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Capital for PE funds seen drying up as investors turn cautious

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MUMBAI: Private equity (PE) firms in India, which were in the fundraising mode before the covid-19 outbreak, have been struggling to reach their targets as investors, also known as limited partners (LPs), have chosen to wait out the uncertainty period before deploying more capital to fund managers.

PE funds raise money from various global institutional investors such as pension funds, sovereign wealth funds, insurance companies as well as family offices.

“Overall, the PE industry is adopting a measured approach when it comes to fundraising or new investments," said Shagoofa Rashid Khan, partner and head - funds, investment and advisory at the law firm, Cyril Amarchand Mangaldas.

“Funds that were about to hit their final close in the coming months have gone back to their investors and sought an extension for covid-19 reasons. For others, where the commitment period is underway, the sunset date for expiry of LP commitment is also being sought to be extended," she added.

During January-March, capital raised by PE firms in India halved to $1.4 billion, compared to $2.8 billion raised in the same quarter in 2019, according to a report by the Indian private equity and venture capital association and consulting firm EY.

The reason for this cautious approach of investors is the turmoil they have witnessed in their public market portfolios and the resulting change in proportion of assets under management (AUM) in public and private investments in their portfolio.

These investors generally have a hard cap on the portion of their capital that they can allocate to private equity. With public portfolios contracting sharply, their allocation to private equity now seems larger in proportion to overall portfolios, and this restricts their headroom to deploy fresh capital towards PE.

"We are indeed seeing some degree of denominator effect playing up as LPs become cautious on commitments to illiquid assets. While no default has happened, we do believe in certain managed accounts, LPs have indeed asked fund managers to go slow in a few cases," said Ruchir Sinha, co-head, private equity and M&A at law firm Nishith Desai Associates.

"Fresh commitments from LPs are naturally very difficult as diligence is difficult in these times. Where a soft close of a fund had happened, LPs are requesting for an extension for a hard close until the situation improves," added Sinha.

LPs such as pension funds and sovereign wealth funds are also adopting a cautious approach due to government mandates to focus on their domestic markets rather than deploy capital elsewhere in times of global macroeconomic uncertainties.

"Large LPs such as foreign pension and sovereign wealth funds may be required by their governments to look inwards and within their home jurisdictions for a while, on account of the covid-19 crisis. Given the same, Indian fund managers may find it even more challenging to raise foreign capital," said Vivek Mimani, partner in the investment funds practice group at law firm, Khaitan and Co.

Large pensions and sovereign funds such as Canada Pension Plan Investment Board, Caisse de dépôt et placement du Québec (CDPQ) and Singapore's state investor GIC are investors in a bunch of Indian PE funds.

“In view of severe dislocation in the public equity and bond markets, high-net-worth individuals and family offices may also reconsider their allocation towards alternative assets," Mimani added.

The covid-19 induced headwinds for PE fundraising come after back to back years of strong capital flows, with the global private equity industry raising $595 billion and $628 billion in 2019 and 2018, respectively, according to alternative assets data tracker Preqin.