earning 2.4X, 3.4X and 2.7X, respectively. **RAHUL BHASIN**, managing partner, Barings India, tells **Ranju Sarkar** how the firm has delivered market-beating returns in an industry notorious for short lifespans where most firms disappear after one good cycle. Edited excerpts:

RAHUL BHASIN
Managing partner, Barings India

There are three stellar exits in a row from Barings India...
Let's understand these deals. Muthoot was a classical private equity (PE) deal, Marico was a pipe deal done to fund brand purchases along with an investor and Godrej Consumer was a public market purchase when they did a preferential offer. All of them were different types of transactions, but delivered returns significantly above the market. Even Inditrade, a prior exit of a buyout transaction, made sector beating returns and a modest profit in the devastated retail stockbroking industry.

We have generated 18 per cent return, higher than public markets return, on average, over the past 20 years.

The key is understanding the nature of the opportunity and in determining what drives risk and return in Indian PE space. We had the courage to be different in the face of severe institutional pressure for classical packaging and conformity. In developed markets, predominant strategy has been buying stable businesses, squeezing costs and adding leverage in an environment of strong 37-year decline in interest rates.

Western PEs needed to do a buyout to be able to access debt. The declining interest rates enhanced debt capacity and lowered discounting rates.

This alone would have accounted for between 28 per cent and 45 per cent incremental internal rate of return (IRR) over this period corresponding to the use of standard four to eight times leverage.

What's different in India?
Here, buyouts are not core of driving returns, as use of financial leverage is modest if used at all. It is only essential where corporate governance risks are predominant. The mode of engagement is less relevant and the key is to ensure apposite risk-return constructs and in lowering risk when the market does not pay for incremental risk. It is essential to forecast, source, identify, partner, catalyse, guide, fast growing compounding business gaining market share. Facilitating, talent acquisition, retention, motivation, meritocracy culture building, improving internal and external communications, improving morale, incorporating ERP systems and technology into the core operations are essential too. Sweating assets, reducing working capital cash cycles, driving more efficient treasury functions and fine-tuning processes' efficiencies, people training, driving experience curves are all essential elements in the tool kit. Assisting in branding, distribution extension, product line extension, sales force scaling up, inorganic acquisitions are all important. Working with operating teams maturely so that they own any new initiative is paramount. Most important is recognising and respecting the primacy of the operating team responsible for delivering and knowing when to get out of their way and leave them alone.

Doesn't your approach result in mark-to-market problems?
We are willing to live through the extended J curves inherent in creation of compounding engines and then riding it long enough to benefit from compounding growth. The opposite optimal behaviour is found in the leveraged buyout industry. Global investors who focus on metrics like high DPI early in fund lives inadvertently promote momentum investing and trading in an illiquid asset class.

A mindset of creating the talent pool and incentivising multiple drivers of alpha creation within the firm is critical as in a fast evolving landscape only some will be relevant at any point in time. This is not a mechanical business and getting nuances right consistently and ensuring no process error is also key to consistent alpha generation.

What are the biggest mistakes you have made?
Underestimating regulatory changes. Two profitable, fast-growing investments in the power sector become bankrupt. These investments account for over ninety per cent of our losses to date.

What are the prospects of favourable exits, going forward? Can you share names of some large ones?
We are expecting to report high multi-bagger returns from Vardhman Textiles, Manappuram finance, Shilpa Medicare and RMZ whenever we decide to exit them. Whenever we have invested against market consensus, promoters usually go out of their way to deliver us multi-bagger returns.

India has underperformed as a PE market in the last decade. What are the prospects going forward?
Currency depreciation depressed returns in the last decade. It is unlikely to be repeated given our current account position. India has not monetised its economy post-global financial crisis like the entire developed world did. Since their outperformance has come from highly-levered valuation increase rather than value increase, they run the risk of reversion to mean. India has had value increase. Growth in India is temporarily depressed due to disruption caused by the reform in the bankruptcy code, goods and services tax, banking sector, governance, direct benefit transfers, etc... India is likely to generate the best returns for investors in the coming decade globally.

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