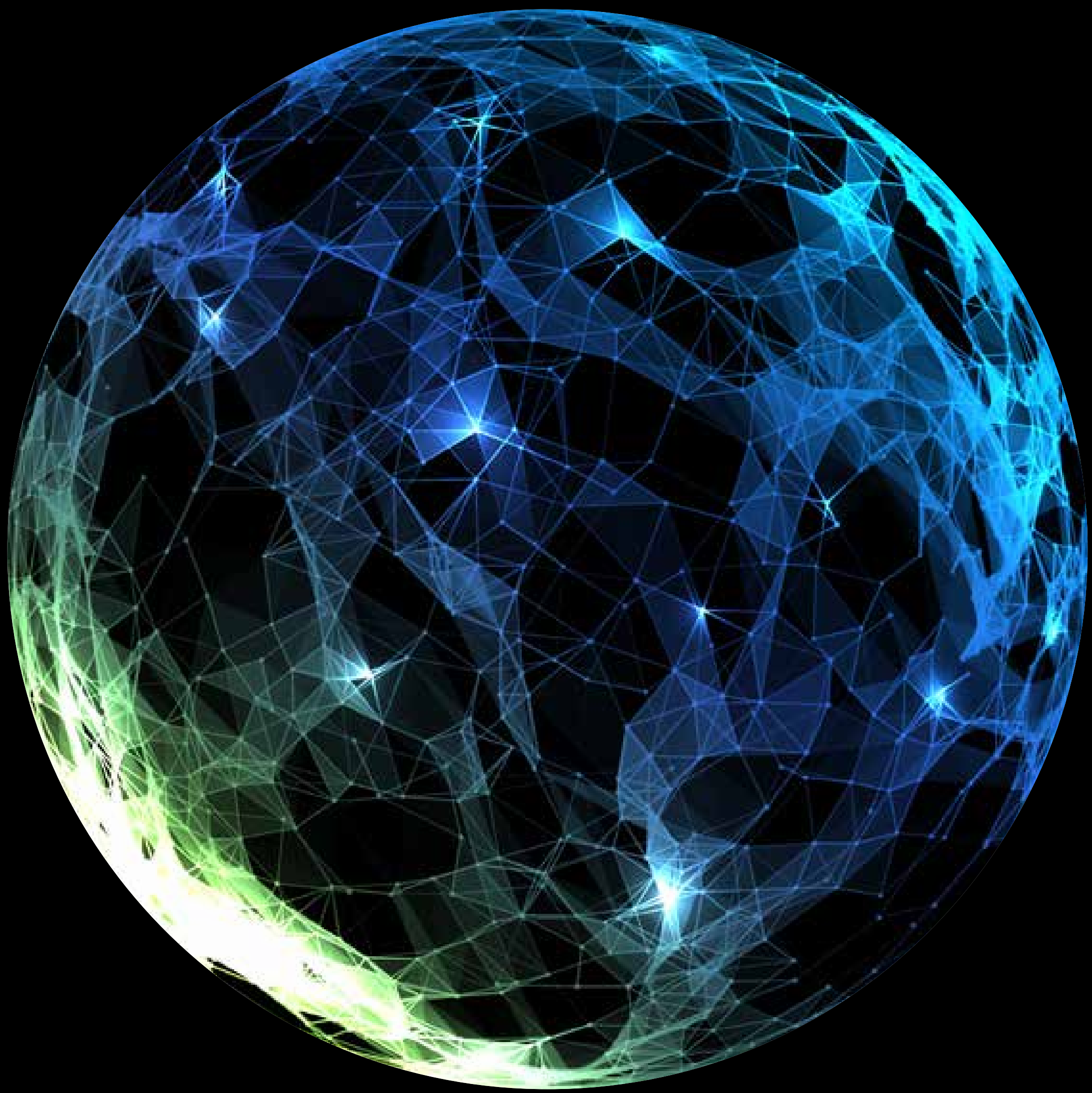

Growth-Deloitte Perspectives Deloitte Private Newsletter

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Contents

Foreword

COVID-19, like a typical black swan event, has taken the world by complete surprise. What started off as a health issue, is now snowballing into an economic crisis; with the entire world staring at a long-lasting global recession.

Public policy measures for containing the spread of COVID-19 are resulting in significant operational disruptions for companies. Staff quarantine, supply-chain failures, orphaned and/ or unavailable inventories, and sudden demand reduction from customers are creating serious issues for companies across a far wider range of sectors than initially anticipated. A number of companies now face weeks, if not months, of exceptionally poor trading conditions. For most, the revenue lost during this period represents a permanent loss, rather than a timing difference and is putting sudden, unanticipated pressure on working capital lines and liquidity.

As per the IMF, the Covid-19 pandemic will severely impact growth across regions. The global economy is projected to contract sharply by –3 percent in 2020, much worse than during the 2008–09 financial crisis. In a baseline scenario, which assumes that the pandemic fades in the second half of 2020 and containment efforts can be gradually unwound, the global economy is projected to grow by 5.8 percent in 2021 as economic activity normalizes, helped by policy support. The corresponding projections for India are growth of 1.9 percent in 2020 and 7.4 percent in 2021.[1]

2019 was a record year for private equity (PE) with investments touching US$41.2 billion; thereby, significantly surpassing investment levels of the last four years.

Going by the data on PE deals for the first four months of 2020 and based on discussions with PE funds across the entire spectrum, it appears that 2020 will be an unfortunate aberration for PE on all counts—new investments, fund raising, exits, or the health of portfolio companies. The moot question now is: “what is the medium- to long-term outlook for the PE industry and what is going to be different in the post COVID-19 world?”

The questions doing the rounds revolve around managing deal flow, the criteria for portfolio selection, managing fund raising, Limited Partner (LP)- General Partner (GP) negotiation, interpretation of legal clauses, and the recent tweaks in the FDI regulations. Even with uncertainty glaring at the entire investing community, some early trends have surfaced, which have been summarised below:

- Fund-raising difficulty for first-time GPs
- Increased communication between GPs and LPs; and GPs and portfolio companies
- Massive behavioural change expectations from most fund managers despite beliefs that valuation reset will offer good investment opportunities. They would want to wait and assess the nature and extent of changes and be cautious about lapping up investments
- Greater interest from domestic HNIs and family offices in private equity amidst fear of LPs going back on their commitment (which seems unlikely given how water tight LP agreements typically are)
- Greater involvement of fund managers in portfolio companies with

1. https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020

the overriding mantra being cash-flow and working-capital management, cost control, and only essential spending

- Additional rounds of fund raising from existing set of investors—an opportunity to consolidate stakes at better valuation wherever possible
- Shrinkage in the average deal size (in the near term) as GPs are likely to be cautious in making fresh bets. Growth capital transactions will take precedence over buyout deals, where investors are likely to exercise a lot more caution
- "Digital" and "supply chain" to be the buzzwords in any business as these have emerged as the most crucial cornerstones in the current situation
- High mortality rate of companies (during the next six months to a year), which will provide an opportunity for PE-backed companies to consolidate their position
- Significantly lower activity in PE-backed exits due to lower valuations
- Increased Public investment in Private Equity (PIPE) deals due to lower valuations of listed company stocks
- More opportunities for special situations and credit funds with the increase in stressed assets and need for funding
- Muted activity in the infrastructure and financial services sectors, which have seen substantial PE activity in the last two years. Pharma, specialty chemicals, certain consumer subsectors (essential foods/goods, personal healthcare), and technology-based (including Ed-tech, e-pharma) will witness higher interest from investors in the next 12–18 months
- High level of dry powder available with India based PE Funds (upward of $5bn) would mean that fundamentally strong companies that respond and recover fast in the current environment would eventually attract significant PE interest

Based on discussions with a number of PE clients, it appears that the current phase is likely to be a 12–18 month pause; post which, there will be sufficient liquidity in the market and the PE environment would emerge stronger than before with the gaps plugged in. That said, while the long-term view on India continues to be bullish, for now, it is time to be extremely cautious. Those that have been quick to respond to this crisis, will recover faster, and thrive when the tide turns.

Andy Khanna
National Leader – Private Equity

Sheetal Nagle
Director

Private Equity Trends

Despite the growing macroeconomic and political uncertainties across markets, global Private Equity (PE) activity did not slow down much in 2019. In fact, the India story continued to shine in most parts.

Overall Trends

Private Equity[2] (PE) investment increased to US$41.2 billion in 2019, thereby recording a 29.56 percent rise from US$31.8 billion in 2018 and significantly surpassing the investment levels of the previous four years. PE[3] investments for 2019 stood at US$27.9 billion compared with the previous highest of US$23.3 billion clocked in 2017 (over the past five year period). VC[4] investments for 2019 were US$13.3 billion, as against the previous peak of US$10.3 billion registered in 2018 (over the past five year period).

The number of PE deals closed in 2019, were however, the lowest over the past five years. 280 PE deals were closed in 2019, which is much lower than 300 plus PE deals closed in each of the previous four years. The number of VC (Venture Capital) deals for 2019 was moreover in the same range as 2018, but registered a drop as compared to the previous three years.

The above is indicative of a trend towards a larger value deals both in the PE and VC space. The average deal size appears to have gone up in 2019. The deal club of US$100 million and above recorded 52 PE deals, contributing to a cumulative deal value of USD$23.3 billion. Of this, there were five deals of more than US$1 billion (four in infrastructure), aggregating to a deal value of US$8.7 billion.

High value deals (above US$100 million) contributed to 83.5 percent of the total PE deal value in 2019, making the year standout as the year of big-ticket transactions. The average VC deal size has jumped from US$4 million in 2015 to US$11 million in 2019. Further, 2019

2. Includes PE and VC
3. NIncludes private equity investment, pre-IPO, real estate, public equity
4. Includes venture capital, angel and seed

recorded 60 high value VC deals (more than US$50 million each) aggregating to a deal value of US$7.6 billion, which was 57 percent of the total VC investments.

Control[5] PE deals continued to be in the range of 20 percent of the total number of PE deals in 2019. In value terms however, control deals seem to have shown an increase in the overall basket of deals from 27 percent in 2018 to 32 percent in 2019. The trend appears to be veering towards more buyout deals.

Sectoral analysis

As regards sectoral trends, infrastructure attracted most investments in terms of value, with Brookfield being the most prolific investor. Top five infrastructure deals accounted for 30.5 percent of the total PE deal value across sectors. Infrastructure recorded 39 percent more investments than the next most attractive sector, Technology Media and Telecommunications (TMT). The average infrastructure deal size for 2019 was as high as US$250 million, as compared with the overall average deal size of US$30 million. The most number of PE and VC deals were recorded in TMT, which were 122 percent more than the next active sector – Consumer and Industrials.

The largest deals of 2019 were in infrastructure including Brookfield's US$3.7 billion buyout of Reliance Jio's tower assets and US$1.8 billion investment in Reliance Industries' East-West Pipeline. Non-infrastructure large deals included Alibaba and Softbank's US$1 billion investment in Paytm.

The top 5 sector-wise deals are listed below.

This trend shows that private equity in India has come of age and buyout funds are prepared to write much larger cheques for Indian acquisitions and investments.

Sector-wise top deals in 2019

Top five financial services deals

Sr. no.	Target	Buyer	Deal value (US$ mn)
1.	One 97 Communications Ltd.	Alibaba Group Holding Ltd., Softbank Group Corp., D1 Capital Partners L.P., Discovery Capital Corporation, T. Rowe Price Group Inc.	1000
2.	SBI Life Insurance Company Ltd.	Carlyle Asia Partners V, CPP Investment Board	812.79
3.	SBI General Insurance Co. Ltd.	PI Opportunities Fund I, Warburg Pincus LLC	433.36
4.	Bajaj Finance Ltd	GIC	339
5.	ECL Finance Ltd.	Quebec Deposit and Investment Fund	253

Top five TMT deals

Sr. no.	Target	Buyer	Deal value (US$ mn)
1.	Citius Tech	Baring Asia	880
2.	Zee Entertainment Enterprises Ltd.	Invesco Ltd.	613.96
3.	Trustroot Internet Pvt. Ltd.	GGV Capital, Altimeter Capital Management, Hillhouse Capital Management Ltd., DST Global, Lightspeed India Partners I LLC, Lightspeed Venture Partners X LP, Footpath Ventures SPV I LP, Citi Venture Capital International, Tencent Holdings Ltd.	585
4.	AGS Health Pvt. Ltd.	Baring Private Equity Asia	320
5.	Zilingo Pte Ltd.	Sequoia Capital India Advisors Pvt. Ltd., Temasek Holdings Advisors India Pvt. Ltd., Burda Principal Investments GmbH and Co. KG, EDBI Pte. Ltd., Sofina SA	226
6.	91Streets Media Technology Pvt. Ltd.	Temasek, Bessemer Veture Partners, Orios Venture Partners, Eight Roads and Others	226

Source: VCCEdge database, press articles, Deloitte analysis

5. Stake acquired being more than 50%

Top five life sciences and healthcare deals

Sr. no.	Target	Buyer	Deal value (US$ mn)
1.	Bharat Serums and Vaccines	Advent International	250
2.	Rubicon Research Pvt. Ltd.	General Atlantic Pvt. Ltd.	100
3.	Akums Drugs and Pharmaceuticals Ltd.	Quadria Capital Fund II LP	70.53
4.	Asian Institute of Gastroenterology Pvt. Ltd.	Quadria Capital Investment Management Pte. Ltd.	52
5.	Tirupati Medicare Ltd.	Affirma Capital	50

Top five CIP deals

Sr. no.	Target	Buyer	Deal value (US$ mn)
1.	Oravel Stays Pvt. Ltd.	SoftBank Vision Fund LP	806.76
2.	Hotel Leela Venture Ltd., Four Hotels	BSREP III India Ballet Pte. Ltd.	572.27
3.	The Indian Hotels Company Ltd. and GIC Pvt. Ltd., Investment Platform JV	GIC Pvt. Ltd.	397.64
4.	Lenskart Solutions Pvt. Ltd.	SoftBank Vision Fund II Lightbulb Ltd.	275
5.	Ola Electric Mobility Pvt. Ltd.	SoftBank Vision Fund LP	248.83

Top five real estate deals

Sr. no.	Target	Buyer	Deal value (US$ mn)
1.	GV Techparks Pvt. Ltd.	The Blackstone Group LP, Sattva Developers Pvt. Ltd., MindComp Regency Park Pvt. Ltd., Neelanchal Properties LLP	379.46
2.	Radius Infra Holdings Pvt. Ltd., One BKC	Blackstone Advisors India Pvt. Ltd.	357.26
3.	TSI Business Parks Hyderabad Pvt. Ltd., WaveRock Hyderabad Office Complex	SPREF II	250
4.	R Retail Ventures Pvt. Ltd.	Warburg Pincus	199.21
5.	IT Citi Infopark Pvt. Ltd.	The Xander Group Inc.	130.84

Top five infrastructure deals

Sr. no.	Target	Buyer	Deal value (US$ mn)
1.	Tower Infrastructure Trust	Brookfield Asset Management Inc.	3666
2.	Pipeline Infrastructure Ltd.	Brookfield Asset Management Inc.	1824
3.	GMR Airports Ltd.	TRIL Urban Transport Pvt. Ltd., GIC Pvt. Ltd., SSG Capital Management HK Ltd.	1153
4.	GVK Airport Holdings Ltd.	Abu Dhabi Investment Council, Public Sector Pension Investment Board, National Investment and Infrastructure Fund Ltd.	1076
5.	Greenko Energy Holdings	GIC Pvt. Ltd., Abu Dhabi Investment Council	824

Source: VCCEdge database, press articles, Deloitte analysis

Exits

On the face of it, PE exits do not seem to have fared well in 2019. In fact, the number of PE exits in 2019 (39 percent drop as compared with 2018) was lower than any of the previous four years. In value terms however, PE exits in 2019 appear to be in the same range as 2017 and 2018, considering that 2018 had an extra ordinary spurt due to the US$16 billion Walmart-Flipkart deal. Having said that, in each of the past three years, PE funds have clocked healthy exits of over US$10 billion.

Sale to strategics, constituted 45 percent of the total exits, and was the most popular exit route in 2019. While the overall number of exits dropped by 39 percent in 2019, PE-backed IPOs lost momentum and dropped by 79 percent. 2018 saw 33 IPOs whereas 2019 only 7. This drop is the lowest in the past six years. In fact in single digits for the first time since 2013. This could be attributed to capital markets remaining non-conducive for listing of mid-caps/ small-caps for a major part of the year on account of the decline in valuations and low appetite for mid-cap/small-cap paper. Also, in 2019, there was a decline of 49 percent in the number of secondary exits.

The biggest PE exit of 2019 was the Oyo buyback of Sequoia and Lightspeed for US$1.5 billion. This was followed by open market exits by Warburg Pincus and Caryle from ICICI Lombard General Insurance and SBI Life Insurance for US$424 million and US$393 million respectively.

Fund raising

As regards fund raising, 16 India dedicated funds announced final close in 2019; raising a cumulative of US$4.7 billion, with the charts being led by Edelweiss Alternative Asset Advisors and Kotak Special Situations Fund raising US$1.3 billion and US$1 billion, respectively, to invest in stressed assets. Of the 16 funds that announced their final close in 2019, three are first time funds – A91 Emerging Fund, Alteria Capital India Fund, and Aaruha Technology Fund, raising a total of about US$500 million. Further, the dry powder available with India based PE Funds was US$5 billion as of June 2019 (has shown a consistent increase since 2012); and that of India based VC Funds was about US$3 billion.[6]

This excludes large global funds that invest in India through global or Asia pool funds and hence if you add that the dry powder, the resultant figure would be a multiple of this amount. This demonstrates a growing appetite for investments in the near future.

Also, India attracted a few completely new set of investors in 2019. Kora Management, N.I.S. New Investment Solutions, Ping An Global Voyager Fund, TrustBridge Partners, were amongst the new funds investing in India in 2019 for the first time.

2020 Outlook

As per the Global Limited Partners Survey of 2019 conducted by EMPEA, India ranked third in EMPEA's global investment attractiveness ranking; behind South East Asia and China. It is however pertinent to note that India has dropped from being the most attractive market in 2017 to the second position n 2018 and finally to the third in 2019. While South East Asia, India, and China represent the most attractive investment markets globally, LPs report different perceived weaknesses within each. In India, investors report an oversupply of funds and high entry multiples as deterrents to future investment.

Sources:

VCCEdge
Venture Intelligence
IVCA - EY, PE/VC Agenda India Trend Book 2020
IVCA - The Private Equity & Venture Capital Industry Presentation powered by Preqin
Global Limited Partners' Survey by EMPEA
DTTILLP Analyses

6. Includes venture capital, angel and seed per Preqin

Interview with Ashley Menezes, Partner and Chief Operating Officer, Chrys Capital

1. **ChrysCapital is one of the most successful private equity investors in India. What is your magic formula?**
   There is no magic formula for success but there are lessons that we have learnt early on. One of the biggest lessons is the importance of taking periodic exits. In some of our earlier investments, after we exited, the value increased manifold but in long term it doesn't matter. As investors, we are passionate about all our investments but being opportunistic and having an unbiased and disciplined view to take exits has helped us over the years. That's perhaps one thing we as a firm do better than some peers.
   It is never too early to exit.

   While four to five years is our typical holding period, and we look for return north of 3X and 25+ percent internal rate of return (IRR), that's not really the only driving force. One cannot be formulaic about these aspects. It's not really cast in stone.

   The decisions of exit are driven by multiple factors. The driving force being your investment position relative to the environment. Where we are today and where will you be vis-a vis your environment after two to three years? Also, exit on specific investments are not just driven by a single view on that investment but also the view of the overall portfolio, considering the overall de-risking strategy. Having said that, we encourage our principals to think at the portfolio company level and not the fund level.

2. **With the fund raising experience of the eighth and largest fund, what would be your good and not so good stories?**
   For our eighth fund, we raised US$900 million from several new investors, including sovereign wealth funds, public pension funds, insurance companies and global fund-of-funds in a time when others were facing challenges in raising smaller amounts.

   Our ability to wear the LP's hat is what has held us in good stead.

   To explain by way of an example, for our fifth fund, we raised US$1.26 billion, which was much bigger as compared with our previous fund of US$550 million. We soon realised that was too much capital to deploy and that we didn't really have the capability to deploy US$80 million- US$90 million for every investment. And that's when we went back to our LPs and pared down their commitments. Not just that, we agreed to drop our management fee, retrospectively, when contractually we were not obliged to do the same. This helped establish that we have the best interest of our investors in mind at all times. This created a deep trust with our investors.

   We have heard our investors say time and again that our track record, deep trust and keeping their interest in mind are qualities that that made us stand out in tough times.

   For the eighth fund, we were targeting US$700 million in 8-12 months and we got to US$900 million in less than three months. That was indeed a very pleasant surprise.

3. **Having worked on significant deals in the life sciences segment, what are the key takeaways for the sector? How has the sector changed in the last five years?**
   Out of pharma and healthcare, we have really shied away from healthcare as it is more about real estate, and more so in the metro cities.

   Instead, we have looked at ancillary segments such as diagnostics, pathology, ortho in non-metros, etc. But there also we have been rather late entrants.

   In pharma, we have been active and have followed a threefold strategy. We have focussed on the bottom of the pyramid generic medicine with General Physician approach, the high-end, i.e. super specialty doctors and medicines where the margins are high and volumes are low, and third is in between these two. We have kept our focus on all three segments.

   Plus, we have looked at companies with strong export markets.

   As far as regulated exports are concerned, the sector has evolved and with various compliances and issues raised by agencies such as the Food and Drug Administration (FDA), and we need to be extremely cautious.

   On any of the sectors that we invest in, there are two things that we evaluate:

   - Do we have the capability/right skill sets in the sector to focus on what we are looking at?
   - Do we have the team or resources to focus on the sector?

     We back teams and companies that are extremely strong and focus on the right skill sets.

4. **Credited with having built several world class companies, what are some of the decisions PE investors like you focus on?**
   We have a hands on approach for all our investments. Our teams who work on a deal, stay involved during the investment till exit. We have now created a separate cell with an operations/consulting background to work more closely with our portfolio companies, and this cell works alongside the deal teams to add further value.

   Having said that, we only act as a sounding board to the entrepreneur where we have a minority stake, for any strategic decisions, but the decisions are not driven by us. We play a key role in four to five areas, and have upfront discussions with the promoters of the company on points like these:
   - Recruitment – we work closely with the promoter to have the best team in place including CEO/CFO or any other CXO
   - Benchmarking – showing companies the mirror as well as giving them a fair understanding of what their peers are doing better
   - Acquisition driven decisions- work closely with promoters to appraise them of the market scenario, help them for strategic sale, IPO, sale of business
   - Raising capital / financing / IPO / exits- basis our knowledge, we help promoters with the fund raising
   - Institutional framework

   We act as a support to the promoters and sound off our ideas to them for growth and ideas that add value to the company.

5. **Walk us through any case study of how your team has worked with a portfolio company on operational performance improvement, formulating corporate strategy and leveraging network?**
   In 2014 we invested in an IT company based out of US. At that point of time, it did not have any operations in India. And one of the reasons the American promoter preferred us was for the India connect.

   Post our investment, the company set up a couple of centres in India, and the offshoring model improved their EBIDTA margins by 300 bps. We also worked with them on optimisation of resources, their charge out ratios to various clients and basis all this, they managed to almost double their EBITDA margins from 5-7% to 12-14%.

   We also helped them with three acquisitions to increase their services portfolio from one service to multiple services, thus further improving margins as well. These acquisitions were also closed at cheaper valuations. We ultimately did a strategic sale of the company to a large MNC in 2018 at a 4X, and the promoter now heads the North American business of this acquirer. What better pat in the back could we have asked for?

   In another investment in a consumer goods, we undertook a benchmarking exercise which helped a margin turnaround .....EBITDA margins jumped from low single digit to low double digit.

   In all our investments, we help promoters to think through various initiatives to improve margins and reduce costs.

6. **With dry powder availability with India based PE Funds estimated at US$5 billion as of June 2019 (as per Prequin), and that of India based VC Funds at about US$3 billion, is PE investing just going to get tougher? And what would be your approach in this scenario? Do you think the India PE market is now showing a clear bias for buyout deals? What are the factors that could have led to that? And does this trend augur well for the PE industry?**
   There is definitely an evolution of the markets. Pre 2017, buyouts

were only about five percent of the total deals. That has now gone up to around 20-25 percent. Initially, promoters were also shy of selling out the entire company, which has changed over time. But buyouts in manufacturing segment are much more complicated and tougher than the services industry, because of the heavy asset base and licensing requirements. In services businesses, as the professional management involvement is improving at an organisation level, there will be bigger play for investors like PE. Also, while earlier we had Series A selling to Series B, we now have growth capital funds selling to global funds. There is a perceptible maturing of the markets and we are witnessing more money coming to India.

For us, we would like to be focussed on the sectors where we have the capability. If the business is fundamentally strong, has differentiated products/services, strong management, adequate business prospects, and have right factors in play, we would focus on those. We would continue to remain disciplined on what we pay for the assets. With the right balance of our enthusiasm and right price we can pay for that asset. For us, it is important to have a walk away price at all times and we try not to be swayed by the bidding/ auction process.

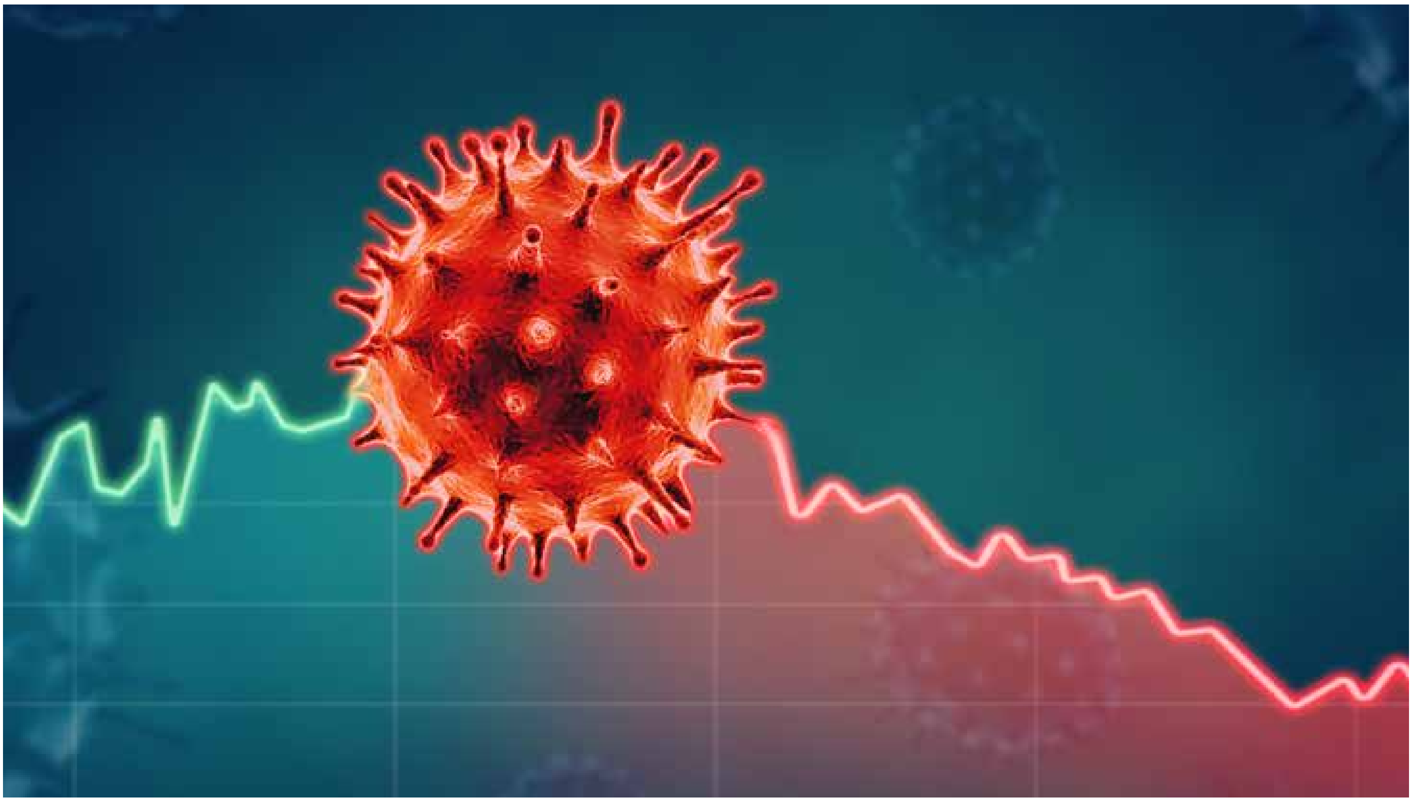
The current capital market scenario is tough but probably it is a temporary phase and we should look at it from four to five year perspective. PE exits will probably reduce during the current time but with the huge capital targeting India, over time there will be an increase in PE to PE transaction than we have seen before.

7. **With the stock markets entering the bear phase, what trends can one expect on PE exits going forward?**
   Capital markets have always been volatile, with good windows available for exit only for short durations. Our belief is that one needs to be opportunistic when that window is available. If that window is not available, then one needs to be ready to explore other exit avenues. For fundamentally good portfolio companies, one will always find exit alternatives.

   In the near future though, one can expect a drop in exits, both in number and value, due to the current environment. But hopefully this is temporary and this should normalise over a window of four to five years.

   In this backdrop, one can expect more secondary PE exits.

8. **How do you see COVID-19 impacting PE investments in India? Any sectors that would see increased focus in the near term future? And any that would fall by the wayside?**
   This is an uncharted territory. It is still too early to say and rather difficult to comment. The temporary dip in valuations could offer good bargains for fundamentally strong and resilient companies. However, these companies would also be facing challenges that are unprecedented. One must tread with caution. Our focus industries would continue to remain the same – pharma, financial services and information technology. There should however be greater clarity in three to six months on how this situation unfolds.



COVID-19: Formulating the immediate economic response

Executive summary

With India entering the third phase of a nation-wide lockdown, it is becoming increasingly evident that the economy will likely see a sharp slowdown in the next few quarters. Supply disruptions, fall in global and domestic demand, and stress on the banking and financial sectors will adversely affect growth. In such a scenario, the silver lining is the falling oil prices that may improve the country's twin deficit and give policymakers some headroom to act.

As there is little visibility on how long the pandemic would last, the economic impact could range from a mild downturn (where the growth slows for a quarter or two, and the economy bounces back immediately) to a severe slowdown (where growth slows for more than a year followed by a tenuous recovery). There could be three possible scenarios that may play out (a) an optimistic scenario, considering a temporary impact of COVID-19 and a V-shaped recovery, (b) a somewhat optimistic scenario, a severe and extended impact of COVID-19 and a U-shaped recovery, and (c) a pessimistic scenario, with a prolonged severe downturn. These scenarios present a varying degree of the economic and financial crisis, and predict the corresponding outcomes.

The government has made announcements in phases since the pandemic has hit the economy. The focus has been primarily:

a) **Managing the endemic and the resultant public health crisis** through augmenting financial resources, increasing insurance coverage, and using technology solutions

b) **Protecting income and employment, particularly for the more vulnerable sections of society** through sending advisory to employers to not terminate their employees, implementing direct cash transfer programmes, and using existing digital payment infrastructure

c) **Supporting the corporate sector to minimise adverse economic impact and facilitate quick recovery** through immediate measures (such as credit support to SMEs) to medium-to-long measures (such as building infrastructure and undertake policies) that help reposition India in the world's global value chain

The government has already acted quickly on these measures. A recent report published by Deloitte has suggested a few more measures.[7]

Speedy economic recovery is an important part considered in the paper and some concrete suggestions are included that will help the country tide over this challenging and difficult time.

Macroeconomic overview

The COVID-19 outbreak has presented new and significant downside risks to the global economic outlook. China, the second-largest economy in the world and the first epicentre of the outbreak, has recorded low and a deeper decline in industrial activity than what it witnessed during the global financial crisis in 2008-09. According to the International Monetary Fund, several advanced countries (such as North America and Europe) may witness a recession in 2020.

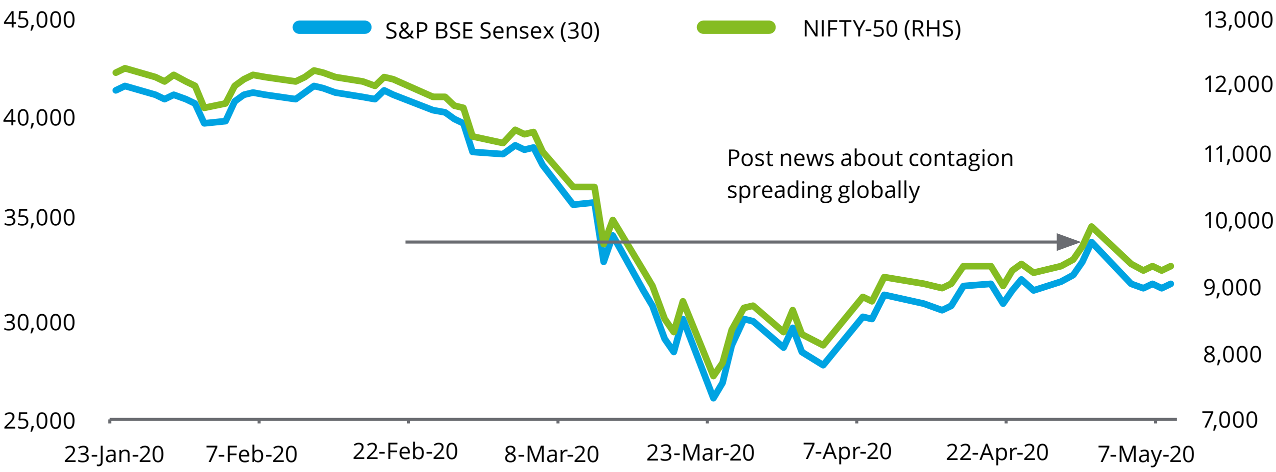
India started witnessing COVID-19 cases in late February this year. As of today, the number of positive cases is rising rapidly. The nation-wide lockdown that was announced on March 25th has been extended till May 17th with a few sectors staggeringly exiting the lock down.[8] At this juncture, there is little visibility on how long the pandemic might last and what will be its impact on the economy. However, there is almost no doubt that the economy would get affected because of this black swan event.

The sharp fall in the capital market indices, the depreciation of rupee, and the reversal of the 10-year government bond yields are some of the evidence (figure 1). An industry survey conducted by the Federation of Indian Chamber of Commerce and Industry shows that more than 53 percent respondents have felt the impact of COVID on their operations and 80 percent reported a decline in business cash flows.[9]

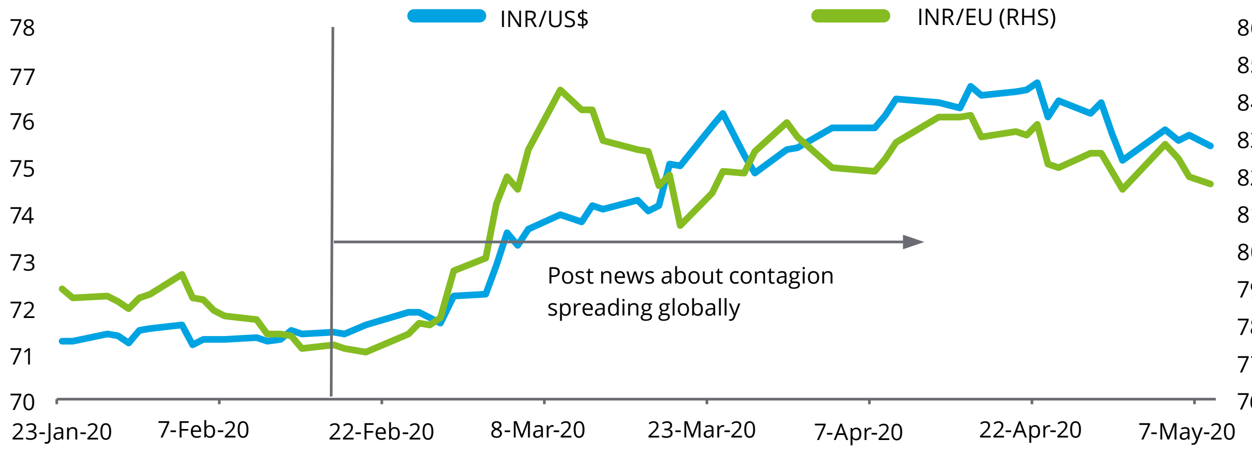
7. https://www2.deloitte.com/content/dam/Deloitte/in/Documents/financial-services/in-fs-deloitte-india-economic-response-noexp.pdf
8 https://www.mohfw.gov.in/pdf/Annexure_MHA.pdf
9. FICCI, Impact of COVID-19 on Indian economy, March 20

Figure 1. Impact on the capital market become more prominent after the US and Europe had the pandemic in third week of February

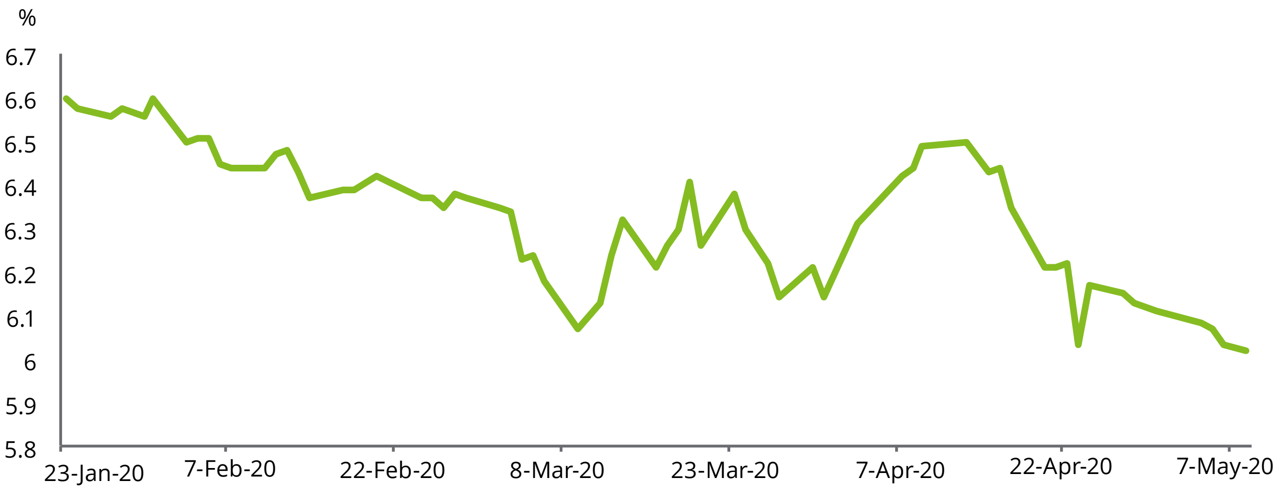
Capital market since the week China closes down Hubei region



Depreciation of Indian currency since the week China closes down Hubei region



India's 10-year government bond yield



Source: CMIE, data till 8 March 2020

Four transmission routes for economic disruption

Going into details, the pandemic outbreak is likely to affect the economy through four levers: supply disruptions, fall in global and domestic demand, stress on the banking and financial sectors, and decline in oil prices. While the first three will adversely affect the economy, falling oil prices could be a boon for India's twin deficit and input prices, and may give policymakers some headroom.

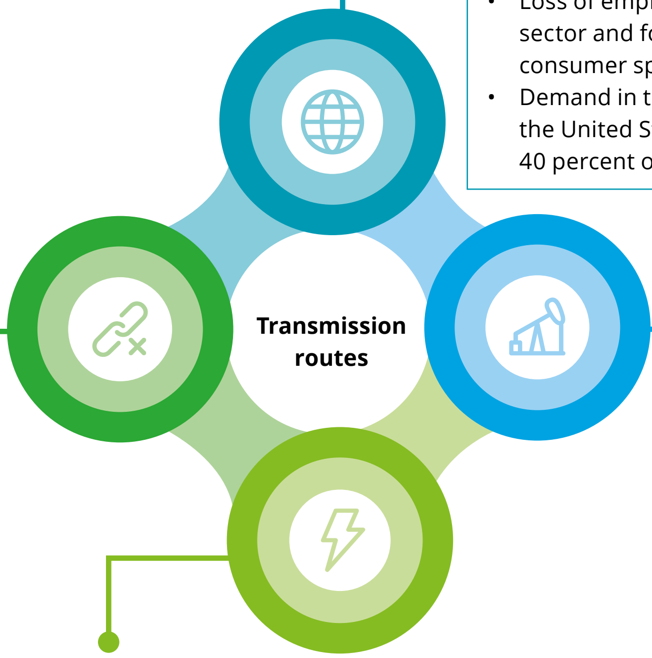
Figure 2: The four transmission vectors through which COVID-19 may impact the economy

Supply disruptions

- Deep production cuts in the US/EU and worldwide supply chain disruptions across industries
- Higher input prices and reduced profitability, leading to decline in capacity building
- Default in MSMEs cause production capacity to fall

Global and domestic demand

- Consumer spending to take a hit due to movement restrictions and fear of falling sick
- Reduced wealth effect due to falling share prices
- Hospitality and aviation sectors are impacted the most at a short span of time
- Low profitability and production disruptions impact business sentiments and investments
- Loss of employment, especially in the informal sector and for contractual workers, reduces consumer spending
- Demand in top few export destinations (China, the United States, and Europe) accounting for 40 percent of India's exports is severely hit



Falling oil prices

- Oil prices have fallen sharply. Brent crude oil fell from US$68.5 per barrel on 3 January to $30.9 per barrel on May 8
- Lower oil prices could be a boon for India's twin deficit (the fiscal and current account)
- Gives policymakers some headroom to act
- The rupee depreciation may partially offset the gains. Rupee has depreciated from INR 71.7 per US$ on 3 January to INR 75.44 per US$ on May 8

Stress on banking and financial sectors and parameters

Banks:

- Exposure to stressed industries and MSMEs
- Rising consumer loan default because of high unemployment and household leverage
- Stress on banks impact credit growth

Capital market and financial parameters

- The stock market has fallen 24 percent since pandemic started spreading in the West
- A sharp depreciation of rupee against the dollar worsens trade deficit as exports contribution to GDP is low
- Rising bond yields make borrowing more expensive, thereby reducing bank margins

Source: Data is from CMIE

Possible consequences of this outlier event on India's outlook

Undoubtedly, there is little precedent of what to expect in such a situation. According to Nassim Nicholas Taleb, a Lebanese-American essayist and statistician '*..an outlier lies outside the realm of regular expectations because nothing in the past can convincingly point to its possibility....(and) it carries an extreme impact.*[10]' COVID-19 is an outlier and to assess its impact requires a scenario analysis. The sheer magnitude of the current shock introduces an unprecedented complexity to economic forecasting.

Considering that such major economic and financial crisis is putting significant strain on our societies, we postulate three scenarios.

Three scenarios developed with varying levels of disruption

	Scenario 1 Best case **The optimistic scenario - a temporary impact of COVID-19 and a V-shaped recovery**	**Scenario 2 Mid case** **A severe and extended impact of COVID-19 and a U-shaped recovery**	**Scenario 3 Worst case** **The pessimistic scenario- a prolonged severe downturn, leading to a new low-level normal**
Description	• Contained in China/North Asia • Spreads rapidly in EU and US • Dramatic change in behaviours and policies • Deep but quick recessions in EU and US • Economic activity rebounds mid 2020	• Contained in China/North Asia • China economy rebounds slowly • Severe outbreak in EU, US until mid 2020 • Deep and prolonged recession in the West • Economic rebound in early 2021	• Outbreak returns to North Asia • EU/US outbreak prolonged • Shutdown of society, several deaths • Containment by late 2021 • Economic rebound by early 2022
Industry impact (Supply side)	• Supply-chain disruptions hurt sectors • Small and medium-sized enterprises (SMEs) debt remains high	• Deep production cuts in EU/US • SME debt becomes a concern without government intervention	• Severe drop in output • Supply chains break down • Investors cut production capacity in several major industries
Industry impact (Demand side)	• Weakness in demand spreads globally • Defaults and credit market stress grows • Central banks respond	• Sharp decline in demand in EU/US • Multiple industries hurt • Non-performing assets jump to double digits in FY2021 • High unemployment, household debt, and lengthier lockdowns impact consumer spending	• Severe decline in global demand • Multiple bankruptcies and failures • Nationalisation of industries • Consumers put off big-ticket purchases such as automobiles and home renovations • Several small banks liquidate
Date recovery begins	Q3 FY 2021	Q1 FY 2022	Q2 FY 2022

10. Nassim Nicholas Taleb, The Black Swan: The Impact of the Highly Improbable, Penguin Books, 2007

Regulatory Update

During the last couple of months, the Government of India (GOI) has notified various regulatory changes and provided clarity for ease of doing business, boosting foreign investment and reducing compliance burden and curbing opportunistic takeovers/acquisition.

Foreign Investment – Relaxation, Impact and Clarity

NRIs allowed to invest 100 percent in M/s. Air India Ltd under automatic route

GOI vide press release[11] on 4 March 2020 has approved to amend the extant FDI Policy to permit Foreign Investment in M/s Air India Ltd by NRIs, who are Indian nationals, upto 100 percent under automatic route. As per the present FDI Policy, 100 percent FDI is permitted by NRIs under automatic route in Scheduled Air Transport Service/Domestic Scheduled Passenger Airlines, except for M/s Air India Ltd. which is restricted to 49 percent.

The amendment in FDI policy will permit foreign investment in M/s Air India Ltd upto 100 percent by those NRIs, who are Indian Nationals thereby bringing level playing field at par with other scheduled airline operators. The proposed changes in FDI Policy are meant to liberalise and simplify the policy to provide ease of doing business in the country, leading to FDI inflows, thereby contributing to growth of investment, income and employment in India.

Government approval for FDI from specified countries to curb opportunistic takeovers/ acquisitions

GOI vide press note[12] on 17 April 2020 announced that entities based in countries which shares land border with India or where the beneficial owner of an investment in India is situated in or is citizen of such country, can invest only under Government approval route. Further, in case of transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the above-mentioned restriction/ purview such subsequent change in beneficial ownership, will also require Government approval.

This amendment is an attempt to prevent and regulate distress takeovers and have deeper regulatory insight on investments by countries sharing land border with India in present economic slowdown owing to COVID-19. The amendment in FDI Policy will not impact the investments made by Foreign Portfolio Investors (FPI) registered with the Securities and Exchange Board of India (SEBI).

Insurance intermediaries

GOI has allowed[13] 100 percent FDI under automatic route for insurance intermediaries including insurance brokers, re-insurance brokers, insurance consultants, corporate agents, third party administrator, surveyors and loss assessors and other notified entities. This will boost investment in India and enable foreign brokerage firms to venture into Indian insurance intermediary space, bringing latest technological and managerial skills into India.

Single Brand Retail Trading

GOI has clarified[14] that goods procured from SEZ units by SBRT entity having FDI beyond 51 percent, would qualify

11. Cabinet press release dated 4 March 2020
12. DPIIT Press Note No. 3 (2020 Series) dated 17 April 2020
13. DPIIT Press Note No. 1 (2020 Series) dated 21 February 2020
14. DPIIT Clarification on FDI Policy on Single Brand Retail Trading dated 25 February 2020

for meeting the mandatory 30 percent local sourcing norms, provided such goods are manufactured in India. This clarification will help SBRT entities to procure goods from SEZ units for meeting the mandatory 30 percent local sourcing norms.

Corporate Laws

Summary procedure for liquidation

In order to allow companies having paid-up capital, turnover, outstanding loans and deposits upto prescribed thresholds, to close their business with ease and without having to go to NCLT, GOI has notified[15] summary procedure for liquidation under Companies Act 2013 with effect from 1 April 2020. Such companies can close their business by making a winding up application to the Central Government instead of NCLT.

Condonation of delay in filings by LLPs

LLPs are now allowed to file for condonation of delay by payment of late fees / penalty in respect delayed filing of any application / documents / forms required to be filed under Limited Liability Partnership Act 2008, thereby allowing the LLPs to rectify the offence committed by them in a smooth and timely manner.

In view of the above, GOI has notified[16] LLP Settlement Scheme, 2020 which will be effective from 16 March 2020 till 13 June 2020. Every LLP which has made a default in filing of certain e-forms (Form 3, Form 4, Form 8 and Form 11), which were due for filing till 31 October 2019, can file the same under LLP Settlement Scheme, 2020 by payment of additional fees of INR 10/- per day per document, subject to the maximum late fees of INR 5000 per e-form. The documents which can be filed under this scheme are: LLP Agreements and changes made therein, statement of accounts and solvency, annual return, notice of appointment, cessation, change in particulars of partners and consent to become partner. This scheme also provides immunity from prosecution by the Registrar of Companies under Limited Liability Partnership Act 2008 in respect of filings done under LLP Settlement Scheme, 2020.

Takeover of unlisted Companies

In order to provide exit opportunity to minority shareholders of unlisted companies, GOI has notified[17] the provisions of the Companies Act 2013 which allows majority shareholders of unlisted company to acquire shares from the minority shareholders by making an application with NCLT. The success of takeover of unlisted companies would depend on the acceptability by the minority shareholders.

Web based SPICe+ form for incorporation of companies

As part of GOI's ease of doing business initiative, MCA has notified[18] and deployed a new web based 'SPICe+' form for incorporation of companies. SPICe+ form in addition to PAN, TAN, GST registration would also allow Companies to obtain EPFO, ESIC, PT (applicable for companies proposed to be registered in Maharashtra) registration and opening of bank account from the day of incorporation itself, thereby would save time and cost for starting a business in India.

LLP cannot be merged with a Company

NCLT, Chennai Bench vide its order[19] that had earlier approved merger of LLP with a Company under Companies Act 2013 in the case of merger of M/s Real Image LLP with Qube Cinemas Private Limited. However, NCLAT has set aside

15. MCA General Circular No. 6/2020 dated 4 March 2020
16. MCA Notification dated 24 January 2020 relating to Companies (Winding Up) Rules, 2020
17. MCA Notifications dated 3 February 2020 relating to Central Government notifying Section 230 (11) and (12) w.e.f. 3 February 2020, Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2020 and National Company Law Tribunal (Amendment) Rules, 2020.
18. MCA Notifications dated 18 February 2020 relating to Companies (Incorporation) Amendment Rules, 2020
19. NCLAT Judgment dated 4 December 2019 in the Company Appeal (AT) No.352 of 2018

the said Order of NCLT stating that the only way to merge a LLP into a company is by following the rules / procedures laid down in the statute, i.e. by conversion of LLP into a company under Companies Act 2013 and thereafter, such companies can be merged by following the procedure laid down under the Companies Act 2013.

Separation of role of Chairman and Managing Director for listed Companies

SEBI has deferred[20] the applicability of provision which requires separation of role of Chairman and Managing Director for top 500 listed Companies (based on market capitalisation) for a period of two years, ie. upto April 2022, ahead of the earlier deadline of April 2020. This has provided relief and time to listed entities to search for appropriate persons play separate roles, and avoid any conflict of interest in the management decision making.

Voluntary Retention Route (VRR) for investments by FPIs

RBI has introduce[21] revised VRR for investments by FPI in debt markets to boost investments by FPI. Some of the key features of revised VRR is increased investment limit of INR 1,50,000 crore, investment limit "tap" shall be kept open till the limit is fully allotted, FPIs can apply online to CCIL through custodians. The revised VRR has been opened for allotment from 24 January 2020.

Appointment of whole-time company secretary for a private company

GOI has increased[22] the paid-up share capital limit from INR 5 crores to INR 10 crores for Private Limited Companies for appointment of whole-time Company Secretary under the Companies Act 2013 with effect from 1 April 2020, thereby providing relief to Private Limited Companies having paid-up share capital less than INR 10 crores.

20. SEBI Notification dated 10 January 2020 relating to SEBI LODR 2020
21. RBI Notification No. RBI/2019-20/151 dated 23 January 2020
22. MCA Notification dated 3 January 2020 relating to Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2020

Applicability of indirect share transfer provisions to foreign portfolio investors (FPI)

Background

In 2012, the Indian Government had amended the tax law retroactively to state that gains from transfer of shares or interest in an entity outside India, would be taxable in India, if such shares or interest derive their value (directly or indirectly) substantially from assets located in India. These provisions are popularly referred to as the "indirect transfer" provisions.

This amendment was brought in to overcome the Supreme Court ruling against the government in the famous Vodafone case.[23] In 2015, the government amended the indirect transfer provisions to clarify that indirect transfer tax will be triggered only if the value of Indian assets exceeds INR 100 million and Indian assets represent at least 50 percent of the value of the assets owned by the foreign target entity (whose shares/interest is being transferred).

A carve-out was also made for investors who neither hold the right of management or control of the foreign

23. Vodafone International Holdings BV v. UOI (CIVIL APPEAL NO.733 OF 2012 (arising out of S.L.P. (C) No. 26529 of 2010) dated 20th January 2012 / [2012] 341 ITR 1 (SC) / [2012] 247 CTR 1 (SC)

target entity, nor hold more than 5 percent voting power or share capital or interest in such entity (hereinafter referred to as small investors).

CBDT Circular dated 21 December 2016

Responding to investors' queries, the Indian tax board (CBDT)[24] in its circular no. 41/2016 dated 21 December 2016, clarified that in the absence of any exemption available to FPIs[25], indirect transfer provisions would indeed apply to investors (except for small investors discussed above) in the FPIs, which derive value substantially from India. However, subsequently, acceding to representations made by the investor community, this circular was kept in abeyance by the government by issuing a press release dated 17 January 2017.

Amendment in Budget 2017

Through the budget amendments of 2017, a specific provision was inserted in the tax law whereby Category I and Category II FPIs registered under SEBI[26] (FPI) Regulations, 2014 were exempted from indirect transfer provisions. Though this was a welcome move, Category III FPIs (which primarily included unregulated or non-broad based funds, corporates, etc.) and their investors continued to be exposed to indirect transfer provisions. Also, other investors such as private equity funds were not provided any such exemption in the tax law.

It is pertinent to note here that the Finance Minister of India in his Budget 2017 speech had promised to also provide a generic exemption in the law whereby any transfer of shares or interest in an entity outside would not be subject to indirect transfer provisions if the transfer outside India resulted in or triggered from a transfer taking place in India. In spite of the promise made by the Finance Minister in his speech, the final amendment in the law only exempted Category I and Category II FPIs.

Replacement of SEBI (FPI) Regulations, 2014 by SEBI (FPI) Regulations, 2019

In September 2019, SEBI replaced the FPI Regulations issued in 2014 with new set of FPI Regulations, 2019. One of the key changes introduced in 2019 Regulations was to consolidate the categories of FPIs which resulted in Category III getting abolished with many Category II FPIs getting re-classified to Category I, and all the Category III FPIs getting re-classified as Category II. With the amendment in FPI Regulations, there was an uncertainty on whether the exemption (from indirect share transfer provision) available to Category I and Category II FPIs registered under 2014 would apply to FPIs once they were re-categorised / registered under the 2019 Regulations.

Budget 2020 proposals

In Finance Bill 2020, it has been proposed to extend the exemption (from indirect share transfer provisions) to Category I FPIs registered under FPI Regulations, 2019. Also, there is a proposal to grandfather investments made by investors in erstwhile Category I and Category II FPIs registered under SEBI (FPI) Regulations, 2014. Consequent to the Budget proposals, following issues have arisen:

- There is uncertainty whether grandfathering provisions apply to "investments made in FPIs" prior to the 23 September 2019 (i.e. the data of replacement of FPI Regualtions) or whether grandfathering provisions also apply to investments made in an entity post replacement of the regulations provided such entity was registered as Category I / II FPI under 2014 regulations.

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24. Central Board of Direct Taxesprovides the facilities for several economies, including India.
25. Foreign Portfolio Investors
26. Securities and Exchange Board of India

- Under 2014 Regulations, a regulated broad based fund from non-FATF member country (e.g. Cayman or Mauritius) was granted Category II registration, and was exempt from indirect share transfer provisions since the exemption back then applied to both Category I and Category II FPIs. However, such a fund would no more qualify for exemption from indirect share transfer provisions since the fund would be classified as Category II FPI under 2019 Regulations and the Budget 2020 proposals would only exempt Category I FPIs going forward.

Considering the above, there is a need for the Government to suitably modify the proposed amendments in the tax law whereby FPIs, which are set up as fund structures, are exempted from indirect share transfer provisions. Also, there is a need for an amendment made in the law to exempt all those transfers (for all types of entities and not limited to Category I FPIs) of shares or interests outside India which result in or are triggered from transfer of shares or interests in India. In absence of these exemptions, there could be significant tax litigation and practical challenges faced by such Category II FPIs and private equity investors. A summary of the potential consequences and challenges that emerge is as follows:

- **Applying indirect transfer provisions to fund structures is against the legislative intent:** The intention of introducing the indirect transfer tax provisions was to address tax avoidance strategies adopted by non-residents wherein corporate structures are created outside India and ownership of Indian assets is transferred indirectly by transferring shares of such offshore corporate structures. In a fund structure, the fund (investing under any route) has a PAN, files its tax returns in India and is subject to assessments. Therefore, applying indirect transfer tax provisions to fund structures is against the intent of the law and would lead to significant tax uncertainty for the funds as well as their end investors.
- **Multiple taxation:** Redemption of shares / units in a fund would trigger indirect transfer provisions at multiple levels (investor level as well as fund level), resulting in a significantly higher effective tax rate for investors. If the fund has a multi layered structure, for example, Master-Feeder structure or a separate sub-fund established for India investments, indirect transfer provisions would be applicable at each fund / sub-fund level. In a worst case scenario, because of tax withholding at every level in a multi-layered fund, the entire gain amount or even the sale consideration could get wiped out before reaching the end investor.
- **Discrimination against India dedicated funds:** It is estimated that India dedicated funds account for 10 percent to 15percent of the total Assets under Custody held by FPIs in India. These funds in a way represent India to foreign investors as they attract foreign investment by showcasing the growth opportunities available in India. Presence of India focussed funds especially in the matured markets of Europe and US is a matter of national pride and goodwill. Since India dedicated funds invest majority of their corpus into Indian securities, they would most likely derive their value, substantially, from assets located in India and therefore would be straight away impacted by the recent circular. Many of the India dedicated funds are set up in Mauritius since it is one of most cost efficient country in terms of setting up a fund as well as operating the fund. Since Mauritius is not a FATF member country, all the funds set up in Mauritius have been categorised as Category II unless the fund has an investment manager in a FATF member country.
- **Practical difficulties in implementation:** Applying indirect transfer provisions to each level in a fund structure would be

impractical. For instance, in a multi-layered fund structure, it would be extremely difficult to ensure tax deduction at source (TDS) upon redemption of shares / units by the fund or upon purchase of shares / units by another investor. Also, the requirements to file TDS returns and issue TDS certificates would be extremely difficult for non-resident investors who have no exposure to India.

While this is welcome, Category III FPIs and their investors continue to be exposed to indirect transfer provisions. The key challenges in applying indirect transfer provisions to Category III FPIs are discussed below:

- **Multiple taxation:** There would be multiple taxations for the same income; first in the hands of the FPI when it sell securities in India, and then in the hands of investors when they redeem shares / interest in the FPI. In a master-feeder structure, the multiplicity of taxation would increase further.
- **Re-organisation of funds outside India:** In case of re-organisation of funds outside India, the investors in the fund would be exposed to Indian tax under indirect transfer provisions, if the share or interest held in the fund derives its value, substantially from assets located in India.
- **Retrospective impact:** Since the circular is of a clarificatory nature, it would apply on a retroactive basis.
- **Impracticality:** Applying indirect transfer provisions to each level in a fund structure would be impractical. For instance, in a multi-layered fund structure, it would be extremely difficult to ensure tax deduction at source (TDS) upon redemption of shares / units by the fund or upon purchase of shares / units by another investor. Also, the requirements to file TDS returns and issue TDS certificates would be extremely difficult for non-resident investors who have no exposure to India.

It is pertinent to note that all the issues discussed above are also applicable to investors in entities who have invested under the Foreign Direct Investment (FDI) route or Foreign Venture Capital Investor (FVCI) route.

Interestingly, the Hon'ble Finance Minster of India in his Budget speech in 2017 had proposed to provide a carve-out in indirect transfer provisions, to avoid multiple taxation of the same income.

Specifically, it was mentioned that indirect transfer provisions would not apply in case of redemption of shares or interests outside India as a result of or arising out of redemption or sale of investment in India which is chargeable to tax in India. Unfortunately, this proposal has not found its way to the tax law and therefore the issue of multiple taxation remains for Category III FPIs and funds making investments in India under the FDI and FVCI routes.

Source: CBDT circular no. 41/2106 dated 21 December 2016, CBDT press release dated 17 January 2017, Finance Act 2017

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Partner, Leader
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Clients and Industries

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Associate Director
Clients and Industries

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