

T&I ASIA

INDIA SPECIAL REPORT



Participants from left to right: Jason Sambanju, Paul Capital; Pravin Gandhi, SeedFund; Joo Hock Chua, Vertex Management; Vikram Godse, Mafield India; Rajesh Subramaniam, Walden International; Suresh Shanmaugham, SVB India Capital Partners.

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ALOK MITTAL, CANAAN PARTNERS: I'm Alok Mittal with Canaan Partners. We're a global venture capital fund operating across the USA, Israel and India. Today I've taken two topics to introduce to our group; what we can look forward to and what we should be



looking out for. In the looking forward category, I see this year as a year when we'll see validation of the venture model, from the point of real exits and real money being made in the category. We've gone through these cycles of 1999 and 2000 when VC saw significant investments

and somewhere along the way many of those funds did okay relative to what many global VC funds of that vintage did. Then from 2005 to 2007, many of us got started in the business here in India. Today I see winning companies across portfolios, a lot of which could realize compelling exits this year answering LPs questions of where are the realizations in the venture industry. I think that question is going to be answered substantially this year. In the look-out category, the market has recovered and we see more and more strategies [overlapping]. Early stage funds want to do more and more growth investing, but even hedge funds want to do early stage. I think that is something for both GPs to contend with, but LPs are also going to have to figure out how they're going to cope with that. In the market this is obviously going to create some pricing pressure, especially as larger funds try to do early stage, they're ability to pay for the same deals is higher because 5% more from their assets for a deal doesn't really matter; this is something that we're going to have to look out for. As for this morning's announcement that Sequoia India's founders are leaving to found another firm to invest in public equities, the clear statement the departures makes to me is that in order to grow really large in investment management, one has to ask whether

private markets offer sufficient opportunities and if you have the ability to raise more capital and you're not wedded to any particular segment then managing a few billion is much easier in a public market, than in the private market. There will be GPs who would like to build specializations and there are GPs with the ability to stretch across segments of the market. But I don't think that you can manage three to five billion in PE money in the Indian market today. It's definitely feasible in public markets. I think the good news is that Sequoia continues to be in India, so I don't see this as a firm level endorsement of one strategy over another, but one thing I think that is being said, is that if you want to manage larger amounts of capital, then there is only one way to go.

T&I: Many US-based VCs in India are no longer tech.

CANAAN PARTNERS: That to me is a different call. Many of the venture funds in India have diversified across sectors over the past 4 to 5 years, recognizing that venture style returns can be made across different sectors in India. So I see that more as an evolution of our business, rather than a shift in our business.

T&I: Canaan has not changed its approach in India.

CANAAN PARTNERS: We have not because we have continued to see significant opportunities in technology. But we have a certain core business in mind when we look at India and think that there are enough opportunities within the technology domain for us to effectively deploy our money and make a fair return from that. We have accordingly, kept our team skill-set oriented around the skills one needs to make money in the technology business. You know, if we had to go in a retail business, or into a financial services business, our team would look very different from the way that it looks right now.

JASON BREEMEN, EVERSTONE CAPITAL: I want to comment for a moment on the private versus public debate that we see arising in India. If one looks at what's going on in the marketplace, everybody knows

that there are 7,000 publicly listed companies in India. But if you look at the number of companies that trade more than a single share a day that number drops to 2,700. This is all based on Indian economic development and its financial history and these companies listed for many reasons; to have more sway



with their bankers, on and on. Now, look at those 2,700 listed companies. Less than half, only 1,200 have a market cap of less than \$20 million dollars. But if you look at promoter holdings across the entire spectrum of Indian firms – and we did this research because LPs were asking us

if it made sense to invest in public versus private companies, in India – 54% of all shares are in private hands. So in fact, public markets are not that liquid. This is the only country in the world where regulators say that at least 25% of a listed company's shares must be in the hands of the public. My point is this; if you're reason for saying that you want to manage more money in India is why you're going to public markets I'm not certain that investing in public companies is the right way to go. With 700,000 private held companies, it seems to me that there are lots of opportunities investing in private companies.

CANAAN PARTNERS: All valid points and I think that most LPs have the ability to play in either public or in private markets, depending upon portfolio allocations, and the percentage of assets in each class one wants. But dollar for dollar the fact is that you can write \$100 million dollar checks for the public markets versus private markets, despite there being a limited number of companies that can absorb those amounts and I see the driver of this decision as being the amount of raw dollars that can be invested rather than the number of companies where one can put to money to work.

SVB INDIA CAPITAL PARTNERS

SURESH SHANMAUGHAM: SVB India Capital Partners has a \$54 million direct equity investment fund for India that we raised in 2007 that invests across stages and industries, alongside partners such as those of you here today, Canaan, Mayfield, Walden and others. The fund differs from our PE fund of funds which is primarily a platform driven, domestic, technology driven fund of funds that operates out of our SVB Capital Group. We also have a venture debt group based out of Mumbai doing work in traditional venture debt; things such as runway extensions to provide extension runway to the traditional equity being provided by institutional investors. My topic today is going to be e-commerce. We've seen a flurry of activity in terms of e-commerce funding recently; it was as if a light switch was turned on along with a groundswell of reports in the media about e-commerce, followed by a swell of activity around a number of companies being funded. I'm curious about what all of you think about this and why now.

PRAVIN GANDHI, SEED FUND: You know switches are turned on and turned off awfully quickly in India. (laughter). People hear about a firm, let's say, FlipKart, you hear they're doing well and though people don't know why they're doing well or even if they're doing well or not, they start investing in that sector. People who came here originally to do technology investing, who are not willing to look at other sectors because they don't understand them, will get on the bandwagon, thinking that there must be something here, so let's go take a look. I think there is still a way to go, before e-commerce in India is a reality, before it's the right time to invest because exits are still 5 to 7 years away. If you don't think that you're going to be running away in three years or so with some kind of a large multiple, perhaps it's okay.

CANAAN PARTNERS: I think that the one part, that has demonstrated itself, broadly, even beyond the kind of example that we have in FlipKart, which does book sales, media online, is that consumers are willing to buy on the net. That is one thing that has been

demonstrated in the last 12 to 18 months, which wasn't there, even three years back. There is still a lot of the plumbing that needs to be put in place, but...

PRAVIN GANDHI, SEED FUND: I agree that there is activity. Is it sufficient for ten companies to go do the same thing? I think the answer is no.



SVB CAPITAL PARTNERS: Is the opportunity then in the plumbing or in the consumer facing side?

CANAAN PARTNERS: There is opportunity on the plumbing side. Every month we're seeing issues

in the supply chain, everyone says that there are issues with cash on delivery payments, delivery, so there is definitely opportunity in the plumbing piece. Having said that, there is also opportunity in individual consumer ventures, and while on the surface this might look like 12 companies in the same space, if you dig a bit deeper, go into categories and business models and there are only two to three companies in a single space, it's not that much. So yes, there is a question about which category you buy into, which business model do you invest in, but that's where there is some [opportunity in your] selection.

T&I: 12 companies does not sound like over-investing in a country with one billion plus people.

CANAAN PARTNERS: But given that there are only about 12 venture investors in India, by the time that you've reached twelve you're done (laughter). The issue is that we're in an environment where the supply for capital is still very constrained in that segment of the market.

EVERSTONE CAPITAL: But you have to consider in thinking about e-commerce, about how many internet users there are in India; 40 million out of 1.2 billion.

SEED FUND: Right. It's extraordinarily low.

EVERSTONE CAPITAL: And the number of high speed internet connections in India? Eight million. The Indian government classifies 256k and above as high speed internet. Our market is small compared to China. That's one reason of many reasons, why e-commerce hasn't taken off yet.

RAJESH SUBRAMANIAM, WALDEN: Thinking about 20 year olds who began using the internet 10 years back, they're a lot more impatient, they want instant gratification; fulfillment has to be immediate. They want the best deal. I think that's why you see the proliferation of deals in the internet space. A lot of these deals in good internet companies are in companies that actually have a revenue model. Ten years back VCs were investing in page views, in eyeballs and today VCs are investing in companies that have a real revenue model. That's gratifying. Whether the inflection point for the models we're discussing is in 2011 or in 2013, we still don't know. But I think that we have the right building blocks to know whether these businesses can scale, whether e-commerce businesses can survive.

PARTICIPANT COMMENT: When I speak to a lot of e-commerce startups they say my revenue model at this point is not that big, unless you're talking about mobile startups where numbers are huge and the telecom story is very good. But suddenly startups are saying that eight million, I won't even bother about them, the number is too small, I'll pursue the market where there are 700 million mobile internet users.

EVERSTONE CAPITAL: I'd say that 700 million number is inflated. Just around the room, how many of you have two numbers, a blackberry number and a phone number. And I hear what you're saying but...

PARTICIPANT COMMENT: At the end of the day, the number that will govern where you're going to invest is that of the larger telecom connections.

RAJESH SUBRAMANIAM, WALDEN: The way I look at it, you're both saying the same thing. We've probably not reached a proven market stage, the sort of stage where a PE firm can see what it's investing in, before going in. We're at the stage, when VC



funds are taking their risks. You've seen the model, you've seen that they have traction and now what you're funding is the scalability. I'll say that we're well beyond the early days and while this is just my opinion, I think we're at the stage before a tipping point, where you

want to be in a market or else you're a little too late to get onto the bus.

ROHAN AJILA, CAPVENT: I think one of the things that has happened over the last two years and one of the things that Alok alluded to, is that we've seen the validation of the VC market for India and over this and next year, we're going to see an increasing number of exits. The question then becomes – because the argument is well articulated about why the venture model is successful or not successful in India, and why it is successful in China – the question is this, whether the venture market has been undersupplied over the last three or four years, despite there being a tremendous opportunity when an entrepreneur wanted to create business models, with very small amounts of money being put on the table, so they've had to put smaller amounts out, risk less in building out, before doing any follow on. Do you any of you see that the supply of capital has changed over the last 12 to 15 months? Do you foresee the level of activity changing or are we just seeing the noise of current events? Alok alluded to this on the growth capital side, where we see people doing things you could call Greenfield, because people want to get away from any model that is fully built out, because it's just too expensive. So

people are looking at roll-outs, build-outs in which they say, I don't mind getting into this a little bit and so we're seeing Greenfield, I won't call it venture, efforts in whatever model you're working on and we're seeing that in growth type investments, where investors are saying, let me look at this entrepreneur, who's built a chain of three diagnostic outlets and I don't mind paying two time, or three times revenues for this, but he or we together are going to build out another 100 at book value. We're seeing that kind of style drift, of people to these underserved areas. Do any of you see this happening in venture?

JOO HOCK CHUA, VERTEX: Vertex is the venture arm of Temasek Holdings. We used to be a fund of funds, an LP investing in GPs like Mayfield and Walden, but we're kind of slowing down our fund of funds work, and making more direct investments. We focus more on Asia now, though we do have an office in Silicon Valley and in Israel where we have an associate fund, as well as offices in Beijing and Taiwan. We're active in Korea and India and we're increasing our activities in Singapore. In other areas, such as Southeast Asia we're more opportunistic. Coming to the point that was just made, about valuations, and paying two times earnings, what I've see is that pricing has kind of run away, where people are asking for 30 times, 50 times earnings. So it has become hard to find situations in which we can take a venture view.

CAPVENT: Right. That was my point. Who is going to pay 20 times earnings to a guy who has two diagnostic shops? Nobody is going to unless they're prepared for the effort to build it out. So we're seeing this, call it Greenfield, Brownfield retail, you may call it roll out, you may call it early stage growth and it's a bit confusing, causes LPs to ask GPs "Hey, what are you doing in this area, aren't you supposed to be doing this?" and it's more Greenfield [development] than it is venture capital, but it also problematic for the growth guy, because when the growth firm is told that the entrepreneur has only two million in revenue, then it doesn't really fit in his profile either.

SEEDFUND: Whatever we do, it's very early stage, so it's Greenfield, it's Brownfield, whatever color you wish, but that's what we do. For example we've invested in a bunch of dental clinics. The founder is operating three clinics and we said, now we're going to build out 200 clinics, around Mumbai. Our basic theory is that the investment team's job is based around serving the customer and we want to create value propositions for the middle class. So you've got to get to get lots of people in, rather than building a Kaya Clinic and trying to get the upper class to come. That's our theory. We've put some money into the company and we have about 5 clinics to be rolled out, without making any real estate investment and with a very low capex. In India when you commit money,



you try and check like hell, because you've got to worry about whether the entrepreneur is sure about the risks that he is taking, because we're also taking that risk. The team has to help build them out and it's a risk on both parties part. The other example that I can

give you from our first fund was money we put into a hospital chain in Bangalore, with some presence in Karnataka. That was one hospital and now they're up to 15 hospitals in that region. These are small \$200,000 capex hospitals with revenues of somewhere around ten million, per annum, run rate. All I'm saying is that this can be a good strategy, but you have to get in very early. And you can't afford to give any brilliant valuation for a one clinic, two clinic guy, because there is no proof of concept. And if we start with anything less than 40% ownership, we get completely washed out by the time we get to the point where we can make some money out of all of this. So there are serious opportunities available. In our new fund, which is \$54 million, what we've done after proving what could be done with our first \$15 million

dollar fund, an early first stage fund, is to ask whether we could put one million max, each, into a company, and create companies which are successful.

T&I: Your first fund succeeded with that strategy?

SEEDFUND: We've had one exit to date, a reasonably good exit for us, in which a European media conglomerate bought one of our companies; that was the Bertlesmann buyout of CarWale. A couple of others have merged into another company in a strategic buyout. And the others are on their way for exit. So I think our getting a 3.5X to 4.5X on that first fund is looking very possible, but okay, so who knows what the environment will be. You know we really don't have to worry about the public markets. We're out of there much before that. So after we learned some lessons in our strategy we raised a \$54 million dollar fund, with two ideas straddling the fund, at both ends, saying that we will run a proprietary incubator. There are all these incubators that are run by the government, but firms don't seem to be getting the right assistance in these incubators and really there is very little money available once they're out of the incubator. So what we are saying is that we will pick some teams and build their firms inside our incubator. We have many theories about how many ideas will work, how many will not work, but I'll tell you all about that when the fund is over, in terms of whether we have to incubate 7 companies or 21, the number I have no idea, but, we'll commit capital. And whoever graduates out of the incubator, will get money. The others who don't graduate, will go to Alok. (laughter)

CANAAN PARTNERS: Going to go back to one of your points, if VCs can get 40% in the first round, there is clearly not enough money in the market.

SEEDFUND: Exactly.

T&I: You're investing \$300,000 to \$1million for a 40% stake in companies in their first round?

CANAAN PARTNERS: No, that's not a competitive market. They have to do better for their initial capital round. And while on some level, we might say great, we have pricing power, still we all have to remember

that our companies have to raise a next round of capital. And this kind of pricing for a first round becomes a concern there. So this is a challenge in my view and this market clearly needs more early stage investors.



SEEDFUND: Alok I will disagree with you to the

extent that even if there is more money, I think you still have the pricing power, if you are the right kind of fund, sitting there and working with these companies. Okay, so then the 40% will go to 35%, that's a different matter, but if you're just going to go ahead and write a check, sure, you can do it with 20% as well. This will also depend upon the kind of people who start these early stage funds, and do whatever it is, that they're all supposed to do with creating value, and working very hard, to obtain their return on the company, so you're right, but I think that at the same time, I think that having had the experience of our first fund, I don't want to take anything less than 40% and that's what it takes for us to make any decent money for our investors, in investments of somewhere around one million.

CAPVENT: Basically you're looking at a valuation of \$2.5 to \$3 million? I saw a deal, where a startup company gave a similar valuation for around 50% and there were around three founders, so each of them gave up around 15%. My question really is, whether there is still an incentive for a founder to really create value, if as in the case of three founders they're each holding around 15%, the VC has around 50%, and if they go and raise money after that series A, what is left for their incentive?

SEEDFUND: In the companies we've invested in, they seem to want to do this. So there is a trade-off, because there is no money available otherwise. And we're also not dumb. We also want to make sure that this guy, doesn't come crying to us every day, "boy, you guys really took me to the cleaners," and so we have some agreements on performance, that gives him back some equity, so that there are incentives for them to believe that if the company performs well, they will gain too. I've been an entrepreneur, so I understand what it means to be on the other side of the table. And that is why the people who work at SeedFund believe we strike a fair balance between what the guy should have and what we should have. We're not in charity after all.

WALDEN INTERNATIONAL: Fundamentally the Indian entrepreneur is never happy, with whatever is his ownership in any case. If he's at 70% or at 7%, it doesn't matter, he's always looking at insuring that he has as much as possible. This is always going to be the case. I think that the expectations of ownership is based on a certain business environment and with the expectations based upon whatever he has committed to his investors that he is going to be deliver. If he delivers what he's said, then he should be happy with the 15% that he has and if he doesn't deliver, then there is reason why he should be penalized.

PAUL CAPITAL, JASON SAMBANJU: Having said that folks who approach venture funds, especially in India, are fundamentally different from the guys who have built a business and who are just looking for growth equity to take them into the next stage. I think that if you're coming at an earlier stage and you are the entrepreneur and you're presenting a business plan and saying, look I need your support and your help to grow my business, or to prove out my concept, or any of these good things that are the classic venture story, I think that he has a different mentality from the guy who is saying that I'm going to do you a favor, by giving you 20% of my business, and I'm going to go out and get three other bids, and it doesn't matter to

me that the color of your money is green, because the other guy's money is green too.

SEEDFUND: True, so in reality I don't think that we're an early stage venture fund at all. But there are many funds which are straddling both ends of the spectrum.

PAUL CAPITAL: Rajesh's colleagues in China will tell you that they've had a similar story in terms of having success around non-traditional venture, pure, true venture in the Silicon Valley sense.

SEEDFUND: I don't think that works here, that's clear.

PAUL CAPITAL: It's a small portion of the market,

SEEDFUND: It's all business model execution here.

ROHAN AJILA, CAPVENT: 90% of the play here is in the business model. I don't think that too many people are taking primary business model risk saying, if there is a technology here that works I'll get 30X, but if it doesn't I have 17 other firms in the portfolio. So the challenge here is that you're taking venture



risks, and on the upside you've got to think 3X and 4X, or it doesn't work. But you're taking the same risks on the downside, and the upside is only 3X or 4X. So over a period of time, people and some of the venture firms have moderated their approach, to take make investments a little less risky.

MAYFIELD: The call Mayfield makes is pretty much what you say, as opposed to taking binary risks for our model. Because in India, many of the core sectors are still where in many of the developed economies, firms here are where others were a couple of decades ago, maybe even more than that. And models are going to evolve. You cannot expect the kind of model

that logistics had, or agriculture warehousing had, or in the ways that these developed in the West. While they could develop the same way here that they did in the West, there is going to be a certain amount of transformation that will happen, the value chains will morph, backward and forward and there will emerge smarter entrepreneurs who can take advantage of that change and create alpha. For those companies, either you go in really early and help them form, like in a platform play, or you'll have to go in with 30 to 40 crore, after they've proven the model and help scale them up and that is essentially the risk that you'll have taken, the scale-up risk. We completely endorse that as a strategy.

CANAAN PARTNERS: Believing that you're not taking binary risk, in venture is a fallacy. You can finally land up with a 3X or 4X, but I don't think that we're playing for a 3X or 4X on a deal by deal basis going in. When you play with venture, you're playing for 10X plus on a deal; it depends upon the stage, maybe it's 7X, maybe it's 10X, but it's not three X as your investment thesis.

CAPVENT: Wherever it is, we'll see it this year?

CANAAN PARTNERS: Absolutely. But I think that the interesting point is this. The validation is not just for LPs right? Those of us around this table, the VC players, are looking too because we haven't seen the validation. Entrepreneurs are worried about ending up owning 7% in a company, because they haven't see a \$200 million exit which will give them \$14 million, they've been getting less. So this notion of validation, and what we believe the venture model is for India, is an enigma to all of us. And all of us are seeking that validation and we're saying, I'm okay with 24% of a \$400 million dollar exit, the entrepreneur will say I'm okay with 10% of a \$200 million dollar exit. Sure there is a discount getting there, but I don't buy the theme of playing for a 3X or 4X on a venture deal. I don't think that exists.

JASON SAMBANJU, PAUL CAPITAL: As an LP we hope that those kinds of returns don't exist.

T&I: Rajesh, I asked you to address valuations, will you introduce this subject?

WALDEN INTERNATIONAL: I think that in VC especially when you're doing early stage investing, deal valuation and metrics becomes less relevant.

SEEDFUND: Completely irrelevant.

WALDEN INTERNATIONAL: Whether I'm at an \$8 million pre-deal valuation or at a \$12 million pre-deal valuation if the company goes bankrupt in two years, it doesn't matter. If it does well, fine, I've put 5% of



the investment on the table. So fundamentally what I look for in a deal is the team; it all comes back to the team. If the teams ability to execute, even if they're working on an idea, they've figured it out, and I'm extremely happy, I mean, if I put in five to

seven million, and they return \$60 million to me, I'm willing to put \$6 million back and get their goodwill for being a great investor to work with. As to valuations, obviously you can't be paying growth valuations to a bunch of guys who come out of nowhere and want funding. You recall that in 2007, we saw what I call panic buying. When you had everybody wanting to buy every asset class, and all of a sudden you saw panic selling, but nobody wanted to touch certain asset classes. The fundamental issue for valuations at Walden is that we know how much we can provide over the life cycle of an investment. And we measure our risk and reward in terms of if I can put out ten million dollars in a company over its life cycle, how do I pace myself, so that I can make sure that I don't get washed or, or so that I make enough money because I got in early enough. Those are the

things that we watch out for. In internet investing, I'll be investing smaller amounts and keeping more. When I'm investing in a company for its expansion, that has three to five million in revenues, I'll be investing larger amounts of money because the company has a larger likelihood of getting to profitability. So valuation is important, but it's not the only factor driving investments.

T&I: Deal flow to VCs has slowed. Does that mean you're out looking for deals more often?

WALDEN INTERNATIONAL: Absolutely. Right now, of the three or four investments that we have made, the ecosystem of those entrepreneurs and the ensuing network effect has become a very good source for us. They've become ambassadors for the fund as they talk to people. That referral network is extremely helpful. Then there is our network with other VCs, the few who are doing our kind of investing, where there are only ten or twelve of us, so we keep talking, and when we see there is an opportunity, when someone wants to come in, share the risk, we try and do a deal together. The question is whether there is a DNA match between the two VCs looking at a deal that will help the entrepreneur. These kinds of things are still very early in this country. A lot hasn't been proven yet, but over the next three to five years, after some good exits and credible success stories the ecosystem that you're going to see will be much stronger.

CAPVENT: Would you take a binary risk, let's say it's a software development company where the risk is let's say a 50% chance of success and I'm just giving a figure as an example, though I think that these odds are not too bad an estimate, that a deal won't work, giving you two possible outcomes, either success or failure, 100% or 0%, which is how I see this.

WALDEN INTERNATIONAL: Sure. I would definitely take that risk, if I understood that business and if I believed that the entrepreneur was clear on what the market is and what was needed in the market and not

based upon what the entrepreneur thinks his abilities are. Fundamentally the problem with the Indian entrepreneur is they come from what I call supply-side economics. I can do this. I'm great at that. I can build a team. They completely forget what the customer wants, what is happening with the customer. Most of these guys burn through a lot of capital before they ever get to a single dollar of revenue. Today we're seeing deals in software products, where India was never considered to be a place for the development of software products, and the market is India. They create a proposition based on local demand, they figure out the bugs in India and then these products are universally applicable to a lot of other markets. We're seeing this in financial services, in asset management and telecom.

VAIBHEV PARIKH, NISITH DESAI ASSOCIATES:
We're seeing some problems in telecom?

WALDEN INTERNATIONAL: If we're seeing problems in telecom, most of those problems are around the On-deck models. The telecom operators worldwide behave in a certain way that has insured more bankruptcies than they've encouraged homeruns. I'm a little skeptical as a member of Walden about telecom, because we have a few scars on our back at Walden from telecom deals.

CAPVENT: What about mobile applications? Is that a market that you're looking at? Because that is a market for which there all kinds of theories, that for these kinds of apps, India is a place where there are many funds that are well suited to help developers, and there are funds that are just focusing on developing applications. Whether it's for the iPhone or Android. Do these enter into your discussions?

WALDEN INTERNATIONAL: Let me step back to answer that. In the case of apps, the consumer and content are the ultimate investments and Walden is very big on doing gaming deals in Korea and China. For us to bet on who will make the next app, which

will be the next blockbuster, maybe somebody in the US is looking at this, but in India I think that we have a lot more domestic consumption plays that we think we can invest in and make money. But apps, in the sense that there are 30,000 apps floating around, is only one medium for accessing the customer. What we really care about is the service or the platform you're building. In India, specifically, on the mobile side, it is landing on the multi-channel offering, right? There will be an app to access the service, there will be a WAP access mechanism, there will be a voice access mechanism for the same service. It's as though service becomes more important; iTunes being a kind of service which is dependent upon many access channels not just the web.

CAPVENT: When I talk about apps and forgive me perhaps this is just a lack of knowledge, I'm coming at this without any preconceived notion, but I'm not talking any broad-based platforms. I'm thinking of an application



like Angry Bird. Now you see that whole platform which used to be an Apple platform, is no longer that, now you can have an Angry Bird on your Nokia, on Google, on whatever, and at the same time, that means that some of these apps are scalable, so that they can reach \$100 million, \$120 million in revenues. And I don't use applet software, but these little things that are going to be taking over the world through tablets.

SEEDFUND: Yes, there are all these little things. I think that the challenge is getting them to the Indian consumer. The Indian entrepreneur can sit in his room and figure these things out, but you're going to need a lot of money for them to take these to the consumer.

CANAAN PARTNERS: The problem is spotting it. Things like this seem to struggle for a bit and then suddenly after 4 weeks they have ramped up

significantly and perhaps they're gone in another few months. If I knew how to spot the next Angry Bird, I'd be rich.

CAPVENT: That's the challenge with this in the end right? And that is my question. What is the argument, for these applications? The fact is that this is a great opportunity, because you don't need distribution channels anymore. Or you don't need to have channel partners anymore. So if you have something people are responding to, if somebody likes it, without any large infrastructure and there is this rating system, so it gets known, it's got a market.

WALDEN INTERNATIONAL: The problem is that for every Angry Bird, there will be \$400 million of capital burned on ideas that don't work. So the question is what has that Angry Bird done to get to its level of success, for those lucky investors who have invested in apps for that platform.

CANAAN PARTNERS: These are also impulse buy of which Angry Bird is a good example as opposed to a Four Square. Both are apps in some sense, but one has a degree of permanence to it, because of the user base, and because of the value outside of the platform that they're building. And that compares to a single game, which will go up, but you know that it will come down. So what you're looking for here is to determine what the sustainable asset is.

MAYFIELD: I agree with what is being said, because it's very difficult to see from the outset whether you're investing in a game that is going to be a blockbuster. But investing in a platform, where you can use the platform to support other things, is probably a more successful model, gives you access to a bigger market and more customers. Still the question is as you've said, how do you identify what is going to be successful?

SEEDFUND: We invested in a couple of these product type of startups in our first fund. Because you always think that you're going to get this 100X hit. And

basically we lost a couple of million dollars in these two companies, but that was because we tranced it sufficiently so that the downside was restricted. The application quality was good, but the kids just didn't know how to get this wireless stuff going and you also begin to discover similar applications and then you say, I'll go back to the lab and re-do features, but by that time the market is gone, nobody is interested.

T&I: Joo Hock, your peers at Vertex created a new fund at SingTel to invest in what we're talking about, borrowing Pravin's model of investment structure.

VERTEX, JOO HOCK CHUA:

Well, I don't want to speak for them, but I think one of the things they would be looking at is the strategy on how they can build platforms and applications around SingTel network and drive their usage base.



T&I: Comment if you will, as you sit between China and India, about your sentiment for China versus India.

VERTEX: Obviously we're seeing a lot more interest and business from China. We're putting a lot more energy and focus in China, partly because there are already many proven, significant returns from China investments like DangDang, Sina, Shanda. All these investments have made a lot of money for their investors. India has not shown this type of returns. The first India investment that we've seen giving investors fantastic returns was MakeMyTrip.

T&I: You appreciate IPOs more in US markets?

VERTEX: Yes, we do. But now my team is looking at deals with exit through IPOs in China. The popular thing now is RMB funds and everybody that matters is doing an RMB fund because they can have access to deals that US or overseas or dollar funds cannot.

And the thing about investing in China deals is because of the high exit P/E the potential returns are high, at least for now. P/Es on the deals that my team are looking at have 40 times P/E levels. It means that a lot of energy is being channeled into China, which in some ways is unfortunate, because I think that there are interesting opportunities in India. But I also see a difference in the entrepreneurs in India and China, in that I find that Chinese entrepreneurs are more willing to dilute themselves, knowing that there is a bigger pie and maybe that is because there is a lot more experience with good exits in China. There are many companies that have gone public that today are worth a billion dollars and 10% of a billion dollars is a lot of money, so entrepreneurs see that companies can go public with a higher market valuation so they're more willing to take a bit more personal risk.

CANAAN PARTNERS: I was asked to introduce the topic of global investment funds who are present here in India, but which have globally offices and teams spread around the world with whom we work and how that is faring and how this works. The obvious things are our weekly partner meetings, which take place every week, starting Monday nights and going on to Tuesday mornings, at 1 AM to 2AM, depending on whether it's daylight savings time in the US (laughter) so it actually works out pretty well for us.

SVB INDIA CAPITAL PARTNERS: We do this on Thursday mornings in Bangalore, but most of our team is here, so it's okay for the India side of the firm, but not so great on Wednesday evening in the Valley.

VIKRAM GODSE, MAYFIELD INDIA: We actually have our meetings on Thursday evenings in Mumbai, but the Mayfield model has been to have separate funds for every geography, so China has a separate fund. India has a separate fund and because India has been doing expansion capital and growth, it's not the traditional VC tech model that the US has been following, so we've had a separate fund structure and because of that we have two managing directors from

the US looking in on our investment committee, so that they know everything that is going on, but it's at a distance. I don't think it's fair to compare us to some of the other models here, where one global fund is investing everywhere, including India.

WALDEN INTERNATIONAL:

We moved from the model of the independent fund to investing in India from the global fund, from PacVen IV, ten or twelve years back.

CANAAN PARTNERS:

There are a couple of things that are working great for us at Canaan. One is that we have this diversification piece; a lot of our LPs care about diversifying their geographic reach; a lot of them of them are not ready to take part in a



dedicated India fund, so that part works well. In the venture industry, while most of the GPs here today are the exception, many in India are first time fund managers and that's another thing that is working very well for us here, bringing experienced investment management to India that our firms would otherwise not have. That's working great. The fact that we tend to invest, behind the same broad themes globally, allows us to bring those networks and expertise in from globally. If you ask if there is a separate Canaan India coming up, I think that there are two perspectives that can drive this. One element is internal, how well is this working for Canaan. That part is working great so that's not a reason why we end up with a Canaan India. But there is an LP side argument to this and if that were to shift predominantly in the direction of LPs saying, I want direct geographic exposure, rather than allowing the global fund to manage their exposure, I think that's a reason why at some point in time we might have a separate India fund; but we're not there yet.

T&I: When does an Indian firm benefit from the Menlo Park or Westport connections you have?

CANAAN PARTNERS: The first answer comes from the three or four broad themes in which we as a firm invest. The first of these is the internet. A lot of the businesses that are being built out on the internet globally are essentially conceptual arbitrage businesses, there is a lot of cross flow of ideas; what has worked, what has not and if it hasn't why hasn't it worked. Things of this nature are common. There is a lot of learning that flows, largely, US to India, in terms of what to look out for. The mobile investments side of the equation, has very little crossover. I think that India as a development market for mobile communications is developing very differently from the US. In terms of the prominence of voice and data as delivery channels, in terms of how strongly the operators continue to be involved with the mobile VAS businesses, as compared a largely independent VAS businesses that is more common in the US. So there are significant differences there. The third aspect of our investments, in software services, where I think that the interconnect is extremely important, in terms of business development, partnerships.

T&I: BPOs?

CANAAN PARTNERS: No, broader offshore services. What used to be BPO. We do have a legal services firm in the portfolio, we've got a direct to consumer, cross-border firm in the portfolio, so for them, the connectivity that we bring, in terms of customers or partners, is important, so there are several parts of the portfolio where this is important, but for the first time, what we're beginning to see, is the opposite dimension where some of our companies in the US, are now seeking India as a market. We started seeing this with Israel a couple of years ago, in telecom businesses where some of the entrepreneurs were not looking at the US as the primary market, but saying that "I want to build for India or China." And now we're beginning to see companies from the US saying

that they want to come to India and China. So there is a fair bit of cross border flow. If I look at all the VC firms in India most of the venture funds in India, either through people or through partnerships, have a leg in the US and I don't think that's incidental.

T&I: Your India portfolios don't mind if your investment comes out of Menlo Park or Connecticut?

CANAAN PARTNERS: They like it. But I don't think that this has sunk into the US as much as it has sunk into Indian entrepreneurs. When US entrepreneurs start their businesses, they start with a US market as their core focus, but over time they figure out that they want to go into other parts of the world. A lot of Indian entrepreneurs are starting off and saying I think that this is going to be a global business.

MAYFIELD PARTNERS:

On that last point, being in the US which is probably a little ahead of the curve, from where Alok is, entrepreneurs in the venture growth space, actually really care about what we were talking about before, dilution.



They really don't care whether it's a US or an Indian VC firm; what they really care about is getting the money in place, how you can assist them in the next round of funding, whether you know the value they want and that they want to derive from you, not whatever else you bring to the table, including a brand. We spent from twenty four to thirty six months, trying to figure out how to align ourselves with these entrepreneurs and once we've aligned ourselves how we make sure that they get what they want out of you. And that eventually becomes, unclear for you; we've reached a stage where very often we may be pitching to an entrepreneur and he will do a equal amount of due diligence on us; he will be calling a group of the

companies that we've been dealing with, that we've been on the board of. He wants to know who is going to join the board up front, to be sure that he gets along with them, that there is a certain amount of chemistry with them. And most importantly after cutting the first five or six million dollar check, he wants to know where the next \$30 million check that he needs in the next 12 to 18 months, that is part of his overall plan.

T&I: That first five or six million costs what?

MAYFIELD PARTNERS: We won't do a deal for less than 25%. There will be follow on investments after us, we' will get diluted, we need to stay in the game to make money, so we have to target the next set of terms going in up front, we need large stakes and valuation has have a certain amount of discipline around it. All of our deals in India have been co-investments, where the larger funds up the value chain, have followed us into our deals. And we've done deals where we've followed other funds as well.

WALDEN INTERNATIONAL: I tend to put investments into two buckets. One is what does this investment do for me as a GP in India, working on a cross-border model, with my team, across the US, Israel, China, Singapore and Taiwan. Fundamentally, the good thing is that I get the benefit of some of the best domain, [expertise] that the team has on any specific deal. If I have a deal, for say a software products firm, whose business model leverages the Cloud, or is on a software as a service basis, I get Mary Coleman, who has been a CEO at Bahn, and who is a General Partner at Walden, to give me the benefit of her insights from her portfolio companies especially relating to customer behavior and scalability issues, and this allows us to cut through the chaff very easily.

T&I: And you bring that to your portfolio companies?

WALDEN INTERNATIONAL: Right or I get her on a co-sponsor basis for an investment and then on that basis, for the deal, while I'm doing the DD on the entrepreneur, on the deal, I can do a lot of things here,

but I can't add any value as far as the customer who is sitting in the US, because ultimately the first revenue into the company insures whether the company survives or not. And that is where the team in the US comes in. To your point about my portfolio caring about where the money comes from, the color of money, whatever it is, is good. And if the deal is done on a competitive basis, if there are four good VCs to choose from and the decision is not being made based on the valuation, but because of the other things that one brings to the table, the VC has to deliver. And while 7 to 10 years back, when one saw lip service to this principal, I think we've moved to VCs actually having to deliver to their portfolio companies.

T&I: You're investing how much in your deals?

WALDEN INTERNATIONAL:

From five to eight million. If its series A or series B it get's tranced, so if it's a series A, you tranche it at \$2 million, then they go 18 months, depending upon milestones, and then another \$3.5 million after the company makes its milestones. Another deal we did, for a company with \$50 million plus in revenues, was \$8 million in their series C round. And another deal that we're in the process of closing is for \$4 million at closing and \$2 million more if milestones are achieved. It's what I'd structure depends on each deal, but they are tranced. You don't spoil a sponsor by giving him a heck of a lot of money at once. That, we don't do. And at least, for the entrepreneurs that we're working with, the kinds of deals that we're looking at, they get the benefit of our cross border network, because partners are flying in and out, all over the place from Walden and there is an immense amount of knowledge. And we believe that we're invitees to his party; we're not there to run his show and we make that very clear, as long as he is not in breach of anything that he has



committed to us. Honestly, if we strangle the entrepreneur, start talking about bringing in a professional CEO, then my deal is gone.

SEEDFUND: I think it's a complete misconception for any VC to believe that he's in charge of anything. When you hear these VCs going around and saying I did this. I did that for this company, Bullshit.

SURESH SHANMAUGHAM, SVB INDIA CAPITAL PARTNERS: And perhaps, because unlike in the US, the founders are the CEOs the majority shareholders, and they have majority control, India is different in that way, you don't have the ability here to tell them to do what they don't want to do.

WALDEN INTERNATIONAL: And you can't throw them out which is unlike the US where that's common. Challenges in enforcing rights in India are of a different order of magnitude.

VAIBHAV PARIKH, NISHITH DESAI ASSOCIATES:



The big distinction I see here, between VC and growth is that in venture capital investment I see a lot more handholding, a lot more operational, let's call them, affirmative rights, that we seek, or maybe the venture investor will put some kind of protection in the agreement, but on a

practical basis they do a lot more handholding. On the growth side they're really focused on the financials and on their exit as their key emphasis, so that when we're negotiating, basically what I get to understand is that if a deal is a private equity they going to assume that the operations are great, they're not even going to get into it. But as financial information and financial rights, are key. In VC you're after a lot more control in operations.

SEEDFUND: Right. You try. You say, I should be able to replace the CEO, blah, blah, blah, but nothing like that actually happens. It doesn't happen. The guy will bring his mother, father, everybody to the board meeting (room explodes in laughter).

WALDEN INTERNATIONAL: Or he'll go and set up a competing company and you'll spend ten years fighting the case in the legal system. (more laughter).

RAHUL SHAH, ADITYA BIRLA PE: You might also consider a different angle, in that there is a lot of input at the general management level. At the operational level he can do anything that he wants, whatever you put in place for corporate governance, general management, planning growth, but in bringing in growth capital, there is no question about such involvement. Generally to have any impact at the operational level, that's done by VCs, but in the VC environment in India, it doesn't work.

MAYFIELD: It doesn't work. And if things go wrong, this should be about how you work with him to correct it. The bottom line is that going in you need to come to agreement about whatever deficiencies there are, get him to see eye to eye with you on those deficiencies, otherwise don't get in. And if you can, find other areas in which you can work with him. Align your interests with him. If your interests are not aligned up front about the ultimate aim, which is making money and going to exit and if he wants to build an empire, but you're seeking an exit in three or four years, it's not going to work.

VERTEX: None of us will do a deal knowing that we are going to replace the CEO or the founder in the next one to two years. As you're saying Vikram, we generally work with them to understand what's going on but at the end of the day, it's like a marriage, if you want to go to bed with them it's a long term thing.

JASON SAMBANJU, PAUL CAPITAL: You know, it's amazing, forgive me, this is a complete aside, but from the perspective of what we do, as a secondaries firm, sitting here on a VC panel, a lot of the things that you guys say here, in terms of your entrepreneurs, in terms of being in bed with someone and not being able to kick them out and despite frankly in practical terms having the rights to kick them out and making



sure that your due diligence is right at the beginning and then you see where things go from there, everything you're saying mirrors the way that we think about our business as a secondaries firm. I say that for a specific reason. Because one of the types of deals that we do, takes place when let's say a GP has

raised a fund one, that is seeking to raise a second fund, but for various reasons is having problems getting traction around raising fund two and they may come to us asking for fresh capital to put to work on their fund one companies, by way of providing more runway. And all of the same rules that you guys apply, apply to us, when we look at investing in GPs and in many ways, as you think about it, and I hope without being didactic, it's often times when you can turn it around and say, well, if I was on the other side of the table, when I go out fund raising, what do I need to think of in terms of talking to my LPs, is exactly what your entrepreneurs need to think of when they're coming to you. That's the bottom line.

T&I: The recent ILPA guidelines have at last included a statement encouraging complete termination of funds, at earlier dates. Does that increase GPs interest in your work at Paul?

PAUL CAPITAL: Yes. But our business is similar to all of these gentlemen around the table; the number of times that an LP actually kicks out a GP I can count on one hand.

T&I: I'm not thinking of removal of the GP, but getting GPs to liquidate funds, rather than going from extension to extension, pushing out the book keeping on a commitment seemingly forever.

PAUL CAPITAL: I see, but at the end of the day, the GP can always say, okay I can distribute these stocks to you if you'd rather manage it yourself. That becomes an awkward discussion because that's not what an LP wants.

T&I: At which point the LP comes to you?

PAUL CAPITAL: Right. And that then can become a constructive discussion.

T&I: Suresh final comments on SVB and the firm's global presence?



SURESH SHANMAUGHAM SVB INDIA CAPITAL PARTNERS: Right, we

have 32 offices globally (laughter) so these corporate communications are something that we have a lot. But for the India fund, most of our companies are India focused and even the exits or at least public exits we'd make would be in India. Though we do have a couple set up with the ability to do offshore IPOs. On the strategic exits side, companies from around the world which want to enter India have to decide, are they making or are they buying. And I think that they're going to buy. I completely agree with Rohan on this. This year is going to be a big year for strategic exits. The bigger companies have tons of cash, they have more stability, they have more visibility into what the future may look like, and they're acting accordingly. They're starting to think about markets that they're not in, and how they get in, and we're going to benefit.

T&I: Let's wrap, with your outlook for the next year.

SEED FUND: I think as we've said here today, that the exits we're seeing are going to create some more entrepreneurial fervor. I hope that will mean that we find smarter, more mature entrepreneurs who are willing to work with us. And as an entrepreneurial firm, we do perhaps lack the wisdom of other offices, so we're on our own, but we're focused on the Indian marketplace so sometimes it's good that we're not confused by advice from America. (quiet laughter).

PAUL CAPITAL: I'm going to use Pravin's remarks and replace every time he said entrepreneur with GPs. And the part about Americans of course. (laughter)

MAYFIELD: Because of the kinds of exits that the last six to nine months have seen and the kind of traction that we and other GPs are seeing in the market, I think that this is all great for us, in the segment of the market that we're in, which is the SME market. As was noted in the previous session, there are more than 700,000 SME companies. And all of this activity is showing entrepreneurs that there is money to be made. That there is nothing wrong with going out and selling your company for a ridiculously large amount of money. A lot of smarter entrepreneurs are now coming to the market, in many sectors and they're saying okay, let's go and work with smart investors, let's go raise money.

T&I: What size are these companies?

MAYFIELD: The figure of the size for an exit that we keep coming back to, regardless of the sector in which we're talking with entrepreneurs is \$100 million. And this is with companies that are barely at \$10 million in revenues today, but they really want to get to a half-billion in market cap on their exits, whether they want to go public or whether they want to sell the company. The first generation is seeing that the second generation doesn't want to step in and run these companies, so they see these exits.

T&I: This means Indian SMEs need to raise what?

MAYFIELD: Anywhere from \$5 million to \$25 million over the life cycle of investment.

CAPVENT: As an LP, our challenge is in finding good, smart, disciplined fund managers.

VERTEX: For us it's a little different, because we're not really a fund, so we don't have a fixed investment life and we're investing at our own pace, we don't have the usual four-year investment cycle, so that we have to finish up investing in fixed period of time, but having said that we can't sit around doing nothing, so my biggest challenge is finding good investments on the ground without really having a team on the ground in India at this point of time. And in order to get people coming to us with deals, we really need to be spending more time here so that we see these deals. And because we're looking at expansion and growth stage investments, my biggest challenge is probably on the valuations side as firms with \$10 million to \$100 million in revenues who are expecting valuation multiples based on their forward revenues, two to four years down the road. It's a challenge educating promoters to accept realistic valuations.

WALDEN INTERNATIONAL: We're hoping to make a couple of investments this year, and the ecosystem of exits is definitely going to help to bring out a new breed of entrepreneurs from all walks of life, including those from well established companies. So I'm looking forward to our next year.

END OF PART FOUR OF FOUR

T&I ■

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recognitions/awards

- Nishith Desai: Recipient of Prof. Yunus 'Social Business Pioneer of India' – 2010 award.
- Nishith Desai: Featured in the Lex Witness publication 'Witness Hall of Fame: Top 50' - August 2010.
- Honourable mentions by Asian-Counsel 2010 for Alternative Investment Funds, International Arbitration, Real Estate and Taxation.
- Winner of the Indian Law Firm of the Year 2010 for Technology-Media-Telecom (TMT) by IFLR.
- Nishith Desai, Founder of Nishith Desai Associates, voted 'External Counsel of the Year 2009' by Asian-Counsel and Pacific Business Press.
- Won the prestigious "Asian-Counsel's Socially Responsible Deals of the Year 2009" by Pacific Business Press.
- Asian-Counsel Firm of the Year 2009 for the practice areas of Private Equity and Taxation in India.
- Indian Business Law Journal listed our Tax, PE & VC and Technology-Media-Telecom (TMT) practices in the
- India Law Firm Awards 2009, as also Legal 500 (Asia-Pacific) that has ranked us #1 in these practices for 2009-2010.
- Ranked the highest for 'Quality' in the Financial Times – RSG Consulting ranking of Indian law firms in 2009.
- Nishith Desai, Founder, ranked No. 28 in a global Top 50 "Gold List" by Tax Business, a UK-based international tax journal, recognized by Chambers and Partners as the 'Most In-Demand Practitioners'.
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- Ranked No. 1 by Asia Pacific Legal 500 in International Tax, Fund Investments, Technology Law, Media Law and Telecom Law.