# THE DEALS DYNAMICS

## A report on the anticipated impact of COVID-19 on the PE/VC industry in India

BDO in India

April 2020

# BDO INDIA OUTLOOK

The COVID-19 pandemic is giving rise to several unexpected circumstances in global trade, economies, healthcare systems, investments, markets, demand & supply chain, and employment. Business closures, revenue loss & supply chain disruptions are inevitable consequences.

Globally, including in India, Central Governments have responded via fiscal and monetary measures, liquidity stimulus, tax incentives, asset purchases etc. as part of relief packages (USD 22.5bn relief package from the Indian Finance Minister, RBI's sharp repo rate cuts/ CRR decline/ moratoriums etc.). Hopefully, savings from oil (having fallen almost 50% since the start of March) will provide a substantial buffer for India and aid in giving the required fiscal stimulus.

**From a sector perspective,** we believe Banks, Financial Institutions, Consumer Discretionary, Retail, Professional Services, Tourism, Aviation, Real Estate & Construction and the Auto sector, could see massive impact with likely de-growth in volumes, delays/ defaults in payments, moratoriums etc.

Defensive sectors like Consumer Staples, Telecom, Healthcare and Utilities will be better performing sectors over the medium term. Disruptive HealthTech, Innovative DTC (direct-to-consumer) Brands, Enterprise Services, Digital Media & Entertainment, Virtual Working Technologies are sectors that would see favour.

**From a PE/VC perspective, particularly,** there could be substantial impact with the investment cycle (especially new investments) being significantly affected, deals in the pipeline experiencing delays/ disruptions, valuations falling, diligence getting prolonged & fund raising for PE/VCs themselves getting extremely challenging. While managing existing investee companies & helping them during these turbulent times remains the focus, the PE/ VC industry will continue to search for new hidden gems which could emerge once the dust settles.

There is no doubt that we have and will continue to see more volatility in the investment world. We have seen record percentage declines several times in history (1920s, 1970s energy crisis, 2008 Lehman crisis etc.), however its worth noting that every catastrophic decline has been followed by similar gains. Though in this case, recovery (whether would be a "U" ,"V" or "L" curve) would depend on how quickly a treatment/vaccine is discovered for the virus, the timing/ magnitude of assistance from the governments, the demand comeback and corporate debt levels.

To unearth intrinsic and thought-provoking, ear-to-ground realities in the current situation, we surveyed the Indian PE/VC industry receiving 65+ responses in 7 days, from the community. What makes the PE/ VC challenge unique is the range of opportunities and risks presented by a complex portfolio of companies spanning a number of sectors and geographies. The key takeaways from the survey are highlighted in this report.

We hope that the Indian PE/VC industry will be at the forefront, coming up with and supporting interesting and innovative business ideas and models, helping the Indian economy in getting back to where it was, a fortnight ago.


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# KEY TAKEAWAYS FROM THE SURVEY

## MANAGING EXISTING INVESTMENTS INCLUDING FOLLOW-ON FUNDING WHERE REQUIRED IS TOPMOST PRIORITY

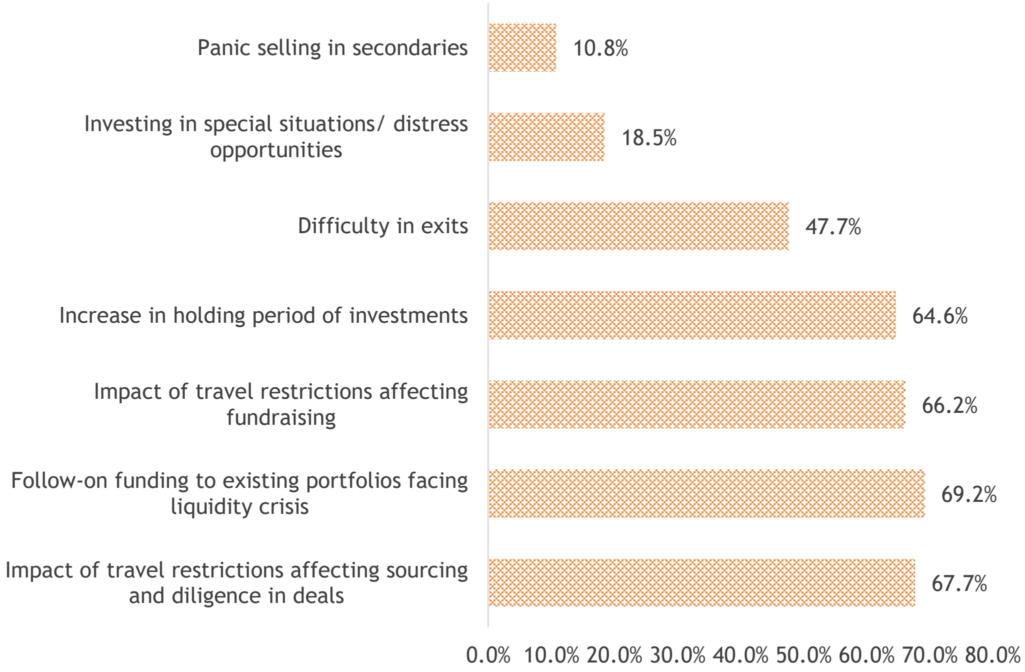
Over 65% of respondents believe that there would be significant impact on deal sourcing & diligence activities and fund raises due to travel restrictions.

Almost 70% felt that their immediate focus will be towards follow-on funding to existing portfolio companies facing liquidity crisis. A fallout of the same along with difficulty in exits would also imply an increase in the holding period of investments.

While panic selling in secondaries does not seem to be on the cards, there could also be a possibility of exits through M&As by share swaps (should watch out for this).

Thus focusing and managing existing investments seems to be the key.

## WHAT ARE THE IMMEDIATE IMPLICATIONS

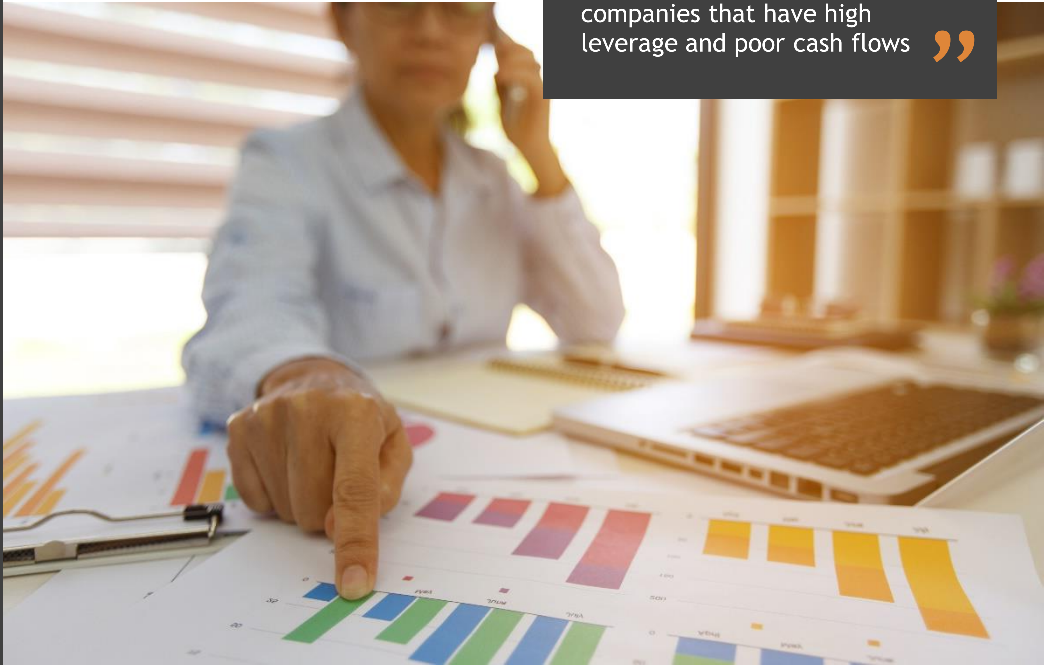


# KEY TAKEAWAYS FROM THE SURVEY

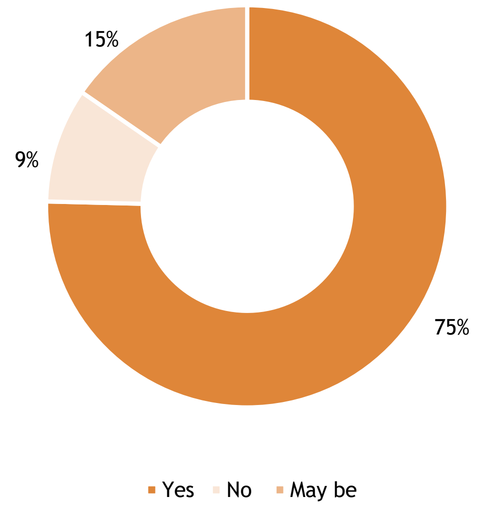
## SIGNIFICANT DELAYS IN DEAL CLOSURES

75% of respondents shared that COVID-19 is certainly causing delays in deal closures.

> "Term sheets may be renegotiated, especially with companies that have high leverage and poor cash flows"



## IS COVID 19 DISRUPTING/ DELAYING DEAL CLOSURES



# KEY TAKEAWAYS FROM THE SURVEY

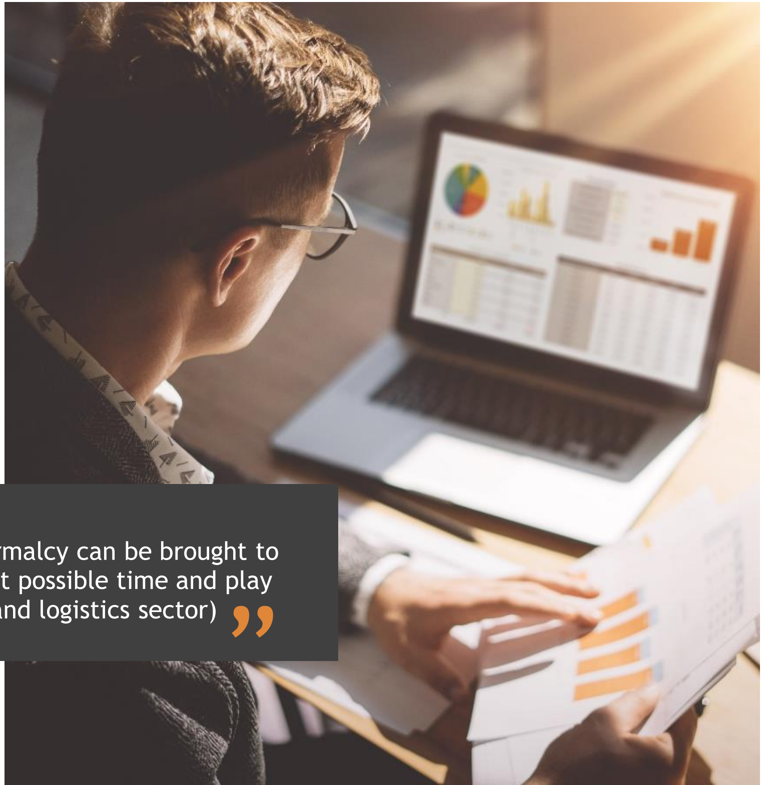
## SECTORAL IMPACT

On expected lines, the responses saw an increasing preference towards sectors like Healthcare / HealthTech / BioTech/ Digi-Health, Edtech, Mobility/ Drones.

Within these sectors, some respondents prefer online and AI centric business strategies/ models.

Many respondents also shared that they would continue with their existing sectors of preference and may diversify within sub-sectors towards annuity/ predictable business models.

Financial Services and Luxury Consumer Goods may see reduced exposure for 2-4 quarters. Expectedly, sectors such as Tourism, Aviation, Hospitality, Auto, Retail are likely to bear the brunt.



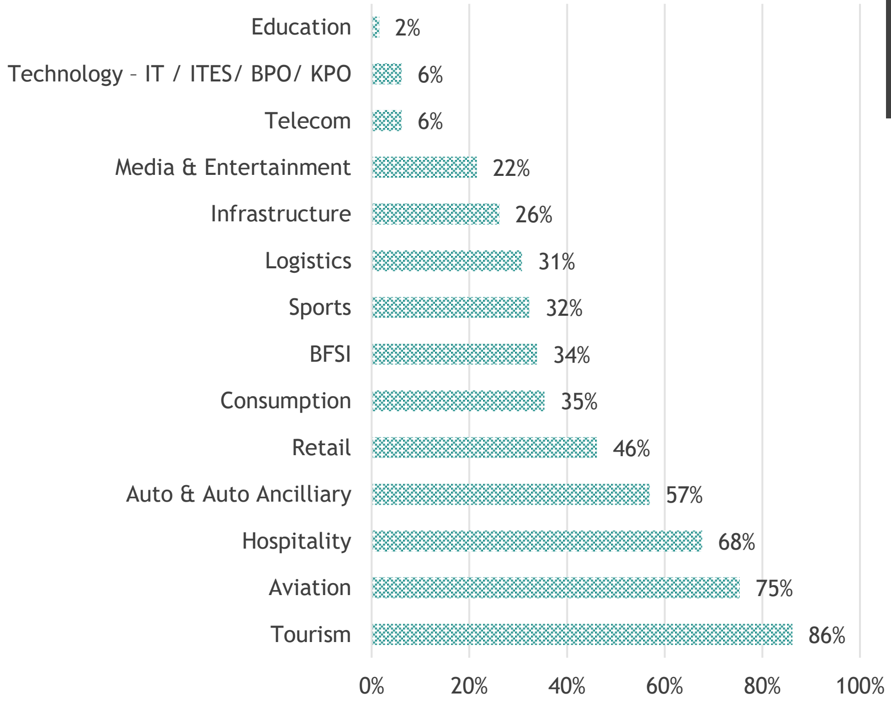
> “PE/VCs need to think through about how normalcy can be brought to the most vulnerable segments in the quickest possible time and play an active role (especially in the healthcare and logistics sector)”

## CERTAIN NEW THEMES/ SECTORS THAT SAW INCREASING PREFERENCE

- SAAS and Productivity Tools / Automation / Industrial Robotics
- Media and Content
- Food Processing
- Communications
- New Age FMCG
- Agri-tech
- Enterprise Tech and Deep Tech Investments
- Fitness
- Remote Working Applications / WFH Technologies / Virtual Reality
- D2C Brands
- Cybersecurity
- Alternative Distribution Channels
- Digital Content and Gaming

# KEY TAKEAWAYS FROM THE SURVEY

## SECTORS WITH MAXIMUM ADVERSE IMPACT




> “We will experience a spike in NPA's in retail and consumer lending companies. This would affect their profitability/ liquidity ratios. And capitalisation plans of banks, NBFCs and fintech lending companies”

# KEY TAKEAWAYS FROM THE SURVEY

## PROLONGED DUE DILIGENCE PROCESS

Given the reduction/ absence of in-person meetings due to policies restricting business travel, a majority of respondents shared concerns over delay in deals and slowdown in the due diligence (DD) process.

Even though the DD process has moved online to virtual data rooms, the turnaround on processes/ queries has elongated due to resource unavailability (like employees of target company not available ).

Factory visits, onsite visits, field visits, management meets, stakeholder meets, which are also very critical in any diligence process, are currently impossible to undertake and have thus impaired the confidence in investing (especially for large size deals).

Also, funds have been focusing on allocating more capital to existing portfolio companies (where they have done DD in the past), instead of new investments.

> “It's the outlook that's changing (and not the Diligence process). And this closure may be extended in many cases by 3-6 months
>
> Forming a view on a post-COVID world is impossible currently”

# KEY TAKEAWAYS FROM THE SURVEY

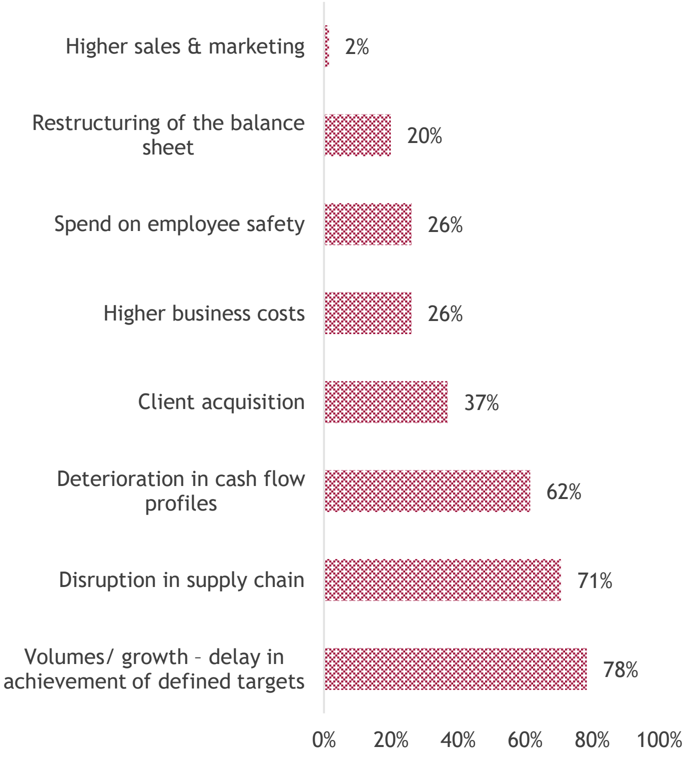
### TOP CONCERNS OF INVESTEE COMPANIES

- Volumes/ growth – delay in achievement of defined targets
- Disruption in supply chain
- Deterioration in cash flow profiles

“Cash becomes the King. Companies that have 24 months cash reserves would be able to gain market share. Many start-ups may see layoffs

Such a situation offers businesses and organisations an opportunity to build the least possible fixed cost and remain conservative.

Cost control measures should be implemented to stretch funds in hand. Alternate / Contingency plans should be evaluated and implemented if need be”



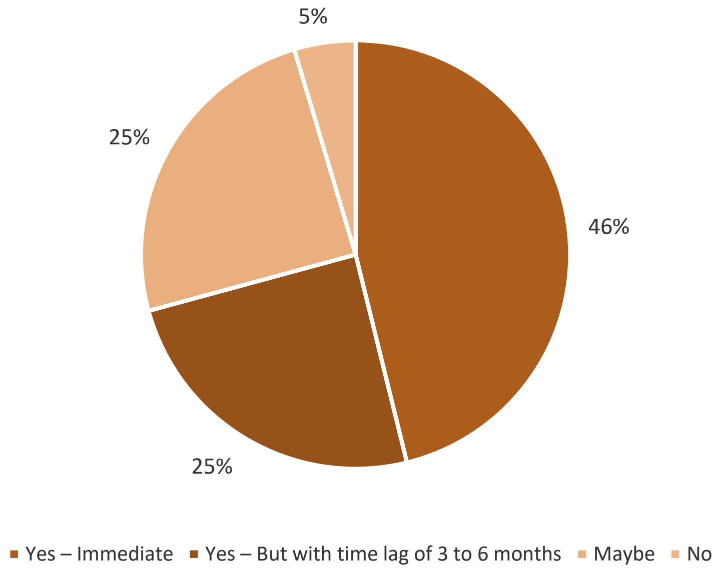
# KEY TAKEAWAYS FROM THE SURVEY

## VALUATIONS ARE BOUND TO FALL IMMEDIATELY

Approximately 71% of respondents believe that valuations will narrow immediately or with a time lag of 3 to 6 months.

> “Overall, Valuations would decline and the industry may see liquidations at depressed prices. The frothiness in valuations will correct and good companies will continue to get funded”

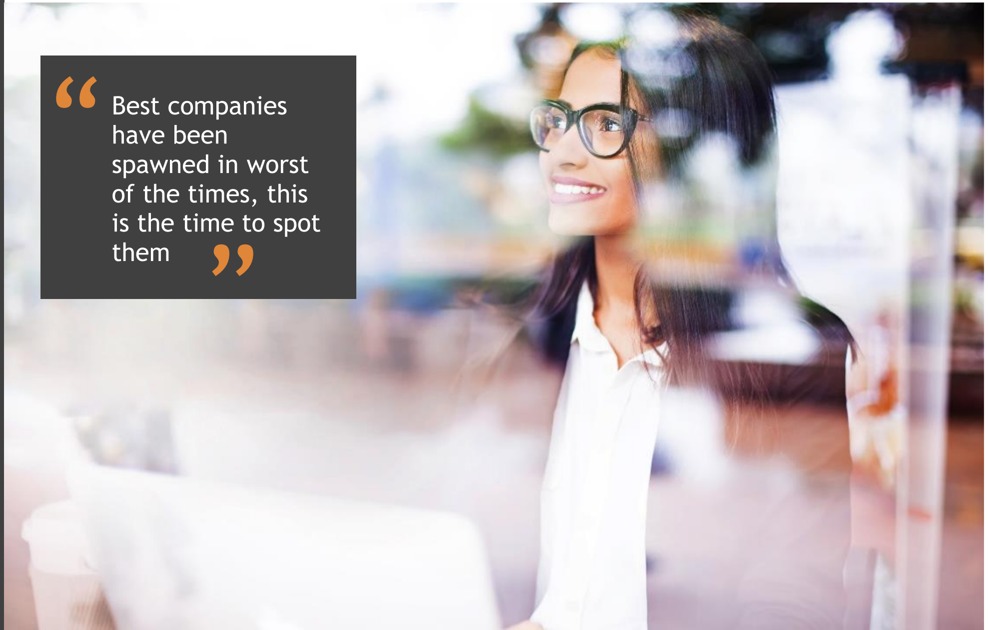
## NARROWING OF VALUATION MULTIPLES...AS GROWTH RATES TAPER



# KEY TAKEAWAYS FROM THE SURVEY

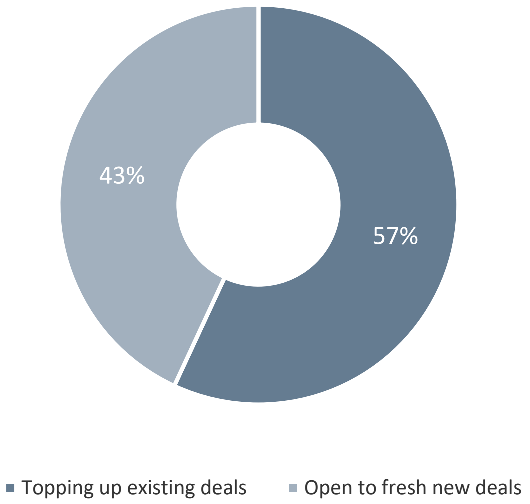
## TOPPING UP EXISTING DEALS IS THE CURRENT PREFERENCE

On capital allocation, while 57% of the PE/VC respondents prefer topping up the existing deals instead of tapping new opportunities, it was heartening to see that 43% were open to new deals.



> “Best companies have been spawned in worst of the times, this is the time to spot them”

## PREFERENCE IN CAPITAL ALLOCATION



# KEY TAKEAWAYS FROM THE SURVEY

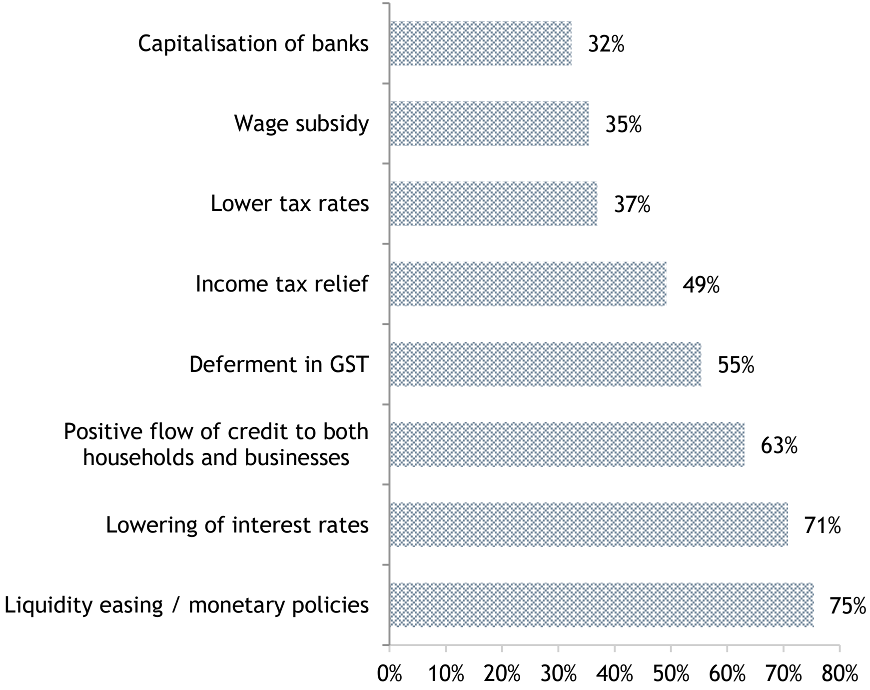
## EXPECTED ECONOMIC RELIEFS IN LINE WITH CERTAIN RELIEFS RECENTLY OFFERED BY THE GOVERNMENT

The respondents from the PE/VC industry prefer these as the top 3 modes of economic relief/ concessions:

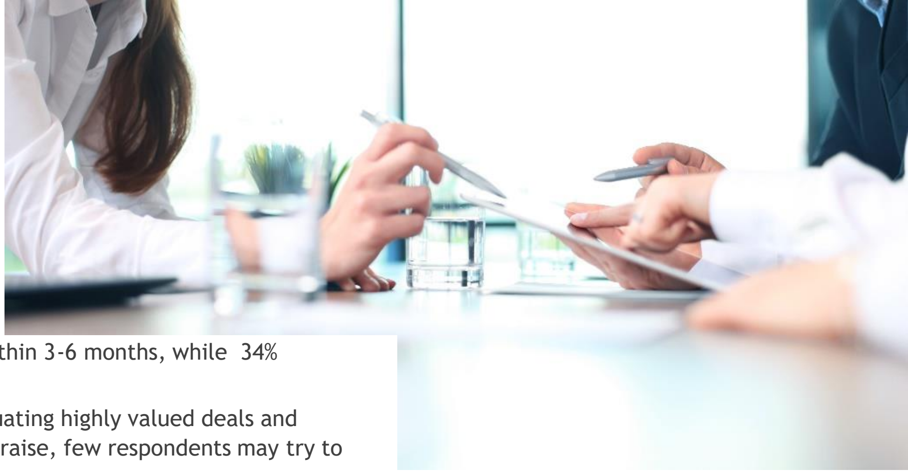
- Liquidity easing / monetary policies
- Lowering of interest rates
- Positive flow of credit to both households and businesses

Our Finance Minister, the Central Bank and the Government are certainly paying attention.

## PREFERRED ECONOMIC RELIEF



# KEY TAKEAWAYS FROM THE SURVEY

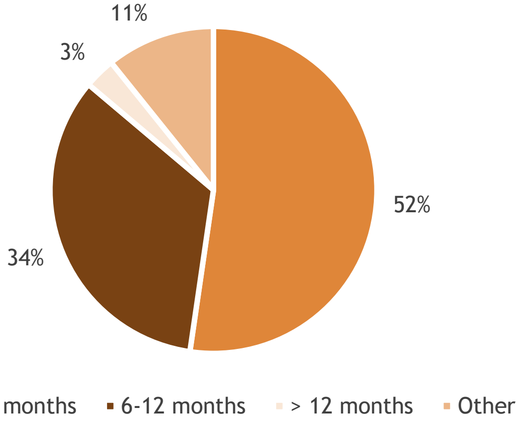


## RECESSION IS CERTAIN, BUT OPEN FOR SELECTIVE OPPORTUNISTIC INVESTMENTS

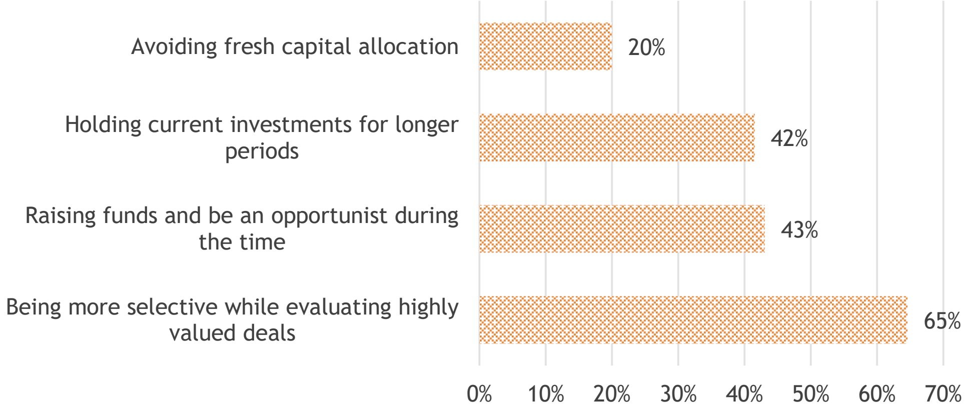
Around 86% of respondents foresee a recession; approximately 52% expect it to happen within 3-6 months, while 34% expect it within 6-12 months.

During this time, their preferred course of action will be, being more selective while evaluating highly valued deals and holding on to current investments for longer periods. Although times are difficult for fund raise, few respondents may try to opportunistically raise funds.

### POSSIBILITY OF RECESSION TIMEFRAME




### PREFERRED COURSE OF ACTION DURING A RECESSION



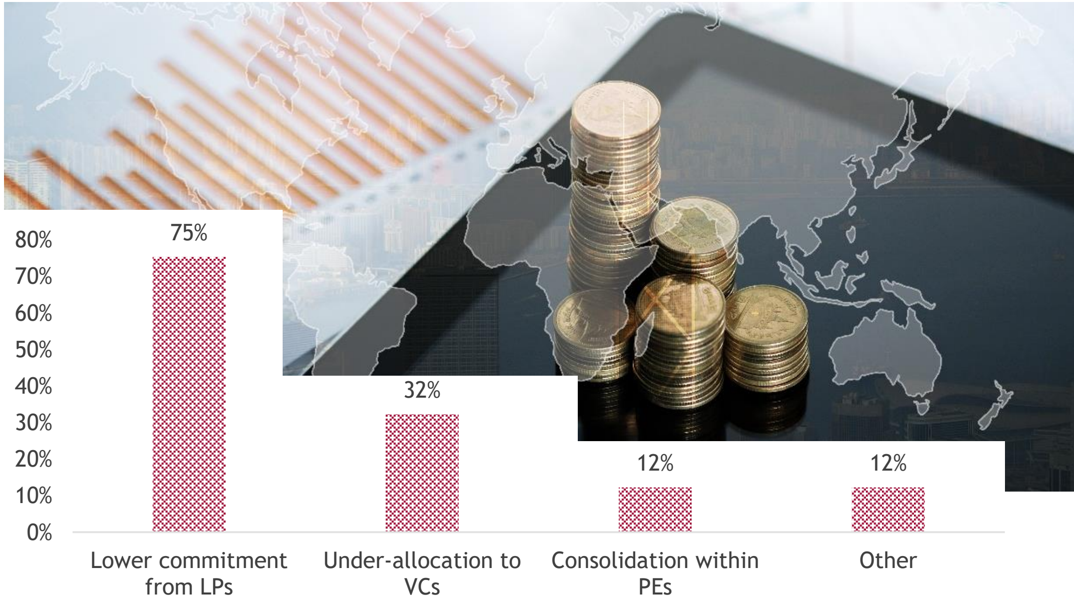
# KEY TAKEAWAYS FROM THE SURVEY

## SERIOUS CHALLENGES FOR FUND RAISE IN THE IMMEDIATE FUTURE

Approximately 75% of respondents see lower commitments from Limited Partners (LPs) and around 32% see under allocation to VCs (aversion to early stage investments before economy stabilises). Among others, respondents have shared the following as risks in fund raise:

- Erosion of public markets translating to a liquidity issue for the VC space
- Delayed prospects of acquiring new LPs
- More onerous terms for the return of capital & in carry
- LPs are themselves facing similar challenges for their fund raise
- Capital freeze
- Lower allocation to high risk geographies
- More time-consuming process

> “All the DFIs, LPs are going to be in a non-decisive mode for a long time, which might even hurt the capital infusion more. Focus has moved from new deals to more of Portfolio Monitoring”




CHALLENGES IN FUND RAISE (SHARE %)

# KEY TAKEAWAYS FROM THE SURVEY

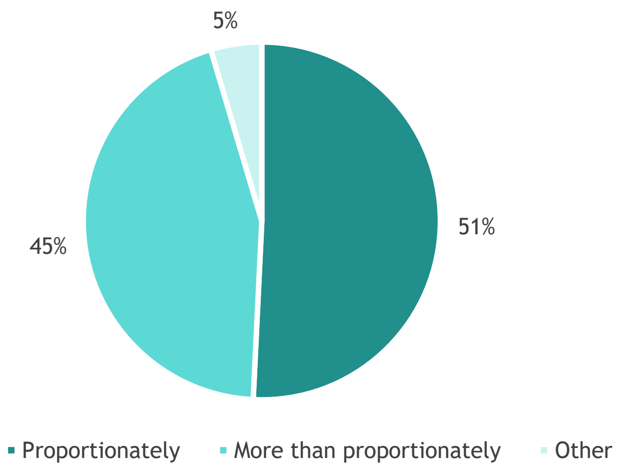
## SIMILAR IMPACT ACROSS THE PE/VC COMMUNITY

With respect to impact across different segments of PEs/VCs, more than 51% of the respondents believe that the impact will be proportionate for mid-market PE/VCs, indicating that all segments of PE/VCs (barring distressed funds) will be equally affected.

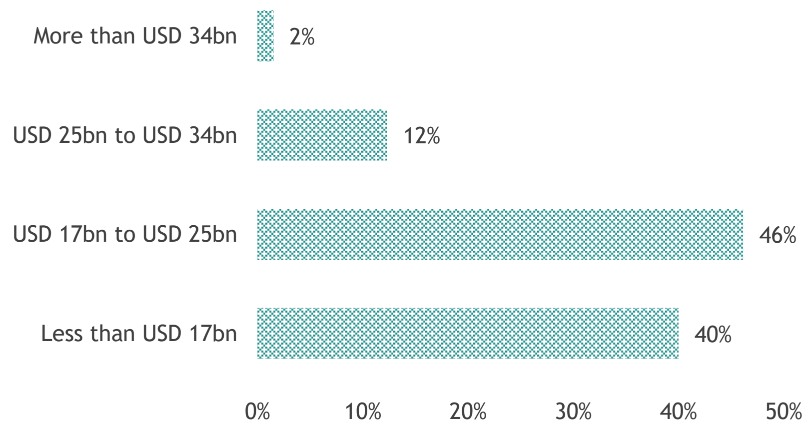
## CY20 DEAL VALUES TO BE LOWER THAN CY19 DEAL VALUE AT LEAST BY 25%

Around 86% of respondents believe that the CY20 PE/VC investments will be below USD 25bn (substantially below the peak PE/VC deal value of USD 34bn in CY19)

### WILL MID-MARKET PE/VCS SEE EQUAL IMPACT?




### ESTIMATE OF LIKELY DEAL VALUE IN CY20

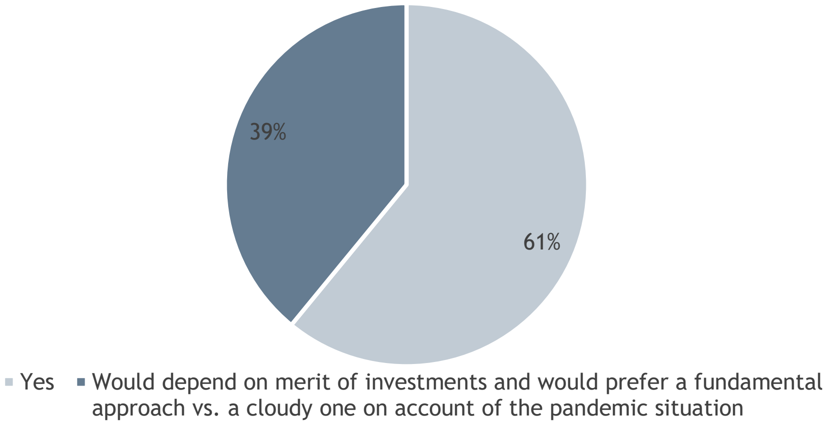


# KEY TAKEAWAYS FROM THE SURVEY

## CROSS BORDER M&A WILL CERTAINLY BE AFFECTED

61% of respondents believe cross border M&A will be affected while 39% believe it will depend on fundamentals of acquisition.

## WILL CROSS BORDER M&A BE AFFECTED




One of the interesting responses coming out of the survey is

> "The current situation is news based and therefore, highly volatile; a reversal will occur on similar lines based on positive news and later followed by sustained recovery. At present, the timing of reversal is unknown"

Lets all pray that this reversal occurs sooner than later.

We would like to express our appreciation to all our respondents for sharing their experiences, valuable inputs, and time.

We also extend our sincere gratitude to our Partners - Akhilesh Pandey, K M Prabhu, Jeetu Bairathi, Suraj Malik, Rajesh Thakkar, Nitesh Mehta, Santosh Maheshwari, Lata More, Mandar Gadkari, Swanand Deshpande, Amrish Vaidya, Shashidhar Jayaraman, Ananthakrishnan Govindan, Geetha Jeyakumar, Yogesh Sharma for their assistance in helping us receive a phenomenal response to our survey.

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