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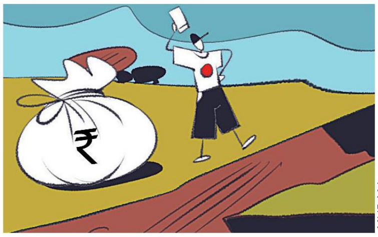
TOO MUCH DRY POWDER



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PE to Cut Risks, Eye Convertible Instruments

Investee cos have seen a steep fall in revenues, valuations

Reghu Balakrishnan & Indulal PM

Mumbai: The private equity industry, sitting on a record pile of "dry powder," or unallocated funds, is likely to witness more deals with convertible instruments or downside protection, as the most likely investee companies see a steep fall in revenue and valuations following the lockdown. Structures or instruments such as compulsorily convertible preference shares — which get converted into ordinary shares at a predetermined date — are expected to become popular. PE investors link the time of conversion to the company's performance.

"Due to the tremendous volatility and uncertainty, it is likely that PE funds will explore more structured instruments like convertibles and warrants rather than relying only on pure equity," said Darius Pandole, the managing director of PE and equity AIFs at JM Financial. This will help mitigate the element of risk in adjusting entry valuations based on future business outcomes, in a scenario where projecting future business dynamics and financials is fraught with uncertainty.

Indian companies have seen a sharp decline in fund-raising activities during the first quarter of 2020 due to the epidemic. By February, PE/VC deal flow (deals above $100 million) began to get severely impacted, down by 65% y-o-y by value, according to a recent EY report.

After global funds temporarily closed local Indian offices and following lockdown, PE/VC investment activity reduced to a dribble in March, down 88% YoY in value terms. March recorded only $818 million in PE/VC investments, going below $1 billion for the first time in 33 months. It was also the lowest monthly value in over three years. January and February witnessed PE deals worth $2.5 billion and $1.7 billion, respectively, the report added.

"In future, the investor may choose to convert the instrument into equity at a predefined pricing formula or remain invested with a certain coupon and plan to exit later from incremental earnings or refinancing," Singhi Advisory Group chairman Mahesh Singhi said.