DC advisory

India Private Equity Mid-Market Monitor: H1 2023

‘Investing in India's growth story’

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The Headlines

1

Indian macroeconomic fundamentals continue to be intact, with public markets at an all-time high

2

However, mid-market deal volumes were down by 62%* in H1 2023, driven by global sentiment and material bid/ask spread on valuations

3

We expect private markets to continue to see two more quarters of pain, clean-up, and consolidation

4

We are confident that deal activity will start bouncing back in early 2024 given private market corrections historically have taken 18 months

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A note from the CEO

"In the ever-changing landscape of global markets, India has emerged as a beacon of growth and resilience. With its public markets at an all-time high, outperforming global peers and the country maintaining its position as the fastest-growing major world economy, India has become a vital destination for global investors.

The significant drop in mid-market PE/VC activity in this first half is in the context of record levels during 2021 and some of 2022. The subsequent global valuation correction on account of persistent inflation and rising interest rates is now working its way through private markets. Primary funding for 'growth at all costs' unicorns has all but dried up. So far in 2023, we have not seen a single new unicorn being added in India.[i] However, high quality solid growth businesses that are profitable and have a clear path towards IPO are likely to continue to see healthy late stage investor interest for secondary transactions.

We expect this trend towards private market secondary transactions in top decile profitable (or near profitable) venture funded portfolio companies to continue as many venture capital firms are under pressure to improve their DPI (distributed profits to paid in capital). This trend combined with India's robust macroeconomic outlook and strong public market sentiment, is expected to further reduce the valuation gap between private and public markets. We expect this will result in a bounce back in mid-market PE/VC activity in India towards the end of 2023 and in H1 2024. Taking a slightly longer-term view, we are confident that the Indian middle market VC/PE eco-system is poised to capitalize on the significant growth opportunities that India's march towards a USD 5 TN economy is expected to bring"

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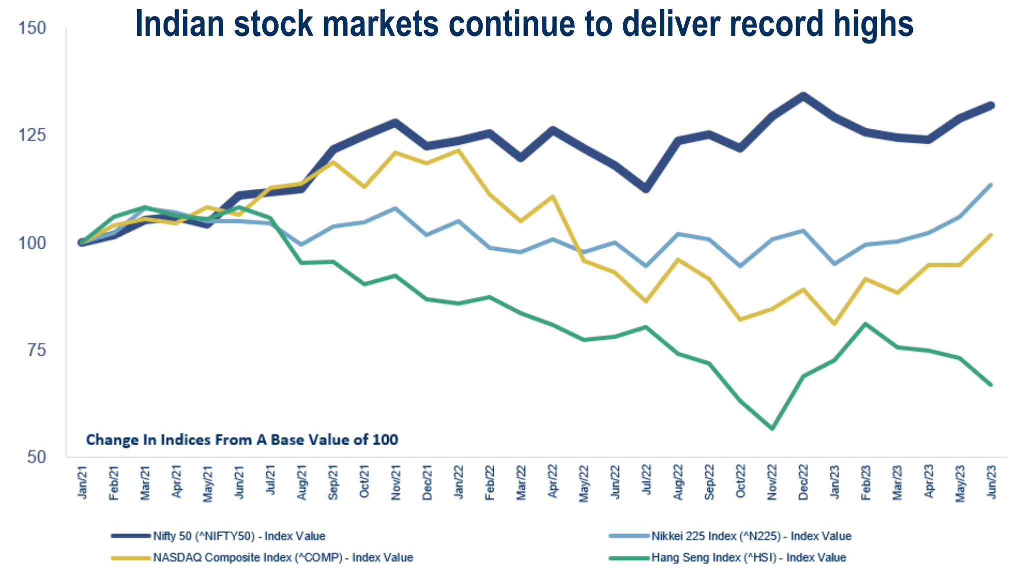
Investor sentiment continues to be bullish due to strong macroeconomic fundamentals



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The story so far

1

Indian public markets have surpassed their global counterparts:

The optimism in Indian stock markets is a result of the strong performance and resilience showcased by leading Indian corporates in Q1 2023, which draws strength from key structural factors such as the rapid digitization of the economy and the continuous improvements in infrastructure.

19%

Growth in Nifty 50 Price June 22 - June 23[ii]

2

India is currently the fastest growing major world economy:

India emerged as a leading performer in GDP growth among major world economies in 2022, driven by strong growth across sectors, despite global headwinds. India is currently a USD 3.75 TN economy and expected to reach USD 5 TN (by fiscal year ending 31 March 2026)[iii]

7.2%

India GDP growth (2022)[iv]

3

Indian allocation of global funds is at peak levels:

Over USD 3 BN has been invested in Indian startups by more than 30 venture capital, private equity, and corporate funds this year, indicating faith in India's growth despite slower deal activity in H2 2022 and H1 2023[v]

USD 3BN+

Funds specifically raised for India investment[vi]

4

India is a key beneficiary from the reallocation out of China into other emerging markets:

India's elevation as a dedicated allocation in the portfolio of global investors, previously only held by China among emerging markets, reflects the robust investor confidence in India's economy[vii]

USD 3TN

Potential for reallocation of investments to India[viii]

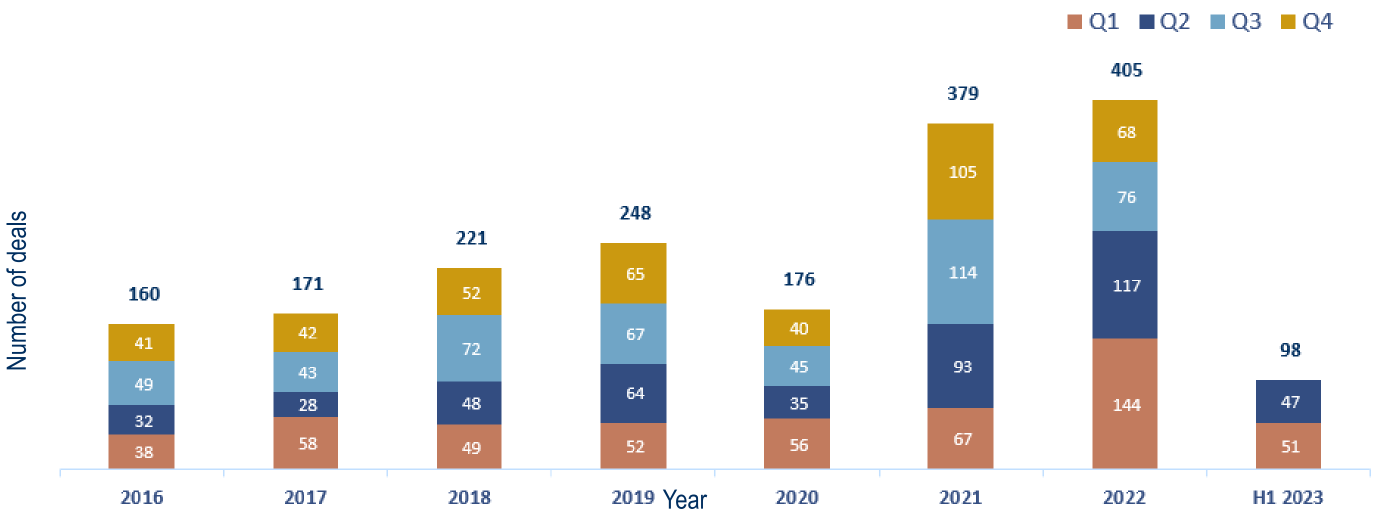
The sustained interest and investment reflects the confidence that investors have in India's thriving economy, setting the stage for an anticipated surge in deal activity and investment opportunities in the upcoming year.

The story so far in numbers

Indian deal volume has experienced a significant decline

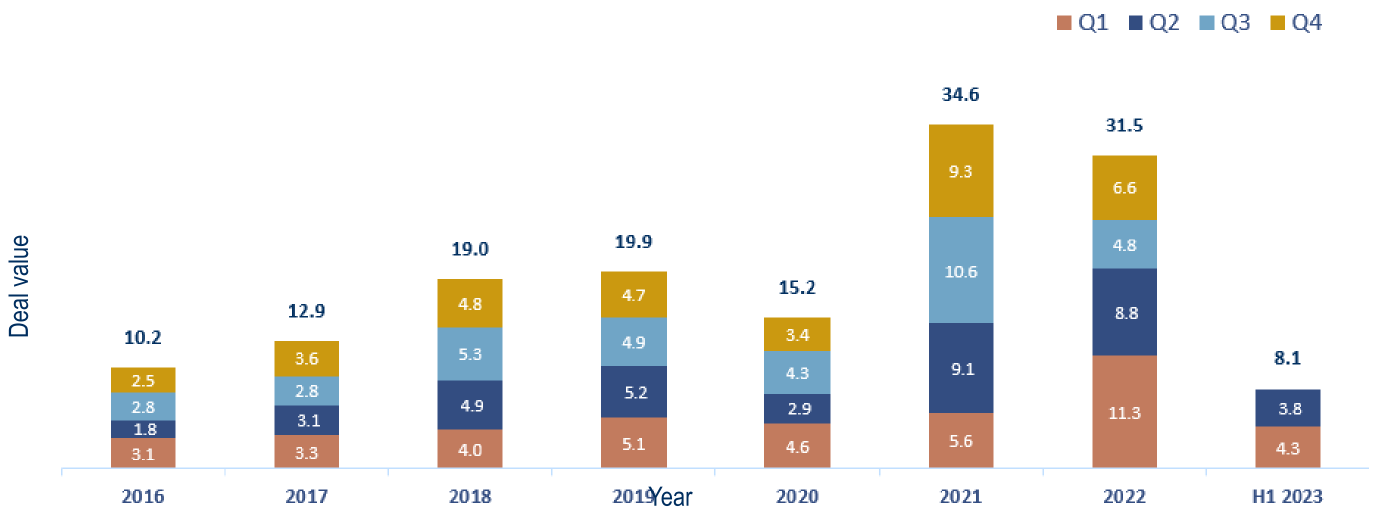
Indian deal volume experienced a significant decline of 62%* in the first half of 2023 compared to the previous year, as the spill over effects of the funding bubble in 2021 waned by the beginning of the second half of 2022. The impact of global macroeconomic headwinds and a shared sense of caution gradually affected private investment activity and behaviors in India, and this trend has continued into the first half of 2023.

Overall deal volume (number of transactions, 2016 – H1 2023)



Source: Venture Intelligence

Overall deal value (in USD BNs, 2016 – H1 2023)



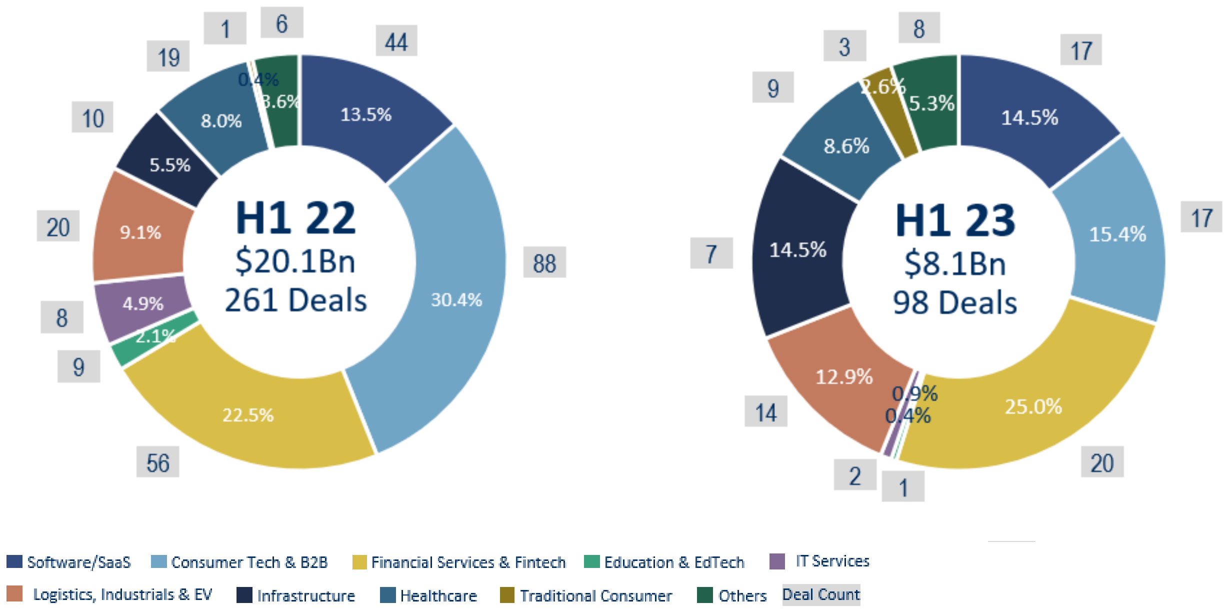
Source: Venture Intelligence

We have considered deals in the mid-market, defined as private equity / fund raise transactions between the range of USD 15 MN to USD 500 MN.

Ed-tech and Consumer-tech sectors have experienced a significant decline in deal activity this year

During the pandemic, Ed-tech and Consumer-tech experienced a significant surge in growth, driven by an acceleration of digital adoption, resulting in premium multiples and frantic deal activity. However, as the effects of the pandemic subsided and offline spending increased, we observed a decrease in investor interest towards online companies with high burn models. This coupled with global tech valuation corrections led to the contribution of these sectors to the overall deal value dropping from 32% in H1 2022 to 16% in H1 2023, as shown in the chart below.

Deals by sector

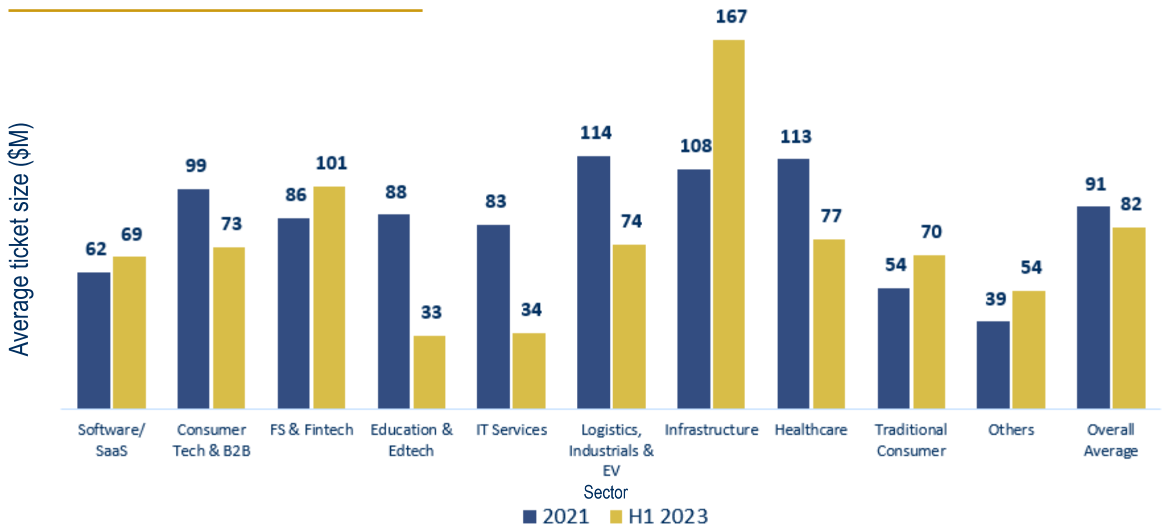


Source: Venture Intelligence

Average ticket sizes have declined by 10% in H1 2023 compared to the peak witnessed in 2021

In sectors such as Consumer-tech, Ed-tech, IT Services, Logistics and Industrials, there has been a notable shift in investment strategies towards prioritizing value-oriented opportunities. Investors are now focusing on companies with positive unit economics and a clear path to near term profitability. Consequently, average ticket sizes have decreased across these sectors, reflecting the changing investor appetite.

Average ticket sizes by sector: 2021 vs H1 2023



Source: Venture Intelligence

We have considered deals in the mid-market, defined as private equity / fund raise transactions between the range of USD 15 Mn to USD 500 Mn.

India's investment landscape

Liquidity is at an all-time high, however investors are extremely selective

Dry powder is at record levels with multiple funds having raised capital on the back of the India macro story

23BN+

Dry powder with India focused funds[ix]

FOMO has faded away with investors adopting a cautious and selective approach to new deployments

High burn business models are facing stark challenges when raising funds. Heightened cautiousness has resulted in longer deal cycles with increased diligence intensity on business, financial and accounting parameters.

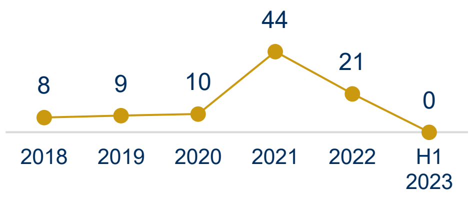
Rising demand for quality assets delivering 'profitable growth'

Investor preferences have changed, focusing on companies that demonstrate attractive unit economics and EBITDA profitability (or almost break-even), rather than those relying on achieving scale to address high-cost structures via operating leverage.

Valuations have corrected from their 2021 peaks and round sizes have become smaller

As the focus on capital efficient businesses increases, round sizes are shrinking with limited fund requirements. There have been no unicorn additions in 2023 with declining ticket sizes and valuation resets observed across the board.[x]

Unicorn additions



Source: Venture Intelligence IPO Tracker

Founders are weathering the funding winter by rationalising costs and opting for smaller rounds

1

Strategic shift towards cash conservation measures

As investor appetite shifts towards low burn businesses and funding becomes increasingly scarce, companies are actively adjusting their cost structures across the board to align with the evolving landscape.

26K+

Layoffs in 95+ startups since 2021[xi]

Source: ET Tech Layoffs Tracker

2

Favoring bridge rounds and smaller rounds to minimize dilution

As companies extend their runways, we have observed a growing preference to pursue bridge rounds or smaller funding rounds and if available, venture debt. This strategy allows the companies to optimize the dilution of founders' stakes, considering the valuation corrections, and positions companies to seek larger funding rounds in the following year under more favorable market conditions.

3

Smaller & less-funded players are becoming consolidation targets

While category leaders are typically well funded, smaller players are finding it increasingly difficult to deliver growth and raise funds. Larger well funded players are capitalizing on the funding winter and depressed valuations to acquire smaller players, enabling them to consolidate the market and expand their channel presence and product portfolio.

4

Larger companies are deferring their IPOs as public markets are rewarding profitability disproportionately

With a stringent lens on healthy margin profiles and profitability, coupled with tepid post-IPO performance of listed startups, unicorn founders are deferring IPO plans until the business delivers positive cash flows. Should IPOs continue to be a less attractive exit option for founders, we expect exits to be driven by strategics and private equity buyers.

12+

start-ups have deferred their IPOs[xii]

digit PharmEasy mamaearth boAt navi ixigo capillary droom navi insurance MobiKwik snapdeal Pine Labs OLA

Outlook

Our view is that deal activity should start to bounce back by year end, but until then...

A 'shakeout' is inevitable & more down rounds are overdue

- A 'shakeout' is currently underway, and we anticipate this trend continuing in the medium term. This shakeout process is a natural outcome as the market evolves and consolidates, paving the way for more sustainable and resilient business models to thrive. As companies with unsustainable business models face challenges, we expect some of them to either fold or seek mergers with larger better capitalized players
- Whilst several companies attempt to salvage their position through convertible notes and bridge rounds, we believe certain unicorns may face difficulties maintaining their status, potentially becoming 'zombie unicorns'[xiii]
- As cash runways shorten, companies and founders will need to embrace down rounds and flat rounds, driven by valuation corrections, in order to adapt to the new normal before pursuing their next growth phase. The current down-round in Pharmeasy[xiv] indicates opportunities for both struggling unicorns and established players to strengthen their positions and drive growth in the market.

Secondary transactions will be bigger than primary transactions

- The poor post-IPO performance of startups listed in 2021 and 2022 has led many companies to defer their IPO plans.[xv] As a result, holding periods for investors have extended, prompting them to seek alternative liquidity options. One notable trend is the increasing appetite for cashing out stakes in large companies through secondary transactions.
- Early-stage investors are increasingly realising that even in portfolio companies that have successfully gone public selling substantial ownership post the expiry of the mandatory lock-in is not a given, and secondaries are gaining popularity especially for portfolio companies that have a clear one-to-three-year path to IPO.
- Private equity firms (both late stage growth investors as well as buyout firms) now prefer investing in profitable, established businesses with proven growth over funding high growth, loss-making ventures.

1 | Software / SaaS

> **SaaS companies that can meet the current demands and expectations of the market are expected to garner strong investor interest, despite valuation pressures - potentially making 2023 the year of attractive, investible SaaS assets**

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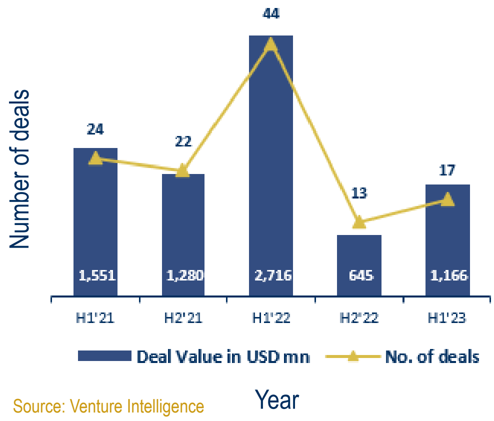
2023 so far: What you need to know

- Indian mid-market deal activity in H1 2023 showed early signs of revival from the softened global tech sentiment that trickled down into the private SaaS market by H2 2022 (H1 2023 saw 60% drop over H1 2022 deal volume, but a 80% growth over the H2 2022 low point), as shown in the chart below
- Based on our conversations with select hedge funds and early stage VC funds, there has been muted activity across H1 2023, while growth equity investors have been active with a 10% increase in the average ticket size
- Private market multiples in H1 2023 are the 'new normal' post-pandemic, inching closer to pre-pandemic levels of listed comparables after a significant correction from 2022
- Fundraising multiples have been uncertain, illustrating the nascency of evolving business models, while M&A multiples have been more resilient

Software / SaaS Transaction Activity



Source: Venture Intelligence

Outlook

- Elongated sales cycles and processes due to macroeconomic uncertainty has resulted in dampened growth, leading to reduced software spending budgets across all sectors, but in particular the tech sector. Companies that can navigate and overcome this trend are more likely to attract investor interest
- Indian Software-as-a-Service (SaaS) companies that can demonstrate sustainable growth models remain attractive. Operating leverage, an abundant talent pool, the 'make in India, sell in US' playbook and dry powder ready to be selectively deployed, are likely to drive increased secondaries transactions in profitable SaaS companies
- Pressure on the ecosystem is yet to fully emerge, with scaled-up SaaS companies having raised high levels of capital in 2021/2022 at premium valuations. These companies are likely to retain their previous round valuations by realigning cost structures and moving towards a more sustainable operating model

Key trends to watch

- **Enterprise AI:** Evolving user expectations and business demands have led to startups using AI as a key product component, moving beyond using it solely as a fundraising tactic
- **Retools:** India's thriving developer community and strong open-source development culture - which is streamlining operations across development, deployment & resolutions – is well positioned to disrupt the market
- **Cybersecurity:** Digital transformation has raised data vulnerability concerns. Stable revenue growth and local regulatory policies have been driving demand for cybersecurity, leading to increased investor interest
- **Product evolution:** With fierce competitive dynamics and budget consolidation, companies are shifting to products that optimize for cost rather than offerings that boost revenue

2 | Consumer-tech

"In spite of near term headwinds, long term sentiment on the India consumer story remains positive. Overall asset quality in the sector is likely to improve on the back of a shift in investors' focus to consistent compounders with positive unit economics & path to profitability, which will likely drive increased deal activity in the coming year"

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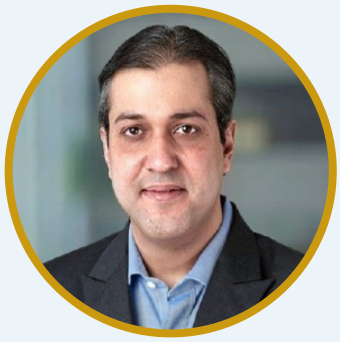
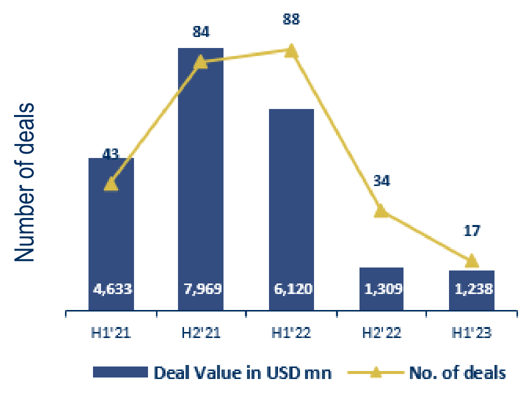


2023 so far: What you need to know

- Deal activity plummeted by approximately 80% at the start of 2023 compared to 2022, as evidenced in the chart below, as investors turned away from high burn business models
- Offline spending across sectors has increased since the start of 2022 when post-pandemic restrictions eased, adding further strain on online-only businesses
- Scarce funding and dwindling cash reserves have led to limited marketing budgets, hindering growth and new customer acquisition in crowded segments. As a result, we observed that companies are finding it increasingly difficult to justify their peak 2021 valuations. This has resulted in a wide bid/ask spread with founders hesitant to accept valuation corrections and therefore delaying larger fundraising plans

Consumer Tech Transaction Activity



Source: Venture Intelligence

Outlook

- Investors have shifted their focus from pursuing 'growth at all costs', to seeking sustained profitable growth, and are now critically assessing start-ups' potential to generate EBITDA and cash flows as they scale
- While founders are revamping their business models to reduce burn, there is still a lack of capital-efficient steady compounders (i.e., what investors are seeking), resulting in a supply-demand disparity
- We expect deal activity will remain subdued for a couple of quarters until deployment pressure aligns, valuation mismatches are resolved, and there is increased availability of companies with leaner profit and loss structures

Key trends to watch

- **Uptick in consolidation:** Both traditional offline players and well-funded category leaders may take the opportunity to expand their channel presence and product portfolio by capitalizing on depressed valuations and reduced runways for smaller players
- **Shifting focus to Tier-2 and Tier-3 cities:** As growth in major urban areas plateaus, companies are redirecting their attention to Tier-2 and Tier-3 cities to leverage the increasing discretionary spending and digital adoption trends. Tier-2 and Tier-3 cities are now the most targeted areas of the e-commerce industry[xvi]
- **Omnichannel strategies:** As the pandemic subsides and offline spending rebounds across many sectors, new age players are adopting omnichannel approaches to drive their next phase of growth. Especially for direct to consumer (D2C) brands, investors are insisting that companies demonstrate reasonable offline growth before raising their next round of capital
- **B2B Commerce and Agri-tech:** While low gross margin profiles remain a cause for concern, B2B Commerce and Agri-tech companies with viable unit economics and capital efficient metrics we expect will attract investor interest

3 | Financial Services - Lending

> Financial services is experiencing a 'purple patch' for dealmaking. With asset quality issues now in the rear-view mirror, the sector is now benefitting from strong growth tailwinds, and a portfolio of more mature and scaled-up assets, presenting unprecedented opportunities for investors and corporates

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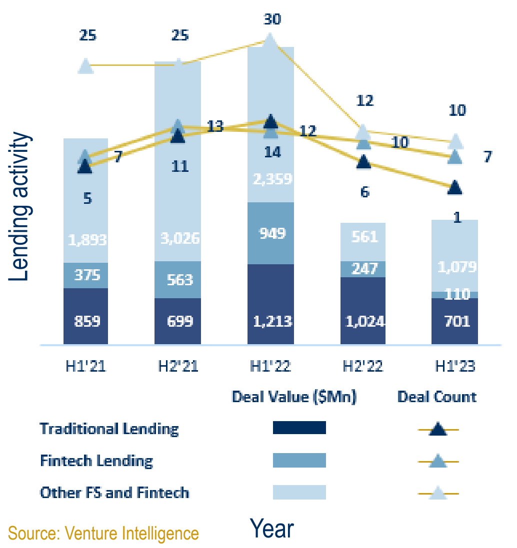
2023 so far: What you need to know

- Financial Services has made a strong comeback in 2023, raising a total of USD 2 BN in H1 2023. This growth can be attributed to improved asset quality post-pandemic, expansion in retail segments, and healthy profitability levels
- Higher deal volumes have been observed across affordable housing, 'Micro, Small and Medium Enterprises' (MSME) finance, vehicle finance and micro finance sectors
- The acceleration of M&A activity has been driven by interest from overseas strategic and large private equity investors, particularly in sectors such as affordable housing finance and secured MSMEs
- Frothy valuations that we have witnessed for the last seven years have experienced corrections in the last 12 months

Financial Services Transaction Activity



Source: Venture Intelligence

Outlook

- Retail lending continues to be a favored sector in India, due to conducive macro drivers such as an increase in per capita income and growing adoption of digitization. In addition, supportive regulations, coupled with stable interest rates and the intervention on governance, further contributes to strengthening investor confidence
- Although there was a slowdown in fundraising in the first half of 2023, largely influenced by underperforming stocks in the previous year, the outlook for the next 12 months appears optimistic. The positive outlook is driven by strong earnings growth across banks and non-banking financial companies (NBFCs)

Key trends to watch

- **New pools of capital:** There is increased visibility of capital sources from strategic investors in Southeast Asia and Middle East sovereign wealth funds. The involvement of these parties can potentially inject fresh capital, expertise, and market access, stimulating deal activity between domestic and international entities
- **Consolidation in micro finance and affordable housing finance:** We expect these sectors to intensify in the next 12 months, driven by selective availability of growth capital, succession issues in select cases, and the need to monetize assets by conglomerates
- **Micro lending:** We expect micro lending in the sub-INR 1 MN ticket size segment to sustain significant investor interest due to the untapped market potential and its ability to generate a high return on equity (ROEs) structurally
- **Co-lending:** This has emerged as a popular method to build liabilities and has proven successful and 'en vogue' in the last 12 months. However, its effectiveness relies on the absence of a sharp rise in interest rates or asset quality issues across the board

4 | Education & Ed-tech

Continuing Education businesses are currently the world dominating category. We are also very excited by some of the emerging Ed-tech players which are reinterpreting the India Education opportunity and disrupting the incumbents yet again

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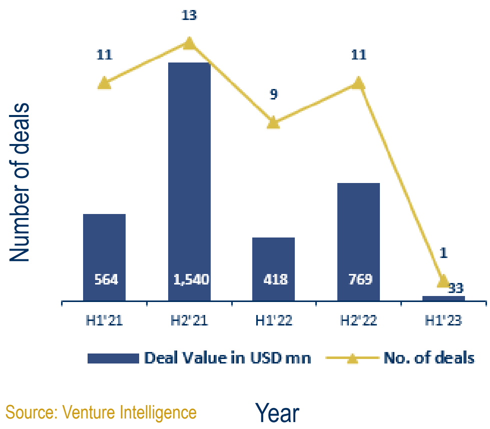
2023 so far: What you need to know

- Deal activity in the Ed-tech space is down significantly, both in deal value and volume terms. Many large Ed-tech companies are facing challenges raising capital at the peak multiples seen during the boom in 2021 and 2022
- The challenging times faced by leading Ed-tech players such as BYJU and Unacademy continue to dampen investor interest and create uncertainty in the Ed-tech space, potentially decreasing investor interest in the short term
- The offline K12 and test prep space continues to do well and take market share away from online rivals. Most leading offline test prep players have reported their best ever performance for the fiscal year ending in March 2023

Education & Ed-tech Transaction Activity



Source: Venture Intelligence

Outlook

- We expect deal activity to pick up slightly in H2 2023. The test prep space continues to remain exciting with major players launching their hybrid offerings
- We are also seeing a consolidation theme beginning to play out with some of the leading Ed-tech players looking to acquire regional players to augment their market position in specific markets

Key trends to watch

- **Upskilling:** Going forward, we see sustained investor interest in continuous learning / upskilling as the need gap between employability and university outcomes continue to persist
- **Trans-national education:** We expect strong interest in trans-national Education and Ed-tech to solve challenges in higher education including enrolment management, learning outcomes, career services and student servicing

5 | IT Services

> **Despite short-term softness in deal activity, the IT Services sector is expected to remain attractive, owing to its long term predictability and the fundamental strength of its business model. We expect specialized sub sectors, such as cloud, digital product engineering, and healthcare services to remain in high demand as PE sponsors execute their buy and build strategies**

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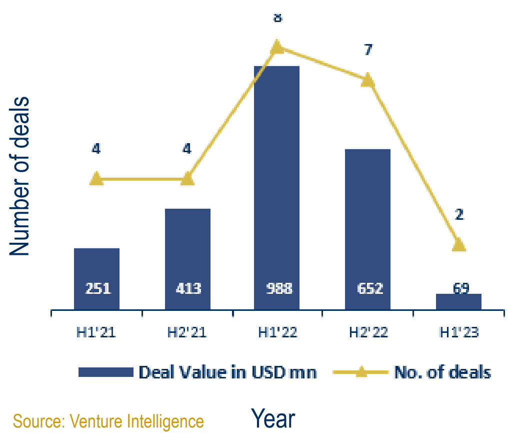
2023 so far: What you need to know

- The IT Services sector in India is currently experiencing a slowdown as end customers encounter the impact of a volatile macroeconomic environment impacting technology spend, particularly discretionary spend
- While the focus for end customers has shifted from transformational projects to cost optimization, the offshore focused business models that Indian IT Services companies focus on has not been immune to the turmoil

IT Services Transaction Activity



Source: Venture Intelligence

Outlook

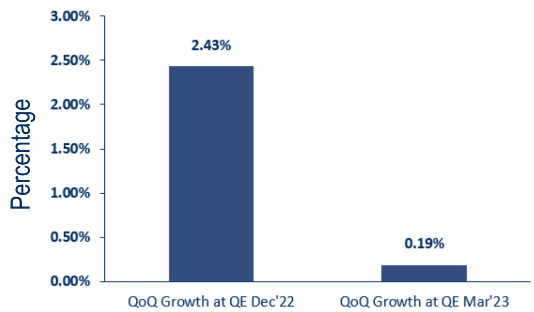
- We have observed many listed companies anticipating near term revenue growth pressures, however confidence in the sector's long term growth trajectory remains unchanged
- We expect the duration of deal processes to take longer compared to the peak observed in 2021. Demand for fundamentally strong businesses, especially in specialized sub segments will likely remain high as private equity investors implement their buy and build strategy, either by acquiring new platforms or strengthening existing ones
- We expect the private equity landscape in the IT Services sector will see some movement on the public listing front with several assets exploring the potential of an IPO in India, however the timing of these listings may be delayed

Key trends to watch

- **Reduction in growth estimates:** A significant number of listed companies have revised their growth outlooks for the year ahead, indicating a lower projected revenue compared to the previous financial year. This trend is also likely to drive private equity investors to focus on the medium term outlook more closely when evaluating investment opportunities

Source: Company filings and Quarterly Investor call transcripts of companies we consider to be the largest listed IT Services companies in India as measured by Market Cap. See endnote xvii for details about the companies and parameters analyzed

Reduction in growth estimates:



6 | Industrials, Logistics & EV

> **Industrials is a diverse sector with distinct opportunities. We anticipate ongoing fundraising activity in the EV and EMS sectors, as well as a growing number of M&A prospects in logistics and specialty chemicals throughout the year**

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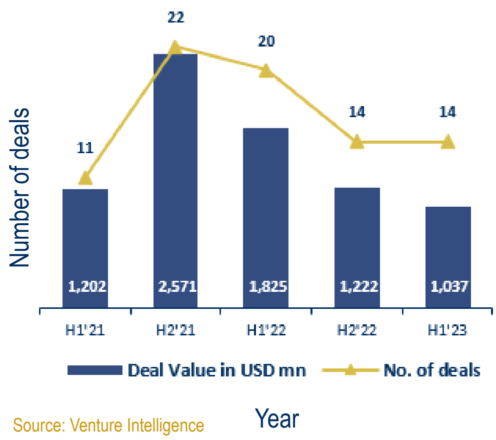
2023 so far: What you need to know

- Deal activity in the Tech-logistics sector has declined by approximately 43% this year compared to H1 2022, as shown in the chart below, primarily due to lower valuations and reduced fundraising activity
- The electric vehicle (EV) space continues to attract active interest in fundraising across the value chain, including original equipment manufacturers (OEMs), charging / swapping infrastructure providers, and component manufacturers, etc. Sovereign wealth funds, pension funds, APAC regional funds, clean tech funds, and venture capital funds are increasingly showing interest in this sector
- There has been an emergence of private investment in public equity (PIPE) deals in the manufacturing and specialty chemicals sectors. In our view, this trend is driven by limited options available in private markets for private equity funds

Industrials & Logistics Transaction Activity



Source: Venture Intelligence

Outlook

- There is continued deal momentum in fundraising in EV and EMS sectors as these have secular growth themes enabled by favorable government policies such as electrification targets and PLI schemes for manufacturing. There lies plenty of scope for multiple large players to emerge in these sectors over the next five years. Public market valuations in EMS continue to be rich, hence reducing deal activity in private markets
- Headway for strong M&A / consolidation activity in Tech-logistics where top 3 players in each segment will likely acquire companies with complimentary service lines and networks

Key trends to watch

- **EV Penetration:** EV adoption is growing, especially in the 3-wheeler cargo segment with established cost advantages. The 2-wheeler passenger market is oligopolistic, indicating a faster adoption curve ahead. However, the 4-wheeler passenger segment faces limitations such as charging infrastructure availability and a modest price reduction compared to internal combustion engine vehicles
- **Outbound M&A from India:** We believe certain sectors such as specialty chemicals and building products may witness more outbound activity going forward, such as Indian companies acquiring European companies for product / capability expansion and customer additions

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xvi. https://www.businesstoday.in/opinion/story/e-commerce-empowering-women-sellers-tier-2-and-tier-3-cities-sellers-367183-2023-01-23
xvii. Data derived from Company filings and Quarterly Investor call transcripts from the following companies, which we consider to be the largest listed IT Services companies in India, measured by Market Cap: Birlasoft, Coforge, HCL, Infosys, LTI Mindtree, Mphasis, Persistent, TCS, Tech Mahindra, Wipro, Zensar. Companies listed represent India's largest diversified IT Services companies by market cap (in excess of approximately INR 100 BN). Others may differ in how IT Services companies are categorized; accordingly, this data may not represent an exhaustive list for that sector. For example, we excluded ER&D and digital product engineering businesses

	Venture Intelligence
Sector	Search criteria
Software	Transaction completed in the IT & ITES – Enterprise Software industry classification between 1-Jan-21 to 30-Jun-23 with deal values between USD 15 million to USD 500 million
Consumer Tech	Transaction completed in the FMCG, Food & Beverage, Retail, Agri-business and Travel & Transport industry classification between 1-Jan-21 to 30-Jun-23 with deal values between USD 15 million to USD 500 million
Financial Services - Lending	Transaction completed in the BFSI industry classification between 1-Jan-21 to 30-Jun-23 with deal values between USD 15 million to USD 500 million
Education & Ed-tech	Transaction completed in the Education industry classification between 1-Jan-21 to 30-Jun-23 with deal values between USD 15 million to USD 500 million
IT Services	Transaction completed in the IT & ITES– IT Services industry classification between 1-Jan-21 to 30-Jun-23 with deal values between USD 15 million to USD 500 million. See endnote xvii for details about the companies and parameters analyzed
Industrials & Logistics	Transaction completed in the Manufacturing and Shipping & Logistics industry classification between 1-Jan-21 to 30-Jun-23 with deal values between USD 15 million to USD 500 million

DC Advisory India team & sector coverage

Sectors

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Consumer-tech

Financial Services

Education & Ed-tech

IT Services

Industrials & Logistics

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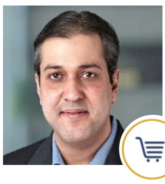

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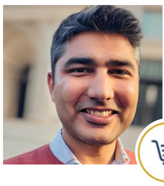

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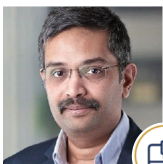

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