Inward sale

The management buyout of NBFC Capital First is the largest in India

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Vaidyanathan: the most significant development for our company

It took a little over three months of negotiations for private equity firm Warburg Pincus to pick up a 70 per cent stake in financial services company Capital First (it was earlier known as Future Capital Holdings). It is the largest management buyout of a listed financial services company in India. "By far the most significant development for our company till date," says V. Vaidyanathan, the firm's chairman and managing director.

The deal is a typical management buyout, an uncommon deal-making structure in India. In a classical management buyout, the promoter's stake is acquired by the managers of the company. If the managers do not have enough funds to make the acquisition, they borrow or engage a private equity fund. Once the private equity firm is convinced of the business model, it expects the managers to offer a long-term commitment.

Investors at times also demand that the managers bring funds to the table along with them. Between promoter and manager, the deal works both ways. In some deals in the UK, promoters have even supported buyouts because at times it can be tough to sell a stake without the managers' commitment. Management buyouts, in all cases, require promoter consent and encouragement.

Promoter Pantaloon Retail's sale of stake in Capital First had been on the cards for over a year. Kishore Biyani's flagship company Pantaloon Retail, which runs malls and supermarkets, needed capital to service debt and fuel growth. But the NBFC, a subsidiary, had large capital needs of its own, making it non-strategic to the firm.

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Vaidyanathan's chance meeting with Warburg Pincus turned into a game changer for the NBFC. The banker to the deal was Morgan Stanley, but it was brought to the table per se by Vaidyanathan, who held a 9 per cent stake in the company.

For Warburg Pincus, owning a majority stake in a consumer-financing business in India makes sense. Its earlier successful investments in India incude HDFC, Kotak Mahindra Bank, Bharti Airtel and Gujarat Ambuja. While Capital First's share price has almost doubled over the past year, it is still much lower than its peak of 2008.

As for Capital First's business model, it had already started to change. When Vaidyanathan took charge of the firm in 2010, the business was largely wholesale, with a loan book size of ₹1,000 crore and non-performing assets at 5 per cent. Today, the book is 68 per cent retail, loan assets under management have crossed ₹6,000 crore and non-performing assets are down to 0.04 per cent. The branch network has crossed 202 in number, and the firm has 1,272 employees in 40 cities across India.

Changing structure

So, through a Mauritius-based fund WP XI that has capital of $5.2 billion and a residual life of about 12 years, Warburg invested $150 million into Capital First (about ₹825 crore). As part of the deal, Vaidyanathan locked in part of his stake for five years. Now elevated to chairman and managing director of the company, he has also locked in his term for five years.

Today, the structure of Capital First is changing. In retail, it has diversified into several businesses to improve stability in performance. It provides mortgage for SME businesses, for instance, backed by security. Of every 100 applications it receives, only 29 get through. Most rejections happen due to either insufficient cash flow of the existing business or defective title deeds.

Till March 2012, the firm's net profit was up 115 per cent to ₹105.8 crore. But profits are likely to see a dip in 2012-13, due to a change in accounting policy. Instead of charging a one-time fee for every loan disbursal, Capital First plans to amortise fees over the loan's term period. While this will lead to a short-term impact on profitability, in the longer term it could provide a buffer against changing credit cycles.

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