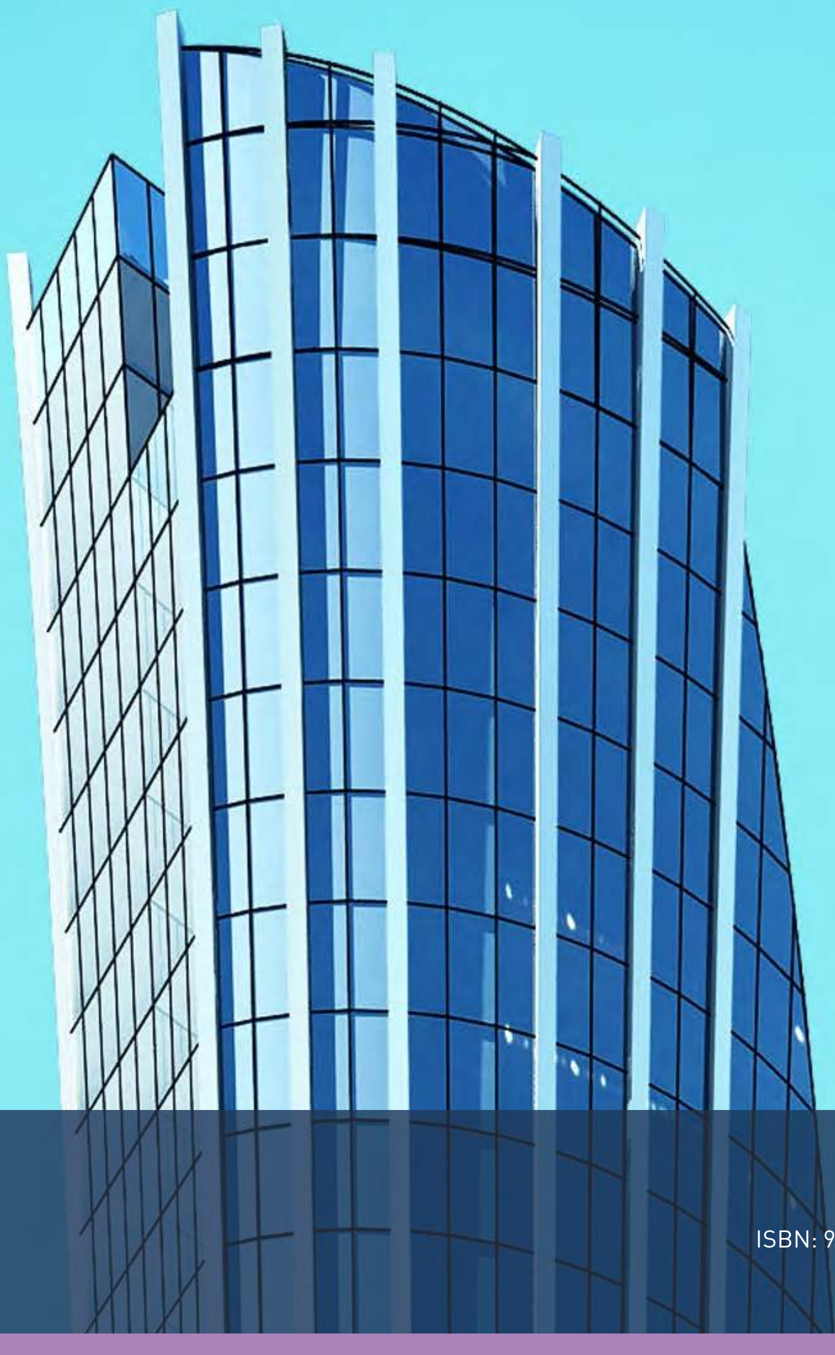
2020 PREQIN GLOBAL **PRIVATE DEBT** REPORT



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The Mainstreaming of Private Credit in India

How regulatory reforms and a changing economic landscape are helping the credit market become mainstream for asset managers in India

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Credit in India: A Long-Term Structural Opportunity

The Indian credit market has seen resilient and sustainable growth over the years, and the growing Indian economy is further fueling the expansion. The country has witnessed credit growth of 18% per annum over the past two decades, but credit penetration is still on a lower scale when compared to other markets. India's private-sector credit-to-GDP ratio currently stands at 80%, whereas in developed countries such as the US and UK, the ratio is upwards of 150%. Even for countries such as Malaysia and China, this ratio stands at 130% and 200%, respectively. These numbers indicate the growth of credit in India as a long-term structural opportunity.

The private credit market in India is on the cusp of evolution. The credit markets are at the same stage as Indian equity markets were in the 1990s. Regulatory reforms and the emergence of new players as providers of credit are institutionalizing credit markets in the country, thus making it attractive for long-term offshore institutional investors. Indian equity markets have undergone a similar phase over the past two decades, with foreign portfolio investment currently at $422bn.

At $2.9tn GDP, India is now the sixth-largest economy globally. During the past three decades, the country has grown at 6.5% per annum. India is expected to move into the top three economies over the next decade. With a likely growth of 6-7% going forward, the country aspires to be a $5tn economy by 2025.

Regulatory Developments Have Been Conducive to Growth

The regulatory environment in the country has also become conducive to the expansion of credit. The introduction of the Insolvency and Bankruptcy Code (IBC) in 2016 was a significant step in this regard. The law provides for the timely resolution of creditor issues, and has also led to the creation of necessary infrastructure to resolve stressed assets in the country. There are currently over 2,500 registered resolution professionals and 16 NCLT benches have been set up to handle the resolution of distressed companies.

The introduction of the IBC has considerably cut down on resolution time. The average time taken to resolve cases has dipped to less than two years from over four years previously. Most importantly, the recovery rate has almost doubled to 43%. Over 2,500 cases were admitted in the Company Insolvency Resolution Process, of which over 1,000 have so far been closed.

The visible outcome of the regulation is that it is leading to a significant shift in credit culture. Recently, some promoters lost control of their companies due to defaulting on their loan obligations.

The entry of Foreign Portfolio Investors (FPIs) in the corporate bond market was an equally critical measure. The government has actively introduced measures to develop a corporate bond market. Large corporates are now mandated to borrow a part of their requirement through the corporate bond market.

In addition, credit information is better disseminated with the creation of the credit bureau. The Indian bourses have built infrastructure for the electronic trading of bonds and transparent trade reporting.

Opportunities for Private Debt Investors

While the demand for credit remains strong, we have seen traditional players like banks and non-bank finance companies (NBFCs) shifting their focus from wholesale credit in India. Banks in India continue to be constrained by a high level of non-performing assets which make up around 10% of the advances.

As a result, banks have shifted their focus toward the retail credit opportunity in India. Furthermore, banks are not allowed to provide funds for a number of situations like acquisition finance, or lending against capital market instruments, etc. NBFCs, which were other large providers of structured credit to sectors like real estate and to mid-market corporates, have been adversely impacted by the tightening of liquidity and the resultant asset and liability management issues. This has significantly limited their ability to participate in the wholesale lending market.

These developments are leading to the mainstreaming of private debt funds in India. Alternative funds like Edelweiss Alternatives Asset Advisors are structurally well placed for direct lending, with their ability to provide flexible capital and bespoke solutions to the borrowers. Unlike banks and NBFCs, such funds are able to provide long-term, patient capital to corporates. Structured credit transactions have emerged as a win-win proposition for both the sponsors of companies and the investors in such funds. Sponsors of companies welcome the flexibility that private debt funds offer without the stake dilution or a loss of control as in a private equity transaction. Investors in these transactions are rewarded with higher risk-adjusted returns compared to private equity. From a risk-mitigation perspective, these investments in the Indian context are typically backed by collateral – loan-to-value for these transactions tends to be around 50-65% – and also have strong business and financial covenants.

The other key development off the back of these reforms is the emergence of the distressed asset market. With stressed assets of $150bn in the Indian banking system, investment in distressed credit is also a large opportunity that needs patient capital to resolve some of these situations. The attractive risk/return profile of some of these transactions is leading to increasing interest from offshore institutional and strategic investors alike. In 2018, high-yield credit trading volumes in India constituted more than 50% of the Asia-Pacific (excluding Japan) volume in such trades. In our experience, these strategies have the potential to generate double-digit USD net returns with risk mitigants through a tight security structure and covenants.

We believe that regulatory reforms – along with a change in the industry landscape – are leading to a shift toward private debt funds as providers of credit in India, which is here to stay. A large, growing, and open economy like India offers credible investment opportunities in a yield-hungry world.

Edelweiss

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Hemant is the CEO for Edelweiss Global Asset Management business. He oversees the entire business including investments and distribution of funds across multiple platforms – alternatives and mutual funds. He was instrumental in the scale up of the asset management business, now one of the leading alternatives asset managers in India. Hemant is also a member of the Management Committee at Edelweiss.

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