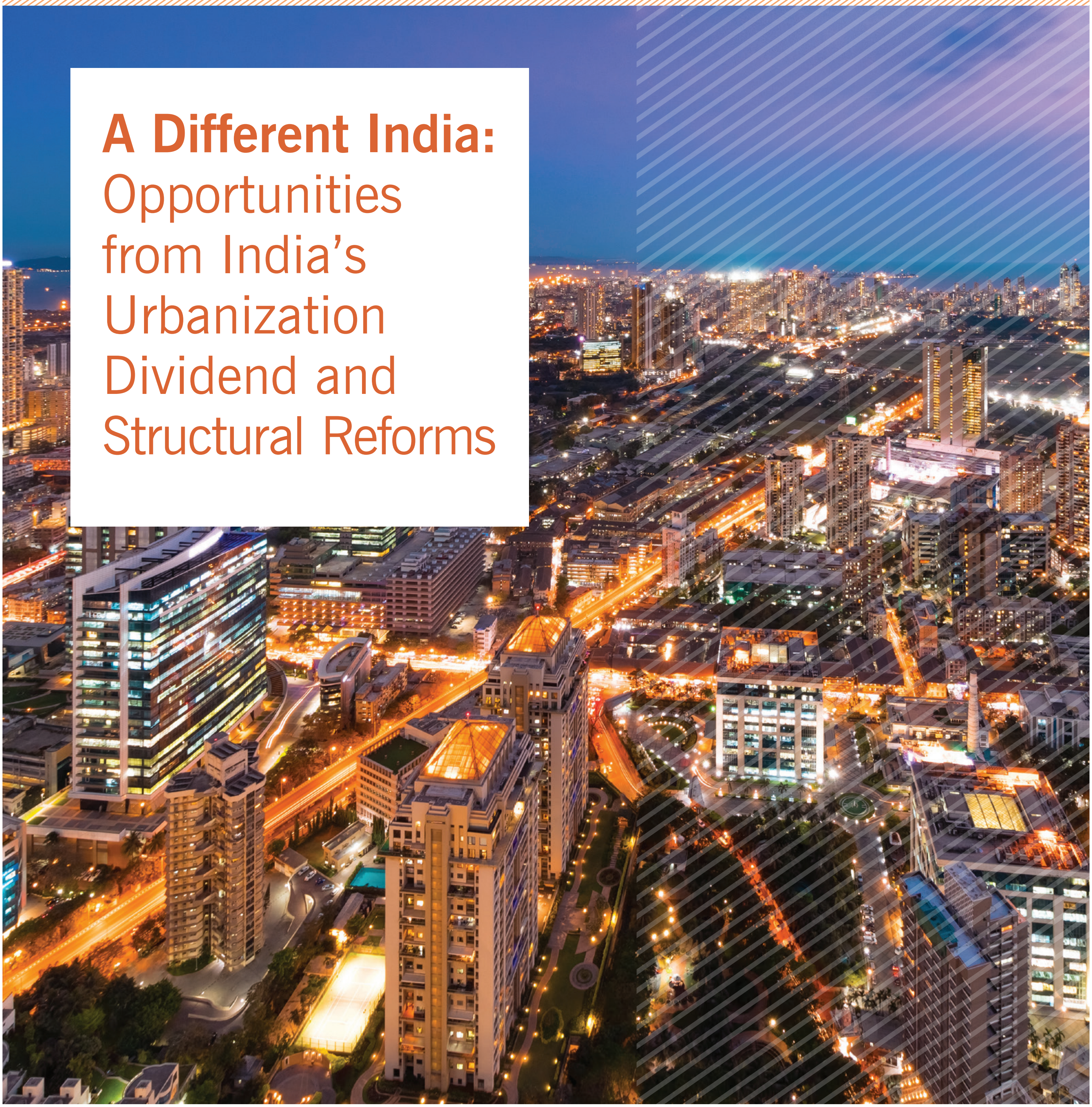
INVESTCORP

INSIGHTS

DECEMBER // 2019

A Different India: Opportunities from India's Urbanization Dividend and Structural Reforms



Gaurav Sharma
Co-head of Private Equity, Investcorp India

Gaurav Sharma joined IDFC Alternatives in 2015 which became part of Investcorp in February 2019. He has more than 19 years of experience in both the US and India across entrepreneurship, private equity, M&A, corporate finance and investment banking. Gaurav was also the co-founder of Prime Gourmet Private Limited. Prior to that, he held the role of Director and was part of the founding team of Providence Equity Partners' India office. Gaurav holds an MBA degree from The Wharton School, University of Pennsylvania and a Bachelor's degree in Engineering from Indian Institute of Technology, Delhi.

Girish Nadkarni
Co-head of Private Equity, Investcorp India

Girish Nadkarni joined IDFC Alternatives in 2011 which became part of Investcorp in February 2019. He has approximately 26 years of experience across private equity, M&A, business strategy, corporate finance and treasury. Previously, Girish worked for several Tata Group Companies for 18 years in various capacities, including as Executive President & CFO and as a part of the Executive Committees of publicly listed companies, including: Rallis India and Tata Chemicals. Girish holds a Bachelor of Commerce & Economics degree from Mumbai University, is an all India rank holder Chartered Accountant and a Cost & Management Accountant.

Harsh Shethia
Partner, Investcorp India

Harsh Shethia is focused on business development for Investcorp India. Harsh Shethia joined Investcorp in 2002 and has held numerous roles and responsibilities, including: Product Specialist for Real Estate and Credit Management, Country Head of Oman, Chief of Staff for President of Gulf Business, Head of the Client Servicing team, and Head of Business Analysis and Reporting. Harsh joined Investcorp from Goldman Sachs in London where he was an Executive Director. Prior to that, Harsh worked as a Manager with Deloitte Consulting in New York. Harsh holds an MBA from Carnegie Mellon University and has a BSc degree in Computer Science.

Ritesh Vohra
Head of Real Estate, Investcorp India

Ritesh Vohra joined IDFC Alternatives in 2011 which became part of Investcorp in February 2019. Ritesh has been a financier, advisor and entrepreneur over the course of his real estate career and has been associated with a number of property developments across India. Previously, Ritesh was a Managing Director at real estate fund manager Saffron Advisors. Preceding that, he worked with several advisory firms including Jones Lang LaSalle and as an entrepreneur. Ritesh completed his undergraduate studies in hospitality management from the Institute of Hotel Management, New Delhi and his post graduate program in management from the Management Development Institute, Gurgaon.

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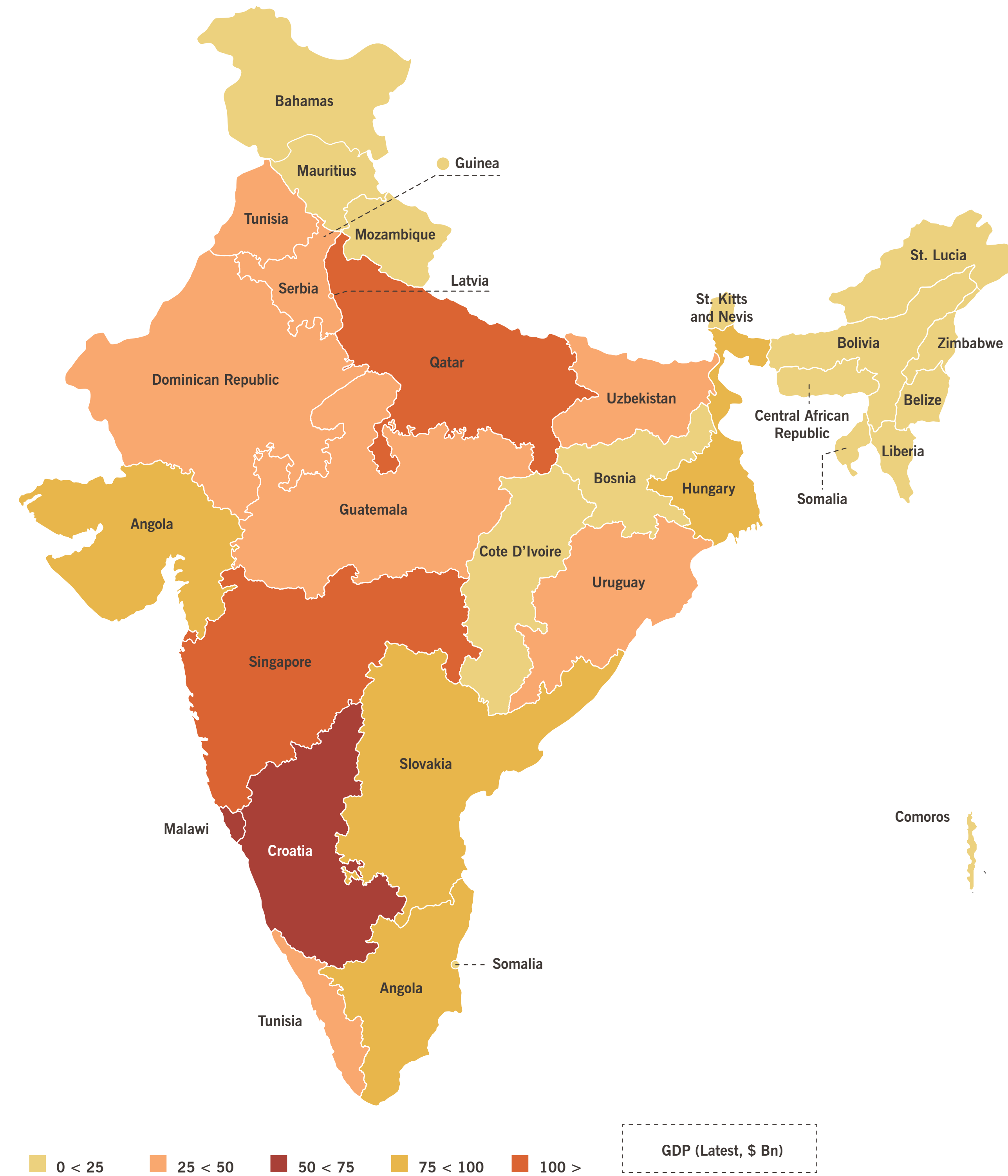
INDIA IN CONTEXT

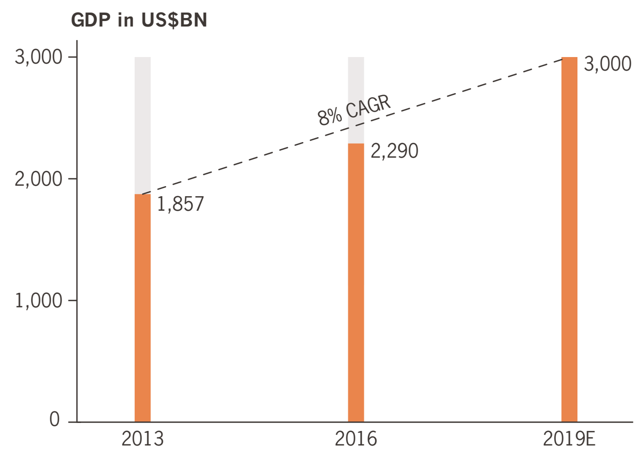


Source: IIFL, CEIC, The Economist, World Bank, Axis Capital

BIG STRIDES

Economic Growth

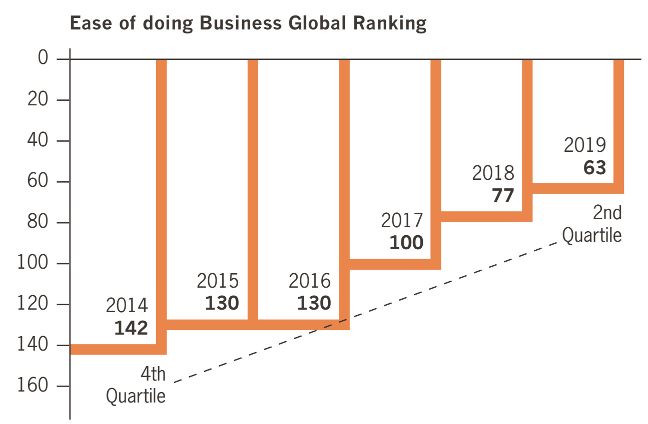
India has been one of the fastest growing economies in the world.



Source: World Bank

Business Friendly

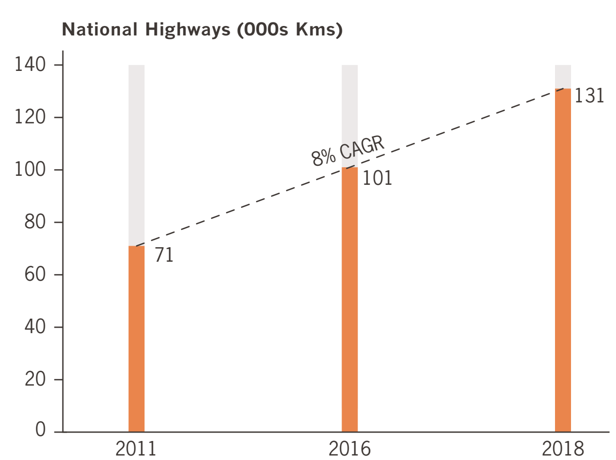
India became one of the few nations to be recognized as a "top improver" in the World Bank Group's global ease of Doing Business rankings for three consecutive years (2016-2019).



Source: World Bank

Infrastructure Catch-up

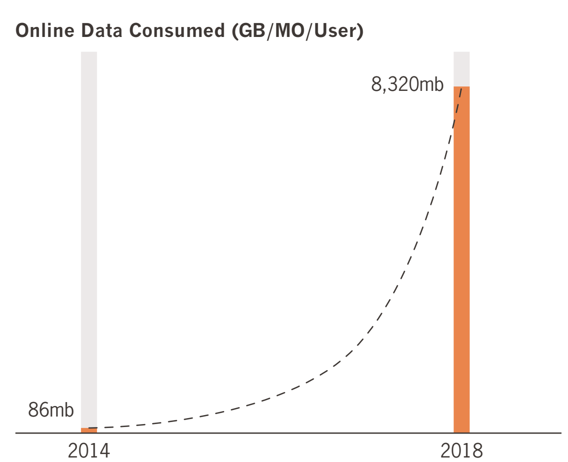
India has doubled the reach of its national highways to nearly half the length of highways in the US. In 2010, only two cities in India had metro railways, which is targeted to grow to 18 by 2024.



Source: NHAI

Rapid adoption of digital technologies

Indians have 1.2 billion mobile phone subscriptions and downloaded more than 12 billion apps in 2018.

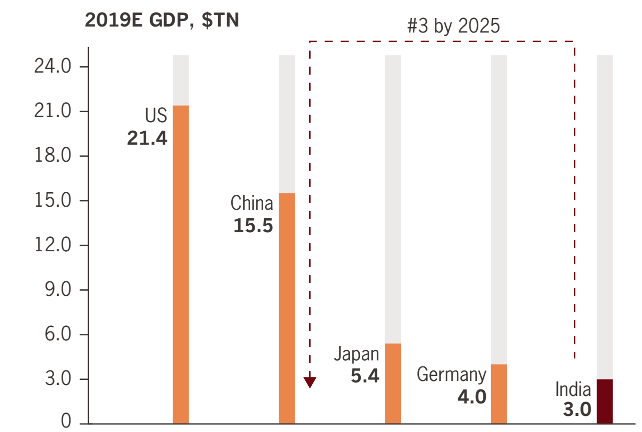


Source: McKinsey Global Institute report

LARGER ASPIRATIONS

Moving from Top 10 to Third Largest Economy in <10 Years

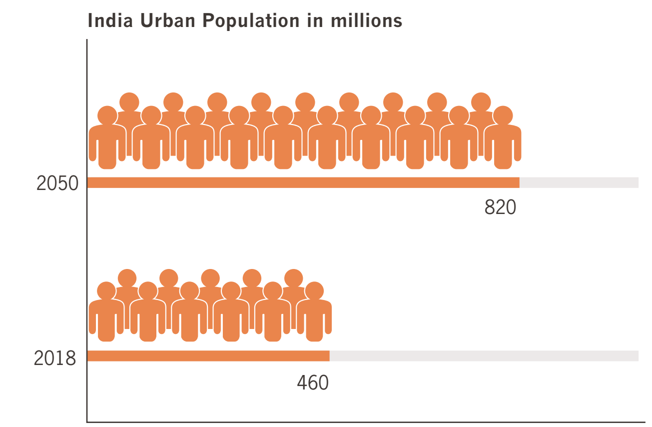
India overtook France in 2018 as the sixth largest economy and is expected to overtake the UK in 2019 to enter the top five, and Japan by 2025 to become the third largest economy in the world.



Source: World Bank, IHS Markit

Consumer Base Equal to US and EU combined

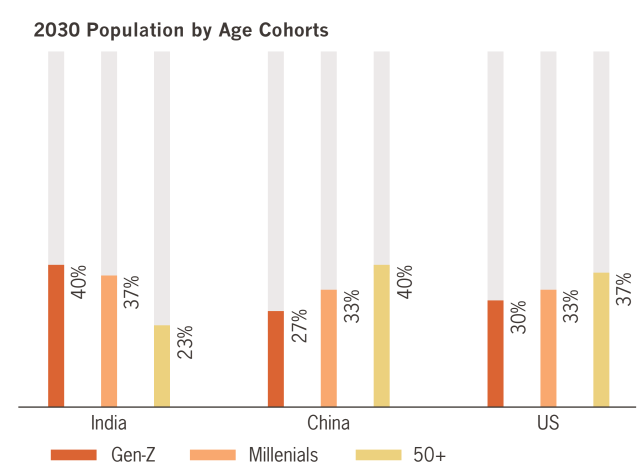
Indian cities are expected to add 360 million consumers in 32 years.



Source: World Bank and UNCTAD

77% millennials or Gen-Z

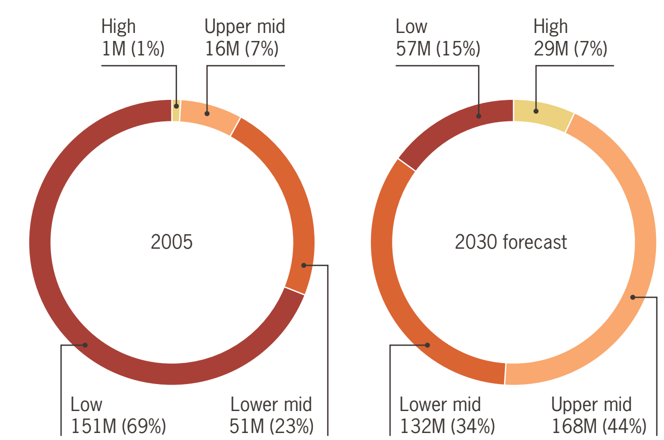
India's population has a large proportion of younger generations and its consumers are expected to be more tech savvy and willing to adopt new business models.



Source: Euromonitor

50%+ Upper Middle to High Income Households

A majority of Indian households are expected to be in the upper middle (> US $8,500) to high (> US $40,000) income categories by 2030, up from 8% of total households in 2005.



Source: PRICE Projections, World Economic Forum

Urbanization x Political Reforms x New Business Models = Unprecedented investment opportunities

SYNOPSIS

The purpose of this paper is to provide perspective on the scale and impact of urbanization in India. We discuss that urbanization is an essential driver of economic growth rather than an outcome. We also highlight why the Indian economy is poised for significant growth over the next few decades, despite recent challenges. However, investing in growth areas does not necessarily lead to good investment results, as hyper-competitiveness, for example, in the airline and telecom industries have revealed. The paper concludes with what we believe are some compelling investment themes driven by urbanization.

Urbanization is a megatrend impacting the global economy as the United Nations estimates that 68% of the world's population will live in an urban area by 2050. India alone is projected to add 360 million people to its cities between 2018 and 2050. Based on urbanization levels, India is today where China was in 2000. Indian cities already contribute 75% to the country's GDP. According to Oxford Economics, over 2019-2035, all of the top 10 fastest growing cities in the world will be from India. Each city in India will be equivalent in population and economy to the size of small developing countries today.

In addition to the forces that will bring hundreds of millions of young workers and families to Indian cities, the incumbent government is changing the political and economic landscape with several transformative pro-growth initiatives. The government has taken multiple steps in the last five years, including structural reforms to the economic, tax, legal, healthcare, real estate and political frameworks. These large-scale reforms have disrupted the normal flow of business, leading to a slowdown. Additional changes are necessary in corporate governance, policy clarity and stability, tax reform for foreign investors (dividend and long-term capital gains), and investment infrastructure (credit market development, regulatory, legal) before the true potential for outsized returns from India becomes a reality for foreign investors.

We believe that housing, consumer tech, healthcare and financial services will benefit disproportionately from the megatrends. Along with our view on these themes, we share case studies highlighting how Investcorp is taking advantage of these opportunities in India by backing a new breed of entrepreneurs, focused on wealth creation, by providing viable, effective solutions that meet the needs of the new Indian consumer.

Urbanization Leads to Economic Growth”

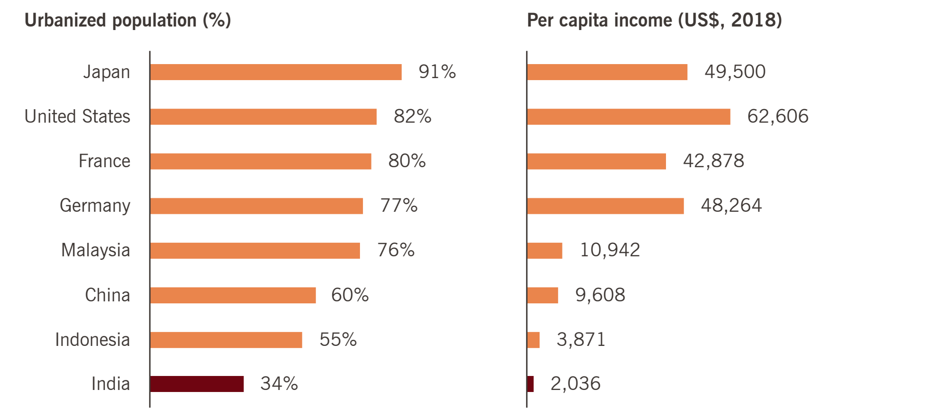
THE IMPACT OF INDIA'S URBANIZATION WILL BE UNPRECEDENTED IN HUMAN HISTORY

At the start of the 20th century, Mahatma Gandhi declared that “The soul of India lives in its villages.” At the time, barely 15% of India lived in urban areas and Gandhi's beliefs inspired political thought and strategy for most of the 20th century.

Fast forward a century later, urban areas have grown twice the rate of rural India and have powered the country since its economic liberalization in 1991. The growth of Urban India has supported the rise of the Indian middle class, a group of educated, productive and highly aspirational people which many economists refer to as India's demographic dividend.

US $2,000 per capita income is an inflection point, after which exponential growth has been witnessed in other economies

Contrary to some opinions, urbanization is not a side-effect but rather an essential part of economic growth. Increasing population density produces more transactions, information and interactions, leading to price discovery, efficiency of delivery, higher productivity and lower costs. Markets open up and these interactions foster a feedback loop that encourages entrepreneurship, innovation, attracts talent and capital, and ultimately translates into economic growth.

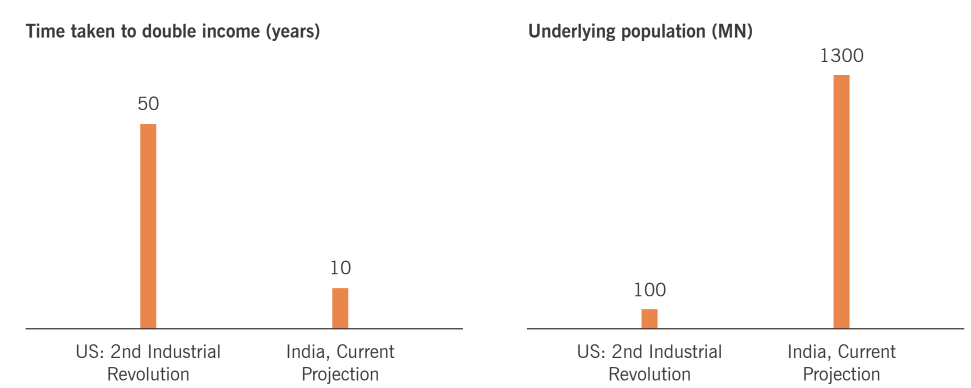


The scale of India's past, present and future urbanization is unprecedented. At the time of economic liberalization in 1991, urban India was home to 220 million people. Since then, the number has more than doubled to 460 million people at the end of 2018, or about a third of its population. We believe that this is just the tip of the iceberg as we estimate another 360 million Indians will live in urban areas over the next 30 years, comprising more than half its population.

The growth of India's cities will require significant infrastructure investments. Our analysis determined that the impact of this transition is 65x the urbanization of the United States during the second industrial revolution of the 20th century.

The United States took five decades to double its national income in the early 1900s. This was a 3x improvement over the industrial revolution in the United Kingdom in the late 1700s. India hopes to achieve this feat in the next 10 years. This is a 5x improvement in terms of time taken. Notably, India is navigating this transition with 13x the number of people compared to the United States. Net-net India's urbanization will have an impact 65x the scale of the industrialization of the United States.

India today = 65x impact of 2nd Industrial Revolution in US



India's urban population at 34% today compares to where China was in the late 1990s. If India follows the same path as China i.e., achieve 60% urbanization in the next 20 years, significant investments will be required to upgrade India's cities and towns. Indian cities contribute more than 75% to the nation's GDP, which is more than double their share in the national population (~34%). This confirms that cities produce greater economic productivity than rural areas in addition to providing increased opportunities for entrepreneurs and investors.

TEN FASTEST GROWING CITIES IN THE WORLD

According to Oxford Economics, a research institute specializing in global forecasting and quantitative analysis, the top 10 fastest-growing cities over the next 15 years are all projected to be located in India. Larger cities in India such as Mumbai, Delhi and Ahmedabad are also projected to grow at high rates.

Rank	City	GDP 2018 (US$ BN)	Growth (% y/y)	GDP 2035 (US$ BN, 2018 constant prices)	Comparable Country based on 2018 GDP
1	Surat	28.5	9.18%	126.8	Ukraine
2	Agra	3.9	8.50%	15.6	Albania
3	Bengaluru	70.8	8.50%	283.3	Pakistan
4	Hyderabad	50.6	8.46%	201.4	New Zealand
5	Nagpur	12.3	8.42%	48.6	DR Congo
6	Tirupur	4.3	8.42%	17.0	Georgia
7	Rajkot	6.8	8.38%	26.7	Cambodia
8	Tiruchirappalli	4.9	8.30%	19.0	Botswana
9	Chennai	36.0	8.17%	136.8	Kuwait
10	Vijayawada	5.6	8.18%	21.3	Laos
Total Top 10 Fastest Growing		**223.7**	**8.51%**	**896.5**	**Netherlands**
Other Indian Cities Will Have High Growth Rates too					
	Mumbai	123.0	6.60%	364.6	Malaysia
	Delhi NCR	109.7	6.60%	325.2	Philippines
	Ahmedabad	73.1	7.50%	250.0	Vietnam

Source: Oxford Economics

The growth of cities in India is an important national priority as 85% of tax revenues and the vast majority of new jobs come from urban areas. The government has taken multiple steps to try and ensure that India's economic development occurs in an efficient, robust and sustainable manner. While the results so far are encouraging, India needs to stay the course over the long run to ensure the standard of living of its citizens reaches global averages.

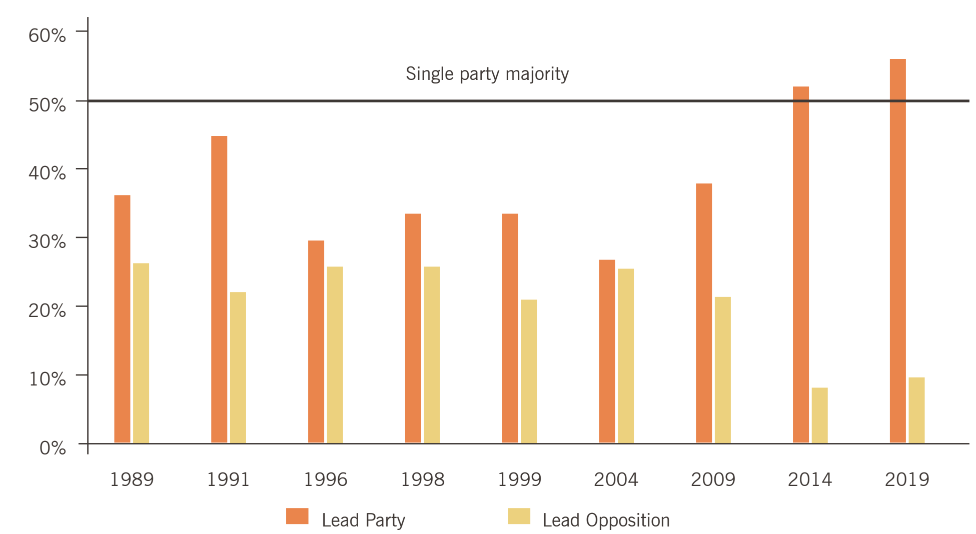
A DIFFERENT INDIA: REFORMS AND GEO-POLITICAL WILL

India can be viewed as a "sub-continent" vs. as a "country" given it is extremely diverse with a decentralized federation and a constitution that recognizes 23 official languages. Much of the political decision making is de-centralized at the state level, of which there are 28 plus 9 union territories, and approximately 2,200 political parties.

This diversity of people, governing rules, taxes, localized infrastructure and systems has led to India having many different markets within its own nation. From an economic perspective, the scalability of businesses pan India has been a large obstacle. For example, logistics costs in India are nearly 16% of retail industry costs versus 6% in Brazil and 3-4% in the US, Germany and UK.[1]

Governing different regions with their own unique circumstances has offered challenges. However, with increased participation in the political process there have been more opportunities for the largest democracy in the world to institute reforms designed to unify India. In fact, 2014 represented the highest voter turnout (at 66%) in Indian history at the time, which was later topped in 2019 elections with 67% voter turnout.

Percent of Seats Won in Parliamentary Elections



The Indian government, led by Prime Minister Modi since 2014, has rolled out a series of bold reforms to transform India from a "sub-continent" of different markets into a single market for goods and services. While India may never be an efficient single market like the United States or China, it aspires to reach efficiencies of the European Union.

[1] Source: Euromonitor International, November 2016.

JAM Trinity: Financial inclusion (“Jan Dhan”), e-government (“Aadhaar” biometric ID) and Mobile connectivity

The JAM trinity brings together three digital transformations and exploits synergies among them. Direct benefits transfer to the poor, in a manner that minimizes inefficiencies through intermediaries, leakages and corruption is the primary aim, as a meaningful portion of the intended benefits were not reaching those in need.

Aadhaar, with 1.2 billion unique identification numbers, covers more than 95% of India’s population and aims to reduce red tape, increase accountability and minimize corruption and fraud. For example, Aadhaar enables customers and banks to easily fulfill know-your-customer (KYC) norms necessary to obtain a bank account or a mobile SIM card, while costs have been further reduced by allowing the possibility of digital or e-KYC. Aadhaar is linked to new bank accounts and mobile connections, making both accessible to large sections of the population.

In 2014, the government announced the Jan Dhan program to achieve the goal of universal financial inclusion. By 2017, 82 percent of India’s adult population had access to a bank account, up from 56 percent when the program started. Much of the increase in financial access has been spurred by reforms to social programs.

Mobile phone subscriptions increased from 17 per 100 inhabitants in 2007 to 85 per 100 inhabitants in 2016, approaching universal access with a growing share of smartphones and internet-enabled devices.

One offshoot benefit of the JAM Trinity is to make India a data rich country. With the advances in Artificial Intelligence (AI), this has the potential to revolutionize businesses, the Indian economy and the public sector.

Swachh Bharat Abhiyan: Clean India Mission

Announced in October 2014, Clean India Mission is India’s largest sanitation program to-date and aims to eliminate open defecation by 2nd October 2019, the 150th birthday anniversary of Mahatma Gandhi. India represented the bulk of the global problem with open defecation, with about 500 million Indians engaging in the practice in 2014. The program has been a resounding success with the bulk of the work carried out by volunteers. More than 100 million toilets have been built in less than 5 years.

According to the government, 4,303 cities in India are now defecation free; 88 megawatts of power are being generated from waste and about 4.4 billion metric tons of waste per annum are being converted into compost.

In September 2019, the Indian Prime Minister, Mr. Narendra Modi, was honored with a Goalkeepers award from the Bill and Melinda Gates Foundation. The Clean India Mission continues, with an aim to reach Sustainable Development Goal 6, focusing on clean water and sanitation for all by 2030.

Smart Cities Mission: Assistance to 100 cities for infrastructure modernization

The Smart Cities Mission, launched in 2015, is an initiative by the Government of India to drive economic growth and improve quality of life by utilizing technology to enable local development and drive better outcomes for citizens.

The Smart Cities Mission is meant to set examples that can be replicated both within and outside smart cities in various regions.

In a phased manner over five years, 100 cities have been selected to receive funding for their projects under the India Smart Cities Challenge. The mission has started rating existing projects under five parameters – planning, technology, governance, services and finance, along with climate sensitive action and ease of living sensitive action. The plan to develop 100 cities has had limited success so far due to multiple challenges from long-term funding to lack of private sector participation.

Demonetization: Curb corruption and shadow economy and increase tax collection

At 8:15 pm on 8th November 2016, Indian Prime Minister gave an unscheduled nationally televised address, where he announced that, to combat money evading taxes, the two largest denomination notes, comprising about 86% of the currency value, would cease to be legal tender at midnight. Holders of these Rs. 500 (US $7.50) and Rs. 1,000 (US $15) notes could deposit them at banks by December 31, 2016, but could not use them in transactions.

The notes would be replaced by new 500 rupee and 2,000 rupee notes. The difficulty of printing new notes, however, meant that the amount of currency in circulation that could be used for transactions declined sharply, recovering only after several months. Chaos and disruption ensued, and the Indian economy stalled, and the effects were felt for over a year. Though the initiative failed to achieve its primary objective of combatting money evading taxes, two years post demonetization:

- Mutual fund AUM +50%
- Cash deposits in banks +61%
- Increase in taxpayers +80%
- Increase in gross tax revenue +51%

Source: Business Today article, November 8, 2018

Real Estate Regulatory Authority (RERA) Act: Order in the real estate development sector

The RERA Act of 2016 makes it mandatory for all commercial and residential real estate projects where the land is over 500 square meters, or eight apartments, to register with the Real Estate Regulatory Authority before launching sales of a project.

Key changes are projects need to be completed within the approved timeframe, 70% of funds from sales of residences have to be used in the project, prices have to be quoted by carpet area and advertisements require approvals. This is a much needed reform as, according to a recent JLL India report, around 220,000 home buyers are stuck across seven major cities due to delayed projects started 2011 or earlier.

Passed in March 2016 by the Indian Parliament, RERA seeks to protect homebuyers as well as boost real estate investments by providing greater transparency.

However, as real estate is regulated on a state-by-state basis, adoption of RERA has taken time and slightly different forms. Adoption remains ongoing and is widely supported by all industry participants, but the prior overhang is yet to be fully cleared.

Insolvency and Bankruptcy Code (IBC): Timely resolution of bad debts

Passed in May 2016, and enacted as law since 2017, IBC overhauled a century old bankruptcy law and four different Acts to increase the ease of doing business by expediting debt recovery applications.

Only Indian banks and big financial institutions were 'armed' under the country's previous debt recovery laws, a large section of non-banking financial companies, foreign lenders and other creditors were left at the mercy of civil courts for recovering debts, which could sometimes take years to resolve.

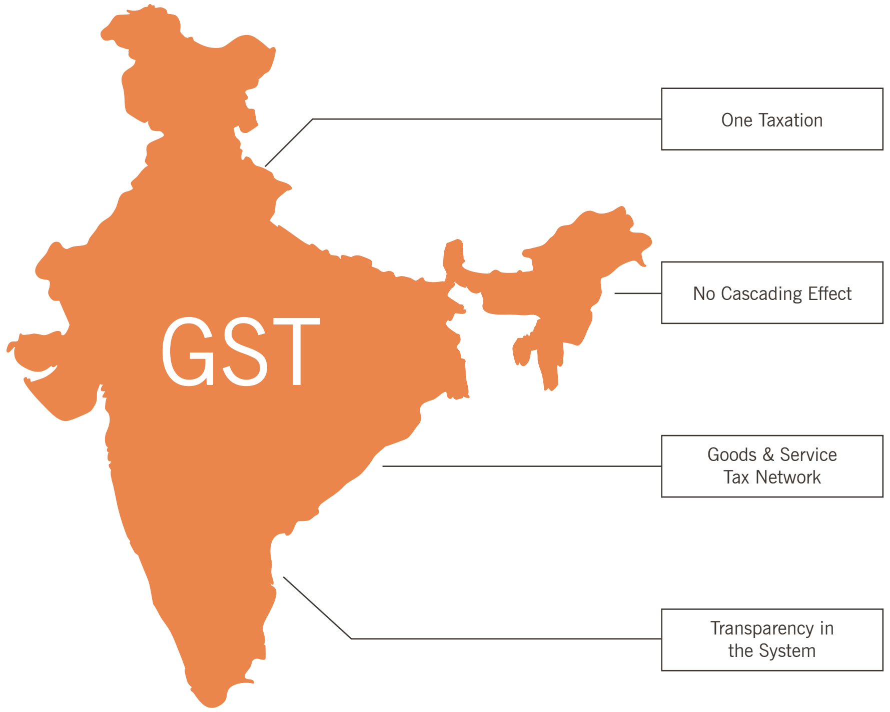
The Department of Financial Services, in its report of companies under liquidation as of 31 October 2015, observed that there were 1,479 pending cases that were ongoing for more than 20 years. According to a 2014 World Bank report, it took an average of four years to resolve insolvency in India.

Speed is of the essence for creditors to ensure the highest recovery in default situations. The IBC provides for a time bound insolvency resolution and restructuring process by setting a timeline of 180 days with a one-time extension of 90 days for initiation and completion of the insolvency process.

The two-year-old IBC has been the most successful mechanism to recover debt. A Reserve Bank of India (RBI) report suggested that the average recovery by banks, based on the amount filed through the IBC, was as much as 41.3% in FY18, compared to just 12.4% through other mechanisms such as the SARFAESI Act, Debt Recovery Tribunals and Lok Adalats (people's courts).

Goods and Service Tax (GST): One efficient market with low tax leakage

Why is GST necessary in India ?



India's largest indirect tax reform rolled out on 1 July 2017, and subsumed the following taxes, that had made India one of the clumsiest indirect tax systems in the world and a very fragmented market for goods and services:

- Central level: excise duty, additional excise duty, service tax, customs duty, countervailing duty
- At Each State Level: VAT or sales tax, central sales tax, entertainment tax, octroi and entry tax, purchase tax, luxury tax, lottery and gambling tax

Implementation of GST has been a challenge, especially for small & medium enterprises (SMEs). The multiple rate structure and an enforcement framework using onerous reporting requirements for businesses places a compliance burden on SMEs and is having a negative impact on the economy. However, GST has assisted organized sectors with direct distribution and supply chains. New, efficient business models are seizing market opportunities and attracting investment to support their growth.

Ayushman Bharat: Universal healthcare

Ayushman Bharat, launched 23 September 2018, is the world's largest health insurance program that provides free healthcare up to Rs 500,000 (approximately US $7,000) for eligible participants, which is estimated to cover 100 million or 40% of India's families. The program is paperless and cashless, leveraging the JAM Trinity.

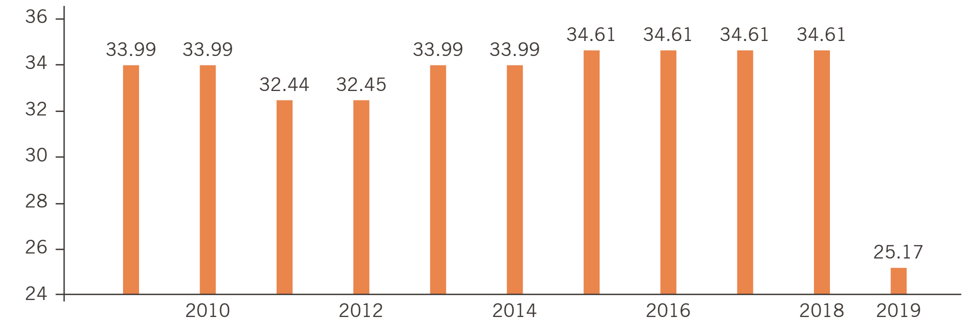
Healthcare spending in India is among the lowest in the world at 1.2% of GDP or US $64 per capita. Affordability is a major issue in a country where 70% of the healthcare is self-funded and medical cost inflation has been greater than 10%.

The other major issue has been access:

- 122 kms is the average distance covered by an Indian to meet a doctor at a primary care center
- There are only 0.9 hospital beds and 0.7 doctors per 1,000 people

Ayushman Bharat and growth of private insurance are expected to fill the large affordability gap in India. Urbanization is seen as the best way to solve access issues.

Corporate Tax Reform: India on par with Asian peers



Source: tradingeconomics.com - Ministry of Finance, Government of India

In the latest bold reform by the Indian government, corporate income taxes effective fiscal year 2019-20, were reduced to a base rate of 22% from a base rate of 30%.

To promote investments in the manufacturing sector, new companies that are established after 1 October 2019 would benefit from a base rate of 15%.

This is the single biggest corporate tax reform in India's history. The slowing Indian economy needed a growth boost to rejuvenate industries and sentiment. Once again, the incumbent government has taken swift and bold action, in line with its pro-growth economic agenda. India still needs to address higher dividend and long-term capital gains for foreign investors compared to other countries.

COMPELLING INVESTMENT THEMES

Roti (food), Kapda (clothes), Makaan (housing), ++

Driven by inherent demand to address the rising income and urban population, consumption in India is poised to grow at double digit compounded rates for the next 20 years. In many ways, India's mass consumption market today is where China was 10-20 years earlier. The most compelling investment opportunities will be efficient, scalable business models that can meet the needs of a young, middle class, urban population by providing affordable goods and services through innovation. The investment challenges are corporate governance, inherent delays and inefficiencies in realizing plans, and limited exit options. Investment teams that will outperform will have to take a more proactive, hands-on approach to deal sourcing, portfolio management and realizing value.

	US$, 2015 per capita per category	China	India	China / India	Equivalent Year For China
1a.	Food: packaged	179	32	5.6x	Before 2000
1b.	Food: services	102	23	4.4x	2002
2.	Clothing	239	60	4.0x	2004
3.	Housing	346	109	3.2x	2006
4a.	Social Infrastructure: healthcare	204	39	5.2x	2000
4b.	Social Infrastructure: education	62	28	2.2x	2002
5.	Financial Services	85	33	2.6x	2008

Source: Euromonitor, CEIC, Goldman Sachs Global Investment Research

FINANCING THE HOUSING OPPORTUNITY

Introduction to Real Estate Industry

The Indian real estate industry is an integral part of the economy and plays an important role in the development of the country's infrastructure. The real estate sector contributes approximately 6-7% to India's GDP, which is expected to grow, according to a report by Federation of Indian Chambers of Commerce and Industry (FICCI), to about 13% by 2025. The present market size is estimated to be around US $120 billion which is estimated to grow to US $650 billion by 2025.

The residential segment comprises around 80% of the overall real estate market in India, making it by far the most significant sub sector within the industry.

Residential Real Estate

During the years 2015-17, residential markets experienced a marginal decline in absorption while new project launches / starts declined by approximately 60%. During this period, the government introduced Demonetization, Real Estate Regulation Act 2016 (RERA) and GST, each of which had an initial negative impact on an already slowing residential market.

End user demand was muted as customers' lack of confidence in under-construction properties and anticipation of property prices to bottom out led to deferred decision-making with respect to property purchases. However, post implementation of the above measures the sector is now in a stage of gradual recovery fueled by evolving market trends along with regulatory reforms. Over 50% of absorption has been driven by increased demand for units in the affordable segment (ticket size range US $30,000 to 100,000).

Credit to Real Estate and Reasons for Growth of NBFCs

Commercial banks have traditionally been the primary source of wholesale real estate credit in India. However, since the early part of this decade, banks started reducing their credit exposure to the real estate sector. This was primarily driven by worsening asset quality on bank's balance sheets. With demand for credit remaining strong, Non-Banking Finance Companies (NBFCs), including Housing Finance Companies (HFCs) stepped in to bridge this gap and their market share grew rapidly from 10% to 18% during the 2010-2018 period.

Total outstanding credit to the real estate sector stands at over US $71 billion and NBFCs and HFCs' market share of this segment stands at over 60%.

Recent Challenges Faced by NBFCs

According to JLL Capital Market Research, overall NBFC & HFC loan books have grown from US $9.1 billion in FY12 to US $37.1 billion in FY18, which is a 26% CAGR. Key factors that fueled this growth and led to some of the current challenges being faced are:

- Availability of Leverage – Average leverage increased from 4.8x to 6.3x over 5 years
- Asset-Liability Mismatch – Even though their asset profile was skewed towards the long term, NBFCs resorted to significant short-term borrowings
- Risk Premium Mispricing – Spreads contracted due to excessive competition for growth amongst NBFCs

Because of such rapid growth and over leveraging, the NBFC sector has been going through several challenges since late 2018.

In September 2018, several subsidiaries of IL&FS, a large infrastructure development group with an outstanding debt of about US $13 billion, including its NBFC arm with an outstanding debt of about US $2 billion, defaulted on debt repayments. Subsequently, DHFL, another large HFC with a book of approximately US $17 billion, experienced asset liability mismatches leading to defaults. In September 2019, Altico Capital, a real estate focused NBFC, defaulted to its lenders because of asset liability mismatches.

These events raised concerns of a systemic asset-liability mismatch in the NBFC sector which led to i) a liquidity freeze for most NBFCs ii) suspension of lending activities by NBFCs to conserve funds for meeting their liabilities iii) and increase in borrowing costs of NBFCs.

Net disbursals by NBFCs/HFCs to real estate developers in FY19 declined by 48% year-on-year to US $3.9 billion. New avenues are being explored by real estate NBFCs to generate liquidity such as divesting loans/portfolios to opportunistic investors and fresh equity raises.

In order to address these concerns, the Government took several liquidity easing measures over the last year, including RBI's open market operations of approximately US $5.7 billion on a monthly basis, accelerating securitization of NBFC/ HFC loan portfolios to banks and a relaxation in bank lending norms to NBFCs.

The Government has also proposed to set up a real estate fund to provide last mile funding for completion of existing projects to assist in resolving issues at the asset level.

Lessons Learned

In the current environment, there is a dearth of capital available for wholesale financing to real estate developers. Premium is attached to available capital, thus providing an opportunity to deploy capital with high quality developers at superior risk adjusted pricing. At the same time, the long-term macro trends favoring greater urbanization and secular demand for housing continue to remain intact.

Given these factors and favorable long-term trends, Investcorp believes launching a new age NBFC that focuses on wholesale financing represents a compelling opportunity. The Investcorp NBFC will be structured to take into account various lessons from recent market experience and focus on:

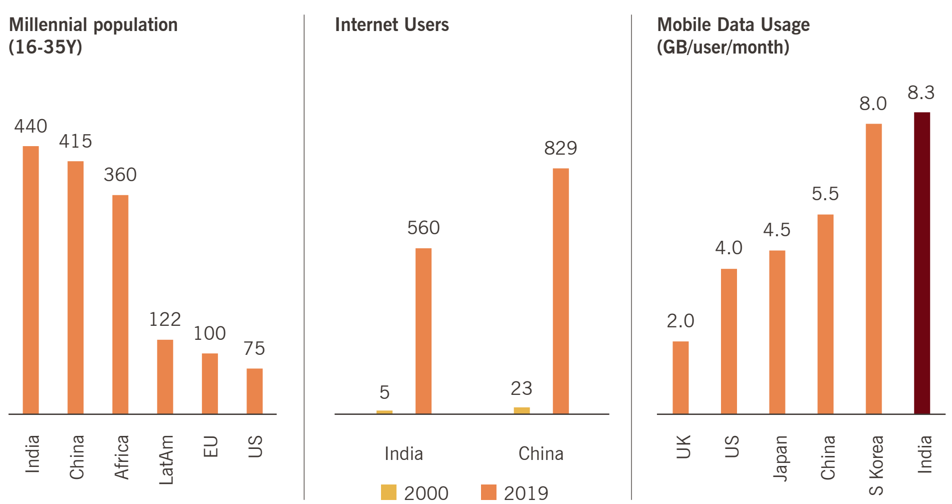
- Strong corporate governance and risk management frameworks
- Maintain conservative leverage levels
- Clearly define Asset Liability Management policies with diversified borrowing sources
- Maintain adequate cash reserves at all times
- Invest with a lower risk profile (accepting potentially lower interest margins)
- Maintain strict limits for exposure towards single real estate group
- Diversification across different stages of the project life cycle

The objective is to create a high-quality business which would stand the test of time and create value for all stakeholders.

CONSUMER TECH

India is a young nation with an average age of 28 years (versus 37 years for China) and a millennial (16-35 years old) population of 440 million, which is 5.8x the US millennial population.

A large number of these millennials were born in liberalized India and by 2030, smartphone wielding millennials that join the consuming class will have leapfrogged the generation that used the personal computer as their primary device to connect to the internet. India is already home to the second largest internet user base (566 million users as of 2018 according to Kantar IMRB ICUBE report) in the world and currently ranks first in mobile data consumption at 8.3 GB per user per month (March 2019 McKinsey Global Institute report).



Entrepreneurs have been quick to spot this opportunity and as India's payments system and logistics network have evolved to keep pace with its young internet savvy users, "consumer- tech" companies that provide consumer goods and services using technology as a medium or channel have flourished. From nine unicorns (start-ups with valuations > US $1 billion) in 2016, India counts 26 unicorns in 2019 and is expected to cross 50 in the next couple of years.

Technology disruption is primarily taking place in three ways:

- Creating a platform by connecting all stakeholders, resulting in quicker access, democratized data and declining transaction costs with growth of the network
- Automating processes
- Using data analytics

Ways in which technology is disrupting businesses

Theme	Examples of Business	Indian examples
Connecting stakeholders	Marketplaces	Flipkart, Swiggy, Rivigo, Ola, Zolostays
Automating processes	Digital payments	PayTM, BillDesk
Mining customer data using AI/ML	Digital marketing, fintech, analytics	Byju's, Dream 11, MuSigma, FreshWorks

CASE STUDY: ZOLOSTAYS (AKA ZOLO)

Zolo is India's largest full stack co-living platform. Zolo was founded by Dr Nikhil Sikri, Akhil Sikri and Sneha Choudhury with a view to solve the urban housing problem for entry level professionals migrating to cities for work.

For most professionals relocating for work, the process of finding accommodation has been a challenge because of the following structural inefficiencies:

- India's fragmented and largely unorganized real estate market meant multiple visits to prospective properties mostly maintained by indifferent landlords in poor conditions
- Various societal taboos due to strong community and conservative biases in the preference of tenants
- For the more premium segment, renting an apartment involves fixed tenor leases

Most young professionals share rooms in hostels, popularly known as "paying guests" ("PG"), or in apartments. The PG market is circa 5-6 MN beds and concentrated in the larger Indian cities.

Zolo controls the entire user experience, with the business model including:

- Leasing space from existing or new properties, upgrading them if required, standardizing the look and feel and letting it out for long stays.
- Demand is digitally sourced from Zolo's mobile app and / or website. Zolo uses the supply engine and micro market analysis to predict the feasibility of a property and selects its partners based on property efficiency.
- Zolo's customers get access to a better customer experience –from searching for properties on their devices, to the transparency of information regarding the property and the expectation of services and pricing.
- The onboarding experience including room preference, food availability and payment options, is also very "plug-and-play" due to the standardization of processes across Zolo properties.

The secret sauce, however, is the community that Zolo's properties foster. Each property usually has 100+ beds with vibrant common areas tastefully curated keeping the millennial "vibe" in mind. Zolo organizes events for the community which include music events, comedy shows, indoor games and even outdoor events. Community members cluster around their hobbies and even vote for the daily menu (Zolo provides food as well, the cost of which is included in the rental). The Zolo app becomes a critical part of the stay experience as customers log service requests on the app as well as make payments and receive notifications of community events.

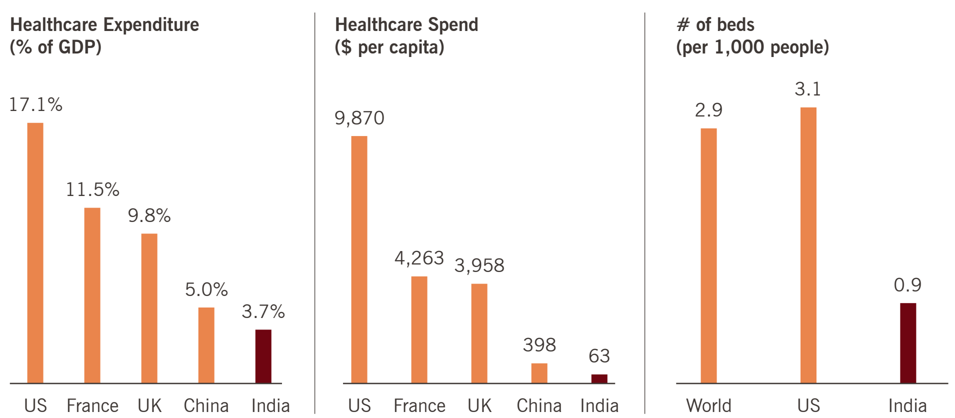
Zolo also offers a premium product wherein they rent a whole tower within a building complex. In a win-win proposition for apartment landlords, Zolo converts these single apartment units, with low investor yields of 2-3% p.a., into multi-occupancy units, with 6% yield p.a.

Zolo is on track to prove its business model across cities at scale. Investcorp invested in Zolo in January 2019 when it had scale of 15,000 beds across 200 properties in 6 cities. Currently, Zolo is present in 10 cities with an inventory of 30,000 beds across 350+ properties. We believe that Zolo has barely scratched the surface of India's PG / co-living market. Given the unorganized incumbents, we believe that there is a long growth runway.

HEALTHCARE

Healthcare is critical to the Indian economy, both in terms of revenue and employment. The sector is estimated to become a US $160 billion industry in 2020. Recent growth has been driven by:

- Increasing income and insurance penetration improving the affordability of healthcare
- New business models that reduce overall healthcare costs with innovative delivery and leaner costs (e.g. short stay-centers for nephrology, maternity, eye and fertility)
- Regulatory support for private provision of healthcare services paid for by the state (500 million people are expected to be covered under Ayushman Bharat, the world's largest healthcare coverage program)
- Impetus from the Government of India's 'Make in India' program and relaxation of foreign direct investment restrictions to drive domestic manufacturing of medical equipment



Within the wider healthcare industry, in our view, single specialty therapy centers are more attractive than large multi-specialty hospitals, as they have better unit economics and lower unit capex. Single specialty care chains have proven to be more scalable as they benefit from asset light, and less capital intensive business models.

One of the key benefits of urbanization has been the availability of a more concentrated patient base with higher purchasing power. As outlined in the following case study, Nephroplus has been a direct beneficiary of urbanization as the megatrend has helped to scale its operations.

CASE STUDY: NEPHROPLUS

Among single specialties e.g. ophthalmology, dental, fertility and nephrology, we believe nephrology (a dialysis network) is particularly attractive with key features including:

- Highly under-served and fragmented industry: Only ~10% of the market is currently served (US $300 million served market). With increased incidence of hypertension and diabetes, this market is likely to grow at 25% CAGR to be 3x in the next 5 years. Organized chains represent 20% of the market today and are expected to take share from small players and grow 5x in the next 5 years.

- Chronic nature of renal disease leads to repeat use: At ~2 times per week, the Indian dialysis patient is expected to use dialysis more frequently and converge to the global norm of 3 times per week
- Better scalability: clinical assistants are the skilled talent needed for this market rather than doctors

Nephroplus was founded by Vikram Vuppala and Kamal Shah in 2010: Vikram (a McKinsey and Abbott Laboratories alum) and Kamal (a dialysis patient himself for 20+ years and an author of a highly prominent blog on dialysis) set out to redefine the dialysis patient's experience. This started from renaming dialysis users "guests" in the Nephroplus network - instead of chronic kidney patients.

Nephroplus launched its first captive center in Hyderabad in 2010. Based on the initial experience, Nephroplus pivoted its business model to focus on building out dialysis centers inside existing hospitals. For most hospitals, dialysis is an essential but ancillary service as it generates less revenue than super-specialties such as cardiology, orthopedics and neurology.

Today, Nephroplus is Asia's largest dialysis chain with 187 centers spread across 18 states and 100+ cities in India. Over the last three years, the Company has grown to:

- 187 centers in FY19 from 68 centers in FY16 (representing a 40% CAGR)
- 128,000+ sessions as of Mar-19 from 40,000+ sessions p.m. as of Mar-16 (representing a 47% CAGR)

Nephroplus has put in place world-class systems to support its growth that include:

- A 56-step dialysis process and patient specific zero infection consumable kit
- A network set up of in-house training academics (ENPIDIA) for skilled clinical staff
- A network of holiday dialysis centers at India's 11 most popular destinations to provide a seamless experience for traveling patients

Nephroplus' low-cost model is intended to provide dialysis at US $20, delivering a critical and affordable service to patients. Today, Nephroplus is the largest dialysis network not only in India but across Asia.

Last year, Nephroplus also acquired the dialysis business of DaVita in India. With this acquisition, Nephroplus has more than 50% market share in the organized segment.

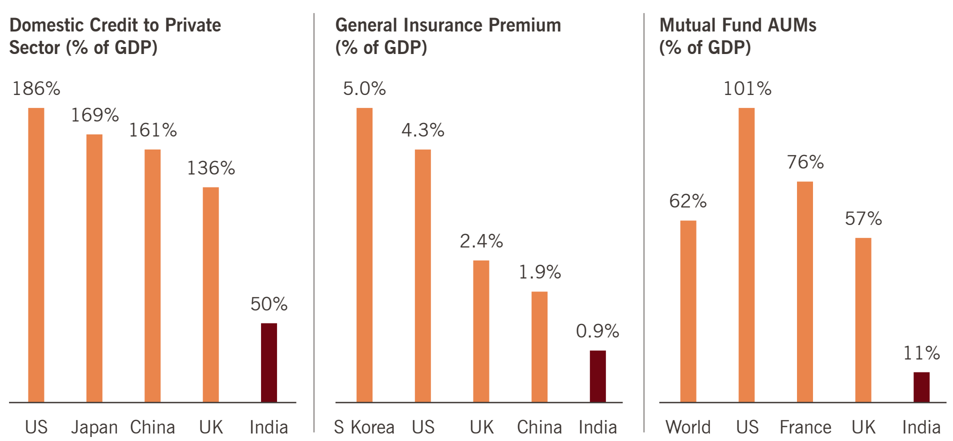
After establishing leadership in India, Nephroplus is now looking to grow outside India, leveraging its cost-efficient model. As a first step, Nephroplus has signed a joint venture with a leading hospital chain in Indonesia where it would manage existing and new dialysis centers of the hospital chain as well as set up new dialysis centers in partnership with other hospital chains. In addition, they have received inward interest from other Asian markets such as Bangladesh, Philippines, Vietnam and the GCC region (Bahrain and Saudi Arabia).

Nephroplus, due to its market standing, has seen significant investor interest since inception. Prior to Investcorp investment expected to close in November 2019, the Company had completed three private equity rounds, with investments from Bessemer Venture Partners, International Finance Corporation and Sealink Capital.

Nephroplus has been a direct beneficiary of urbanization as people migrate to cities and gain access to critical healthcare services.

FINANCIAL SERVICES

Financial Services serve as an important catalyst for growth across all sectors of the economy. However, the financial services sector has traditionally been under-penetrated due to complexity in distribution, difficulty in underwriting due to credit data unavailability, high cost operating model and regulatory restrictions.



The need to drive growth across banking, insurance and other segments of financial services is fully recognized by India's policymakers. As a result, Indian policy making has supported growth with three key measures:

- Financial inclusion, by opening bank accounts for everyone: over the last five years, 373 million new Jan Dhan bank accounts were opened (source https://PMJDY.gov.in/account) raising the number of adult Indians having a bank account from 53% in 2014 to 80%+ in 2018 (source Global Findex Report).
- Push towards digitization by providing residents with a biometric identity (Aadhaar) and a digital platform to authenticate it. This has benefited the financial services sector immensely with easier verification and loan availability, reduced transaction costs, direct transfer of subsidies and a host of other financial transactions.
- Regulatory support for new business models: To enable access in small towns and villages, policymakers have allowed new businesses e.g., payment banks and small finance banks. Importantly, India previously did not encourage or support the 12,000 NBFCs that were historically believed to be outside the banking system. India's central bank has changed its approach in the last decade by bringing NBFCs into the system to enable their growth and ability to support borrowers.

Urbanization has played an important role in the growth of financial services in India as more people secure access to financial products and services. Overall, urban customers have more banking relationships and are more open to exploring other non-lending products such as mutual funds, insurance. This in conjunction with the reliable data availability (through credit bureaus) and use of alternate data (utility payments, e-commerce purchases, social media etc.) has led to non-banking financial (NBFCs) and fintech companies disrupting the traditional banking model by serving underbanked and new to credit customers.

CASE STUDY: INCRED FINANCE (A CONSUMER-FOCUSED NBFC)

Investcorp sees consumer-focused NBFCs as an attractive segment due to the following reasons:

- High credit growth: NBFCs have been growing at a CAGR of 16% over last the last 6 years to reach an asset book of INR 20 trillion as compared to <10% CAGR for traditional banks
- Target segments: NBFCs, especially the retail ones, have been able to target SMEs and households. A majority of these segments still do not have formal access to financial services due to complexity in distribution and underwriting, which represents a significant growth opportunity
- Easier investment framework: Well documented information on key parameters due to stringent RBI regulations

InCred was founded in 2016 by Bhupinder Singh (former co-head of banking and securities for Asia Pacific at Deutsche Bank) and backed by Anshu Jain (former co-CEO Deutsche Bank). The Company launched operations in Feb-17 and since then, has become one of the fastest growing retail NBFCs in India, with a loan book of US $250 MM across 275,000+ customers and 350+ business partnerships. The Company has also expanded its presence across 17 cities with an employee base of ~800 people.

InCred primarily lends across multiple product categories in three segments: SMEs, education, and consumer loans. The Company has integrated traditional lending practices with a state-of-the-art technology platform that accelerates speed to market and enables better risk management and higher profitability.

The Company has demonstrated a strong track record across all relevant aspects through its:

- Rigorous focus on risk management with a leading risk, analytics and underwriting team
- Diversified liability profile with borrowings raised from ~20 financial institutions.
- InCred also secured a credit rating upgrade to CARE A1+, the highest short-term rating (up from A1)
- Ability to attract top-tier talent from leading financial institutions in India such as HDFC, Kotak, ICICI Bank, McKinsey, Amazon, Standard Chartered and Capital One

Investcorp invested in InCred in Nov-16, when the Company was just at a conceptual stage. Since then, it has attracted capital from various private equity investors such as The Netherlands Development Finance Company (FMO), Moore Strategic Ventures, Alpha Capital, Elevar Capital and Paragon Partners, among others.

InCred has primarily focused on targeting under banked and new to credit customers in urban geographies, which are typically underserved by banks. Urbanization and digitization have benefitted InCred immensely as the company was able to meet this huge demand through technology and data analytics.

InCred has also set up a fintech platform under its subsidiary, mValu, which focuses on loan origination using technology (digital channels) for InCred and other lenders in the personal loans segment. The subsidiary has been scaling with 25+ member team across product, engineering and sales onboarded and recently raised US $5 million from Elevar Capital to support its continued expansion.

CONCLUSION

Urbanization in India inevitable and will bring more than 300 million additional consumers to locations where they can be better served by businesses.

We believe India's robust economic growth will continue for several decades, having passed the critical inflection point of US $2,000 per capita income.

Landmark government reforms will provide easier access to a single economic market, which is fast approaching its entry into the top five global economies.

A new generation of entrepreneurs are taking advantage of new business models to more efficiently reach their end customers.

The combination of these factors will unlock large markets in housing, consumer tech, healthcare and financial services over the medium to long term.

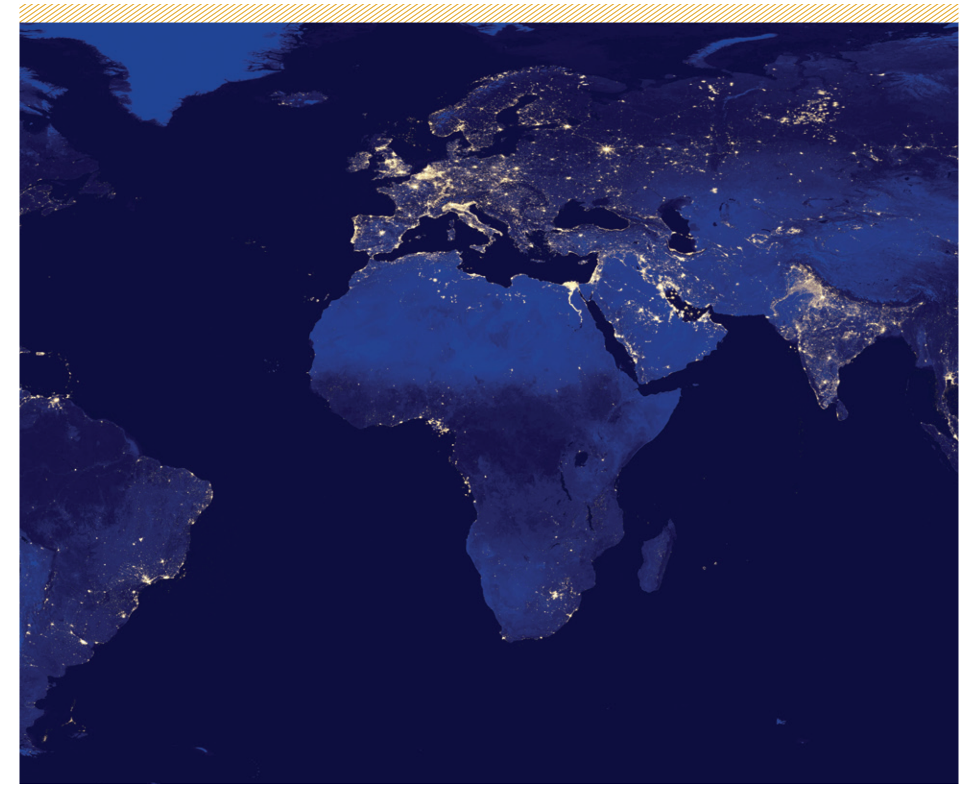
Investcorp is in the process of setting up an NBFC, subject to receipt of regulatory approvals, which will focus on providing credit for real estate in India. We believe it is the right time to enter the sector as its past challenges are in the process of being resolved and the first signs of a gradual recovery is underway. Investcorp will be disciplined in its strategic approach, leveraging the learnings from past market cycles in India.

The intersection of consumer and technology will continue to be a focus area for Investcorp. We have made two investments in this space in India. ZoloStays is a key example of how technology can be effectively used to disrupt traditional business models.

We believe that healthcare and financial services will continue to be very attractive markets over the long-term due to the low penetration of products and services and a favorable regulatory framework. Investcorp India has made two investments in healthcare and one in financial services.

Nephroplus is a direct beneficiary of urbanization as it secures access to a concentrated patient base and provides a critical, yet affordable, healthcare service. Similarly, InCred benefits from underbanked and new to credit customers which it has been able to serve and convert using technology and data analytics.

Investcorp is bullish on India's long-term trajectory. However, India continues to present several challenges for investors. Hence, we believe that passive index investing will not generate outsized returns in a competitive and dynamic market like India. Leveraging an active, hands-on approach with a medium to longer term outlook will, in our view, unlock the most value for investors in one of the potentially more attractive markets in the coming decades.



Source: Google Earth satellite image of earth at night

ABOUT INVESTCORP

Investcorp is a leading global manager of alternative investments. Led by a new vision, Investcorp has embarked on an ambitious, albeit prudent, growth strategy. The Firm continues to focus on generating value through a disciplined investment approach in six lines of business: private equity, real estate, absolute return investments, infrastructure, credit management and strategic capital.

As at June 30, 2019, the Investcorp Group had US $28.2 billion in total Assets Under Management ("AUM"), including assets managed by third party managers and assets subject to a nondiscretionary advisory mandate where Investcorp receives fees calculated on the basis of AUM.

Since its inception in 1982, Investcorp has made over 185 Private Equity deals in the US, Europe, the Middle East and North Africa region and Asia, across a range of sectors including retail and consumer products, technology, business services and industrials, and more than 675 commercial and residential real estate investments in the US and Europe, for in excess of US $60 billion in transaction value.

Investcorp employs approximately 430 people across its offices in Bahrain, New York, London, Abu Dhabi, Riyadh, Doha, Singapore, and Mumbai. For further information, including our most recent periodic financial statements, which details our assets under management, please visit: www.investcorp.com

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