JM Financial PE chief Darius Pandole on market valuations, PE trends and more

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Darius Pandole, MD and CEO of PE and equity AIFs, JM Financial

Mumbai-based financial services company JM Financial Ltd's private equity arm has struck three new deals this year as it looks to wrap up capital deployment from its second fund and start the process to raise the third vehicle. The PE fund invested in BRFL Textiles Pvt. Ltd in February, packaging company **Canpac Trends Pvt. Ltd < https://thecapitalquest.com/2021/03/26/jm-financial-pe-bets-on-packaging-firm-canpac-trends/>** the following month and ice-cream retailer **Walko Food Company Pvt. Ltd < https://thecapitalquest.com/2021/06/09/jm-financial-pe-bets-on-ice-cream-label-nic-in-second-deal-of-2021/>** in June.

Leading the mid-market fund is Darius Pandole, managing director and CEO of private equity and equity alternative investment funds at JM Financial. Pandole, an economics graduate from Harvard University and an MBA from the University of Chicago, joined JM Financial five years after working with New Silk Route and IDFC PE for a dozen years.

The Capital Quest caught up with Pandole to talk about the macroeconomic scenario, how the Indian PE industry has changed over the years, its planned fund and frothy stock market valuations. Edited excerpts:

How did PE, VC deals stage a smart recovery during Covid-19? Was it because a huge amount of dry powder was to be deployed or were there other contributing factors?

The economy has turned the corner quite nicely on the back of significantly improved corporate results, along with expectations of a continued strong recovery. Most importantly, the government seems to have done a very good job by increasing the pace of vaccine administration.

Stock markets are experiencing historic rallies on the back of robust FII inflows as well as strong domestic liquidity. The long-term growth opportunity in India remains amongst the most attractive in the world and the improving business environment is keeping PE and VC investors like us bullish through this tough period.

All of these are evident from the strong deal flow that we witnessed in the first half of the calendar year. We have seen roughly $25 billion of PE and VC investments in total from January to June this year. This is about 15-20% higher than the same period last year. Additionally, the strong investor interest in the Indian startup ecosystem has created as many as 26 new unicorns since the beginning of 2021.

What has led to this phenomenal interest in Indian startups?

One, the improved domestic and foreign liquidity. Two, better prospects and improved corporate results. Three, exit activity has witnessed a very strong revival once again in the first half of this year.

Broadly speaking, reported exit transaction values hovered around $20 billion, which is up significantly over the last one year. Sure, this data may appear skewed because of two-three very large transactions. Nevertheless, whenever the exit value picks up, it gives investors not just the confidence to invest money but also the belief that they can profitably divest and take their money out.

It is safe to assume that PE and VC funds are more focussed on dealmaking. Last year, dealmaking alone was not the key area. Managing the portfolio had become very important owing to the Covid-19 situation.

What is the view on investments? Is the market too hot right now that you wouldn't want to invest and adopt a more wait-and-watch approach?

Absolutely, entry valuations are not favourable. Having said that, we are long-term investors. When I say this, I refer to the PE and VC investors as opposed to listed market participants. Since we have to play through various economic and market cycles, we have a fundamental belief in the long-term growth prospects of the Indian economy.

However, with inflationary pressures building up, central banks may have to consider tightening their purse strings soon. The pace and extent of tightening will determine how stock markets react.

Investors will need to dig deeper in terms of their due diligence and conviction on future performance, in order to build an investment rationale.

You talk about PE exit activity. How do you view the massive rush in primary markets?

The IPO party is in full swing. The first half of 2021 witnessed 14 IPOs of PE-backed businesses, totaling to $1.6 billion. The January-March quarter accounted for nine of those IPOs – the highest quarterly number on record. PE exits through public listing has been a continuing trend in India, and the overwhelming response received by Zomato's recent public listing proved to be another watershed moment for the Indian startup ecosystem.

The primary market is expected to remain strong, bolstered by ample liquidity and positive investor sentiment. PE-backed companies are looking to capitalize on the momentum with a pipeline of hotly-anticipated public offerings from Nykaa, Paytm, and PharmEasy, and a number of others still in the works.

Even IPOs that are entirely secondary sales by existing investors, for example, the recently concluded CarTrade IPO, are being lapped up. Also, recent IPOs in the non-tech segment like Shyam Metalics and Rolex Rings were well-received. So, this IPO party is broad-based and across a wide variety of sectors.

Could you tell us a bit more about the deal activity from the second fund?

The fund has completed eight investments across a range of sectors, as well as a profitable exit very early in its life. Since January, the fund has completed three new investments—BRFL Textiles, Canpac Trends and Walko Food. The fund led a consortium to invest a total of about Rs 240 crore in BRFL Textiles to support its growth plans. It completed an investment of Rs 60 crore to augment Canpac's capacity.

We are looking to close one more investment and are also in the process of raising the third fund.

Is the new fund going to be sector agnostic?

It is going to be relatively sector agnostic with key focus on three broad verticals — consumer, financials, and manufacturing, with an overarching focus on small- and mid-cap companies. The small and mid-cap space is an area where we believe we have developed a very good expertise and positioning. From a revenue perspective, our investment will be into companies that have a revenue typically of less than Rs 750 crore.

How important is ESG integration for businesses and investors? Is it just a fad or is it really an important factor?

ESG is becoming increasingly important in the overall investment landscape. This had been initially driven by some of the large global investors that invest in PE funds, as well as invest directly across geographies. But now it has been recognized, acknowledged and adopted by a whole host of investors. It has not only become a lot more important today, it will continue to become a much more important aspect of the overall investment evaluation process.

Does it put pressure on due diligence or narrow down the investment universe and make it more challenging?

It does put more pressure on due diligence, but I don't think it narrows down the investment universe because this is becoming a more accepted norm today. All companies over time will accept this and adopt this to some extent. I don't think we can actually have a significant number of companies who say they will not abide by widely accepted ESG principles.

We've seen a rise in control deals over the past few years. How has the mindset changed for Indian business owners as well as PE players?

Control transactions are going to increase in India like they have in the western markets. It started out in a small way a few years ago, and now we are seeing more and more control transactions happening.

The Indian PE industry is maturing and has become well segmented. Control transactions are steadily gaining favor with larger, buyout-focused funds. KKR's acquisition of a controlling stake in Vini Cosmetics is a recent example. As PE investors gain more confidence in India as a lucrative investment destination, this trend will only increase. There is also a view that control deals allow for greater exit flexibility.

Covid-19 also played a part here, as strategic players had to shift focus to managing their core businesses amidst massive demand- and supply-side disruptions, leaving little bandwidth and resources to pursue inorganic growth opportunities. Large PE funds sitting on record dry powder seized the opportunity to pick up quality businesses at attractive valuations.

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