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Fund Scan: How Blackstone found its mojo in India despite initial setbacks

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In June 2007, as the global bosses of Blackstone Group LP were getting ready to launch the initial public offering of the private equity powerhouse in the US, the firm's Indian leadership was busy sealing a deal that would turn out to be one of its best bets in the country.

That month, the world's largest alternative assets manager acquired an 80% stake in Intelenet Global Services Ltd for $260 million (Rs 1,065 crore then). In Blackstone's short, chequered 12-year-old India history, the investment in the back-office services provider is unique in more ways than one.

The PE firm's investment in Intelenet was a control deal in an unlisted company at the peak of the global bull run. It reaped handsome gains when it sold Intelenet to the UK-based Serco Group in 2011. This is not all. The PE firm bought Intelenet back from Serco after four years—at a price lower than what it had received at the time of its exit.

Outside of Intelenet, however, Blackstone hasn't had a smooth ride in India.

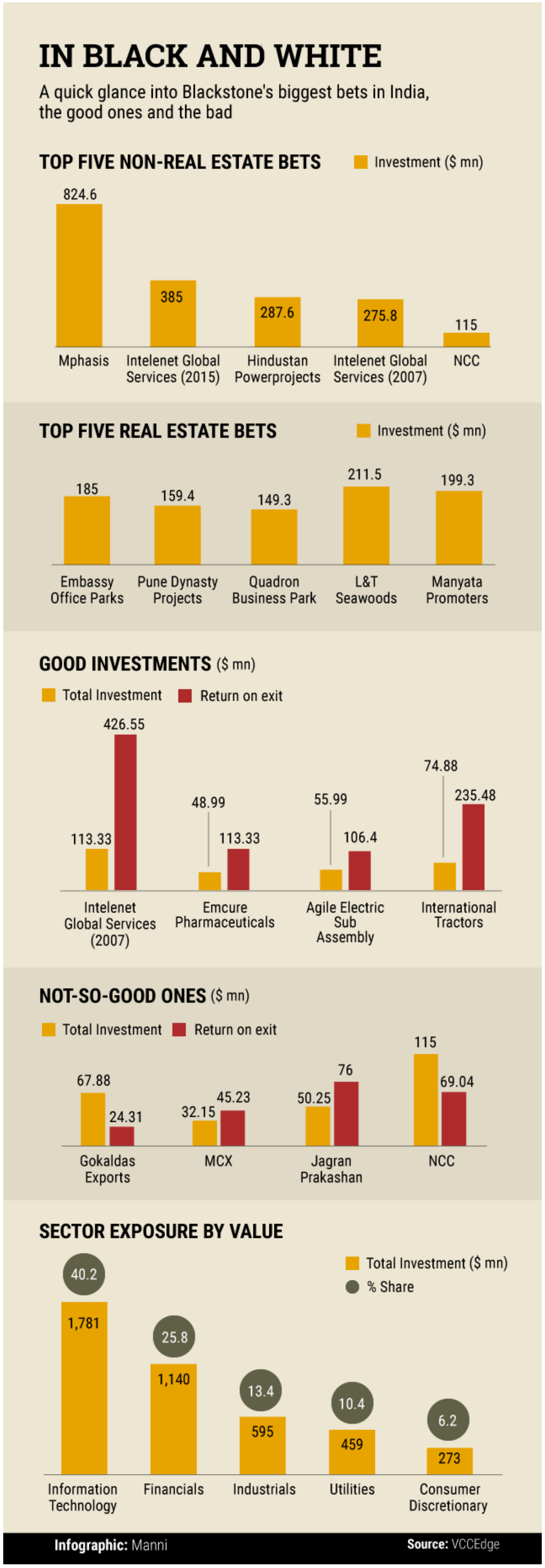
Blackstone had sewed few control deals in the country before the global financial crisis of 2008-2009. Till then, it had mostly acquired minority stakes in Indian companies. Many of those bets failed. It had also struck several PIPE (private investment in public equities) deals at high valuations. Many of those bets went sour, too.

The PE firm, however, has now bounced back from the initial setbacks, and in a spectacular fashion. So much so, that the success in India is believed to be a key part of its pitch for its first-ever Asia buyout fund, two people familiar with the firm's operations told VCCircle. We will get to that a little later. First, let's look at its initial setbacks.

Rough childhood

Blackstone started operating in India in May 2005 and named senior managing director Akhil Gupta head of its PE and real estate verticals. Since then it has invested almost $6 billion in India. Of this, nearly three-fifths has gone into PE deals – via two global PE funds—the $21-billion Blackstone Capital Partners V and the $16-billion BCP VI—and the remaining in real estate.

The PE firm struck its debut deal in India in July 2006 when it invested $49 million (Rs 224 crore then) in Emcure Pharmaceuticals Ltd. Over the next four years it invested in many listed companies across sectors including garment exporter Gokaldas Exports, Allcargo Logistics and Nagarguna Construction Company (NCC) as well as unlisted firms such as CMS Computers, Nuziveedu Seeds and Moser Baer Projects (now Hindustan Powerprojects Pvt. Ltd).



In 2011, Blackstone made at least eight investments, according to VCCEdge, the data research arm of VCCircle. These deals included fresh investments in Jagran Prakashan Media Network and Monnet Ispat & Energy Ltd.

The PE firm made all these investments out of its BCP V fund. Although a handful of these investments—including Intelenet—struck gold, most produced average results at best at best. This contributed to BCP V's dismal annualised return on all investments worldwide. A December 2015 filing with the US Securities and Exchange Commission shows that BCP V's internal rate of return was just 8%.

The firm spent the past year cleaning up a lot of these legacy bets. It managed to only recover its principal investment in NCC when it exited last year.
It doubled its investment in AllCargo and Jagran Prakashan, but its IRR in both cases took a hit because of the long holding period.

The bet on garment maker Gokaldas Exports left a big hole in Blackstone's pockets and the firm lost an estimated 75% of its investment by the time it fully exited this year.

In fact, it was this failure that perpetuated Blackstone's reputation as a poor investor in India in its early days. To be fair, Blackstone had invested in Gokaldas just before stock markets slumped in the aftermath of the 2008 global crisis. Gokaldas was also affected by the global slowdown as it depended on exports to the developed markets.

Some other companies made for an excellent investment opportunity in theory, but are now struggling. These included infrastructure firms Hindustan Powerprojects, which eventually sold its solar assets, and Monnet, which defaulted on its debts and is now controlled by its lenders.
Blackstone is still invested in some other older portfolio companies such as MTAR Technologies, Gateway Freight, Nuziveedu Seeds and FINO Paytech.

The PE firm declined to comment on specific portfolio companies. However, a spokesperson defended its overall performance. "When operating in any new geography it takes time to get the right team, build a repeatable investment model and deal with a set of regulations. Sector selection and investment timing are critical factors that impact investment success."

An investor, who has spent at least 15 years in India, says Blackstone made a flurry of investments in initial days. "This was a mistake," says the veteran investor, who spoke on the condition of anonymity. "Most other bulge-bracket PEs like Warburg Pincus or Carlyle were doing one or two deals a year."

The two people familiar with the PE firm's strategic planning cited above say that these investments were "made for the right reasons". One of them said that the only "lemons" in the portfolio might be Gokaldas Exports, Monnet and a few other small investments.

To be sure, not all the early bets during 2006 to 2011 went bad. Blackstone earned multi-bagger returns on at least three investments made during this period. One of these was Intelenet, probably Blackstone's best-performing asset of this period. The PE firm earned three times the investment in dollar terms in the three years of its investment.

Blackstone made about five times return in dollar terms on its 2008-vintage investment in CMS Infosystems when it sold its stake in the ATM services company in 2015 for about $180 million, people familiar with the deal said at that time. It also earned three-fold return in rupee terms in Emcure Pharmaceuticals in four years when it sold its stake to Bain Capital, according to people familiar with this deal.

Growing up

In 2012, Blackstone started making PE deals from BCP VI. Around this time the PE firm changed its strategy and investment team. It began focusing on larger deals as well as control-oriented transactions and limited growth-equity investments, people familiar with the firm's functioning say. It also started taking a more active operational role in portfolio companies, they say.

These deals included investing in Mumbai-based speciality chemicals maker SH Kelkar & Company, International Tractors—maker of the Sonalika brand of farm equipment—and Financial Technologies (India) Ltd in 2012. The next year, it invested more in FTIL and added three companies to its portfolio—FTIL affiliate Multi Commodity Exchange of India, auto-parts maker Agile Electric Sub Assembly Pvt. Ltd and Igarashi Motors India Ltd.

Most of these bets have turned out to be winners for Blackstone. It churned out profitable exits from Agile Electricand International Tractors, and is on its way to earning a multi-bagger return from SH Kelkar.
The only exception, perhaps, is FTIL. Blackstone took a deep haircut in FTIL, now known as 63 Moon Technologies (India) Ltd, after the company was hit by a scam. Eventually, however, Blackstone recouped some money through its investment in MCX.

The years 2013 and 2014 saw a change of guard at Blackstone India. Toward the end of 2013, Blackstone elevated two senior managing directors—Amit Dixit and Mathew Cyriac—to head its private equity business in India. At the same time, Akhil Gupta was made non-executive chairman in December 2013. He eventually left the firm a year later.

Cyriac quit earlier this year, leaving Dixit at the helm of Blackstone's PE business in India. Blackstone declined to make Dixit available for an interview with VCCircle for this article.

In 2015 and 2016, Blackstone bought into three IT and IT-enabled services providers. One was Intelenet, another was IBS Software Services. Its biggest Indian bet came in early 2016 when it bought a 60% stake in IT major Mphasis for about $825 million. In barely a year, Blackstone has already pulled out its first $100 million and Mphasis may yield the best return for the PE firm till date.

Shreyas Bhushan, senior member of the M&A and PE practice at law firm Nishith Desai Associates, says a sizeable portion of Blackstone's investment in India–close to $1.5 billion–has been committed to the IT and ITeS sector.

"Blackstone's strategy of focusing on this sector seems aligned with its global portfolio. More importantly, Blackstone's unique formula of ensuring that its portfolio companies tap into each other's services (as was the case with Intelenet) results in an overall win-win scenario," he says.

These profitable bets have helped Blackstone earn an IRR a tad above the upper end of the 20-30% range that PE firms typically chase in rupee terms in India, according to the two people familiar with the firm's operations cited above. India, in fact, likely beat Blackstone's global returns by as much as 10 percentage points, the people added.

Strengthening the foundation
Around the time Blackstone was tweaking its PE strategy, it was also simultaneously ramping up its real estate play.

Blackstone entered the real estate sector in India in 2011, striking two deals for office parks in Bangalore and Pune. Next year, it acquired a 50% stake each in two more office parks in Pune and Bangalore for a total of almost $345 million.

Over the past five years, it has sealed many more deals to emerge as the biggest owner of office properties in India with nearly 30 million sq ft of completed and leased out office assets. These include an office project of Salarpuria Sattva Realty LLP in Bangalore and an office park of K Raheja Corp in Hyderabad.

In late 2015, it set the ball rolling on its retail game plan when it acquired Gurgaon-based Alpha G:Corp's retail assets in Amritsar and Ahmedabad under the AlphaOne brand. Since then it has also acquired Westend Mall in Pune and a shopping mall being developed by L&T Realty. Blackstone now manages seven malls, operated by its retail subsidiary Nexus Malls.

Overall, the PE giant has invested almost $2.7 billion across 19 transactions in India's real estate sector in the past decade.

Blackstone is now looking to acquire two real estate-focussed PE funds as part of deploying new growth strategies.

Unlike the early PIPE deals which Blackstone made at peak prices, the real estate bets came when a prolonged slowdown in the property market had forced debt-heavy developers to shed assets at relatively lower valuations.

Interestingly, some of the tenants at Blackstone's office parks are its own portfolio companies such as Intelenet.

Tuhin Parikh, head of Blackstone's Indian real estate operations, could not be contacted for comment. However, Ramesh Nair, CEO at real estate consultancy JLL India, gives some insight into the PE firm's real estate play.

"Blackstone entered the market when nobody else wanted to enter," he says. "In 2012, the office space market was down and India was getting a lot of negative press because of many scams."

Nair says that Blackstone started with buying fully operational properties and then moved on to buy assets that were partly leased and partly under construction. "Today, they are even willing to buy land. This shows the comfort level Blackstone has developed in the market in the past four-five years," he says.

Blackstone may have an early-mover advantage but a few bulge-bracket global investors are now giving it competition. Singapore sovereign wealth fund GIC Pte Ltd, for instance, outclassed Blackstone earlier this year to buy a billion-dollar stake in the rental arm of developer DLF Ltd. Canada Pension Plan Investment Board is another PE-style investor expanding its real estate investments in India. But Blackstone's strategy differs from some other global PE giants such as KKR, which are focusing more on private credit instead of real estate.

To be sure, Blackstone has yet to record any exit from a real estate investment. And since nearly half of its India exposure is to real estate, these investments would be key to its overall success.

The new narrative

For a firm that made several missteps in its initial days of investing in India, Blackstone has undoubtedly turned around the narrative around its investments in India, especially over the past six years. This is largely due to its sharp sector focus, which aligns with its global investments, besides a new team.

"Blackstone indeed had initial hiccups but over the last few years it has assembled a good team in India and managed to turn things around," the veteran investor cited above said.

Some of this success is also because of the PE firm's hands-on approach and its focus on exerting operational control even in companies such as NCC and SH Kelkar where it had picked up just a minority stake, industry observers say.

The Blackstone spokesperson says the PE firm strives to be an active investor always whether in a control or a minority deal.

"We look at deals where we can add deep operational value and scale up. Blackstone's private equity business avoids passive minority deals and small investments. We are value-added investors and actively support our entrepreneurs as they scale up their businesses," the spokesperson added. Bhushan, the Nishith Desai lawyer, says this may be an indication of how the mindset with which portfolio companies are looking at PE funds has changed. "Increasingly, promoters have started looking at PE funds as value creators and not just financial investors," he adds.

PE industry veterans also say that Blackstone's successes in recent years may even help the firm recoup its early losses. The clearest evidence of this is how the firm is riding on the Indian success to raise its new Asia fund.

When Blackstone entered India 12 years ago, it had committed an initial investment of $1 billion and had plans to raise a dedicated region fund "in due course". But so far, the firm has been investing in India and Asia out of two global funds.

This will change soon. Earlier this year, it put in place plans for its maiden Asia buyout fund to raise at least $3 billion. The Blackstone spokesperson declined to comment on the firm's fundraising plans.

This is how a senior investment banker sums up Blackstone's India journey: "In the beginning, the street may have laughed at Blackstone. But now, it seems to be having the last laugh."

This article is the first in a monthly series where we will trace the performance of private equity and venture capital funds operating in India. The aim is to go deeper than what the daily news coverage offers and provide a broader perspective with an analytical lens.