

Private credit in India: H1 2022 update





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01 | MARKET OUTLOOK

Over the last six months, since we first published our report on the private credit market in India, we have had several conversations with existing and new players actively seeking to raise India-specific private credit funds. The list of players operating in the Indian market continues to increase. During H12022 itself, seven new credit funds have registered with SEBI¹. While there is strong interest in the Indian markets, the opportunity landscape is changing. Opportunities in the distressed space are drying up, and there is an increased pressure on yields. The focus is shifting to providing customized and lower cost performing credit (and in some situation high yield credit) to finance growth and the new capex cycle. After a peak of distressed deals, several players are now going slow and are selective in the distressed asset acquisitions.

In this edition, we also cover insights from a survey conducted with top private credit fund managers and their outlook on the Indian private credit market.

In recent years, asset quality of banks and NBFCs has improved due to improved focus on risk assessment, cautious lending, and focus on resolution and recoveries. The huge NBFC defaults that triggered the financial sector crisis are now largely behind us. Resolutions under the Insolvency and Bankruptcy Code, 2016, continue to receive a mixed response from stakeholders. Since inception, until 31 March 2022, against the 5,258 CIRP cases admitted under the Insolvency and Bankruptcy Code (IBC), 480 cases with an average recovery of ~33% to financial creditors have been resolved². The period for completion of the resolution process has increased to 700+ days in FY 2021 to 2022 from 464 days till March

2021. Sluggish resolution timelines under IBC have forced banks/NBFCs to consider resolution options outside the NCLTs, such as sale to ARCs, one-time settlements with promoters, debt restructuring under RBI's circular dated 7 June 2019, etc. In addition to the mounting delays in IBC timelines, a recent Supreme Court judgement in the case of India Resurgent ARC Private Limited ('IRA') v Amit Metaliks (2021) has weakened the rights of secured creditors in IBC. The Supreme Court in this case ruled that India Resurgent ARC was not entitled to the value of its specific security interest even as a dissenter and held that it must share the resolution proceeds in the same ratio as other secured creditors³. As we noted in our earlier report on the private credit market in India, protection of creditor rights and its effective enforcement are pre-requisites to a strong credit market in India. Secured creditors' ability to seize their collateral is an essential component of creditor rights and uncertainty around the same will increase the riskiness for investors looking to participate in the Indian private credit market. Despite IBC's drawbacks, some success stories (DHFL's takeover by Piramal, Ruchi Soya – exit from IBC followed by an oversubscribed FPO, Jet Airways – a first in aviation in India) deserve special mention.

Measures taken by the Reserve Bank of India (RBI), focus on resolving historical NPAs, and slow credit growth have led to significant reduction in corporate NPAs throughout the banking system. SBI reported GNPA at 3.9% in FY22 as against 6.1% in FY20 and 10.9% in FY18⁴. The overall GNPA of scheduled commercial banks (SCBs) declined to 6.9% as of September 2021 and dropped to 6% as of March 2022 – lowest since 2016. The GNPA ratio of NBFCs has

¹ SEBI data and EY analysis

² IBBI Newsletter - January to March 2022

³ Dilution of Secured Creditor Rights under the Indian Insolvency Regime | Oxford Law Faculty

⁴ SBI Annual Report FY 2021-22

decreased from 6.1% in March 2021 to 5.8% in March 2022. This broadly explains why private credit investors are pivoting toward special situation driven by post-COVID-19 economic growth, renewed capex cycle, bridge finance, credit portfolio acquisitions and other special situations.

An analysis of the data published by the RBI indicates that credit to non-PSU non-financial sector borrowers has grown by 7% between September 2021 and March 2022 (detailed analysis in next section). However, from current macro-economic standpoint, there are inflationary pressures which may dampen credit growth rate going forward as RBI, like other global central banks, tighten the belts. Equity markets have already seen some steep corrections and maybe more is on the way depending on where the long-term view of inflation sets in. The CPI inflation, led by higher food and fuel-based inflation, increased for the seventh successive month to a 95-month high of 7.8%⁵ in April 2022 – followed by a marginal fall to 7.04% in May 2022 and 7.01% in June 2022 (which is higher than RBI target of 2-6%). Owing to high inflation, the RBI increased repo rate thrice in May, June and August 2022. After the recent revision, the repo rate currently stands at 5.4%, after being stable at 4.0% since May 2020. The Monetary Policy Committee also decided to stay focused on withdrawal of accommodative policy to ensure inflation remains within target going forward. Despite these challenges, India's GDP growth prospects, forecasted at 7.2%⁶ for FY23, appear to be brighter than most of its peer countries. We will have to wait and watch how the mid to large corporates react to changing marketing conditions over the next 12 months in terms of their decisions to finance growth and incur new capital expenditures.

Due to the above economic factors, higher capital expenditure by the government and expanding scope of the PLI scheme (which currently has 14 sectors under it) may help overcome the adverse impact on the investment landscape. Sectors such as automobile and auto components, advanced chemistry cell batteries, specialty steel and high-efficiency solar panels have attracted the maximum interest. India Inc. expects the PLI scheme to boost the country's capex cycle and trigger a faster growth. The Government has committed to invest substantially in infrastructure for which a National Infrastructure Pipeline is already in place and is planned to be integrated into Gati Shakti masterplan, to realize the

benefits of intersectoral linkages. Overall, the investment activity is likely to get an uplift from robust government capex, improving capacity utilization and stronger corporate balance sheets.

On the regulatory side, in January 2022, with a view to provide additional avenues to invest in stressed assets, SEBI introduced a framework for Special Situation Funds (SSF) – a sub-category under Category 1 AIF, which shall invest in special situation assets. Each scheme of SSF shall have a corpus of at least INR 100 crore. The offshore investors are no longer required to rely on ARC framework to invest in stressed assets. Further, SSFs can act as resolution applicant under IBC. This regulatory development is likely to provide impetus to global investor community looking for investment opportunities in India, across the broader spectrum of secondary market for corporate debt. Further, realizing the important role of IFSC in the government initiative of addressing the issue of NPAs faced by banks, a framework has been prescribed for special situation funds to be launched by fund managers in IFSC. For the SSF framework to meaningfully take off, certain additional measures, such as extension of SARFAESI protection to SSFs, ability to aggregate loans from all lenders and clarity on taxation aspects will be necessary.

Separately, GIFT City, India's first offshore International Financial Services Centre (IFSC), continues to make rapid strides with various initiatives being taken by the International Financial Services Centre Authority (IFSCA), the regulator at GIFT City. Specifically, the IFSCA's new Fund Management Regulations issued in April 2022, seeking to regulate the fund manager and not the fund, now provide a framework comparable to Singapore and other global asset management centers for setting up of funds and is expected to give a significant boost to fund management activities in the GIFT City.

Credit funds set up in the GIFT City raising foreign capital enjoy a beneficial tax regime in the form of exemption from gains on sale of debt securities, income from securitization trust and concessional tax rates on interest income. This is in addition to a 10-year tax holiday and a favorable GST regime for the fund manager in GIFT City. New fund managers as well as existing managers launching their next fund can no longer ignore the GIFT City in deciding the location of the new fund.

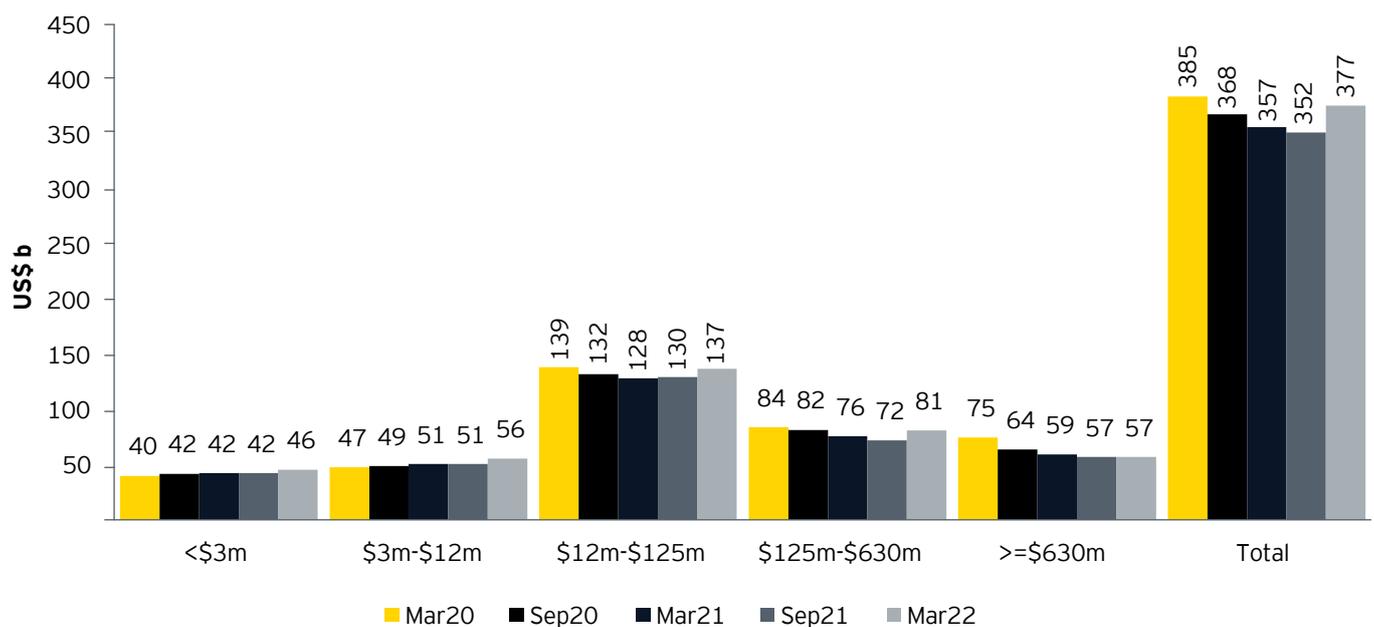
⁵ MoSPI, Office of Economic Advisor, Gov

⁶ RBI Bulletin - June 2022

02 | ANALYSIS OF CREDIT GROWTH

A comparison of the wholesale credit extended by SCBs to non-PSU and non-financial borrowers by exposure size has been presented in the chart 1 below.

Chart 1 - Wholesale credit exposure of SCB's to non-financial non-PSU borrowers⁷



In accounts with exposure between US\$12m to US\$125m and between US\$125m to US\$630m, after multiple periods of outstanding credit de-growth, the half-year period ended 31 March 2022, finally saw an average credit growth of 6% and 12%, respectively. However large borrower segment (> US\$630m) remains flat.

An analysis of the balance sheets of the listed manufacturing companies also indicates that the leverage levels have decreased over the last two years (Refer Chart 2).

⁷ Page 40 Financial stability report (Issue No. 25)

Chart 2 - Debt to equity % of listed manufacturing companies⁸



Additionally, while the new credit cycle takes off, credit growth for companies with credit rating below AA is much lower than for those companies with credit rating more than AA. This indicates risk aversion persisting in the system and is maybe a potential opportunity for private credit funds.

Table 1 - % Growth in wholesale credit to non-PSU non-financial companies⁹

	Mar20	Mar21	Mar22
AA and above	16	-15	10
Other investment grade	-5	-6	0
Below investment grade	-16	4	1
Unrated	-6	-10	13
Total	-4	-7	6

In terms of sectoral deployment, aviation has witnessed significant incremental deployment of credit during the Q4FY22 (1.9x of deployment in Q3FY22), followed by tourism, hotels, restaurants, and shipping (1.2x). The increase in deployment of credit is potentially due to Emergency Credit Line Guarantee Scheme (ECLGS), the scope of which was expanded recently to include hospitality and related industries. The scheme has now been extended till 31 March 2023.



⁸ Page 22 of Financial Stability Report Issue No. 25

⁹ Page 30 of Financial Stability Report Issue No. 25



03 | NEW FUND SETUP AND DEAL ACTIVITY

A. New funds registered (AIF-SEBI)

Seven credit funds have been registered with SEBI under AIF Category -2 during H12022. Further, as on 30 June 2022, at least three private credit funds have applied to SEBI for seeking AIF registration. In January 2022, The SEBI (Alternative Investment Funds) Regulations, 2012 have been amended to introduce the 'Special Situation Funds' as a sub-category under Category I AIFs. However, we did not find any registrations under the 'Special Situation Funds' category.

B. Key players –fundraising announced during H12022¹⁰

- ▶ Bain Capital has raised US\$2b for its second APAC special situations fund, with US\$300m to US\$400m earmarked for India. The fund is likely to target a ticket size of US\$100m with mid-teen US\$ IRR and focus on customized solutions for companies in need of growth capital.
- ▶ KKR has raised US\$1.1b in its inaugural Asia credit fund with themes of senior and unitranche corporate lending, subordinate corporate lending, and asset-based finance investments
- ▶ Neo Asset Management is likely to raise US\$105m, with a green shoe option of US\$160m. The fund will focus on providing customized credit solutions to EBITDA positive companies, with ticket size of US\$12m to US\$25m
- ▶ Edelweiss Alternative Asset Advisors is raising US\$1b special situation fund, with a hard cap of US\$1.5b. As part of this fund raise, they have launched India Special Asset Fund-III in the Indian market as well with size of US\$130m and green shoe option of US\$260m.
- ▶ Kotak Investment Advisors has announced its plan to launch a dedicated US\$130m private credit fund, with green shoe option of another US\$130m. The sector-agnostic fund will focus on performing credit space to secure mid to high teen returns. Further, Kotak is likely to launch its next special situation fund with a size of more than US\$1b in second half of 2022.
- ▶ Incred Capital is also set to raise US\$130m for deployment in performing companies, with IRR expectation of ~16% in INR terms
- ▶ Certus capital is planning to raise US\$130m for secured and performing credit lending and underwriting through its NBFC
- ▶ Avendus Structured Credit Fund II has achieved first close of US\$57m, with a target corpus of US\$130m. The fund is likely to deploy capital in growth-oriented companies and in sectors such as IT services, B2B services, specialized manufacturing, healthcare, etc., with target deal size of US\$20-35m.

Overall, based on publicly available information, fundraising of more than ~US\$1.4b has been announced/undertaken in India during H12022.

¹⁰ VCCircle.com, Privatecircle.co and public information

C. Overview of select transactions¹¹

Deals amounting to more than US\$1.7b+ have been successfully closed during H12022

Investor	Investee	Deal Value (US\$ m)	Sector	Credit strategy	Transaction rationale	Instrument	Tenure
Apollo Global Management	Adani Airport Holdings	750	Airports	Performing Credit	Refinance existing shorter maturity loans and new capital expenditure	Senior secured notes	20 years with option to convert at any time before 20 years from date of issue
CPPIB	Eruditus	350	Edtech	Performing Credit	Fuel M&A as part of global growth strategy	n/a	5 years
SSG and Farallon Capital	Evangelos Ventures (Shapoorji Pallonji Group)	183	Conglomerate	High Yield	Retire existing high-cost debt with IRR > 15% and tenure of 3 years	NCD	3 years
Bain Credit Deals	TARC Limited	175	Real estate	n/a	Special Situations - Retire entire existing debt with multiple lenders	NCD	n/a
Apollo Global	Hero Fincorp	125	Financial Services	Performing Credit	Provide growth capital to HeroFinCorp to double its existing AUM	CCPS	3-5 year
Kotak Investment Advisors Limited	Gold Plus Glass Industry Limited	60	Manufacturing	High Yield	Capex funding for setting up new floating glass and solar glass manufacturing lines.	0.1% Compulsory convertible debentures	n/a
Capri Xponentia Managers	Deepak Fasteners Limited	48	Auto components	High Yield	Provide exit to select lenders and growth capital	Debt, convertible, and equity	n/a
Edelweiss	Thriveni Earthmovers	31	Mining	Performing Credit	Acquisition of 76% partnership interest in Sky United LLP and refinancing of bridge loan	NCD, Coupon of 16% p.a	4 years
Edelweiss Alternative Asset Advisors Limited	Jupiter International Limited	23	Renewable energy	High Yield	Capex funding for new solar cell lines and repayment of dues to Phoenix ARC.	NCD and OCD	4 years

¹¹ MCA filings, News Articles, Credit Rating Reports



04 | PRIVATE CREDIT INDIA PULSE SURVEY

About the survey

We have initiated a periodic survey of private credit market in India. The survey aims to capture the pulse of the market and identify any pivots in overall direction of the key players.

This survey was conducted in July 2022. Senior leaders of large Indian and global, high yield and performing credit funds participated in the survey.

Summary of survey

From a sector perspective, manufacturing, retail, and real estate still constitute the largest share of deal flow witnessed by the private credit investors. Interestingly, stress related deal flow has given way to bridge funding to IPO transactions, driven by lower credit stress in credit

markets and indicating a pivot in strategy from several investors. A revival in the capex cycle is also leading to higher deal flow towards private credit.

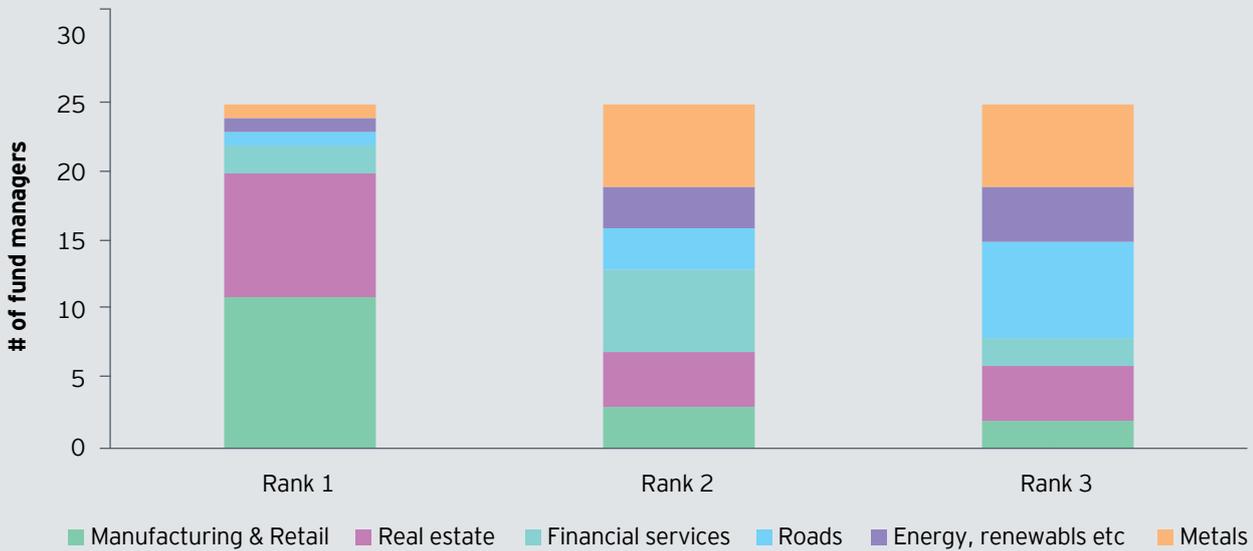
Global monetary tightening is also having its impact on sourcing of funds to invest in India numerous market participants are finding it difficult to raise funds.

Amidst, tightening supply of dry powder due to global monetary tightening and reduced stress in Indian credit markets, and as new funds set up shop in India, competition for deals has increased. This may put pressure on yields and potentially lead to mis-pricing of risk.

Lastly, our Private Credit Senti-meter, indicates that private credit investors are more cautious in the near term (next one to two years) as compared to the longer time horizon of two to five years. None of the survey participants are bearish in either time horizon.

Detailed results

Q How did fund managers rank the sectors in order of deal flow?
(Rank 1 indicates maximum deal flow)



Most fund managers ranked manufacturing and retail followed by real estate as sectors with the highest deal flow. Financial services and energy renewables were sectors ranked lowest in terms of deal flow by fund managers.

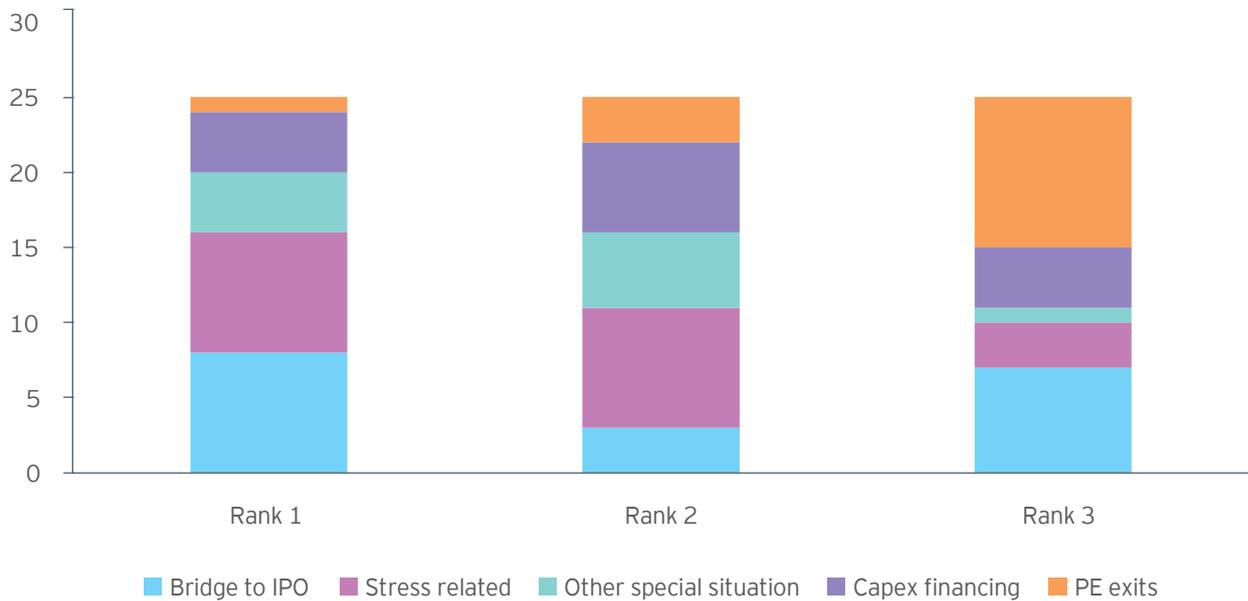
Q How did fund managers rank the drivers of demand for private credit, in the current deal flow?
(Rank 1 indicates the most significant driver)



Most fund managers stated that in the current deal flow, the are the most popular drivers for private credit demand:

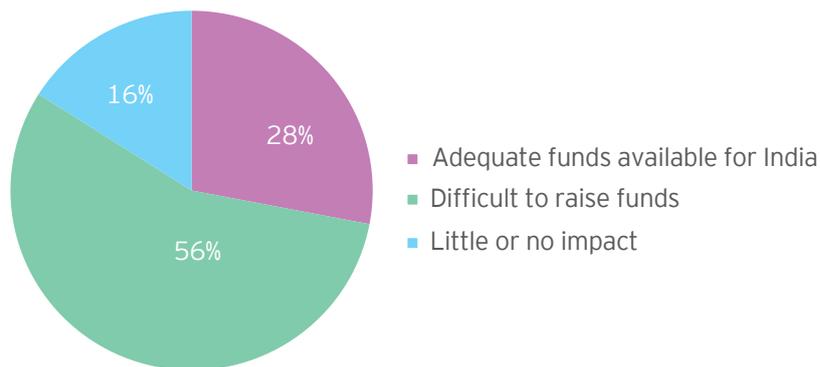
- ▶ Stress related financing;
- ▶ Bridge to IPO

Q How did fund managers rank the drivers of demand for Private Credit over the next 12-24 months?
 (Rank 1 indicates the most significant driver)



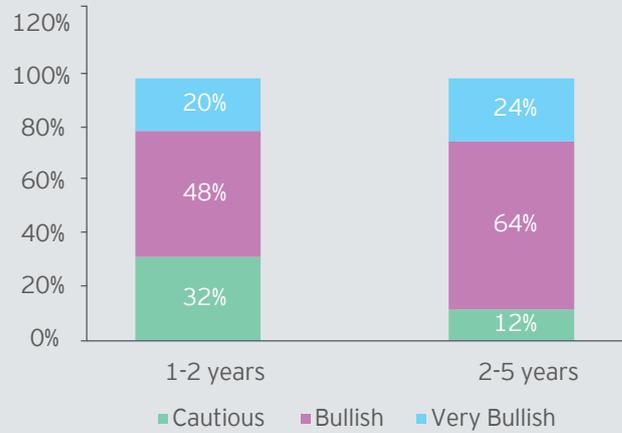
Most fund managers stated that stress and bridge to IPO will continue to dominate the private credit demand over next the 12 to 24 months.

Q How do fund managers perceive the impact of ongoing monetary tightening on the availability of funds over next 12 months, for private credit investing in India?



Most fund managers believe that given the current monetary tightening, it will be difficult to raise funds over the next 12 months

Q *What is the overall sentiment on Private credit over the next one to two years and two to five years?*



~70% managers are positive (bullish and very bullish) on private credit investment for the next one to two years; the corresponding number is ~90% over two to five years.

Q *Has the level of competitiveness in private credit deals, over last 12 months, increase/decreased or remained the same?*



60% of investors believe that competition in private credit deal has increased over the last 12 months

LEADERSHIP CONTACTS

- BY SOLUTION

Turnaround & Restructuring Strategy

Abizer Diwanji

Head, Financial Services
Ernst & Young LLP

E: abizer.diwanji@in.ey.com

Dinkar Venkatasubramanian

Partner & Head, Turnaround and
Restructuring Strategy
EY Restructuring LLP

E: Dinkar.Venkatasubramanian@in.ey.com

Ramkumar SV

Partner
EY Restructuring LLP

E: ramkumar.sv@in.ey.com

Shailendra Ajmera

Partner
EY Restructuring LLP

E: Shailendra.Ajmera@in.ey.com

Bharat Gupta

Partner
Ernst & Young LLP

E: Bharat1.Gupta@in.ey.com

Nitin Jain

Partner
Ernst & Young LLP

E: nitin.j@in.ey.com

Vishal Bansal

Partner
Ernst & Young LLP

E: Vishal.Bansal@in.ey.com

Lokesh Gupta

Partner
Ernst & Young LLP

E: lokesh.gupta@in.ey.com

Pulkit Gupta

Partner
EY Restructuring LLP

E: pulkit.gupta@in.ey.com

Partha Guha

Partner
Ernst & Young LLP

E: partha.guha@in.ey.com

Vishal Joishar

Partner
Ernst & Young LLP

E: vishal.joishar@in.ey.com

Anoop Narayan

Partner
Ernst & Young LLP

E: anoop.narayan@in.ey.com

Abhishek Dasgupta

Partner
Ernst & Young LLP

E: abhishek.dasgupta@in.ey.com

Suyog Karmarkar

Partner
Ernst & Young LLP

E: Suyog.Karmarkar@in.ey.com



Transaction Diligence

Kuldeep Tikkha

Partner and Head
Transaction Diligence
Ernst & Young LLP
E: Kuldeep.Tikkha@in.ey.com

Ambarish Bharech

Partner
Ernst & Young LLP
E: Ambarish.Bharech@in.ey.com

Private Equity Services

Vivek Soni

Partner and National Leader,
Private Equity Services
Ernst & Young LLP
E: Vivek.Soni@in.ey.com

Tejas Desai

Partner
Ernst & Young LLP
E: Tejas.Desai@in.ey.com

Ajit Krishnan

Partner
Ernst & Young LLP
E: Ajit.Krishnan@in.ey.com

Editorial

Bharat Gupta

Partner, Turnaround and
Restructuring Strategy
Ernst & Young LLP
E: Bharat1.Gupta@in.ey.com

Rohit Somani

Director, Turnaround and
Restructuring Strategy
Ernst & Young LLP
E: Rohit.Somani@in.ey.com

Yash Punwani

Senior Associate, Turnaround and
Restructuring Strategy
Ernst & Young LLP
E: Yash.Punwani@in.ey.com

Glossary

Term	Full form
AIF	Alternative Investment Fund
ARC	Asset Reconstruction Company
AUM	Assets Under Management
CIRP	Corporate Insolvency Resolution Process
CPI	Consumer Price Index
CRISIL	Credit Rating Information Services of India Limited
FPO	Follow On Public Offering
FY	Financial Year
GDP	Gross Domestic Product
GIFT	Gujarat International Finance Tec-City
GNPA	Gross Non Performing Assets
GST	Goods and Service Tax
IBC	Insolvency and Bankruptcy Code, 2016
IFSC	International Financial Services Centre
IPO	Initial Public Offering
IRR	Internal Rate of Return
m	Million
n/a	Not available/ Not applicable
NBFC	Non-banking financial company
NCD	Non convertible debentures
NCLT	National Company Law Tribunal
NPA	Non-performing assets
 OCD	Optionally Convertible Debentures
PLI	Production Linked Incentive
PSB	Public Sector Banks
PSU	Public Sector Undertaking
RBI	Reserve Bank of India
SARFAESI	Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002
SBI	State Bank of India
SCB	Scheduled commercial banks
SEBI	The Securities and Exchange Board of India
SSF	Special Situation Fund

Our offices

Ahmedabad

22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon
Temple, Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru

12th & 13th floor
"UB City", Canberra Block
No. 24, Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground Floor, 'A' wing
Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Chandigarh

Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai

Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR

Golf View Corporate Tower B
Sector 42, Sector Road
Gurugram - 122 002
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad

THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jamshedpur

1st Floor, Shantiniketan Building
Holding No. 1, SB Shop Area
Bistupur, Jamshedpur - 831 001
Tel: + 91 657 663 1000

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

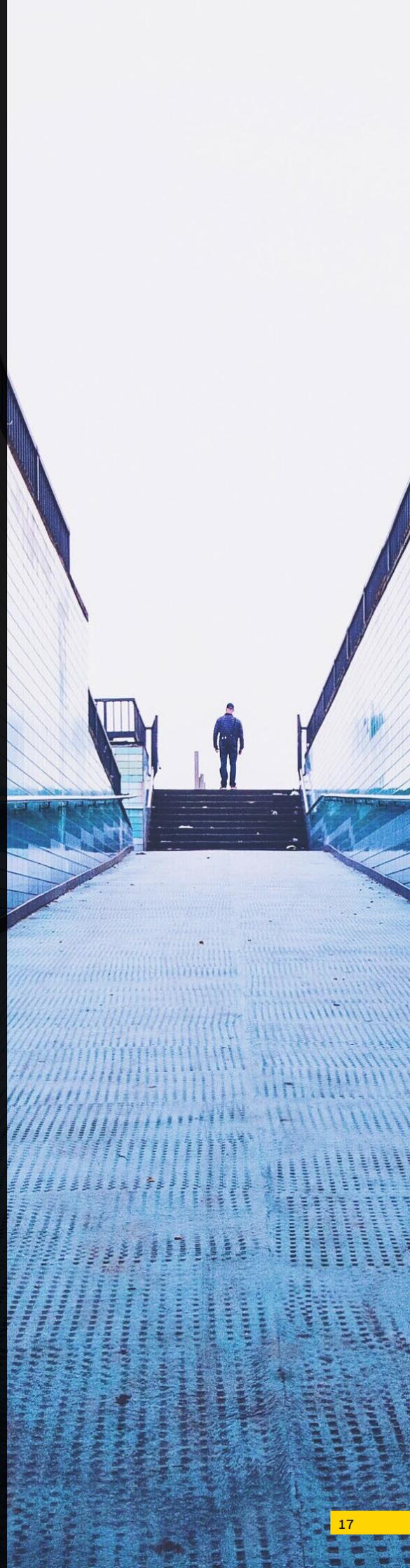
Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

Pune

C-401, 4th floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000



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