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Private Equity in India: A Special Reference to Healthcare Sector

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ABSTRACT

India, as it stands today, is on the trajectory of becoming the world's 3rd largest economy by 2020. Healthcare continues to form a key ingredient for the success of India's raising economy. However, one would need an association of true intellect and expertise to unravel India's true potential.

Over time, investments in the healthcare sector in India have shown steady growth. Healthcare is an industry clearly set to grow in India, and one in which private equity and venture capital can play an active role. Entrepreneurs already value PE and VC funds for the skills, expertise and network they bring to the table that other sources of capital are unable to provide.

The paper deals with the above aspects and is divided into two parts. Part I is all about the Private Equity in India, its investments and exits on an overall. Part II deals with the Private Equity investments specific to the Health care sector in India, the investment strategies, attractive factors of investments in the sector, exits, drivers and modes of exit, challenges and trends.

KEYWORDS : Private Equity, Portfolio companies, Limited and General Partners, Investment Strategies.

INTRODUCTION

In finance, the term private equity is an asset class consisting of equity securities in operating companies that do not publicly trade on a stock exchange. Private equity investment will generally be made by a private equity firm, a venture capital firm or an angle investor. Each of these categories of investor has its own set of goals, and investment strategies; however, all of them provide working capital to a target company to expand, to develop new product, or for restructuring of the company's operations, management, or ownership.

A private equity firm act as an investment manager that makes investments in the private equity of operating companies through variety of investment strategies including leveraged buyouts, venture capital and growth capital. On the other side, a private equity firm will raise pools of capital, or private equity funds from general and limited partners that supply the equity contributions for these transactions. Private equity firms, with their investors, will acquire a controlling or substantial minority position in a company and then look to maximize the value of that investment. Private equity firms generally reap the return on their investments through one of the following avenues:

- Initial Public Offering (IPO)
- Merger or Acquisition
- Recapitalization

PRIVATE EQUITY IN INDIA

An Overview

2014 was a year of a lot of increasing aspirations and optimism for India, specifically in light of a single party framing the government after a very long time. The Indian stock market has also given huge returns of more than 30% over the year, compared with less than 10% in the year 2013. Backed by the stronger macroeconomic environment, PE activity continued to play an important role in the country's capital requirements, accounting for 53% of FDI inflows.

India's GDP had grown by 6.6% from 2013 to 2014, when compared with 4.9% from 2012 to 2013. The services sector experienced particularly very strong growth, and its contribution to GDP climbed to 51% in 2014. Notably, communication, trade, transport, hotels and related services grew by nearly 11%, leading the sector's overall growth.

Not surprisingly, PE investments in India saw a strong increase over 2013. Deal value, including real estate and infrastructure deals, increased by 28% to $15.2 billion—edging closer to 2007 highest levels of $17.1 billion. Overall deal volume in India raised by 14%, with early- and growth-stage deals accounting for 80% of total deals in 2014. Deal value also rose as a result of a few megadeals. The consumer technology sector led in both deal value and volume, constituting 31% of overall deal value and 35% of overall deal volume.

Figure 1

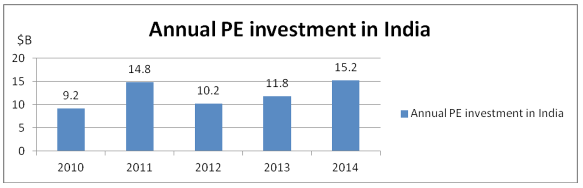
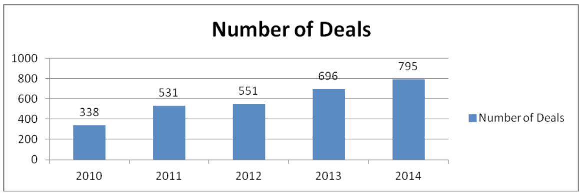


Figure 2



In terms of drawing foreign investments, India continues to have competition from other emerging economies with prospects for growth, comprising South Africa and Nigeria. That said, India claims strong GDP growth, an energetic entrepreneurship ecosystem and a positive future stance, making it one of the most attractive out of the emerging economies in terms of PE investments.

Making of Deals

Deals volume in India raised by 14%, driven mainly by the consumer technology sector. Deals value amplified by 28% from the prior year, driven by the banking, financial services and insurance (BFSI) sector; the consumer technology sector; and the real estate sector.

Funds feel very positive about their potential to produce returns, and more than 60% expect the average Internal Rate of Return (IRR) to be more than 20% in the next three to five years.

- Deal activity was vigorous in 2014 as deal value and volume raised at about 28% and 14%, respectively. BFSI, Consumer technology and real estate were the main drivers of the increase in total deal value.

- The median deal size of PE investments increased by 28% over 2013, attaining $53 million in 2014.
- The top 25 deals accounted for$6.4 billion of the installed capital, constituting 49% of the total PE deal activity in 2014.
- Minority portion of deals accounted for more than 90% of the total deals, and this figure is expected to increase as competition for deals deepens.

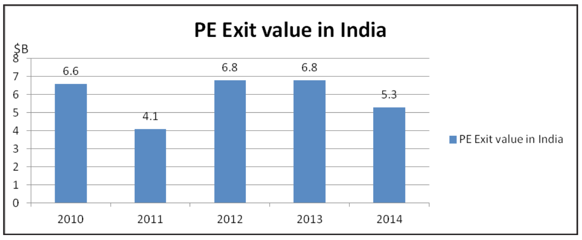
Exit Strategies

The number of exits in India raised by 14% from 2013 to 2014, though the exited investments value fell by 22% to $5.3 billion compared with $6.8 billion in 2013. In 2014, the robust performance of capital markets had driven up sales in public market.

PE funds aim to focus increasingly on developing and employing value creation plans with portfolio companies to ensure that exit stories are constricted and profitable.

- Promoters continue to expect PE support for decisions about international financing, customer access and expansion.
- Funds are also bearing in mind expanding their operating teams to crack higher value in their portfolio companies.
- Exit volume raised by 14% in 2014, even as total reported exit value fell. Exit volumes are expected to increase sharply in coming years in retort to continued pressures for returning of capital.

Figure 3



PRIVATE EQUITY IN INDIAN HEALTH CARE SECTOR

According to World Health Organisation, although the total expenditure on healthcare in India is only about 4.1% of GDP, in which government expenditure is less than 1% of GDP. While the 12th Plan has visualized increase in healthcare expenditure to about 2.5% of GDP by the end of the Plan period 2017 quite evidently private sector investments will have to play a vital role.

Figure 4

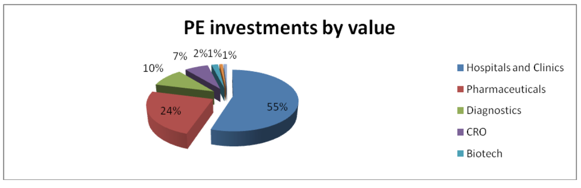
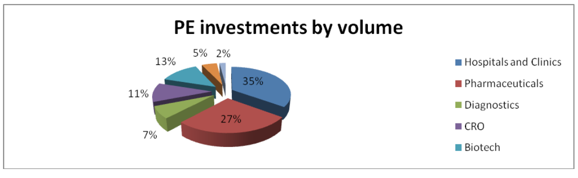


Figure 5



While the private equity investments have seen an overall increase in last year, the healthcare sector is assumed to emerge as a sector of growth. The investments in healthcare almost tripled over the past few years, rising with16% of CAGR during 2010-2014. On an overall, India's dynamic healthcare sector assures to be an area of expansion, with high prospective for both private equity and venture capital investment.

The healthcare sector is broadly categorized to include delivery centres such as hospitals and clinics, life-science companies, medical devices, pharmaceuticals, diagnostics, biotechnology and insurance firms. Healthcare was the third largest sector drawing PE investments in the year 2013, accounting for 12% of the total deal value, with 46 firms making investments. Many funds, such as India Venture Partners, NEA and Aarin Capital, have chosen to make more than one investment over the course of the year. The Halcyon Group, Sequoia Venture Capital and Goldman Sachs were among the 13 funds that have chosen to follow their last investments in healthcare with the additional deals.

Growth in Indian healthcare sector has its origins in a number of factors.

Investment opportunities in Indian Healthcare

According to certain studies, the Indian healthcare sector is graceful to grow to over $270 billion by the year 2020. The sector also needs huge investments. According to one approximation, India would require an investment of $160 billion by the year 2020 in the hospital segment alone to touch a world average of 30 beds per 10,000 heads of population.

Globally the best source of PE funding for different themes including the healthcare sector comes from endowments, insurance companies, pension funds and trusts, which are looking for opportunities to meet their long term investment horizon.

The healthcare sector in India is estimated to be $78 billion and has been rising at 11%, on average. That supposed India to be a highly underpenetrated market. The World bank's 2010 estimates discovered that India's per capita outlay on healthcare was $50, trailing behind China's $221, and in a far different club than in the West, where the UK expends $3,500 and the US expends $8,400 per capita. India's ratio of nine hospital beds per 10,000 people is a fraction of those in the West (30 beds for the US,33 beds for the UK) and lags behind those of fellow BRIC nations, China and Brazil, with 42 and 24 beds, respectively.

India Brand Equity Foundation advises that the already high CAGR for the healthcare sector is expected to accelerate by 20%, signifying that the market will be worth $280 billion by 2020.

Healthcare is giving exceptional opportunity for PE investors for the following reasons:

Sound fundamentals for growth. The healthcare sector presents limited risk, as most growth drivers are macroeconomic and informed by highly reliable data and trends. It's estimated that India is 20 to 25 years behind the US in terms of the maturity of the healthcare sector, and there is growing confidence that India will follow the same trajectory as the US.

Growth in population. India's population has increased by 1.5% per year for over a decade now, and this trend is expected to continue. The population over the age of 15 is expected to grow even faster, at around 2% per annum.

Increasing incidence of diseases. Lifestyle diseases, such as diabetes and heart disease, have grown at approximately 3% and 9%, respectively, in the last three to five years. The prevalence of these conditions shows no signs of decline and is going to push the demand for healthcare higher.

Increased affordability. India's per capita disposable income is expected to increase by about 1.6 times by 2017 to around $2,300 per person. The percentage of families counted as "high income" is expected to double by 2025, up from 20% in 2010. Healthcare will inevitably see an increase in spending as families at the bottom of the pyramid move above the poverty line.

Rise in insurance. Health insurance penetration is expected to increase to 20% by 2017, up from 15% in 2010. This is still low but will have a real impact on both attitudes and spending when it comes to healthcare.

Established track record of value creation. Over the last five to seven years, several healthcare businesses have shown attractive growth and margin expansion records.

Recession-proof nature. Given the current uncertain economic climate, it is not surprising that PE and VC investors have focused their attention on healthcare, along with consumer goods or services.

Government support. Across India, state governments are making a commitment to improve the health of citizens. Government support has also addressed a key issue: the cash transactions, which made PE firms uncomfortable. An improved policy framework and increased insurance penetration mean the industry is seeing more white money, with neater transactions and a more suitable environment for larger investments.

New delivery models. Resource constraints have pushed innovations such as short stay centres and specialised delivery centres through specialist hospitals like Vasan Eye Care or Nephroplus, a renal care unit. As companies offering these new ways of delivering healthcare services seek to stabilise and scale up, their demand for capital is growing.

Value addition of VC and PE investors. Most healthcare companies are run by medical professionals or a family of doctors, who are commercially oriented but often lack strategic vision or a professional management approach. Such firms may have limited business experience and are often looking for skills and competencies that can supplement their technical knowledge: a win-win situation for private equity investors.

Track record of exits. While the number of exits seen in the healthcare sector is in line with the overall exit rate (47 out of 288 investments have exited so far), the value of those exits is more positive. Of the $5 billion invested into healthcare, $2.8 billion has been returned, an improvement on India's overall track record of $30 billion of returned capital from the $85 billion invested.

All these factors point to the important role that private equity have to play in the Indian healthcare sector. As the healthcare sector continues its swift growth, it is likely to realize an accompanying rise in the levels of PE involvement.

Challenges in Indian Healthcare

Healthcare sector saw private investments shrink in 2014 after hitting an all-time high the previous year. Lack of big ticket deals as well as lower number of transactions slowed down overall investment activity in the sector even as merger & acquisitions (M&As) shot up further continuing the previous year's momentum.

Over time, investments in the healthcare sector in India have shown steady growth. The number of deals has increased by 50% in the last year. The total funds invested have tripled over the last three years, from $345 million in 2009 to almost $1.3 billion in 2012.

Within healthcare, there has been a move away from investment in pharmaceutical companies towards the delivery/provider subsector.

Healthcare investing in India took off with pharmaceuticals, as the generics opportunity opened up possibilities from 2003 to 2004 and onwards. However, by 2008 this trend had matured, peaking in 2005 when healthcare investments made up 11% of the total funds invested. The years 2009 to 2010 saw some investment in diagnostics, which has since subsided. Investments in the delivery space began about five years ago, but it is only recently that this interest has picked up.

But the issue with private sector investments is that they tend to get concentrated around urban centres, with very little investment flowing into rural India. There are, however, areas that offer exciting possibilities. The first such area is Telemedicine since it addresses rural healthcare challenges like inaccessibility, severe shortage of skilled and qualified doctors, and dispersed patient volumes.

The second class of potential opportunities exists in the healthcare infrastructure space including soft infrastructure such as Health Insurance. Tertiary and secondary care hospitals are generally able to get funding support.

In comparison primary care centres, which can effectively provide primary and preventive care are often unable to get funding support. A policy framework capable of delivering effective PPP between government and private sector for primary and preventive care can deliver this impact. Like in other infrastructure sectors such as Transport, where an effective PPP model has enabled huge amount of PE funding, an effective PPP model for healthcare can achieve the same.

Medical education is a capital intensive business and can benefit from PE support. Current policy frame work of accreditation of teaching hospital needs to be revisited to accelerate the process of increasing the capacity of high quality medical education in India. In the world of mobility and tele-presence, current limitation of having the hospital and institution in the same campus needs to be relaxed to leverage on existing hospitals infrastructure.

Exits: drivers and modes of exit

About 140 healthcare companies have received investment over the past five years. Of these, 15% to 20% have raised more than one round of capital, pointing to increasing confidence in the value-creation potential of the sector. The picture is also promising for exits. Of the $5 billion invested in healthcare, $2.8 billion has been returned, with an average holding period of five years for the top 25 deals. The biggest exits in 2012 were Trivitron, sold by ePlanet Ventures and Headland Capital; and Arch Pharmalabs and Sahyadri Hospitals, both sold by ICICI Venture (the former sold with IL&FS Investment Managers). Of the 115 total exits in 2012, which we explored in section 3, seven were in healthcare. A large proportion of these exits (three out of seven) were in delivery. Public market sales, including IPOs, seem to be the most popular exit routes, constituting 40% of healthcare exits in the last three years.

In contrast, the only significant exit this year was ChrysCap part exiting IntasPharma in a secondary deal with Temasek. Other transactions included Fidelity PE's liquidity event when Warburg Pincus bought into Laurus Labs, GE Capital exiting Syngene, India Build Out Fund pulling out of Krishna Institute of Medical Sciences besides OrbiMed, Carlyle and Signet pulling out from Claris in its buyback offer. The number of M&A deals rose by over a third to 92 this year with an announced value of $4.6 billion against 68 deals with an announced value of $3.3 billion in 2013.

The exit activity in the second quarter of 2014 has achieved an improvement of more than threefold in terms of value and twofold in terms of volume. Total exits were worth 1.06 billion USD in this quarter in 37 deals while in Q1'14, PE exits were worth 300 million USD from 18 deals. When compared to the same period last year, exits have shown a decline of 45 per cent and 12 per cent in value and volume respectively. In Q2'13, there were 42 exits worth 1.94 billion USD.

The majority of the exits in Q2'14 came from the healthcare & life sciences and manufacturing sectors which together contributed almost 80 per cent to the total exit value and 27 per cent to the total volume.

In this quarter, almost 50 per cent of the exits by value have been through public market sale (519 million USD from 25 deals). Exits through strategic sale reported the next highest share, with 334 million USD from nine deals

Conclusion

The challenges the Indian healthcare industry faces of providing access to healthcare services at an affordable price can be met by appropriately planned single specialty or service focused business models. These business models should focus on a narrow service offering enabling them to optimize processes to reduce costs and reduce the minimum capacity per facility required for profitable operations thereby enabling increased penetration of healthcare services at lower costs.

Clearly, given the opportunities, there will be sustained PE interest in health care in the years ahead.

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