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Put option favoured exit route for private equity

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In May this year, P R S Oberoi promoted East India Hotels (EIH) acquired 45.85% stake held by its joint venture partner Amex Investment in EIH Holdings for \$45 million (about Rs 200 crore).

The same month, Reva Electric Car Co, a joint venture between Maini Group and US-based AEV LLC, bought out stakes held by Global Environment Fund and Draper Fisher Jurvetson in the company for an undisclosed sum. Later, Reva sold 55.2% stake to auto major Mahindra & Mahindra as part of a strategic sale.

The two deals had one thing in common — the promoting companies (EIH and Maini-AEV) had given their respective private equity investors an exit through the 'put' or 'buy back' option.

"Amex wanted an exit, so we decided to buy out their interest in the company," Oberoi had told DNA Money in an email response at that time.

Put, or buy back, is one of the exit options listed in agreements between a private equity firm and its investee company.

There are two ways of having a put or buy back option in the investment agreement, viz. put on the company and/or buyback by the company promoter.

"What it basically means is, in case the investee company is not able to give an exit to the private equity firm through an initial public offering (IPO), strategic sale or a secondary transaction, the investee company will buy back the stake at a mutually agreed internal rate of return," said Vaibhav Parikh, partner - fund investment practice, Nishith Desai Associates.

The option seems to be gaining ground amongst private equity firms operating in the Indian market, particularly those nearing the end of their investment cycles, to be able to return money to their limited partners.

According to Chennai-based research firm Venture Intelligence, of the 74 exits concluded so far in 2010, 16%, or 12 exits, have been buybacks.

"The number of such deals is the highest since 2007, which saw eight buyback deals from the overall 76 exits," said Arun Natarajan, MD & CEO, Venture Intelligence.

Besides EIH and Reva, exits through the put route this year include India Infoline buying back Orient Global's \$72 million investment in India Infoline Investment Services and the acquisition of Citi's \$60 million investment in JBF Global by JBF Industries.

Nitesh Estates' buyback of Citi's investment in the Bangalore hotel special purpose vehicle is also said to have been one such exit, as are Emcure Pharma's redemption of Blackstone's \$50 million investment in 2006 and Emaar-MGF's buyback from Citi Venture Capital International (CVCI). Going by media reports, CVCI made a complete exit — of just over 1% stake it bought in 2006 at Rs 1,557.84 per share for \$50.98 million (Rs 227 crore) — from Emaar MGF recently following the close of the put option date (June 30).

Till date in 2010, the Indian market has seen PE exits worth \$2.47 billion surpassing \$1.79 billion worth of PE exits in the entire 2009. The exits are primarily being driven by significant recovery in the stock markets wherein investors are cashing in on every opportunity for a profitable exit. Most of these exits are happening from portfolios dating back to 2005-07, which have reached the end of their investment horizons.

With the IPO market still shrouded in uncertainty, will more PE firms take the put or buy back exit route?

"It will be very difficult to say at this stage that there will be increased traction with this exit route, particularly with the revival in the IPO market. Besides, such exits are very deal specific and generalising it as an increasing trend would be early, though I am not saying that it

may not happen. However, I'd agree that of the overall exits this year, there has been a significant increase in the put or buy back exits," said Parikh.

Industry experts feel put is the last option used by investment firms, both private equity and venture capital. It is not a preferred option as there are certain legal issues pertaining to implementation as in some cases the enforcement of the option by the PE or investment firm may be looked upon as debt funding with fixed returns as against equity placement based on the investor's risk appetite.

"Enforcing the put option is a challenge in India primarily because of regulatory issues. A case in point is the DLF wherein the investors had a tough time exercising the option," an investment advisor said, requesting anonymity.

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