

## Corpsec Hotline

June 19, 2020

### CREDIT, SPECIAL OPPORTUNITY DEALS APPEAR MORE CONDUCTIVE NOW

Ruchir Sinha Co-head of our private equity and M&A Practice in an exclusive interview with LiveMint shares his views about the impact of COVID-19 on the dealmaking landscape, delisting, promoter financing, unlisted InvTs, standard asset securitization and FPI participation, Infrastructure Credit and LP - GP relationships. Edited excerpts below. Please click [here](#) for the full story.

MUMBAI: Ruchir Sinha, co-head, private equity and M&A at law firm Nishith Desai Associates, in an interaction with Mint, spoke about impact of covid-19 on the dealmaking landscape, emerging opportunities for credit and special situations investors in infrastructure, promoter financing and securitization of loans. Sinha also spoke about how the relationship between private equity fund managers and their investors is rapidly evolving. Edited excerpts:

**With a growing interest in delisting, is there a big opportunity for special situation/credit funds for promoter financing? Are you seeing a lot of activity in this space, not just for delisting but also for promoter financing in general?**

Delisting and acquisition financing queries are clearly on the rise. With banks facing liquidity and risk issues, alternate capital with customised solutions seem attractive. Structured commonly through collateralised redeemable bonds with pay-outs deferred until maturity, these bonds may have equity kickers built-in as well, in the form of redemption premium linked to any variable, such as underlying equity share price or cashflows. While offshore capital is interested, currency, tax withholdings, enforceability and regulatory risks dampen the return profile on a risk adjusted dollar return basis. Hence, there is a big opportunity, but enough competing opportunities exist in global markets as well.

**We understand that there is strong investor interest for retail NBFC loan portfolios through the securitization route? What kind of action are you seeing there?**

Retail NBFC portfolio naturally looks promising in certain niche segments. For instance, I think the entire consumer loan segment for white goods where the borrowing may happen at 20 - 30% IRR, which is a great segment catered to by emerging fintech companies. Middle income groups that take such loans have the requisite income streams and are unlikely to default on such small amounts. Foreign investors however aren't yet allowed direct participation, but since 2017 FPIs (foreign portfolio investors) can subscribe to PTCs (pass through certificates) representing securitised interest in such loan portfolio. We also see interest in high yield corporate loan books, but asset quality in most cases hasn't been up to the mark. The FPI 50% diversification rule tends to be a big challenge. Regulations are unclear, but since PTCs anyways represent a diversified pool of assets, there is merit in arguing that the 50% rule should not apply.

**There is a lot of liquidity in the offshore debt markets, but is this option open for Indian companies to raise short term debt, given the regulatory restrictions on raising foreign debt through FPI or ECB route? What relaxations could help Indian companies tap these pools of capital to meet their urgent capital needs?**

The biggest issue with FPI subscribing to NCDs is the 50% diversification rule, else they have to opt for the voluntary retention route where 75% of capital is locked-in in India for 3 years. ECB, similarly, with its all-in-cost ceilings, end-use prohibitions on working capital etc. doesn't help either. There is a need to remove the 50% rule and facilitate credit secondary transactions with foreign participation. Such steps could substantially address the liquidity and risk management issues and also reduce cost of capital.

**Buyouts have been on the rise in the Indian market in the last few years. But in the current environment, do you think we will see funds slow down on buyouts and look at more growth deals?**

Buyouts were indeed on the rise, until covid-19 disturbed the 'normative' financial benchmarks that would be basis for deal making. New terminologies like EBITDAC (with C for Corona) are coming up, but it is too early to assess the impact. Bid-ask gap is therefore huge. Offshore leverage for fund investments in India has also taken some degree of beating. In the current uncertain environment, growth, credit and special opportunity deals appear more conducive.

**Last two years have seen large amounts of money flow into the infra sector. Do you see that continuing, especially from sovereign and pension funds? Are these investors also interested in infrastructure credit opportunities?**

While certain GDP linked sectors with embedded volume risks such as roads, airports, ports have suffered, sectors which have contracted revenues like transmissions, telecom, annuity road assets have been less impacted. Irrespective, bid-ask gaps are widening making way for credit investments.

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Though tax exemptions have been given to sovereign wealth funds (SWF)/pension funds, these benefits unfortunately don't yet extend to key sectors like power and telecom. Tax exemptions will naturally accentuate investments, both in equity and debt.

While funding for stabilized yield generating assets may be available from banks and annuity investors, funding for under construction assets is challenging. This is a gap private debt may address. Investors are interested, but regulatory issues need to be sorted. For instance, in road projects, any change of shareholding of more than 15% requires NHAI approval and MHA approval, which can take more than 6 months. If an offshore lender were to enforce pledge on shares of concessionaire, wait time for enforcement cannot be 6 months. Inordinate approval delays are a major concern for investors.

#### **With the budget providing tax pass through status to unlisted InvITs, will we see more investors opt for this structure, as compared to listed InvIT structures?**

Tax incentives for unlisted InvITs was a huge reform, and they clearly will be the flavour until retail interest picks up on the back of shrinking credit rates. Unlike public listed InvITs, even under construction assets can now be transferred to InvIT in a tax optimised manner, and investors can have the comfort of investing in a well-governed SEBI regulated entity.

Governance regime for unlisted InvITs is evolving and SEBI has been quite responsive and proactive. Care should be taken that the regime is neither misused (because of tax benefits), nor overly prescriptive that investors lose interest in the product. Leverage is another issue - while there are no leverage limits, banks are reluctant to lend to InvITs and guidelines for FPI investments in NCDs are yet to be operationalised.

#### **How will covid-19 change the LP-GP relationship? Will we see more direct deals by LPs going ahead?**

Covid19 is clearly testing LP-GP relationships. Denominator effect also had its share of contribution as LPs pulled the plug on fresh investments. Whilst no LP defaults happened, LPs 'requested' GPs not to draw down capital. There is renewed focus on portfolio valuations, fund governance and reporting at both fund and portfolio levels.

I think LPs are maturing to Indian markets, gradually increasing their direct exposures and setting up direct investment teams, obviating the need for GPs and attendant costs. With enhanced involvement, blind pools, for instance, are being replaced with managed accounts. LP investment platforms with reputed developers will also continue to rise.

**Ruchir Sinha**

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