unitus capital

A Report on Strong Impact Investment Returns

2017

Table of Contents

Executive Summary

India has been challenged with the harsh reality that it has been unable to provide basic access to water, sanitation, education, energy, healthcare, jobs, and financial services for a significant portion of its citizens. While government programs, coupled with the work of non-governmental organizations (NGOs), have supported citizens in gaining access to basic necessities, there have been shortcomings due in part to scale, infrastructure, and delivery mechanisms. The gaps, created from these deficiencies, are what impact investing seeks to fill. While the Indian government and NGOs continue to provide their services, impact investing seeks to bolster the livelihoods and basic services of the bottom of the economic pyramid through market-based solutions and endowing entrepreneurs with access to the capital needed to scale their businesses and deepen their social impact.

In the last 15 years, since the start of impact investing, innovative business models have emerged to create financial return along with social impact. Successful business models have traditionally been defined as those that achieve scale, demonstrate profitability, and attract private capital. However, another way to assess true value creation is by understanding and analyzing not only how private capital helps a company grow, but also how it deepens the impact of a company's operations on society and the environment.

Unitus Capital (UC) is authoring this report, on the exits it has facilitated, to demonstrate to the investor community that financial gain and social impact should be complimentary rather than mutually exclusive. Exits facilitated by UC have seen extremely strong returns, much higher than the typical traditional private equity (PE) and venture capital (VC) returns. These robust returns are driven by fantastic management teams rapidly scaling their sales of essential services. We must note that data in this report is based on the exits made by investors from successful businesses and does not include businesses from which investors have not exited or where investments have been entirely written-off. The exit returns have been calculated in Indian Rupee, denoted as INR. For returns in US dollars (USD), please refer to the section on foreign investor returns.

This report has four important and unique elements:

a) *Purpose*: This report seeks to analyze the exit performance of various transactions facilitated by UC and will serve as a useful guide to various investors and stakeholders enabling them to make an informed decision on investing in impactful businesses.

b) *Measurement Approach:* Generally, exits are evaluated solely on the basis of financial returns. However, this report has adopted a multidimensional approach to analyze exits from the prism of returns, nature of investors, exit modes, exit stages, investment periods and social impact.

c) *Data:* This report provides data from the results of UC facilitated exits. The data analysis covers deals across various impact businesses from our inception in 2008 to present day.

d) *Conclusion:* This report provides data highlighting that impact investing can yield unusually strong returns on the back of robust growth.

Impact Investing in India

Impact investing[1] is the act of investing capital into companies, organizations, and funds with the intention of generating social and environmental impact, alongside a financial return. Capital is targeted at companies that are working on the world's most pressing challenges in sectors such as sustainable agriculture, renewable energy, financial services, and affordable and accessible basic services including housing, healthcare, and education.

As mentioned above, India has struggled with the inability to provide access to basic social goods to the base of the economic pyramid and this problem is further compounded by the unaffordable alternatives provided by various private ventures. This gap between government and private sector offerings means that there exists a large, unreached and untapped population that needs affordable, quality products and services.

A shift to for-profit, impact businesses was accompanied by the emergence of impact investors in the early 2000s, presenting a pivot from traditional investment frameworks. The dichotomy and gap between "impact first" and "finance first" narrowed through the efforts of pioneering investors. This infusion of capital sparked tremendous growth in impact businesses, and a new landscape emerged emphasizing scale and sustainability to drive both financial and impact returns. With strong investment performance, the impact investment space has also attracted the attention of financial investors looking to invest purely on the grounds of strong financial returns. Based on the data provided in this report and UC's learnings from working with both impact and traditional financial investors, many financial investors invest in the impact space simply because of great investment opportunities.

Exit Types

Investors allocating capital to both traditional and impact investments cite[2] their top motivations for impact investments as:

i. a commitment to be a responsible investor
ii. an efficient way to meet impact goals
iii. a response to the bottom-of-the-pyramid population's demand

While a vast majority of the exits facilitated by UC were through secondary sales, investors identify the following ways as means to make a successful exit from the company:

Exit Option	Brief
Secondary sale	Secondary sales are most common in impact space, with a new investor purchasing equity stake of a company from an existing investor
Initial Public Offering (IPO)	Exiting via IPO or public market sales is the most preferred route for investors

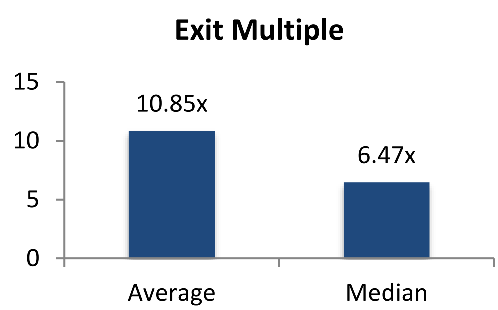
[1] https://thegiin.org/impact-investing/need-to-know/#s1
[2] J.P. Morgan. (2015). *Eyes on the Horizon: The Impact Investor Survey.*

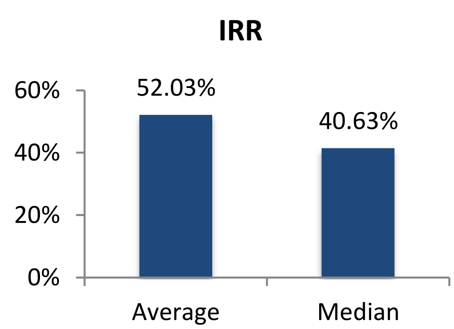
Strategic sale	Investor(s) might get better consideration when they look to sell their stake to a large third party company, which operates in the same sector, either domestically or internationally
Buyback	Rarely, the investment company and/or its promoters buy back the investor's equity stake in the investment company

Drivers for a successful exit include exit timing, method, getting the right buyer and the right price. However, several factors such as political climate, investors' confidence in the market, and market performance can influence the type and success of an exit. It is advisable for investors to communicate their intent for exit to existing shareholders, co-investors, promoters and management with as much lead time as possible. However, investors should fully recognize that exit opportunities do not always materialize as planned and companies appreciate investors who display flexibility.

Overall Returns Achieved

Unitus Capital has facilitated 32 successful exits for 24 investors, across 14 companies in the industries of financial services, healthcare, education, and agri-business (dairy). The average initial investment pertaining to partial or complete exit, as the case may be, was INR 3 Crore (~500K USD). The types of investors who exited include both impact and traditional financial investors. Out of the 14 companies from which exits were facilitated by UC, one was based in Russia and the rest were based in India. The graphs below exclude two exits, for arriving at average numbers, that yielded exit multiple of 1745x and IRR of 572% for two promoters. These two exits are outliers and would have skewed the average results substantially, otherwise.



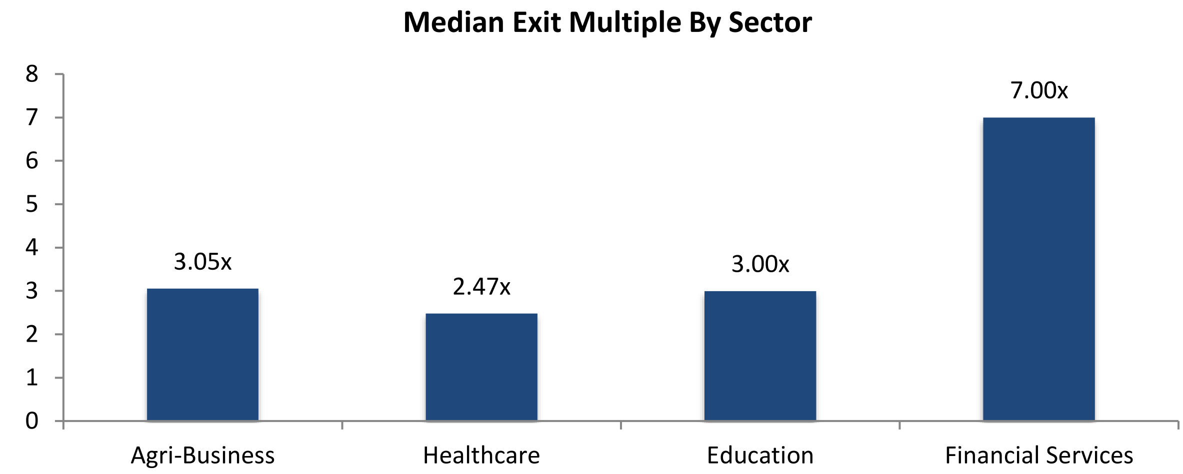


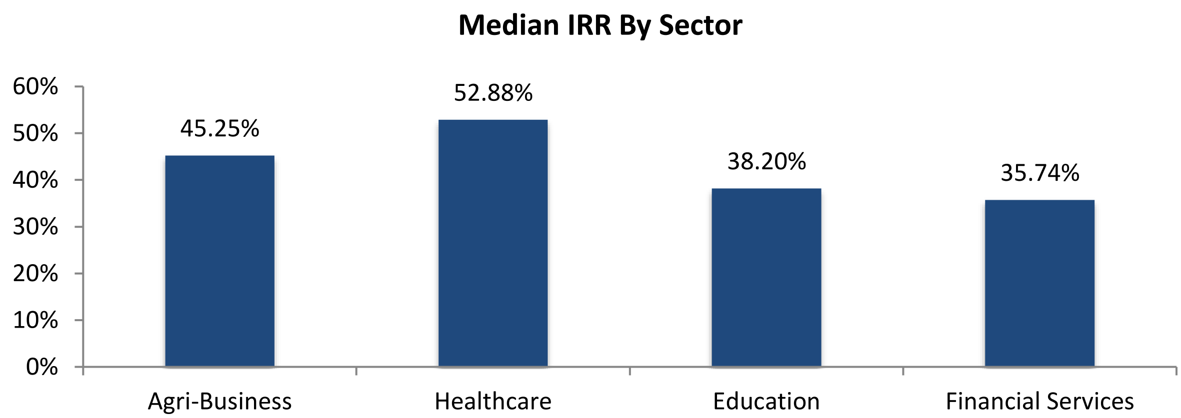
The total exit value generated was INR 1,085 Crore (~170M USD), with an average exit value of INR 34 Crore (~5.3M USD). Majority of the exits were through secondary sales (which typically take place during a company's growth phase). A few investors exited by way of an IPO as the company was brought to market and one exit was a strategic sale. While majority of exits occurred during the companies' growth stage (23), exits have also been facilitated during early (5) and mature stages (4). Majority of the transactions were a mix of primary and secondary[3], and there were only a few that were purely secondary.

[3] Primary transactions are those where capital is infused directly into the company by the investor. Secondary transactions are those where a new investor buys the shares of an existing investor in the company.

Returns by Sector

The financial services sector has traditionally been the most active and attractive impact sector for investors due to straightforward business models and robust demand from unbanked and under-banked segments of the economy. The agri-business industry has continued to draw investor's attention, especially in the dairy sector. India ranks number one in milk production in the world and is on a high growth trajectory with 16% CAGR in value expected on the back of lifestyle changes, product and technological innovations, and government incentives.



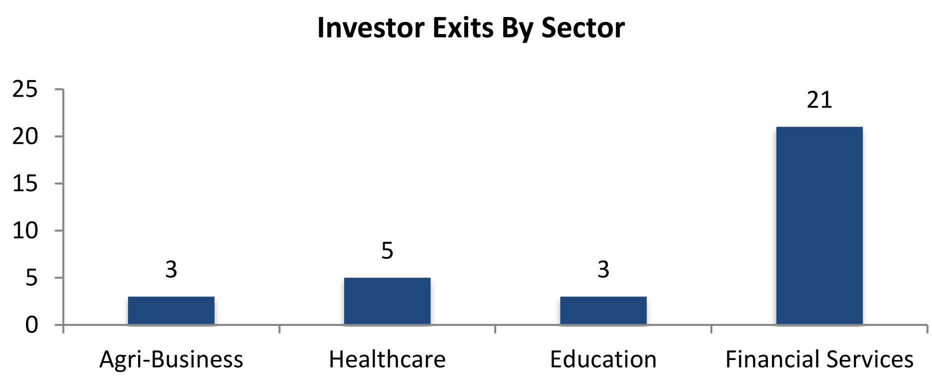


The education space is poised for growth because India has the largest base of students in the world, coupled with rising per capita income. Approximately 10% of per capita income is spent on education, and the sector, along with hard work, is widely considered the key to social advancement. Healthcare has also attracted attention in India due to a rise in per capita income, an aging population, and an increase in healthcare affordability. A number of technological factors are converging to perpetuate healthcare investment in segments such as disruptive medical devices, hospital delivery chains, and tele-medicine.

Sector Distribution

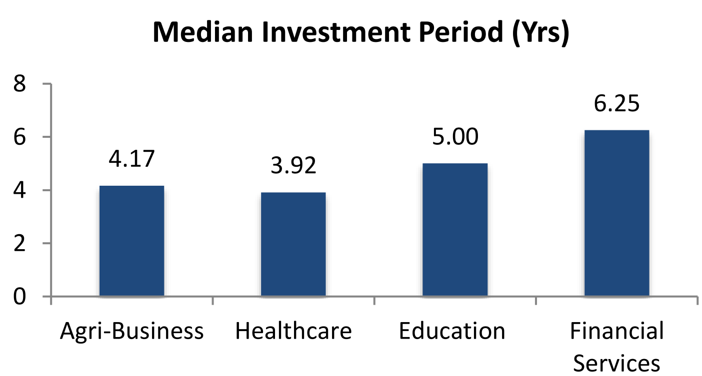
UC has facilitated majority of the exits from companies in the financial services sector. Under financial services, UC has facilitated majority of exits specifically for microfinance institutions that give income-generating loans (17), while three exits were for non-banking financial companies (NBFC), and one exit was for a peer-to-peer (P2P) online lending company. Exits in the healthcare industry were for companies focused on the manufacturing of medical devices (3) and delivery of medical services (2). In the education sector, UC has facilitated exits for companies that focused on tele-education (2) and the funding of private schools in marginalized communities (1). In the agri-business sector, investors exited a company focused on the production and distribution of quality milk products (3). As such the number of exits in other sectors, outside of financial services, are limited, and it is premature to draw specific sector conclusions.

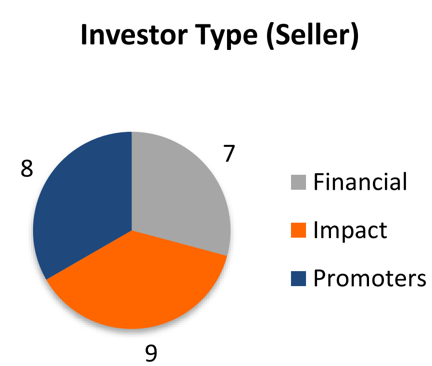
Of exits facilitated by UC, the sector distribution breakdown is as follows:



Investment Period and Investor Type

The median investment period by investors was 4.83 years across all sectors (average investment period of 5.58 years). Financial services, especially MFI investments, were held for longer due to the nascent stage of the sector during the initial investment.

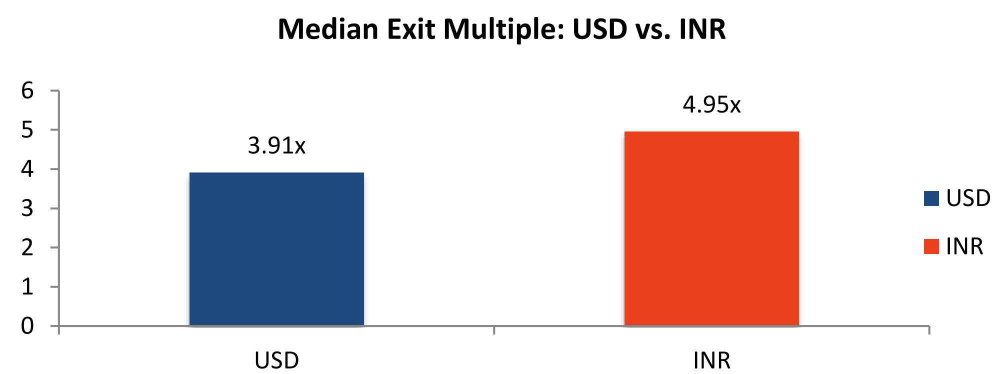


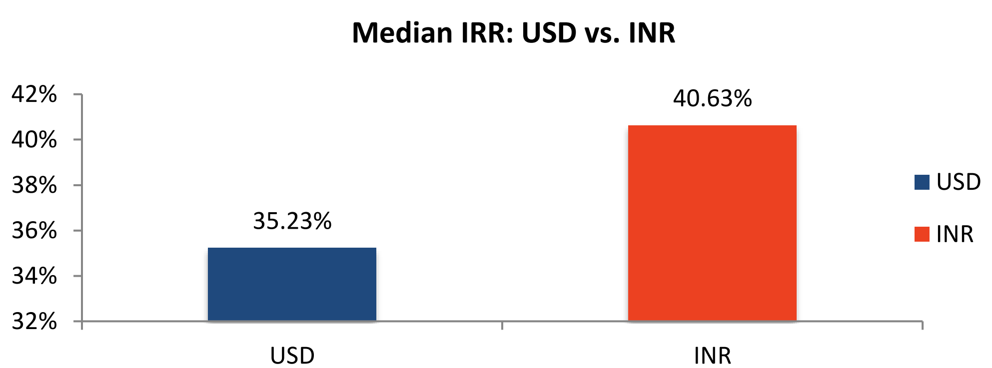


The exit transactions that UC has facilitated is almost evenly distributed between the Financial Investors, the Impact Investors and the Promoters. This is due to impact investors' mission to find companies that embrace the "double bottom line" meaning a focus both on impact and on profitability. Increasingly this is being expanded to focus on a "triple bottom line" that also includes the environment. UC has also facilitated exits for financial investors for impact businesses, where these exits have occurred in early (2), growth (4) and mature (1) stages. On the buyer side for these exits, majority of investors have been traditional financial investors. This is because impact investors are normally seed to early stage investors and late stage investors tend to be traditional financial investors.

USD Returns

In this section, we have converted all exit deal data to USD and have compared the returns in USD to the same returns in Indian Rupee.

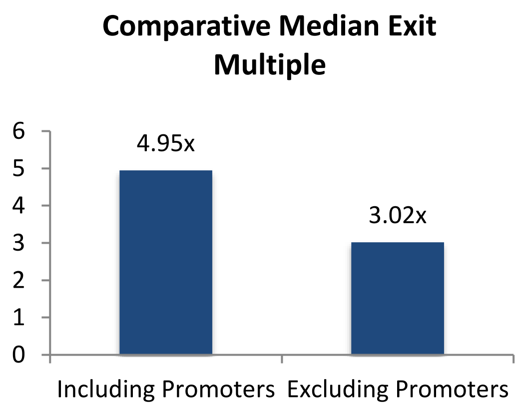


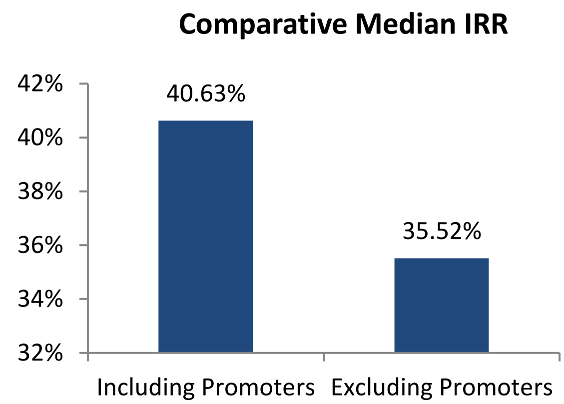


The USD returns and exit multiples have been lower compared to the returns in INR due to the depreciation of Indian Rupee since late 2000. Still the USD returns generated through these exits are very healthy returns for foreign investors. This has encouraged more offshore investors to look at the impact space in India. Additionally, the INR has recently rallied relative to the USD.

Financial Investors' Returns

The figures in this report, so far, have been calculated based on all exits facilitated by UC. In this section, we analyze the return figures of only the financial investors' exit data to observe how those compare with the figures including promoters' exits. For clarity, promoters are those that are responsible for setting up and funding initial capital, typically at par or face value, of the company's share, implying no immediate value for the unique idea or proposition. However, during seed stage or Series A, the company is valued for its unique idea along with traction, creating large value for the promoters' stake. This usually results with promoters having higher returns. The data with promoters includes 32 exits compared to 24 exits excluding promoters.





As the company grows further, the pace of value accretion is relatively more for the promoters and hence, during exits, their return figures are higher.

Social Returns

As there is no universal standard of social impact measurement, we can broadly look at the number of individuals who have utilized a product or service at the time of investment, and benchmark that against the number of users at the time of the exit. Naturally, we are simply pointing out the correlation between the investment duration and the growth in the impact variable. We have chosen to highlight a few examples of social impact created by clients with whom UC has worked:

Financial Services:

Access to financial resources is a critical need for those at the bottom at the economic pyramid. Microfinance loans can help to empower women through entrepreneurship, sustainable livelihoods, and economic empowerment for their families and communities. To measure the impact on female borrowers, UC compared the total number of female borrowers at the time of the equity investments (636,210) to the total number of female borrowers at the exit of such investments (5,769,828) to calculate percent change over time, concluding in an 807% change. We realize that this is a very crude measure, and that while access to basic financial services is a remarkable thing, all clients may not have benefited.

Healthcare:
The investments that have been made into the healthcare industry have allowed companies to further their impact and expand their offerings of healthcare products and services to those at the bottom of the economic pyramid and those in marginalized communities. One of UC's clients was screening 10,000 patients for avoidable blindness at the outset of investment. When the exit occurred, the company was screening 200,000 patients, representing growth of 1900%.

Education:
Investments in the education sector have allowed UC's clients to grow their operations to reach and empower marginalized children across India. Equity was raised to invest in a company that was dedicated to providing loans and support to private schools. At the outset of investment, the company had funded 13 schools. At the time of exit, the company had loans and support reaching 1,900 private schools.

Agri-Business:
Agri-business is one of the largest contributors to India's GDP and employment, but is fatigued by fragmented markets. One of UC's clients in the dairy sector used the equity raised to deepen its impact through scale, allowing it to reach more farmers, create market linkages and increase ethically and sustainably sourced milk products through its supply chain network. At the time of the initial investment(s) the company had reached 4,500 farmers and by the time of the exit(s) over 25,000 farmers had been reached. Using the number of farmers reached as the social metric, the percent growth over time was 456%.

Challenges and Opportunities

Given that the impact investing industry is still in its infancy, the number of overall exits is low. However, this number is expected to increase in the near term. A challenge in generating more exits is aligning the strategies of late stage investors with the missions of impact businesses. Historically, investors have been skeptical to invest in "impact" businesses, as there is concern that companies could shift from enhancing the bottom line to enhancing the bottom line along with social and environmental gain.

However, the skepticism also represents the opportunity. Impact investing is a relatively new industry and with the advent of impact businesses, the opportunity is vast and this is already being taken advantage of by a few large traditional financial investors. Some of the large financial investors are setting up dedicated impact funds by partnering with experienced impact fund managers and professionals, showing their interest and commitment for this segment. Thus, it is only a matter of time before more financial investors focus on the impact investment space and generate a higher number of successful exits.

Conclusion

This report highlights the performance of exits facilitated by Unitus Capital, and the return data on such exits is extremely encouraging. Based on the limited data set, we have witnessed extraordinarily high investor returns in the exits we have facilitated. These returns are driven by fantastic management teams and robust growth in the investment companies, and are also indicative of the companies having rapidly increased their provisions of goods and services previously not available or affordable for their low-income customers. We do believe that companies providing essential goods and services targeting massive, underserved populations should continue to grow robustly. Similarly, we strongly believe that impact investors should continue to achieve very high financial returns, often higher, than those investing in traditional VC and PE investments. Moreover, given the nature of the companies we work with, we believe that social impact gains go hand-in-hand with strong financial returns. As more deals happen, and subsequently more data becomes available, investors will be better able to assess their risks and returns, helping them to identify their strategies for financial gain and social impact. We share this data in hopes of signaling to the investing community that the impact investing space is ripe for growth, strong in financial and social returns, and poised for even greater success in the future. We believe that investors who ignore the impact investment space risk being left behind.

Appendix: Unitus Capital's History

Unitus Capital was founded in July 2008 by Unitus Labs, several visionary global investors, and a hard-working team to accelerate the development of capital markets for entrepreneurial businesses serving low-income populations in Asia and globally. Since our founding, we have established a strong track record in delivering best-in-class investment banking services. To date, we have successfully raised over $1.6 billion for over 80 important businesses in India, Indonesia, China, Philippines and Australia, across a range of diverse sectors including financial services, renewable energy, healthcare, education, agriculture and women's empowerment. Our leadership position and extensive experience provides us a unique role in helping our clients access the capital they need to fuel rapid and sustainable growth for deep social impact. Headquartered in Bangalore, India, with representation in New York, San Francisco and Sydney, our team of ~30 dedicated finance professionals has strong corporate finance experience with Morgan Stanley, Citigroup, KPMG, Deloitte, HSBC, Goldman Sachs, EY, Kotak, SBI, SIDBI, Darashaw, ICICI, Ambit, PwC, McKinsey, and Bank of America. With respect to deal volume, UC has been ranked as the number one investment bank by Venture Intelligence (2013-2016) and by VCCEdge (2014-2016). Since our conception, we have cultivated deep relationships with over 150 top financial and impact investors, as well as global Development Finance Institutions (DFIs). Driven by our mission to serve the needs of those at the bottom of the economic pyramid, we are dedicated to helping our clients scale and positively impact the society and environment.