Why Are Private Equity Firms Looking Hard at India? Ask Warburg Pincus

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In March, when the international private equity firm Warburg Pincus sold a $560 million stake in Bharti Tele-Ventures, India's largest publicly traded mobile telephony company, it created a sensation both in that country and among private-equity investors around the world. The transaction, on the Bombay Stock Exchange, was the largest block trade ever on the Indian market. It was also consummated in a breathtaking 28 minutes, prompting stock market observers in India to remark on the unexpected depth and maturity of their equity markets.

Private equity investors marveled at the profitability of the investment -- in a market that was in its infancy barely a decade ago. Money from U.S. private equity investors was going to Asia back then, but it was to destinations such as Indonesia and Thailand. India did not figure in most investors' definitions of "Asia" -- or at least not in any major way. The March transaction was the largest of a series of retrenchments, over several months, that saw Warburg reduce its 18.5% stake in Bharti to about 6%.

Warburg, which invested nearly $300 million in Bharti between 1999 and 2001, walked away with a profit of $800 million from selling two-thirds of its holdings. At Bharti's current share prices, Warburg's remaining 6% stake in the company is worth some $700 million, or more than twice what it originally invested. Bharti, which trails privately held Reliance Infocomm, had a sallow $100 million market capitalization when Warburg entered the scene. It now has a market capitalization of $15 billion. In 1999, Bharti had 104,000 subscribers. It now has 14 million.

So is the Bharti deal the tip of the iceberg or, alas, the entire iceberg? Two Warburg veterans at the center of the firm's activities in India from its inception in 1994 are emphatic that the Indian story is no one-deal wonder.

India has done well by Warburg, generating returns in "the mid-30s over 10 years," the firm's co-president, Charles R. Kaye, said during a presentation on October 11 organized by the University of Pennsylvania's Center for the Advanced Study of India. (Kaye will return to Philadelphia next month to speak at the Wharton India Economic Forum on November 17 and 18.) In turn, the firm has favored India. Warburg is the largest private equity investor in India by far, having ploughed $811 million into the country as of mid-2005. This amount is more than twice the $362 million Warburg has invested in China, according to data provided by the National Venture Capital Association in Arlington, Va.

Bears and Bulls

Warburg's vote of confidence in India is not universally shared. Globetrotting financial commentator Jim Rogers has written off the country as a haven for slow-moving bureaucrats who are insensitive to the needs of business. He has predicted a gloomy future for India not only as an economy but also as a country -- predicting its breakup into smaller nation states, torn apart by ethnic and religious strife.

But Rogers drove through India and sought out its most difficult political and economic terrain. Warburg has an office there. Rogers was dejected by the country's decaying roads and bridges. Warburg investors see investment opportunity in them. Rogers hated the rickety telephone landlines he encountered in India.

Warburg investors, like millions of Indians who are simply bypassing the landlines and migrating to mobile telephony, fell in love with Bharti.

The Indian government reluctantly embarked upon political and economic reforms in 1991, after years of stifling government control of business and profligate spending on propping up failing state-run enterprises brought the country to the brink of bankruptcy. The reforms have continued unimpeded through four different coalition administrations with seemingly disparate economic ideologies, according to Dalip Pathak, the managing director at Warburg who spearheads the firm's strategy in India.

"There may be debate about the pace of reform, but not about its direction. Indian businessmen today very rarely point to government as an obstacle," Pathak says. As for that vaunted Indian bureaucracy, he mentions that Warburg repatriated its profits in 48 hours. It's easy to take money out of India, perhaps even easier than bringing it in, he jests.

What has Warburg discovered in India during the last decade? Pathak lists the developments that are exciting investors like him: Foreign institutional investment has boomed (more than $12 billion in 2003-04) as curbs on foreign investment in Indian industries have been relaxed; there is a virtually open skies approach to investment from the United States; and gross domestic product has grown at rates between 6.5% and 8% in recent years. The volatility of the Indian rupee has been curbed and inflation has declined. "There are smart people running that economy," Pathak says.

Declining inflation has meant lower interest rates, and in turn has goosed the equity markets. Since October 2004, the Bombay Stock Exchange's Sensitive Index, or Sensex, of 30 blue chip stocks has added 2,500 points, to cross 8,000. "We made a big bet on interest rates coming down, and it was the right bet to make," Pathak says. He even compares India favorably with parts of Europe in one surprising aspect: "Labor issues are far more difficult in France than in India," he says.

High Confidence

One of the biggest changes Pathak says he has noticed has nothing to do with numbers. "There has been a complete change in the confidence level of people in India," he says. The "tipping point" here was the contribution of Indian information technology companies to averting a worldwide Y2K meltdown. Suddenly, India's small IT companies went global, and the government -- long accustomed to regulating big industry but unfamiliar with IT -- had nothing to do with it. Now "most people believe they will not let government get in their way," Pathak says, "and that's why we keep putting money there."

There's a swagger in the step of India's business, and the country's government is showing signs it has caught the contagion, Kaye says. According to a 2003 Goldman Sachs report, "India's economy could be larger than all but the U.S. and China in 30 years." It's a prediction that doesn't appear far-fetched to Kaye and Pathak.

As Warburg's substantial divestment from Bharti shows, however, the investment firm has not lost its head over India. "Bharti has reached the scale and quality level that ensures it will have a long and bright future," Kaye says. But that very milestone means it is "less appropriate from a risk-reward perspective." That's investor-speak for "there's not enough upside left" in the company.

Warburg's other notable holdings in India include Rediff Communication, the country's largest consumer web portal; Gujarat Ambuja Cement; Sintex Industries, an industrial plastic-goods manufacturer with a 60% share of the market for water-storage tanks; Kotak Mahindra, a financial services conglomerate; Nicholas Piramal India, a major pharmaceutical company, and WNS Global Services, a business process outsourcing company.

As the list shows, Warburg's bets in India are hardly reckless. The firm generally sticks to the tried, true, big and stock-market listed. That is rarely a winning strategy for a private equity investor in the United

States, but can be in India, where the pent-up demands of a billion people leave plenty of room to grow for even the largest conglomerates. So in India, the investment firm is not spending much time seeking out early-stage companies or funky technology. In fact a couple of its forays into tech were jettisoned. They involved minor investments, under $2 million each, Pathak says.

"Larger companies are less risky; listed companies are less risky," he says, citing the transparency afforded by India's capital markets. One other reason to pick big over small, in Pathak's view: Bigger Indian companies are increasingly seeking capital and acquisitions abroad, and if they play foul with Warburg, "they know they will never get investment abroad."

But success has brought competition. Several significant names in the U.S. private equity world are now operating in India, among them Intel Capital, Oak Hill Capital Management, the Carlyle Group, Citigroup Venture Capital International, General Atlantic Partners, CSFB Private Equity, and the California Public Employees Retirement System, or CalPERS. Most of them have invested only in the double digits so far -- Citigroup has invested as little as $23 million. But "we need to keep on our toes," Pathak says. Warburg is now looking to participate in India's raging real estate market, he adds. "Last year we were not." A growing number of Indian financial institutions, including Kotak, have created venture funds to tap into the sector's potential. Indian news media say fund managers expect returns of 20% to 30% a year.

Big Pool

"Being smart and having a lot of money is not a differentiator anymore," Kaye says. So Warburg is working assiduously to become a recognizable brand in India. It is doing that in part by staying close to the market, operating from offices in the commercial hub of Mumbai. Unlike many private equity firms, Warburg invests through a single fund worldwide. That allows it to be nimble in adapting to change, Kaye says. Warburg has more than $10 billion under management invested in more than 100 companies in Asia, Europe and the United States. In August it raised $8 billion more -- the largest single pool of capital the firm has raised since it was set up in 1966.

In India, Kaye and Pathak expect the thirst for capital will be unquenched for years to come. Just infrastructure improvements -- greater power generation, better highways and more efficient ports -- are estimated to require $20 billion to $25 billion in investments each year. For policy makers in India, Kaye says, the main social challenge is to lift 200 million people out of abject poverty. Infrastructure projects, far more than IT, have the potential to generate the large numbers of jobs needed to accomplish that task, he adds.

Towards the end of their session, a seminar participant asked Kaye and Pathak to describe their "most pessimistic scenario" for India's future. Both men were silent. That silence spoke as loudly as their optimistic presentation about the possibilities India holds for investors like Warburg.