LEADING THE GAME

COVER STORY

With path-breaking deals like Avendus, and big-ticket exits such as ATG in a difficult environment, KKR has shown that it has the pulse of the complex Indian investment market

BY DEEPTI CHAUDHARY

Sanjay Nayar, CEO of KKR India

VIKAS KHOT

It was a light day at work for Abha Agarwal—a rarity for her—in June last year. The 35-year-old had just closed a large, complicated transaction at Avendus Capital, where she works as director, financial advisory, and was contemplating a short break—another rarity. But her pleasant reverie was soon broken by her boss Gaurav Deepak, co-founder and head of Avendus's flagship financial advisory business and international operations. He informed Agarwal about her next big assignment—"one of the largest mandates" Avendus had ever taken up. At that point, the only information that could be shared with her was that it was in the financial services space. Deepak would not even reveal the name of the company. It was only later in the day that she was told that the deal involved her own employer. Avendus had initiated talks for a fund raise with global marquee private equity (PE) firm KKR India.

"I tried guessing, but never thought it was Avendus," says Agarwal, who is responsible for crafting the KKR India-Avendus deal, one of the largest PE transactions last year. Considered a first-of-its-kind deal, it saw a mid-cap financial services firm, largely known for its investment banking advisory services, raising capital from a PE investor to expand the scope of its operations: This would include adding a credit solution offering, and a differentiated wealth management and alternate asset management service.

It was only in November that Agarwal could envision any sort of holiday. By then, KKR India had invested $106 million for a 68 percent stake in Avendus.

The rationale for the deal is easily explained. Avendus has a formidable investment banking advisory practice in the country which is growing year-on-year despite general sluggishness in the investment banking business. The digital and technology boom is adding to its deal count and fee pool. The firm is now looking to create a market leading position in its other businesses on the back of unique product offerings and relationships that it has built with entrepreneurs in the last 15 years. KKR, meanwhile, has backed several financial services firms globally, ranging from India to the US to China. In India, besides Avendus, it has backed firms like Max Financial Services and Magma Fincorp, a non-deposit-taking non-banking finance company (NBFC).

Also important is the man at the helm at KKR: Sanjay Nayar, whose expertise and interest in the financial services world is well known. Consider that Nayar, 55, has been the CEO of two marquee firms in India —Citibank (from 2002 to 2008) and now KKR India. A 23-year Citigroup veteran, Nayar managed the bank's key businesses in India, including consumer banking, corporate and investment banking, among others. In the 2003-2008 period, Citi India's revenues jumped from Rs 3,167 crore to Rs 8,410 crore (up 166 percent) and profits grew from Rs 572 crore to Rs 1,804 crore (up 215 percent).

At KKR, Nayar not only set up its India office, but also created an investment firm that went beyond typical mediated, minority deals. He has deftly leveraged his understanding of the Indian market and long-standing relationships with entrepreneurs from his banking days, creating an institution that advises, mentors and backs businessmen while trying to stay clear of the rat race. Over the last 10 years, KKR India has invested about $1.7 billion in 11 PE transactions.

"Sanjay is someone who not only understands credit extremely well, given his Citi background, but over a period has also [gained] complete proficiency in value investing. His transactions not only ensure that the downside risk is limited in terms of intrinsic value, but he is also creative enough to come up with structures that suit both his needs [for risks and rewards] and the entrepreneur's for cash flow and fund flow," says Munesh Khanna, leader, corporate finance and investment banking, PricewaterhouseCoopers India (PwC) India.

While most investors only talk about proprietary deals, Nayar actually practices it. Take the case of Avendus. For him, Avendus was not an investment opportunity that suddenly emerged in a few months. Nayar (who was with Citi at that time) first met co-founders Ranu Vohra, Gaurav Deepak and Kaushal Aggarwal 10 years ago, when Avendus became a channel for Citigroup to service their SME market segment. The trio closed a few deals even as Nayar observed their methods as well as their client focus.

Not one to forget people that impress him, Nayar kept track of their work over the years. His interest in Avendus piqued about four years ago, at a time when the advisory firm's name started coming up in almost every third or fourth deal to get closed. At the same time, Avendus acquired a small NBFC, indicating keenness in the credit business, and also sharpened its focus on wealth management—all areas of interest for Nayar.

After several let's-get-better-acquainted meetings, things got serious 18 months ago. Nayar and Vohra spent many Sunday afternoons at Mumbai's upscale Willingdon Club discussing Avendus's future plans.

"Having created a platform which is trusted by entrepreneurs across industries, the mantra now for each of Avendus's businesses was to 'scale up'," says Vohra, 44, who is co-founder, managing director and CEO of Avendus.

Vohra and his partners, Deepak and Aggarwal, started Avendus from a cramped garage in Khar, Mumbai, in 1999. It was called Coolstartups at the time, and the basic business idea was to connect startups with investors. Unfortunately, soon, the dotcom bubble burst, venture capital investing came to a halt and in over 18 months, they could close only three deals.

But that was then. In 2015 alone, Avendus closed over two dozen deals. To get a sense of the change they are aiming to effect, consider this: For FY2015, Avendus had revenues of about Rs 200 crore and profits of Rs 45 crore. As it stands, investment banking accounts for 80 percent, while other businesses like alternate asset management and wealth management contribute 20 percent to the revenues. According to what it calls its "2020 vision", investment banking will contribute 40 percent, while wealth management, alternate asset management and the NBFC will bring 20 percent each to the topline.

(From left): Avendus co-founders Ranu Vohra, Gaurav Deepak and Kaushal Aggarwal

JOSHUA NAVALKAR

KKR is convinced that Avendus can pull off the transformation. "We are backing three bright bankers, but the vision is a joint one, which is to build a truly diversified financial services firm encompassing investment banking, wealth management, lending and alternate asset management... a really high-class mid-market merchant bank," Nayar tells *Forbes India*.

He would know a thing or two about straying outside the comfort zone. Nayar is, after all, the first PE investor in the country to go beyond traditional investments. In 2009, Nayar started KKR's performing credit business in India and later added the real estate NBFC and special situations business. It is this multi-capital vehicles strategy that makes KKR a formidable investment firm in the country today.

A MULTIFACETED ALTERNATIVES COMPANY

For long, investors—attracted by the country's 7 to 8 percent GDP growth—have thronged the private investment sector in India, assuming returns of 15-20 percent which could even go up to 25-30 percent with the right push.

Their expectations, however, have been tempered over time with the realisation that it is unfair to assume that the Indian PE space would follow an investment model created and perfected in the US, a deeper and more mature market. The companies here have extended gestation periods and promoters want long-term patient capital; in that context, to truly grow, private equity would have to do more than just be an equity player.

KKR, which has been investing in India since 2006 and opened its India office in 2009, has understood the pulse. It is one of the few PE firms in India to have four distinct

OVER THE LAST 10 YEARS, KKR INDIA HAS INVESTED ABOUT $1.7 BILLION IN 11 PE TRANSACTIONS

funding vehicles to cater to the diversified capital needs of promoters here—the PE business, performing corporate credit, performing real estate credit and special situations and distress. Across its various verticals, KKR has invested more than $5.2 billion in India. (KKR does not have an India-dedicated PE fund and is currently investing in the country through its Asian fund.) “We want to be a solution-based capital provider which is impactful and value-adding to the companies we partner with,” Nayar says.

And Nayar has set the tone for that. VG Siddhartha, 56, chairman and managing director of Coffee Day Enterprises Limited (CDEL), has known Nayar since the latter was with Citi. But that in no way implied that Nayar would blindly invest in Siddhartha’s diversified coffee empire. “He did his due diligence and in three months, he made an investment,” recalls Siddhartha. In 2010, KKR along with Standard Chartered Private Equity and New Silk Route invested $200 million for a 34 percent stake in CDEL.

“Sitting on the board [of CDEL], he [Nayar] has contributed a lot to the growth of the business,” adds Siddhartha. For example, for CDEL’s Cafe Coffee Day business, Siddhartha says that Nayar closely monitors metrics such as customer service and customer satisfaction. “When it comes to service standards, he goes into the details of how we can improve them. He is not a man who only looks at numbers,” says Siddhartha. “He knows what is good and bad. And his ability to judge people is tremendous.”

And it shows in the results. KKR has been on an upswing in India. The last year has been especially exciting for KKR in India as its four verticals have started taking clear shape. Its real estate lending platform raised funds from The Townsend Group; KKR made its first investment in India from its new Special Situations Fund when it invested $150 million in the JBF Group; it also made three exits since March 2015. Further, it got approval from the government for its asset reconstruction company in March this year. This may prove game-changing, as has its approach to debt.


BV Krishnan, member, KKR, and head of third party credit and capital markets, India

JOSHUA NAVALKAR

DEBT, A FORMIDABLE TOOL

KKR was the pioneer in identifying the opportunity in the debt and structured deals space in 2009 in India. It has used two entities to this end: Performing corporate credit or its corporate NBFC, and performing real estate credit or real estate NBFC. In the last 5-6 years, KKR has executed about $3 billion in corporate direct lending across about 65 deals. Half of this amount has been paid back already. Last year alone, the corporate NBFC did financing worth around $1 billion.

“The corporate NBFC has come of age, with a clear brand position in the market. Entrepreneurs know they can talk to KKR for long-term structured debt to tide over difficult times. There are situations where they don’t want to go into CDR (corporate debt restructuring), don’t want to sell their businesses to PE firms or do an IPO (initial public offering) in a hurry but are happy to give their businesses another shot,” says Nayar.

KKR provides term financing by working with companies at an operating level, and with promoters at holding companies. Operating companies find this helpful in addressing their need for flexible growth capital, last-mile financing, consolidation of debt and putting in place an appropriate capital structure well-suited to their business cycles and cash generation profile. At the holding companies, KKR helps promoters manage asset-liability mismatches, as well as consolidate their shareholding. Last year’s Metropolis Healthcare deal was one such. KKR’s performing corporate credit business funded the buyout of the 27 percent stake held by Warburg Pincus in the pathology chain.

The performing corporate credit platform has proven to be a strategic move for KKR. India doesn’t have an active corporate bond market. For an over-$2 trillion-economy, that emerges as a big gap. Historically, banks have been on one side and equity markets on the other: KKR sees the need to fill that void (between bank loans and equity), and considers a flexible direct lending business model the optimal approach. This belief stems from experience. KKR has seen the evolution of the full credit spectrum and creation of multiple segments in markets like the US, and believes that India has to systematically step away from the reliance on bank markets in the long run. These are simple term loans, flexibly structured, either added to or at times replacing existing term loans; they give companies breathing space for 2-4 years before the economy starts to grow at a faster clip and earnings come back.

“Our view is that mid-market companies find it very tough to raise financing in India. Historically, the system is geared to providing capital to larger corporates, but doesn’t help the economy thrive as you need a healthy financial services system that can address the core needs of the mid-market ecosystem,” says BV Krishnan, member, KKR, and head of third party credit and capital markets, India. “Once we come out of the present tough economic cycle, we believe this will repeat itself because of the capital constraints at banks, NPL (non-performing loan) issues and so on that will lead to a pull to larger credits for right or wrong reasons. Again the mid-market companies may suffer as a consequence.”

KKR AT A GLANCE

Investing in India since → **2006**

Opened a Mumbai office → **2009**

KKR has invested about → **$1.7 bln in 11 PE deals**

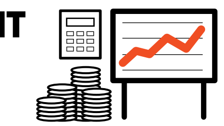
KKR has extended more than **$3.2 bln** of structured financing

It has invested nearly **$200 mln** from its special situations business

Has also co-invested **Rs 350 crore** in IARC (International Asset Reconstruction Company)

Source: *KKR*

INVESTMENT STRATEGY IN INDIA



Long-term, deep relationship building with the business community

A **‘patient-capital’** provider

Differentiation through **proprietary, partnership** approach with key entrepreneurs and focus on driving operational value-add

KKR’s real estate credit business, which is two years old, has executed about $300 million in financing. On the real estate lending side, these funds largely go to projects which are under construction, with approvals in place and that have completed basic land acquisition. Currently, its focus is on residential development. The platform also gives capital to projects that can be used by developers to consolidate their holdings by buying out PE investors, and help them grow to the next stage of the same project or in others. “We feel that it is a significant market opportunity given that you have meaningful real estate development under way across the board and banks are somewhat constrained by how much capital they can lend to the sector,” says Krishnan.

That is not surprising, given the stress India’s real estate sector is under. In 2015, the industry saw a fall in property prices, dip in demand and increase in unsold inventory. Does that bother KKR? “Of course, but real estate is all about micro markets,” says Krishnan. It boils down to each individual locality. Simply put, KKR may invest in a promising pocket of Gurgaon, but not necessarily all over the region.

BREAKING NEW GROUND

Having established its presence in the more traditional areas, KKR has now directed its attention to special situations and distressed assets. Bringing these businesses into financial viability is not easy. KKR, however, is going in where few like to tread. For instance, KKR and Akhil Gupta of Bharti Group acquired a majority stake in International Asset Reconstruction Company (IARC) for about Rs 350 crore. “It is yet another permanent capital vehicle which gives us bankruptcy and Sarfaesi (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act) rights and the opportunity to take on the asset and make it operationally and

PE DEALS FROM 2010-2016 YTD (TILL MARCH 2016)

	Excluding Real Estate		Including Real Estate	
	# of deals	Value ($ mln)	# of deals	Value ($ mln)
2010	565	**10,227.33**	550	**10,030.21**
2011	762	**11,486.81**	807	**12,730.30**
2012	864	**11,025.46**	921	**12,174.43**
2013	911	**11,029.39**	958	**11,872.84**
2014	1005	**12,865.02**	1083	**14,673.60**
2015	1507	**21,199.45**	1573	**23,073.74**
2016YTD	311	**2,038.93**	315	**2,082.39**
Total	5925	**79,872.39**	6207	**86,637.51**

Source: *VCCEdge*

financially viable," says Nayar.

India has the potential to be a large NPL market as a result of a weak economic cycle, among other things. This market can be addressed either by working with banks to buy stressed loans, or collaborating with companies to provide capital—equity and debt, or a combination. In order to enable an investment firm to actively address this market, the toolkit should have a few things—an asset reconstruction company or ARC (to help buy loans from banks), deep capital pools (which can invest side-by-side with the ARC, or directly with companies), and restructuring expertise.

"Once you buy a bad loan, you need to recover money and you can do that by reworking operations, improving efficiency and finding alignment with the stakeholders involved. Through our special situations business, and our global Special Situations Fund, we can address this market," says Krishnan.

While KKR may see value in this business, none of the 14 ARCs in India have made much money so far. This could also be because, typically, shareholders of ARCs have been banks themselves; so effectively banks sell, and also indirectly buy and recover. Since banks have their own capital needs, they were not able to capitalise ARCs in a meaningful way. Can KKR change that? Observers are hopeful. "Sanjay is a banker at heart. He has a good understanding of what works, what doesn't and which segment to target. That's how he is differentiating KKR," says Sanjeev Krishnan, leader-private equity, PwC India.

Consider how he has differentiated KKR PE. Instead of buying minority stakes, the firm is interested in transactions involving majority stakes, and is even adopting a platform approach for a few sectors.

For instance, KKR and The Chernin Group joined hands in November 2015 to create a new platform called Emerald Media to invest in the media and entertainment industries across Asia. KKR has committed up to $300 million to the Emerald Media platform from its KKR Asian Fund II and The Chernin Group will join as a minority co-investor. It intends to invest approximately $15-75 million in any such business.

"The number of deals in the $25-40 million range in this space is huge. There is a lot happening in the digital media space and when 4G, broadband connectivity increases in India, there could be a large opportunity of consumption of information and content," says Nayar.

Even as there are new ways of delivering content, revenue models are still a question mark for a majority of these firms. Rajesh Kamat, joint head, Emerald Media, says the concept of a paid app or content is not as alien as most would believe, provided the offering is important enough for the user. "If what's being offered is differentiated enough, people will pay," Kamat says.

However, even though Emerald Media is a bold step for KKR, nothing reflects the new approach better than the Avendus deal.

THE BIG BET

Founded in 1999, Avendus started as a firm with advisory as its core. It was called Coolstartups then. It gradually expanded from being a pure technology advisor to a wider industry advisor. It also started honing its cross border deal-making strategy, becoming one of the few home grown I-banks to do that.

Between 2008 and 2014, it focussed on getting operating capital and started seeding some new businesses in capital markets, wealth management and alternative asset management. Avendus's I-bank business did well, managing high profile deals such as Satyam (Goldman Sachs and Avendus were appointed as investment bankers by what was then Satyam Computer to help the board explore strategic options) and Serco Group's acquisition of business process outsourcing firm Intelenet Global Services from PE firm Blackstone for $635 million.

The practice accelerated with the addition of the digital and technology verticals and Avendus was consistently ranked among the top three investment banks in India, according to Merger Markets, on the back of deal count. But the company faced challenges in its capital markets and broking businesses where, Vohra says, "it could not find the right angle".

After 2014, Avendus sensed it wasn't operating in the big markets. For example, in investment banking, the market in India had shrunk from $670 million in 2008 to about $250-300 million in 2014. While Avendus increased its market share and fee pool, its ability to expand the profit pool was hampered by the market size. That is when Avendus considered bringing a financial investor on board. "There was no way we could have built a balance sheet without capital infusion. Our profit was not enough for us to create a balance sheet to scale a business like the NBFC, which needs capital," says Vohra.

That decision was never going to be easy. As investment bankers, they understood the nuances of being a minority stakeholder; they were worried about how such a transaction will impact their work life, work culture and freedom. Would they end up working for the investor, was a question that crossed their mind several times. They did a number of referral checks on KKR and even got feedback on Nayar's operating style. "It's not about money, it's about destiny. We serve the market at large; we needed clarity on KKR's role and its expectations of us," says Deepak, who at 41 is the youngest of the three founders.

But that conflict is history. Both sides were clearly convinced, and Avendus has already started allocating the funds raised to its businesses. About 70 percent will go to the NBFC that it acquired two years ago to start a credit solutions business for the mid-market.

"People have family doctors, family lawyers; they also want a family banker. You [as a client] may have a strategy, but you can't share it with everyone. A majority of our clients don't want just transactional relations," says Aggarwal, 42, co-founder and managing director, Avendus. He co-heads the financial advisory business and leads the firm's structured finance operations.

For Avendus, its investment banking business is its largest with year-on-year growth. "There is a lot of business to do. Investment banking is more of the same but a few new verticals could be added," says Deepak.

In wealth management, Avendus has formulated new products. Its yet-to-be launched Avendus Private Access Investment Pvt Ltd business will allow shareholders in unlisted firms to sell their stake to others, including investors keen on getting equity exposure in a private firm. This is a huge business opportunity, given the number of people interested in investing in startups is on the rise. Similarly with treasury management: Flush with capital, startups are often unsure about managing the funds. Avendus is working with several venture capital firms, managing the wealth of their portfolio companies.

Ultra-high net worth individuals are increasingly opening up to the idea of investing in very early stage firms. Avendus's wealth management team is advising clients on sourcing, curating and structuring deals.

The plans are many, but peers sound a note of caution. Avendus is a smart organisation which has created a niche in the IT sector, says Vikas Khemani, president and chief executive of Edelweiss Securities.

"But of organisations which have grown from a niche into diversification and broadening of products on offer, few have been successful," he says. "Scalability while moving from mono-line to multi-line will be a challenge, but I am not saying they cannot achieve it."

A founder of a large financial services firm says all companies have a "centre of gravity" and usually for an investment banking firm, it remains just that—investment banking. "I-banking firms find it hardest to change. If they expand to asset management or brokerage or corporate finance, the profile of the organisation appears to drop," he says.

The good news for the believers: The co-founders' approach. "I have worked hard but never harder, there is so much to do. It's a great team, great partner and good times for business, if we don't make something big out of it, it's our fault," says Deepak.

And the investor's street cred: KKR's exits indicate they don't make their bets lightly.

AVENDUS FACT SHEET

87
M&A transactions with deal value of $5.6 billion since 2007, including 55 cross border transactions

26
Structured credit transactions with deal value of $480 million since 2007

$1 bln
Assets under management in its **Wealth Management** business, 200+ families

Consistently ranked by Merger Markets among the **top three** investment banks in India

99
Private equity transactions with deal value of **$3.8 billion** since 2007

115+
Employees globally. One of the largest investment banking teams in India.

$140 mln
Assets under management through its **technology and public funds**

Global presence with offices in five cities, three countries

*The deals/figures mentioned above are across all Avendus Group Entities globally

Source: *Avendus*

OF EXITS AND PARTNERSHIPS

Since the beginning of 2015, KKR has seen three exits, which is remarkable in an exit-starved PE industry. In March-April 2015, it exited from Bharti Infratel. 2016 for KKR began with a partial exit from Dalmia Cement.

The next exit followed two months later. On March 25, The Yokohama Rubber Co said it had reached an agreement with KKR and others to buy Alliance Tire Group (ATG) for $1.18 billion. KKR had bought ATG in 2013 for an amount said to be around $500 million. The investment firm will make over 2x returns on this deal in less than three years of the investment period. The Yokohama-ATG acquisition is expected to be finalised on July 1, 2016.

The kind of value add that most investors talk about was apparent in the case of ATG. Since August 2013, ATG's management has worked with KKR and members of KKR Capstone, an independent team of operational executives who deal exclusively with KKR portfolio companies, to measure its coal consumption, energy usage and its scrap losses. The programme led to quantifiable environmental results. Between the second quarter of 2014 and the first quarter of 2015, ATG's calculations showed that coal consumption per tonne of production has reduced by 90 kg/tonne; steam consumption by 10 percent per tonne; and scrap waste is down by 4.3 percent.

Yogesh Mahansaria, founder and CEO of ATG, tells *Forbes India* in a phone interview: "KKR helped us strengthen our global management team. They helped in formulating the right structure, they sat on the interview panel and once employees were hired they worked on integrating them into the company and our culture. We also needed help in Europe and the US where Capstone worked on market penetration as well as on seeing how ATG could execute better on the sales and marketing front. They were a very critical and integral part of our growth story over the last three years. They understand the strategy of the company and then they see where they can play a role."

Such exits are coveted by the industry, but Nayar says he is in no hurry for them. However, he does add that strategic exits compared with IPOs are more active and "attractive", should India remain a preferred destination.

In its spirit of evolution, KKR has also gone beyond financial partnerships. For the last 18 months, the PE firm, along with Impact Investment Exchange (IIX) and Shujog, was working with Hyderabad-based plastics recycling business Banyan Nation to help chart a plan to make it more sustainable and attractive to financial investors.

While KKR didn't put any capital of its own into the company, it helped Banyan Nation raise more than $800,000 in their first fund-raise. Members of IIX, Shujog and KKR conducted site visits and assessed Banyan Nation's business model and social impact.

IIX and KKR supported the development and vetting of a business plan and financial model, and brainstormed economics and scalability. "Our partnership highlights how social impact entrepreneurs can raise the capital they need from investors with the right business and financial models," says Steven R Okun, director of public affairs at KKR Asia Pacific.

Yogesh Mahansaria, founder, Alliance Tire Group

VIKAS KHOT

From pure financial investments to social partnerships, KKR has created an almost all-encompassing model in India. It has the country's pulse, but there is the lingering fear. "The one fear we all have is of real growth not picking up. Also, if the rupee keeps depreciating, investors would not see returns of the kind they intended to make in India," Nayar says. At the same time, he believes India is uniquely positioned with a new government and a stable set of macros. Of course, it helps that KKR has its bets hedged with its fingers in all the right pies. F

(Additional reporting by Samar Srivastava, Anshul Dhamija and Salil Panchal)