Private Credit in India

H2 2023 Update

Building a better working world

Table of contents

1. Executive summary

The overall macroeconomic environment in H2 2023 continued to face similar challenges. Interest rates remain high. To add to that economies are grappling with the ongoing conflicts in Ukraine and Gaza, besides added tensions in the Red Sea, and inflation which is still above target levels for most economies. Amidst this scenario, the World Bank expects that global headwinds will continue to persist and intensify, and global growth will decline to 2.9% in CY 2024. Despite the uncertain global environment, the World Bank in its Global Economic Prospects 2024 report noted that India continues to retain its tag of the fastest growing major economy with an estimated growth rate of 6.3% in FY23/24 edging up to 6.4% in FY24/25. As per the RBI, the real GDP is likely to grow at ~7% in FY24 and is likely to touch 7% in FY25.

In line with the strong domestic growth in India, the overall bank credit growth between December 2022 and November 2023 was approximately 23%. It is no surprise that the growth in credit continues to be fueled by retail lending. However, some interesting trends have emerged in H2 2023. Outstanding loans by the Scheduled Commercial Banks to real estate sector have grown significantly from US$39b as of May 2023 to US$52b as of November 2023 (US$38b in December 2022), a growth of 33% in a very short span of time. There is hyperactivity in the real estate sector which is also evidenced by heightened real estate related private credit deal flow and the results from the survey of private credit fund managers. NBFC wholesale books have remained flat on aggregate during H2 2023.

Growth in loans by Scheduled Commercial Banks to the large industries continues to remain sluggish and has grown by 7% in CY 2023 as compared to the overall credit growth of 23%. A sectoral analysis of credit given to industries indicates that while credit to a few large sectors such as metals, textile and chemicals grew by 10–12% in CY 2023 all other sectors recorded low/no-growth in bank credit. There has been a lot of discussion regarding kick-start of the private capex cycle which should result in credit growth of large industries, and we may be witnessing green shoots of the same. RBI in its survey on capacity utilization in the manufacturing sector reported that aggregate capacity utilization stood at 73.6% in Q1 FY24. SBI has also reported a healthy pipeline of sanctions worth US$57b being sought to finance capex however given the long project lifespans of capital projects over which disbursements are typically spread we will need to monitor the credit data for a couple of more quarters.

Private Credit Deals CY2023

In CY 2022, private credit deal activity witnessed a significant slowdown in H2 2022 (US$1.22b) vis-à-vis H1 2022 (US$4.08b) primarily on account of elevated geopolitical uncertainty and increase in interest rates starting May 2022. Now that the interest rates seem to have peaked, we have seen better deal flow in CY 2023. In CY 2023, based on the deals tracked by us, a total of US$7.8b was invested in private credit deals. A quick summary of the highlights from the deal flow in CY 2023 are summarized below:

- Deal flow in CY 2023 was higher than CY 2022 both by deal count and deal value (CY 2023: 108 deals totaling to US$7.8b versus CY 2022: 77 deals totaling to US$5.3b)
- The surge in deal value in CY 2023 can be largely attributed to two high-value deals, namely the Shapoorji Pallonji group's refinancing and Oaktree's investment in Vedanta group, collectively amounting to US$2.4b. These deals validate the fact that there are pockets of stress / special situation opportunities in the market and corroborates the results from our survey of January 2023 when 38% of the fund managers had reported that stress related deals will be the top driver for private credit deals in CY 2023. Large value deals in CY2022 included debt raised by Greenko, Adani Properties, Shapoorji and Pharmeasy aggregating to ~US$1.6b.
- In our H2 2022 report we had reported that global funds (by virtue of their ability to do large deals) dominate the share of investments by deal value but domestic funds lead the way in terms of deal count due to their ability to serve the mid-market. In line with that trend, in CY 2023, global funds contributed to approximately 63% of the total deals by value in CY 2023 (primarily due their participation in the large deals mentioned above), however approximately 61% of the deals by number were done by domestic funds by virtue of their focus on the mid-market segment, local presence and strong deal origination capabilities.
- Investments in real estate totaled to US$1.7b in CY 2023 versus US$1.6b in CY 2022 continuing to remain one of the largest sectors attracting investments.

Please refer Section 6 for a detailed analysis of the private credit deal flow in CY 2023.

EY Private Credit Pulse Survey

- 50% of the fund managers surveyed ranked real estate, closely followed by manufacturing as the sectors with most deal activity over the next 12 to 24 months. This trend is similar to the last survey we conducted in January 2023.
- 50% of the fund managers believe that over the next 12 to 24 months capex related financing will be the biggest driver of private credit deals, followed by stress related. This is a distinct change since the last survey. In the last survey of January 2023, stress-related deals were the biggest driver by 38% followed by bridge to IPO and capex financing.
- 67% of the fund managers reported that the private credit investment activity in CY 2024 is likely to range from US$5–10b in CY 2024.

Please refer the EY Private Credit Pulse Survey for detailed analysis.

2. Macroeconomic outlook[1]

As we close CY 2023, the global macroeconomic environment continues to experience slowing growth rates, increase in geo-political hostilities and fragmentation, elevated levels of public debt and high interest rate environment. Inflation across advanced economies while following different trajectories are higher than target levels indicating limited headroom for any rate cuts by the central banks. IMF has projected that the global growth will decline to 2.9% in CY 2024 as against an average growth of 3.8% between CY 2009–2019 and it seems that the macroeconomic situation will continue to remain subdued in the near term.

Despite the global macroeconomic environment, India remains one of the fastest growing major economies. The real GDP is likely to grow at ~7% in FY24 on the back of strong domestic consumption, high level of public expenditure and strong export of services. Inflation after peaking at 7.4% in July 2023 has eased to 5.6% in November 2023 and is closer to the medium-term target of 4%. Based on data till December 2023, there has been net positive capital inflow US$51b in the fiscal year so far (includes FPI, FDI, ECB and non-resident deposits) as compared to US$16.4b in the previous financial year. The Indian rupee's performance relative to the US dollar has also been resilient in CY 2023, falling only 0.65%, as compared to its performance in CY 2022 where it fell by almost 10.25%. Trade deficit has also marginally improved from US$189.2b during April–November 2022 to US$166.4b during April–November 2023.

SCBs' gross non-performing assets continued its downtrend and fell to a 10-year low of 3.9 per cent in March 2023 and the NNPA declined to 1.0 per cent. The provisioning coverage rose to 74 per cent. Led by strong growth in net interest income and significant reduction in provisions, the profit after tax of SCBs registered a growth of 38.4 per cent in FY23. The business and financial restructuring that the corporate sector went through over the last decade is clearly showing in the financial performance which reflects in the improvements in the interest coverage ratio and operating profits of the listed non-financial corporates. The total ratio of credit rating downgrades to total ratings has declined to 0.4% in Q2 FY24 after peaking at 20.3% in Q1 FY22. The low leverage levels of Indian corporates provide room for investments in capex as well as making them resilient to withstand any shocks in external demand. The capacity utilization in Q1FY24 stood at 73.6%[2] in Q1 FY24.

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[1] *RBI's Financial Stability Report Issue No. 28*

[2] *RBI OIC Survey - October 2023*

There also seems to be an uptick in the capital investments made by corporates as there has been an improvement in the fixed asset to total asset ratio from 33.6% in H1 FY23 of previous year and 34.6% in H1 FY24. The capex tracker[3] index of institutional research firm Avendus Spark shows a reading of 342 in June 2023 - the highest in more than 12 years. The index has been consistently rising since December 2020 - when it hit a low of 147. SBI has also reported in Dec'23 that they have pipeline of US$57b of corporate investment proposals that are at various stages of evaluation. Besides rejection of any such investment proposals by banks, the requirement of promoter/ equity contribution and cash flow mismatch situations over the next few years may present opportunities to private credit funds to partner with business owners as they execute these investment decisions.

There has been a significant slowdown in PE activity[4] in CY 2023 (CY 2022 - US$408b versus CY 2023 - US$267b). The decline is mainly on account of slowdown in investments in new age tech led businesses. While PE activity has been slow, the domestic equity markets have been outperforming other peer economies backed by strong corporate balance sheets and healthy growth rates which have helped companies mobilize resources. Interestingly, as compared to the rally in the benchmark Nifty 50 index, that represents the largest firms, the rallies in the micro/small/mid cap indices (mid-market segments typically targeted by Private Credit funds) was significantly larger. This also underlines the bridge to IPO theme which has been playing out in the private credit space and we have reported some successful exits made by Private Credit funds on the back of an IPO. Please refer our deal table for more details.

[3] *Economic Times article dated 15 December 2023 "India Inc's capex cycle may move into top gear."*

[4] *Includes all deals above US$20m. Analysis of EY PE/VC newsletter.*

3. Analysis of credit deployment and growth

3.1 Credit deployment by scheduled commercial banks[5]

Overall bank credit growth between December 2022 and November 2023 was approximately 23%. A deep dive into the sectoral deployment report of banks indicates that the growth has been across all sectors except large industry which has lagged relative to other sectors.

Particulars (US$b)	December 2022 (a)	November 2023 (b)	Change (US$b) (b-a)	Annualized growth rate[6] (%)
Agriculture and Allied Activities (a)	199	236	37	21%
Industry:				
MSME	100	119	19	22%
Large	303	321	19	7%
Sub-total (b)	**402**	**440**	**38**	**11%**
Services:				
NBFC	161	183	21	15%
Trade[1]	94	111	17	21%
Real Estate	38	52	15	44%
Others[2]	135	175	40	33%
Sub-total (c)	**428**	**521**	**93**	**25%**
Personal loans (d)	**481**	**618**	**137**	**32%**
Total (a+b+c+d)	**1,511**	**1,816**	**305**	**22.8%**

Note:
1. Trade includes Wholesale trade (food procurement credit outside the food credit consortium) and Retail trade credit.
2. Others include transport operators, computer software, hotels, restaurants, professional services, aviation, shipping, mutual fund (MFs), banking and finance other than NBFCs and MFs and other services which are not indicated in the aforementioned categories

RBI in the financial stability report has also noted that there is a compositional shift happening in the credit dispensed by banks and NBFC's with an increasing proportion of credit being disbursed to the service sector and retail loans which is evident in the consistently high credit growth rates in these segments. Expansion of retail lending has also been supported by bank lending to NBFC's. Such lending is mostly limited to top rated NBFC's with 80% of such credit given to NBFC's with credit rating of AA and above which in turn primarily dispense retail loans. Another interesting observation in the recent sectoral credit report is the expansion in the credit to the real estate sector. In our H1 2023 report the aggregate bank loan outstanding to real estate as at May 2023 was US$39b. Between May 2023 and December 2023 banks' lending to real estate sector has increased by US$13b which is significant.

Growth in loans to the large industries continues to remain sluggish and has grown by 7% in CY 2023 as compared to the overall credit growth of 23%. A sectoral analysis of credit given to industries

[5] SCB's credit deployment report and RBI's Financial Stability Report Issue No. 28

[6] *Computation is based on number of days*

indicates that while credit to a few large sectors such as metals, textile and chemicals grew by 10–12% in CY 2023 all other sectors recorded low/no-growth in bank credit.

Schedule Commercial Banks continue to record a reduction in their GNPA ratios which have fallen to a 11-year low of 3.2% in September 2023. The consistent reduction in NPA's has been mainly on account of persistent fall in new NPA accretions, write-offs and recoveries and higher upgradations.

3.2 Credit deployed by NBFC's[7]

The gross credit deployment by NBFCs in September 2023 stood at US$455b (March 2023 - US$419b and September 2022 - US$359b). We have presented the gross credit outstanding by type of NBFC's in the table below. Infrastructure Credit Companies ('ICC's) operate primarily in the retail space while Infrastructure Finance Companies ('IFC's) provide infrastructure funding.

The RBI stated in its report on the trends and progress of banking in India that double-digit growth in loans and advances extended by NBFC's is mainly on account of unsecured loans. Amidst tightening liquidity conditions and increasing competition from banks, NBFC's have focused on lending to segments such as unsecured loans, micro-finance loans and MSME's.

Loans & advances of NBFC's by type of NBFC's (US$b)

Particulars	March 2021	March 2022	September 2022	March 2023	September 2023
Investment and Credit Companies	123	133	132	164	176
Factors	0	0	0	0	0
Infrastructure Debt Fund	4	4	4	4	5
Infrastructure Finance Company	143	152	154	169	181
Micro Finance Institution	8	10	9	14	17
Sub-total NBFC-ND-SI (a)	**279**	**299**	**300**	**351**	**379**
Deposit taking NBFC	52	56	59	68	76
Sub-total NBFC-D (b)	**52**	**56**	**59**	**68**	**76**
Grand total (a+b)	330	356	359	419	455

A sector-wise analysis of gross credit (see table below) increase between September 2022 and September 2023 indicates that retail books of NBFCs have increased by US$40b and credit to industry has increased by US$29b. Credit to industry primarily comprises infrastructure lending by large government backed NBFC's.

[7] *Report on Trends and Progress of Banking in India by RBI 2022*

Loans and advances of NBFC's by Sector (in US$b)					
Particulars	**March 2021**	**March 2022**	**September 2022**	**March 2023**	**September 2023**
Agriculture and Allied Activities	5	6	6	7	9
Industry	130	136	136	156	165
Services	40	49	47	58	61
Retail Loans	97	101	108	129	147
Other Non-food Credit	59	63	63	68	72
Total	**330**	**356**	**359**	**419**	**455**

3.2.1 Wholesale book of NBFC's[8]

In our previous editions we have reported that the wholesale book of large listed NBFC's have largely remained stagnant / declining since the ILFS crisis and that trend has continued. We have analyzed the wholesale books of 15 large listed NBFC's over last several quarters and we can observe that the aggregate wholesale book of these NBFC's have declined consistently. (December 2022 - US$51b, March 2023 - US$51b, June 2023 - US$48b and September 2023 - US$47b).

This is in line with the strategy reported by some of the NBFC's, in their quarterly investor presentation reports, such as L&T Finance, ECL Finance, Piramal and Indostar to name a few who have focused on retailization of their loan books.

In December 2023, the RBI has also issued a circular to address concerns about potential evergreening by regulated entities through AIF's substitution of their direct loan exposure to borrowers with indirect exposure through investments in units of AIF. This circular may impact the trend of shifting of loan exposures from NBFC's to AIF's and we will have to wait for a couple of quarters to review its full impact. We have discussed this in detail in the regulatory updates section.

[8] *Quarterly Investor Presentation Reports of listed NBFC's*

3.3 Debt mutual funds

Debt oriented schemes have witnessed net inflows of US$7b since May 2023. Credit risk funds (which invest a minimum of 65% of the investment portfolio in debt papers) saw a small decline in AUM.

Considering the disruptions in the corporate bond market due to impact of COVID-19 an announcement was made in the Union Budget of FY22 regarding creation of a backstop facility for the corporate bond market that would purchase investment grade security in case of dislocations in the market. Government has notified setup of a GFCD as an AIF. The units will be subscribed by AMC's of specified debt mutual fund scheme.

Debt mutual fund AUM

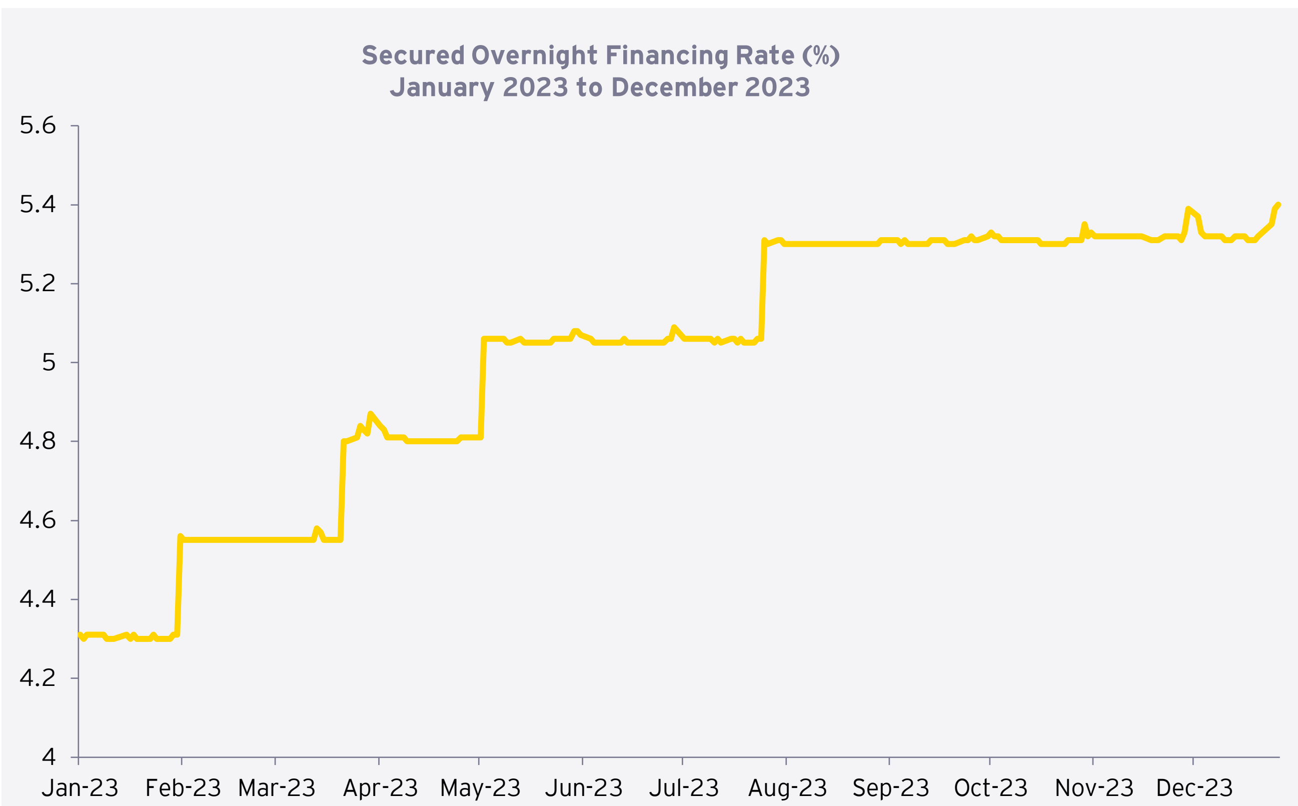
Funds (US$m)	March 2019	March 2020	March 2021	March 2022	March 2023	May 2023	October 2023
Liquid Fund	62.5	40.9	44.9	47.5	56.0	54.1	53.7
Money Market Fund	7.2	7.0	11.6	14.1	14.4	16.2	18.1
Corporate Bond Fund	7.4	10.0	19.0	16.2	14.2	16.4	17.0
Overnight Fund	1.4	9.8	10.9	15.3	14.1	10.0	12.7
Low Duration Fund	11.1	9.9	16.4	14.0	11.5	11.6	13.3
Short Duration Fund	9.9	11.4	18.2	14.6	11.4	12.1	12.2
Ultra Short Duration Fund	10.5	8.8	11.7	10.8	11.2	12.0	11.7
Banking and PSU Fund	4.2	8.9	14.9	11.8	9.1	10.0	9.7
Floater Fund	3.7	4.0	7.8	9.9	7.1	6.8	7.4
Medium Duration Fund	4.6	3.5	3.8	4.1	3.2	3.4	3.3
Credit Risk Fund	**9.9**	**6.8**	**3.5**	**3.4**	**3.1**	**3.0**	**2.9**
Dynamic Bond Fund	2.4	2.2	3.2	3.1	2.8	3.7	3.7
Gilt Fund	0.9	1.1	2.0	1.9	2.0	2.7	3.1
Medium to Long Duration Fund	1.2	1.2	1.3	1.3	1.1	1.2	1.2
Long Duration Fund	0.1	0.2	0.3	0.3	0.4	1.1	1.2
Gilt Fund with 10 year constant duration	0.1	0.1	0.2	0.2	0.2	0.5	0.5
Total	137.1	125.8	169.7	168.5	161.9	164.9	171.9

Source: SEBI Website

4. Corporate bond market

The total outstanding corporate bonds as at Sep23 totaled ~US$523b[9]. Additionally, the aggregate issuances from January 2023 till September 2023 totaled to US$140b as compared to aggregate issuances of US$117b in CY 2022. Banks, NBFC's (including Housing Finance Companies) and PSUs formed more than two-thirds of total bond issuances while body corporates constituted approximately 17% of the issuances.

One of the reasons driving higher issuances in the domestic market was the unfavorable interest rate environment that persisted in global markets. The SOFR[10] (that reflects the cost of borrowing cash overnight collateralized by U.S. Treasury securities) has only marginally increased by ~30 basis points in H2 2022 but stood at ~5.4% at the close of CY 2023. As a result, the cost of raising dollar debt hedged into rupee was higher than the domestic debt pricing. High interest rates globally have resulted in the lowest dollar debt issuances in the last 14 years[11].



[9] *Depository Data and SEBI Website*

[10] *SOFR rates on https://fred.stlouisfed.org/series/fedfunds*

[11] *https://www.marketscreener.com/quote/stock/ADANI-PORTS-SPECIAL-ECONO-9059803/news/Indian-firms-dollar-debt-issuance-hit-14-yr-low-amid-global-yield-pressures-45604666/*

Large corporates such as Reliance Industries has raised the largest bond issue (US$2.4b[12]) by a non-financial firm by paying 40 basis points more than the government borrowing cost. The companies 10-year bond was priced at 7.79% as compared to the 10-year benchmark rate of 7.39%. The issue was subscribed by insurance companies, pension funds and provident funds. Similarly, HDFC had also raised US$3b[13] in February of this year from local bond market. This is in line with the inversion in the spread between local and overseas bond markets.

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[12] India's Reliance Industries raises $2.4 bln in mega local bond sale | Reuters

[13] India's HDFC raises $3 bln in largest-ever local bond issue-bankers | Reuters

5. Regulatory and other developments

5.1 Performance under the Insolvency and Bankruptcy Code[14]

IBC has proved to be a progressive step bringing about a major change in the insolvency landscape of India. The code was introduced seven years ago and has been amended six times to address emerging needs of the Indian insolvency ecosystem. The code has been successful in dealing with insolvency issues and shielding the Indian economy from the adverse impact of bankruptcies. Its implementation and planned amendments show promise of further improvement in the years to come.

As per data reported in IBBI's quarterly newsletter and since the implementation of IBC, as of 30 September 2023, 7,058 cases were admitted under CIRP. Out of the admitted cases, 5,057 cases have been closed and 2,001 cases are ongoing. Corporate debtors were rescued in 2,808 cases through approval of resolution plan (808 cases), withdrawal u/s 12A of IBC (947 cases) and by appeal/review/settled (1,053 cases). Corporate debtors in 2,249 cases ended in orders for liquidation. It is noteworthy that out of 808 cases resolved under IBC, 138 cases had admitted claim amounts greater than US$120m each.

The average time taken for closure of CIRPs yielding resolution plan (i.e., from admission till NCLT approval) is about 541 days (far exceeding the original planned timeline of 180 days). This does not include the time taken to admit cases and time excluded by Adjudicating Authority, which would further extend the recovery timelines for creditors. To address such issues, the Government is considering addition of dedicated "admission benches" at NCLTs so that process of admission or rejection of admission applications can be expedited. The Regulators (including RBI and IBBI) are also continuously engaging with the stakeholders. Recently, the RBI Governor shared his thoughts on the delays in resolutions under IBC and possible way forward to address the issues. These include realigning the dynamics between creditors and corporate debtors, reaffirming the role of financial creditors, envisaging a group insolvency mechanism and development of a vibrant secondary market for stressed assets.

As per the latest quarterly report of September 2023 released by the Insolvency and Bankruptcy Board of India, the banks, financial institutions, and other creditors of stressed companies have realized ~US$38b since inception of IBC through NCLT-supervised corporate insolvency resolution

[14] IBBI's quarterly newsletter – September 2023

processes against total claims of ~US$119b till 30 September 2023, a recovery of ~32%. On an aggregate basis, since implementation of IBC, the creditors have realized 169% of the liquidation value and 86% of the fair value. The haircut for creditors relative to the fair value of assets was less than 14%, while relative to their admitted claims is around 68%.

Interestingly, in a recent development, the lenders of Appu Hotels Limited recovered 100% of their dues of ~US$47m under IBC. The resolution applicant provided a two-year debt facility to Appu Hotels at a coupon of 17% p.a. It would be noteworthy that three financial service providers - Dewan Housing Finance Corporation Limited, Srei Equipment Finance Limited and Srei Infrastructure Finance Limited, have been successfully resolved through insolvency resolution process with the creditors realizing ~42% of their claims. The CIRP in respect Reliance Capital Limited is currently underway.

In our earlier reports, we discussed the case of State Tax Officer v. Rainbow Papers Ltd., which unsettled the prevailing legal position regarding the rights of financial creditors and statutory dues. In a recent development, the Supreme Court dismissed a batch of five review petitions that sought a review of its judgment in the case, noting that the grounds for review were not met. This dismissal indicates that the legal position specified by the Apex court earlier will remain intact, and tax authorities keen to recover tax dues, will enjoy the same rights as secured creditors under the IBC waterfall mechanism.

Further, we discussed the voluntary insolvency process initiated by GoFirst and the rights of the lessor thereof. Recently, MCA amended the IBC to exclude aircraft, engines, airframes, and helicopters from being held by lessees who come under moratorium protection. This will not only allow aircraft lessors to be able to repossess their aircraft, but also encourage aircraft financiers/creditors by making aircraft financing efficient and viable.

In connection with Pre-packaged Insolvency Resolution Process for MSMEs, only 6 applications have been admitted as of September 2023. Out of these one has been withdrawn, two are undergoing the process and the resolution plans have been approved in three cases. The industry has been urging the government for such a framework (or a similar creditor-led mechanism) for larger firms.

In November 2019, the central government had tweaked the bankruptcy law to allow personal insolvency cases against guarantors of corporate entities that fail to honor their debt. In November 2023, the Supreme Court dismissed more than 200 petitions and upheld the constitutionality of provisions of IBC relating to Personal Guarantors' Insolvency Resolution. The Apex Court denied reprieve to the personal guarantors in case of default by a company under the IBC. This decision will help creditors to aggressively pursue action against ousted promoters of several companies that underwent insolvency resolution. The lenders can, through the insolvency resolution of the personal guarantor, recover the portion of debt that had not been recovered in the corporate insolvency resolution process of the principal debtor.

To understand and assess the impact of resolution process on rescued firms, a recent study was conducted by Indian Institute of Management Ahmedabad. The study examined the performance of the firms, against their peers by sector and size, both before and after the resolution process. The report revealed that the IBC framework has yielded, for the resolved firms:

- 76% increase in average sales,
- 50% increase in average employee expenses which could be attributed to increased employment generation,
- 50% increase in average total assets,
- 130% increase in capital expenditure
- Threefold increase in market valuation of resolved firms (from US$24b to US$72b), and
- Improvement in liquidity of the resolved firms by about 80%.

While the above outcomes are pursuant to the admission of cases under of the code, it would be imperative to consider the impact of IBC in a more holistic manner. The credible threat of IBC has significantly changed the creditor-debtor relationship. The debtors are keen to resolve the stress, even before the admission of the case before the NCLT, to avoid a change of hands of the company and other consequences of the resolution process. This is evident from the fact that more than 26,000 applications (with a default of ~US$112b) for initiation of CIRP filed before the NCLT have been resolved even before admission of the case by the courts.

A committee was constituted under Ministry of Housing and Urban Affairs examined the issues relating to legacy stalled real estate projects. The committee concluded that the primary reason for stress in real estate projects is lack of financial viability of these projects, which has resulted in cost overruns, project and time delays. The committee observed that the steps to improve the IRR of these projects would attract more funding, and judicial interventions such as IBC should be used only as a last resort. Further, IBBI in its discussion paper has proposed real estate specific amendments (such as mandatory registration under RERA, separate resolution plan for each project, etc.) to address issues in insolvency process of real estate projects.

The introduction of group insolvency and cross-border insolvency frameworks is under consideration by the law makers in India. These shall enable value maximization as well as avoid multiple insolvency proceedings. However, the group insolvency is not new under IBC and there have been notable cases of judicial consolidation such as Videocon group companies, Lavasa group and consolidation of FISPs - Srei Equipment Finance and Srei Infra Finance Ltd.

5.2 ARC related activity

Due to low levels of GNPA in last few quarters, the supply of loans to ARCs is expected to remain moderate in the near term. The ARC sector is likely to witness a transition towards higher supply of retail bad loans and higher proportion of cash deals. Further, the RBI is in process of formulating a framework for securitization of stressed assets, which currently can be undertaken by ARCs under regulatory norms only, through the Special Purpose Entity route.

On the Bad Bank front[15], lenders have referred 125 accounts with debt exposure of ~US$42b for evaluation to NARCL. As against this NARCL has aggregated debt of over ~US$7b covering 8 assets so far. This is despite NARCL submitting binding offers in 30 accounts with aggregate debt exposure of ~US$21b. Further, due diligence is already underway in another 30 accounts having debt exposure of ~US$8b. While the GoI has renewed its guarantee, the reluctance of lenders to accept security receipts (SRs) and the time taken in negotiation and valuation of stressed loans have impacted the transaction closures by NARCL.

5.3 Development in alternate investment framework

5.3.1 Reserve Bank of India Notification on investments in AIFs

In a significant development, having an impact on credit funds, the Reserve Bank of India (RBI) issued Notification dated 19 December 2023 restricting regulated entities (RE) from making investments in any scheme of AIFs which has downstream investments directly/indirectly in a debtor company of the RE. Regulated entities would include banks, NBFCs as well as all India Financial Institutions such as SIDBI and NIIF. The notification seeks to restrict transactions that entail substitution of direct loan exposures of lenders to borrowers, with indirect exposures through investments in AIF, in what is popularly described as 'evergreening of loans' or concealment of NPAs.

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[15] *https://www.business-standard.com/economy/news/reluctance-to-accept-receipts-lengthy-negotiations-hit-narcl-s-work-exec-123092700678_1.html*

In case lenders have aforementioned investments, they were given 30 days to liquidate them. Further, if lenders are not able to liquidate their investments within this time limit, they have to make 100% provision on such investments. In addition, the notification also provided that investment by REs in the subordinated units of any AIF scheme with a 'priority distribution model' shall be subject to full deduction from RE's capital funds. Furthermore, the RBI has introduced a 12-month lookback period for classifying a debtor company, which is retrospective in nature. The intent of the circular is to prevent any evergreening of loans disbursed by regulated entities by routing funds through an AIF and keeping the account of the debtor standard/performing.

The industry has been in dialogue with the RBI to seek some clarifications/relaxations in the applicability of the circular. Collaboration among regulators and various stakeholders remains crucial in navigating this transformative phase, ensuring the AIF ecosystem which has played a significant role in domestic capital formation, continues to thrive while upholding investor interests.

5.3.2 SEBI consultation paper on to enhance trust in AIF ecosystem to facilitate ease of doing business[16]

To ensure sustained capital formation, SEBI believes it is important to take steps to restore the trust and prevent circumvention of financial sector regulations. Accordingly, it issued a consultation paper on 19 January 2024, that identifies the areas where it believes financial sector regulations are circumvented and proposes to introduce a general obligation in AIF regulations that would require AIFs, Managers of AIFs and the Key Management Personnel of AIFs to ensure that AIFs do not facilitate circumvention of extant financial sector regulations. The specific verifiable standards to demonstrate adherence to this obligation are proposed to be formulated by the pilot Industry Standards Forum for AIFs, in consultation with SEBI. Specifically, SEBI has proposed that the following provision be introduced in the AIF Regulations:

"Every Alternative Investment Fund, Manager of the Alternative Investment Fund and Key Management Personnel of the Manager and the Alternative Investment Fund, shall carry out specific due diligence, as may be specified by SEBI from time to time, with respect to their investors and investments, before each investment, to prevent facilitation of circumvention of extant regulations administered by any financial sector regulator. Provided that, if participation of an investor of an AIF in an investment opportunity has been ascertained to result in facilitation of circumvention of any extant regulation, the manager of the AIF shall –

- not make the investment; or
- exclude the particular investor from the investment"

SEBI shall prescribe a framework under the above-mentioned regulation, to specify the objectives and the regulatory principles envisaged to address regulatory circumventions. Public comments are invited for the proposal given above by 11 February 2024.

[16] *SEBI consultation paper on 19 January 2024*

6. New fund setup and deal activity

6.1 Fund raising[17]

Based on data published by SEBI, in H2 2023, at least 11 new AIFs have registered with credit/special situation orientation. As on 31 December 2023, 45 AIFs are in the process of registration with SEBI, with at least five of them being private credit funds.

The H2 2023 witnessed continuous fund-raising announcements. Based on select public information, the following key fund raisings were announced:

- Edelweiss Alternatives raised ~US$1b for its third special situation fund – ISAF III
- AllianzGI has closed fund raise for its secured lending fund of ~US$610m with target returns in mid-teens and ticket size of ~US$25–60m
- Capri Xponentia is raising its fund with a target of ~US$240m. The fund recently concluded a first close at ~US$53m
- Vivriti Group closed fundraising for its three private credit funds with cumulative ~US$200m
- Axis Asset Management launched a private credit fund and is aiming to raise ~ US$150m. The fund will be sector agnostic and will seek to generate gross yields in the 13–14% range
- Sundaram Alternates completed raising ~133m for its corporate credit opportunities fund which shall provide debt finance to MSMEs. Sundaram Alternates also launched its high-yield credit fund which shall raise ~ US$180m, including green shoe option of ~US$90m, with target returns of ~18–22%
- True North raised ~US$120m for its private credit fund. The fund will extend performing credit to mid-market companies, with expected IRR of 15–18% and ticket size of ~US$10–25m
- Nippon made first close of its credit fund with a target of ~ US$120m. The fund is expected to have a ticket size of ~US$10–15m
- Modulus Alternatives (formerly Centrum Alternatives) is raising its second private credit fund. The target commitment is ~ US$90m with a green shoe of ~US$60m

[17] *News articles*

6.2 Investments: deployment during CY2023[18]

In this section we have reported on the private credit investments in CY 2023 deals based on publicly available data including regulatory filings, press releases etc. Kindly note that the analysis presented below does not include venture debt deals, investments into financial services players, term loans / WCLs disbursed by NBFCs and offshore bond placements by Indian corporates. We have also taken a cut-off of single private placement over US$10m for the purpose of our analysis.

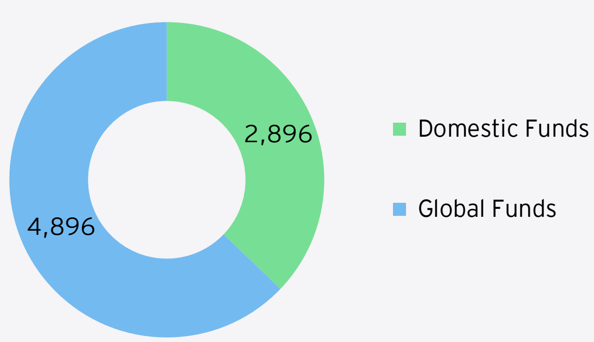
In CY 2022, private credit deal activity witnessed a significant slowdown in H2 2022 (US$1.22b) vis-à-vis H1 2022 (US$4.08b) primarily on account of elevated geopolitical uncertainty and increase in interest rates starting May 2022. Now that the interest rates seem to have peaked, we have seen better deal flow in CY 2023 vis-à-vis deal activity in CY 2022 (CY 2022: 77 deals and US$5.3b versus CY 2023: 108 deals and US$7.8b).

One of the reasons for the surge in deal value in CY 2023 is on account of two high-value deals, namely the large refinancing round at Shapoorji Pallonji group and Oaktree's investment in Vedanta group, collectively amounted to US$2.4 billion.

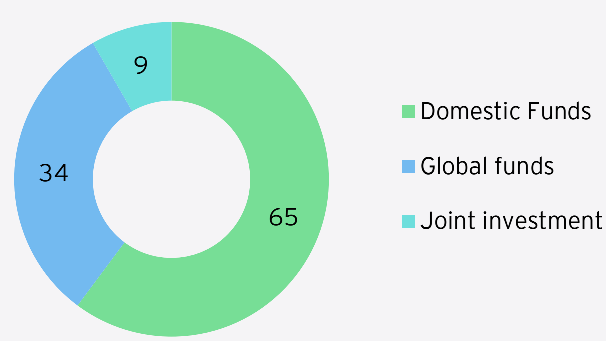
6.2.1 Global funds versus domestic funds

In the chart below we have split the investments made in CY 2023 by Global Funds and Domestic Funds. Global funds comprise institutions headquartered outside India and with a multi-country presence. Domestic funds on the other hand are headquartered in India. In our report for CY 2022, we had noted that global funds, by virtue of their preference and ability to do large deals, contributed about 56% of total investments made in private credit deals in CY 2022. The distribution of private credit transactions has continued the same trend in CY 2023. Global funds contributed to approximately 63% of the total deals by value in CY 2023. However, it is interesting to note that the domestic funds did 61% of the deals by number in CY 2023 by virtue of their focus on the corporate mid-market, local presence, and deal origination capabilities.

Share of total investments made in private credit deals (US$m) between Global and Domestic Funds



Share of private credit transactions by deal count between Global and Domestic Funds

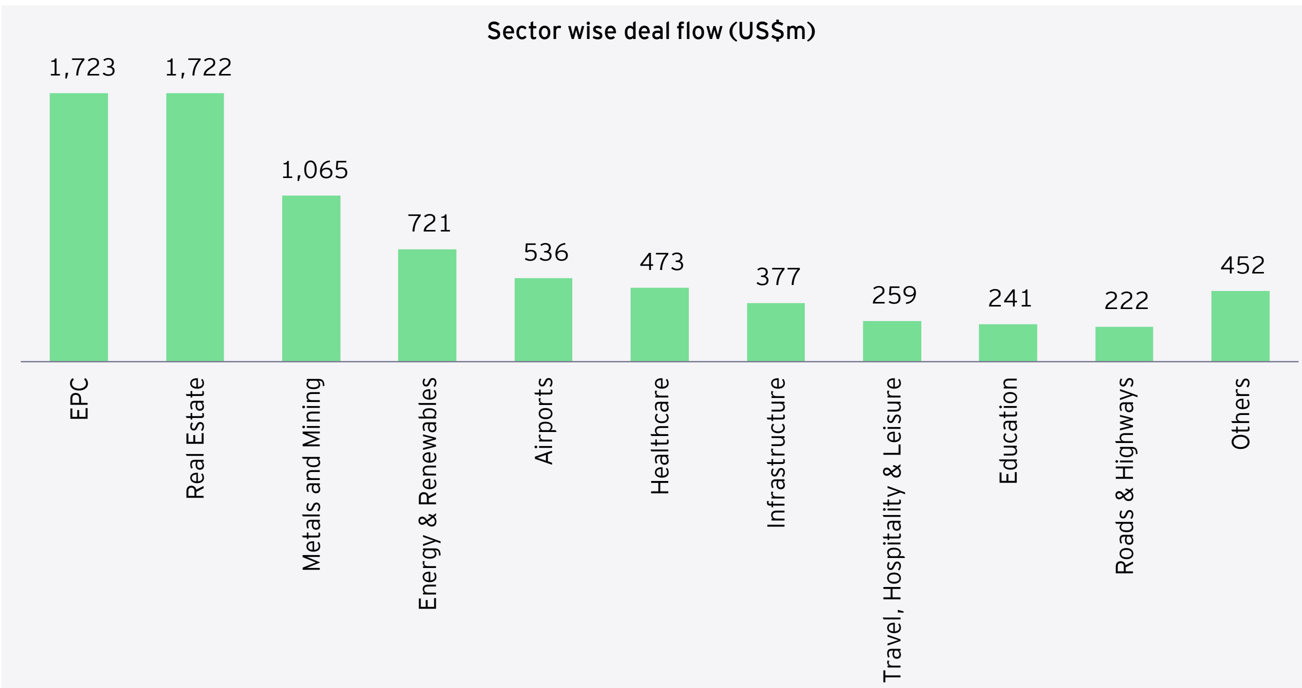


[18] *EY analysis and Company filings*

6.2.2 Sectoral dynamics of private credit deal flow

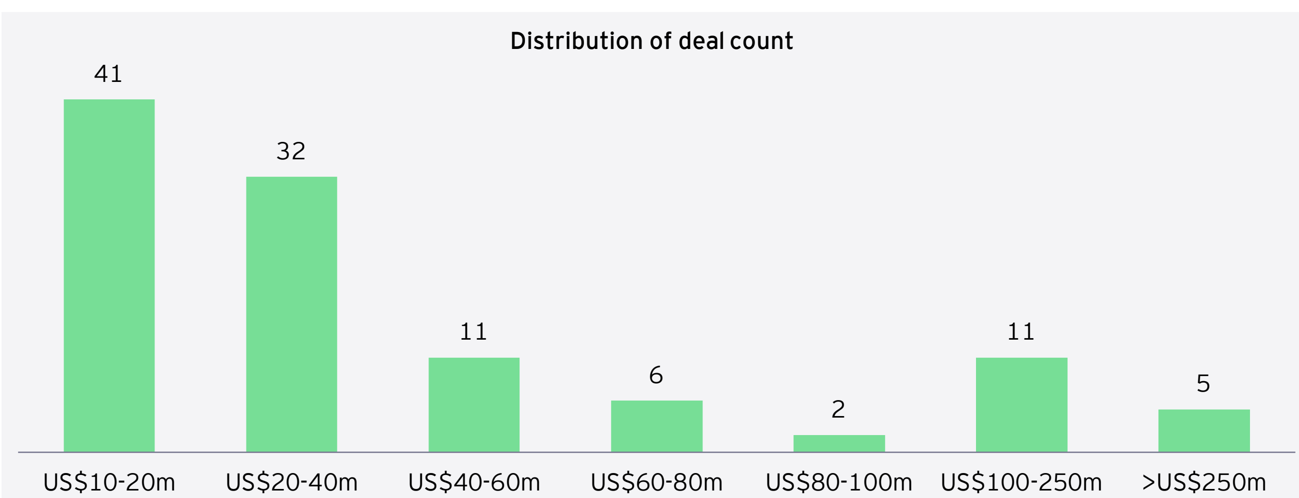
In the chart below, we have presented the sectoral split of the private credit deals in CY 2023. EPC includes Shapoorji Group's refinancing of US$1,723m. Real estate continues to remain the dominant sector in terms of deal value ~22% of total deal value and more than 50% by deal count.

Notable deals in the metals and mining sector include Oaktree's investment in Vedanta and the investment by Kotak, Edelweiss and Allianz of US$386m funding in Jayaswal Neco. A summary of marquee deals by sector has been presented at the end of the section.



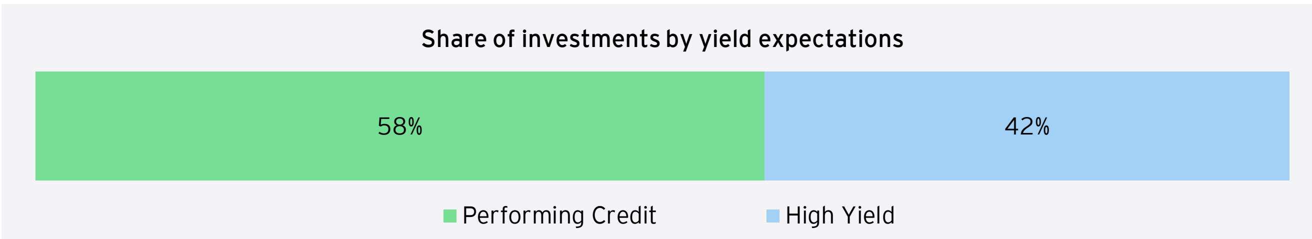
6.2.3 Distribution of deal size

In the charts below we have presented the distribution of deal count by size of deal. Deals over >US$100m represented 15% of the total deal count but from a deal value perspective contributed to over 67% of the overall deal value in CY 2023.



6.2.4 Target yield of private debt investors

Based on the publicly reported target IRR's we have also split the total investments into high yield (>18%) and performing credit (<18%) and the same is presented in the chart below.



6.2.5 Summary of marquee deals in CY 2023[19]

Month	Borrower	Investor group	High yield	Deal rationale	Amount US$m	Average of tenure (years)
EPC						
June	Goswami Infratech Private Limited - Shapoorji Pallonji Group	Apex Management, Davidson Kempner, Deutsche Bank, Farrallon Capital, IIFL, Nomura, Omers, SSG Asia, Standard Chartered, Synergy Capital, Varde	High Yield	Refinancing / Stress	1,723	3
Metals and Mining						
September & December	Vedanta Limited	Oaktree Capital	High Yield	Refinancing / Stress	711	1-2
December	Jayaswal Neco Industries Limited	Edelweiss, Allianz, Domestic Corporates and Kotak Strategic Situations Fund	High Yield	Refinancing / Stress	386	5
November	Cropnosys (India) Private Limited	Kotak	High Yield	Capex / Bridge to IPO	36	5
Airports						
November & December	GMR Airports Limited	Deutsche Bank, J P Morgan, Standard Chartered, Trust Group, Varde, Aditya Birla, Standard Chartered	Performing Credit	Refinancing	331	3
November	GMR Goa International Airport Limited	Aditya Birla, India Infrastructure Finance Company, JP Morgan, Tata Cleantech	Performing Credit	Refinancing	225	20
Energy & Renewables						
March	Avaada Ventures Private Limited	Brookfield	Performing Credit	Growth financing	396	8

[19] *EY Analysis, Public Filings*

Month	Borrower	Investor group	High yield	Deal rationale	Amount US$m	Average of tenure (years)
December	GI Hydro Private Limited (formerly known as Gati Infrastructure)	Allianz Global Investors, Nuvama Wealth and Investment, Trust Group	High Yield	Refinancing / Stress	117	3
Healthcare						
February and May	Biocon Limited	Kotak Special Situations Fund, Edelweiss	High Yield	Acquisition financing	189	4-6
July, September and October	Manipal Healthcare Private Limited	IIFL / 360 One	Performing Credit	Acquisition Financing	181	3
Real Estate						
September and November	Twenty Five South Realty Limited	Oaktree Capital	High Yield	Real estate project financing	193	2-3
August	Candor Gurgaon One Realty Projects Private Limited	Brookfield, GIC	Performing Credit	Real estate project financing	128	10
July, August, September and November	Phoenix It City Private Limited	Varde	High Yield	Real estate project financing	114	3
Education						
May	Aakash Educational Services Limited	Davidson Kempner	High Yield	General corporate purpose	241	3
Travel, Hospitality & Leisure						
January	Bharat Hotels Limited	Kotak Real Estate Fund	Performing Credit	Refinancing	133	5
May	Moonburg Power Private Limited (acquisition of Leela Hotels)	Brookfield, Deutsche Bank	Performing Credit	Acquisition financing	57	3-10
January	Kamat Hotels (India) Ltd	Alt Alpha, SBI Special Situations Fund	High Yield	Refinancing	36	4
Roads & Highways						
March	Kashi Tollway Private Limited	NIIF	Performing Credit	Growth financing	97	15
October	Thrissur Expressway Limited	Edelweiss Infrastructure Yield Plus	N/A	Refinancing	69	13
Infrastructure						
March	Tulsyan NEC Limited	Edelweiss credit opportunities	N/A	Refinancing	32	5
May and December	NASDA Infra Private Limited	360 One and Investcorp	Performing Credit	Refinancing	62	10
February, March, May and June	GMR Enterprises Private Limited	Synergy Capital, Neo Capital	Performing Credit	Refinancing	57	1-3
Automobile & Components						

Month	Borrower	Investor group	High yield	Deal rationale	Amount US$m	Average of tenure (years)
June	Viney Corp	Kotak Strategic Situations India Fund	High Yield	Refinancing and Acquisition financing	52	4
August	Shivam Autotech Limited	Centrum	Performing Credit	Refinancing	18	2
Logistics & Transportation						
September	T.S.Rajam Rubbers Private Limited	ICICI Prudential Corporate Credit Opportunities Fund, JM Financial	Performing Credit	Refinancing	31	3
September	Avigna Private Limited	Barings Private Equity Asia Credit	Performing Credit	Refinancing	9	4
Capital Goods						
September	Steamhouse India Limited	Barings Private Equity Asia Credit	Performing Credit	Capex financing	9	5

6.3 Exits: select investment exits during CY 2023[20]

In this edition of our report, we have commenced coverage of private credit exits during CY 2023 based on publicly reported information or information shared with us by exiting funds. A summary of select exits has been presented below -

- The companies from which Edelweiss Alternatives concluded exits in 2023 included Steel Exchange, Viceroy Hotels, Chenani Nashri, Jupiter International, Tilaknagar, Platinum Holding, Kohinoor Planet Constructions, Max Group, Adarsh Realty and Hotels, Sterling Group, PR Jindal Group, and MTC Group. The total invested amount was ~US$440m.
- Kotak Special Situations Fund exited its investment of US$30m in Sanjaya Mariwala's Special Purpose Vehicle, SJM Capsol, in August 2023. Kotak had provided acquisition finance in December 2020 to help the latter buy-out two B2C supplement businesses and to provide dry-powder for further investment in the nutraceutical's businesses. We understand that the exit has happened on the back of funding from Investec Capital.
- Piramal Structured Credit Opportunities Fund holding CCDs worth ~US$19m (subscribed in August 2022) in Azad Engineering were converted to equity shares in December 2023. With launch of IPO in December 2023, PSCOF received a complete exit.
- Investec exited its investment of US$19m in Incor Hospital made in March 2022. We understand that the company has raised funding from BPEA Credit fund which will be partly used to refinance the investment from Investec.
- Veld Capital has also announced sale of its education-infrastructure assets to a large private equity investor. At the time of exit, the portfolio comprised nine distinct K-12 school and student housing assets, with a total built up area of 1.6m square feet and total enrolment in excess of 11,000 students.
- Modulus Alternatives received complete exit from ~US$16m investment in convertible securities issued by NDR Warehousing Private Limited through the proceeds of additional equity investment in the company.

[20] Publicly available information and regulatory filings

- Modulus Alternatives also received a complete exit from ~US$8m investment in Kalpataru Group
- Goldman Sachs-backed Samhi Hotels secured credit from Citi Bank to refinance a US$90 million high-cost loan from Cerberus and Standard Chartered, strategically aligning with the proposed public offering of shares having a portfolio of marquee hotels across India.
- Shapoorji Group has raised US$1,723m from a consortium of lenders of 11 lenders (please refer deal table for details of the lenders). The amount raised will be used to refinance the existing non-convertible debentures issued by the company in CY 2021/22. The funding in CY 2021/22 was primarily done by Ares SSG and Farallon who are also participating in the new round of refinancing along with other 9 lenders.

We also understand that there some exits in the pipeline which will materialize in CY 2024 such as Kesoram Cements (lenders include Goldman Sachs, Edelweiss and Cerberus) and Ind Swift Laboratories (Edelweiss).


7%
24%
20%

7. EY private credit pulse survey

7.1 About the survey

We have initiated a periodic survey of private credit market in India to gauge market dynamics and detect shifts in the industry's overall direction. The survey, conducted in January 2024, involved senior leaders from prominent Indian and global high-yield and performing credit funds.

7.2 Summary of survey

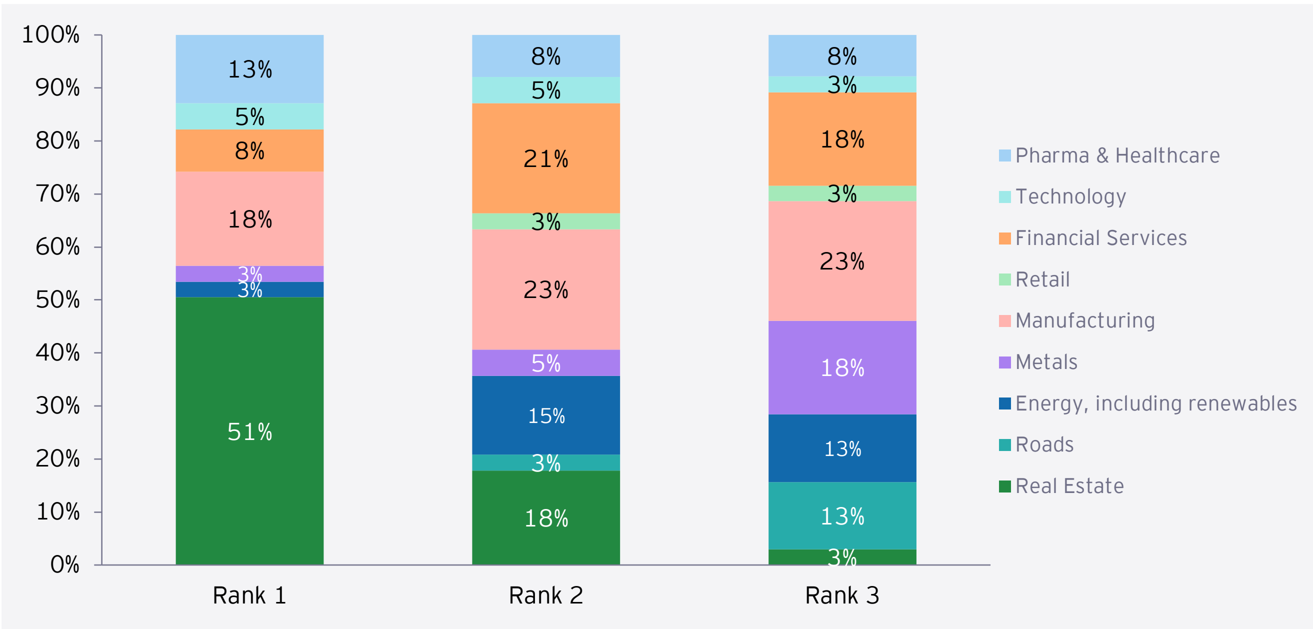
Our survey findings reveal that 72% of respondents had a target yield of 18–24% (high yield) and 28% targeted 12–18% (performing credit). Real estate was favored by half of the respondents, with manufacturing and financial services in close pursuit. Interestingly, real estate was also perceived as the riskiest sector in the current private credit portfolio. Capital expenditure followed by stress-related and working capital financing has driven the current deal flow and the fund managers anticipate same over the next 12–24 months.

While optimism exists regarding sufficient fund availability for private credit deals, competitiveness in the industry has intensified over recent years. Respondents suggest an overall private credit investment of US$5–10b in CY 2024. In line with our past surveys, there is an indication of a slightly more bullish outlook in the two to five-year horizon compared to the next one to two years.

Lastly, our Private Credit Senti-meter indicates a low to moderate contribution from domestic family offices to the overall private credit deal flow.

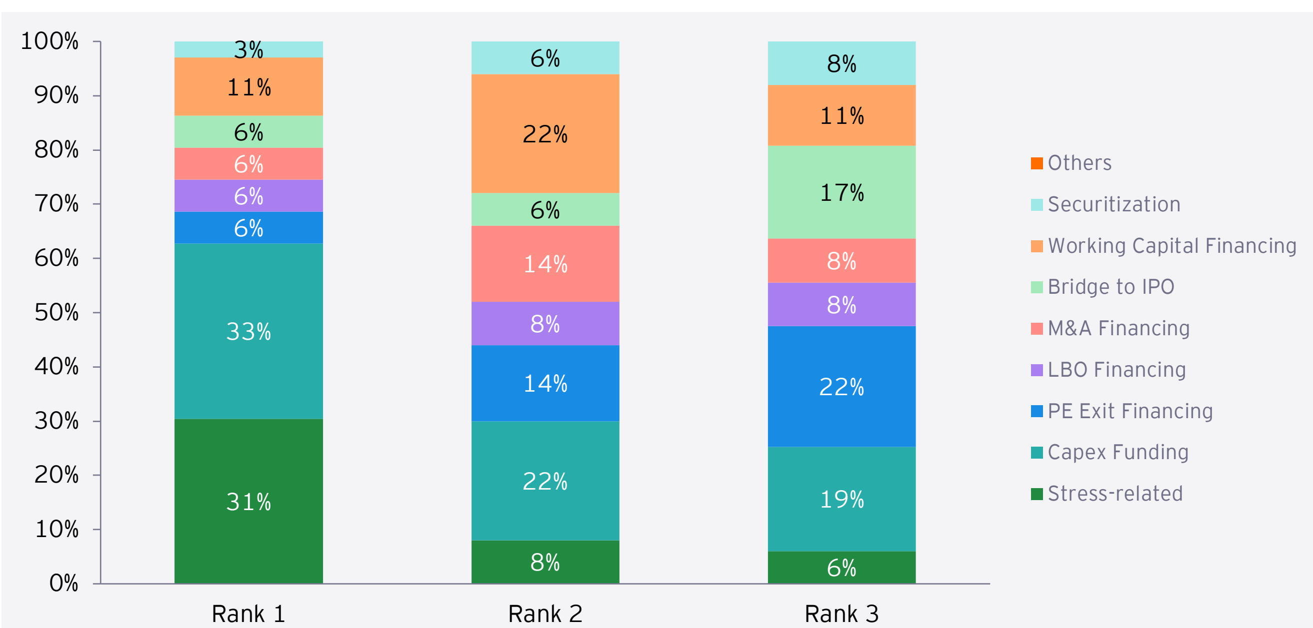
7.3 Detailed results

Q1. Assuming you are a sector agnostic fund, rank the sectors in order of deal flow
(Rank 1 indicates the maximum deal flow)



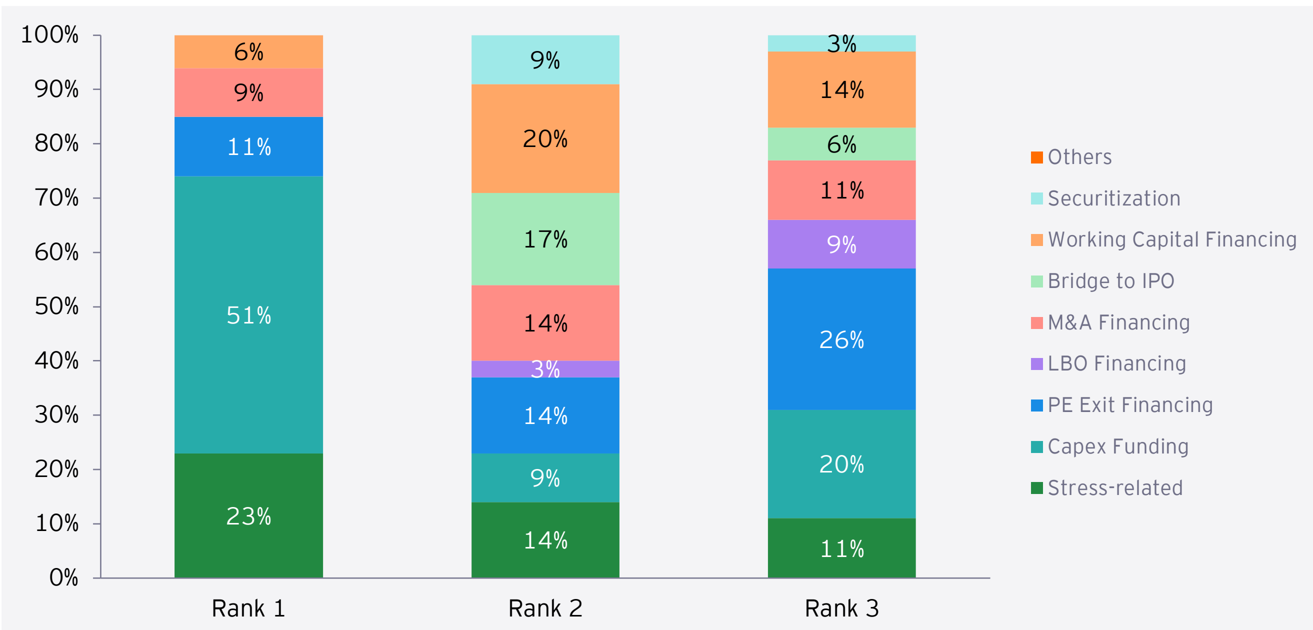
In the current survey, the 50% of respondents favored real estate as their top sector, 95% of which were from the high-yield segment. Manufacturing and financial services followed closely, receiving 64% of overall votes, of which 68% were from high-yield fund managers. The general sentiment among respondents suggests that retail and technology are expected to have the least deal flow traction. These findings align with similar surveys conducted in June 2023 and December 2022.

Q2. In the current deal flow, rank the drivers of demand for private credit
(Rank 1 indicates the most significant driver)



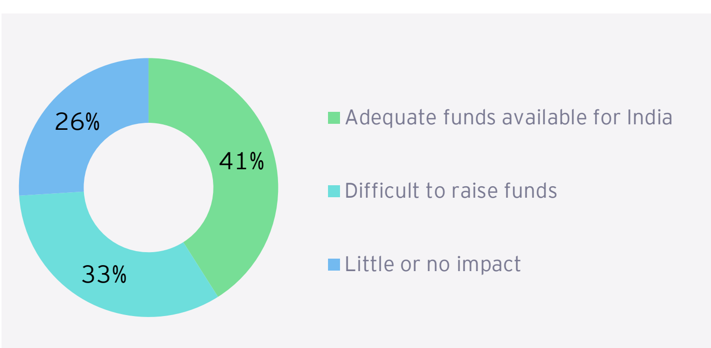
Upon analyzing the survey data, capital expenditure is seen as the foremost driver of private credit deals. Also, stress-related and working capital financing exert notable influence, followed by PE Exit financing. Conversely, securitization occupies the least impactful position in this assessment. Notably, in the December 2022 survey, fund managers predominantly anticipated that Bridge to IPO and special situations would fuel the demand for private credit, with some endorsement for capex financing.

Q3. Over the next 12 to 24 months, kindly rank the drivers of demand for private credit
(Rank 1 indicates the most significant driver)



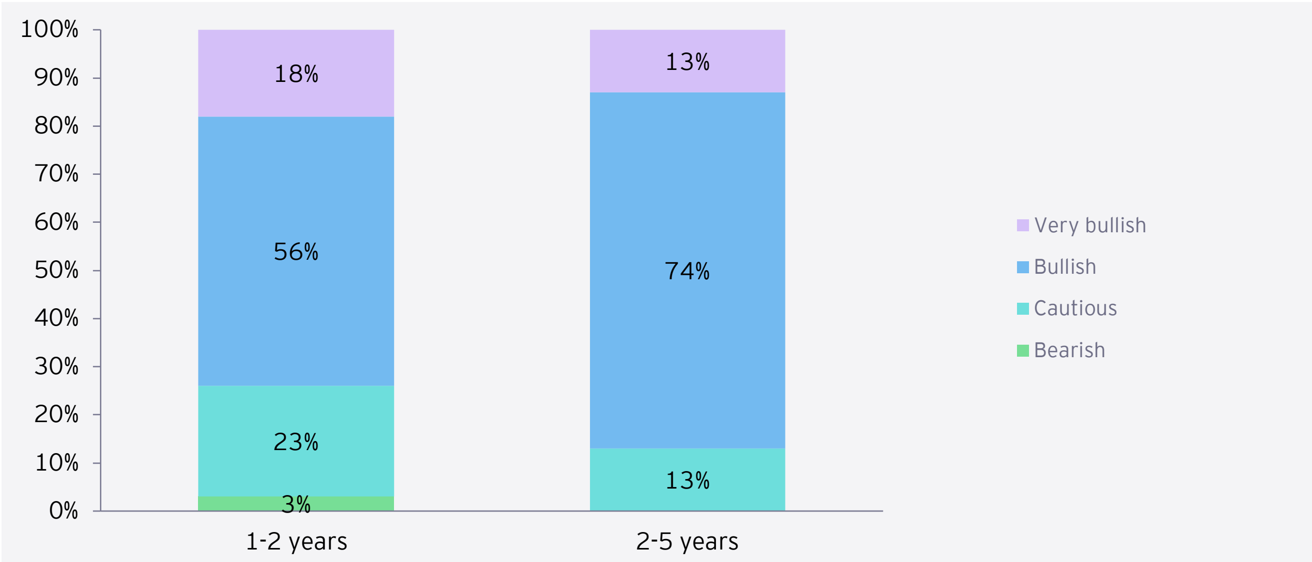
In alignment with the ongoing deal flow drivers, 50% of fund managers anticipate capex to sustain its prominence in driving private credit demand over the next 12-24 months. Stress-related and working capital financing, coupled with PE Exit financing, are identified as the subsequent favored drivers.

Q4. What would be the impact of ongoing monetary tightening on the availability of funds over next 12 months, for private credit investing in India?



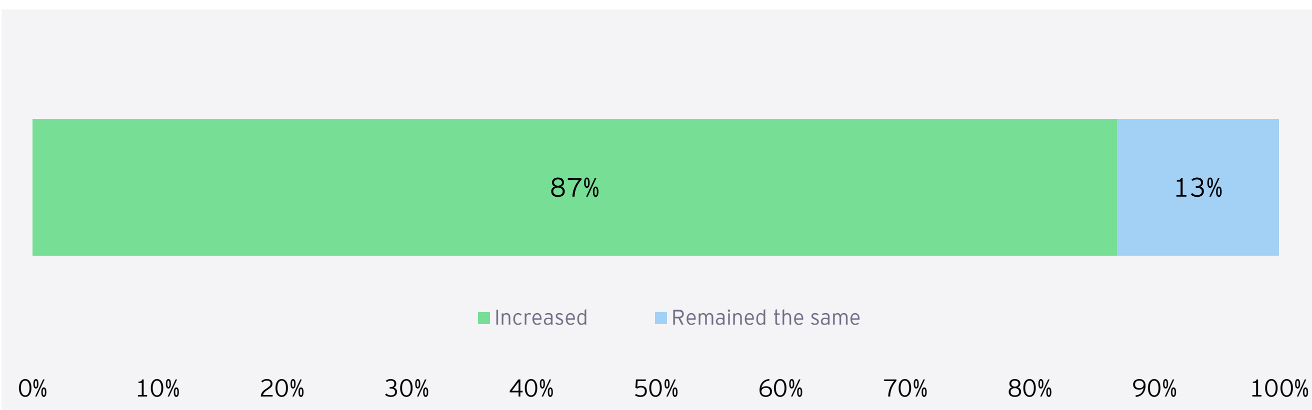
The survey reflects optimism among fund managers where 41% foresee sufficient funds and 26% expect minimal impact during the ongoing monetary tightening.

Q5. What is the overall sentiment for private credit over the next one to two years and two to five years?



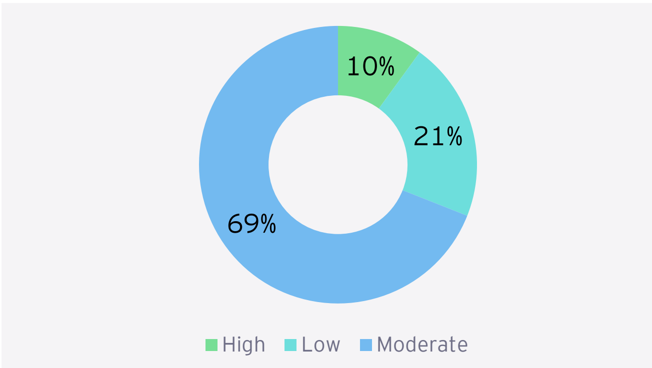
Where 75% of funds managers are positive (bullish and very bullish) on private credit investment for the next one to two years; the corresponding number is 87% over two to five years. Among high yield fund managers, 75% expect the bullish trend to continue in the next one to two years, and this confidence rises to 86% for the two to five years horizon. All performing credit funds show a positive sentiment in both time frames. It is worth noting that the overall sentiment remains consistent compared to the survey conducted in December 2022.

Q6. Over the next 12 months, will the competition for private credit deals increase, decrease or remain the same?



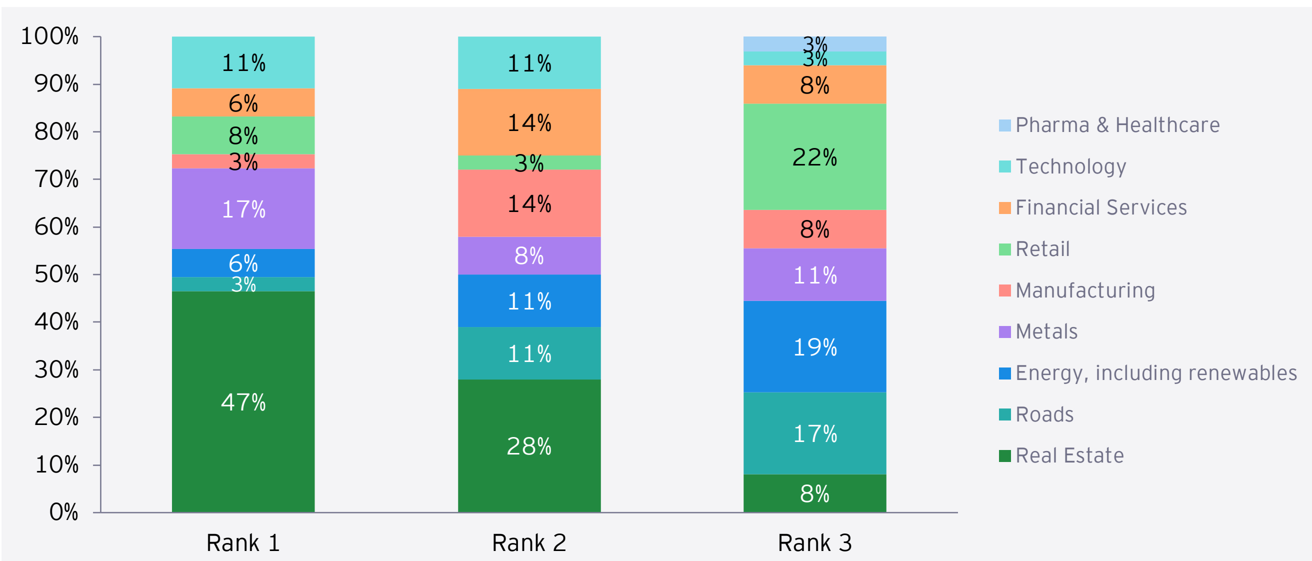
87% of investors believe that competition in private credit deal has increased over the last 12 months. The perception of competitiveness in the private credit industry seems to have become intensive in the current survey as compared to the last survey in June 2022.

Q7. What is your estimate of default risks residing within the current private credit portfolio in India?



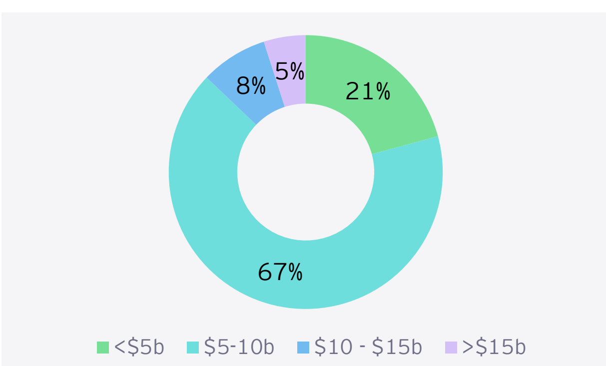
Most fund managers estimate that the default risk residing within the current private credit portfolio in India is moderate. It is noteworthy that none of the performing credit funds believe it is high.

Q8. Which of the sectors within the India private credit portfolio are at the highest risk of default?
(Rank 1 indicates the highest risk of default)



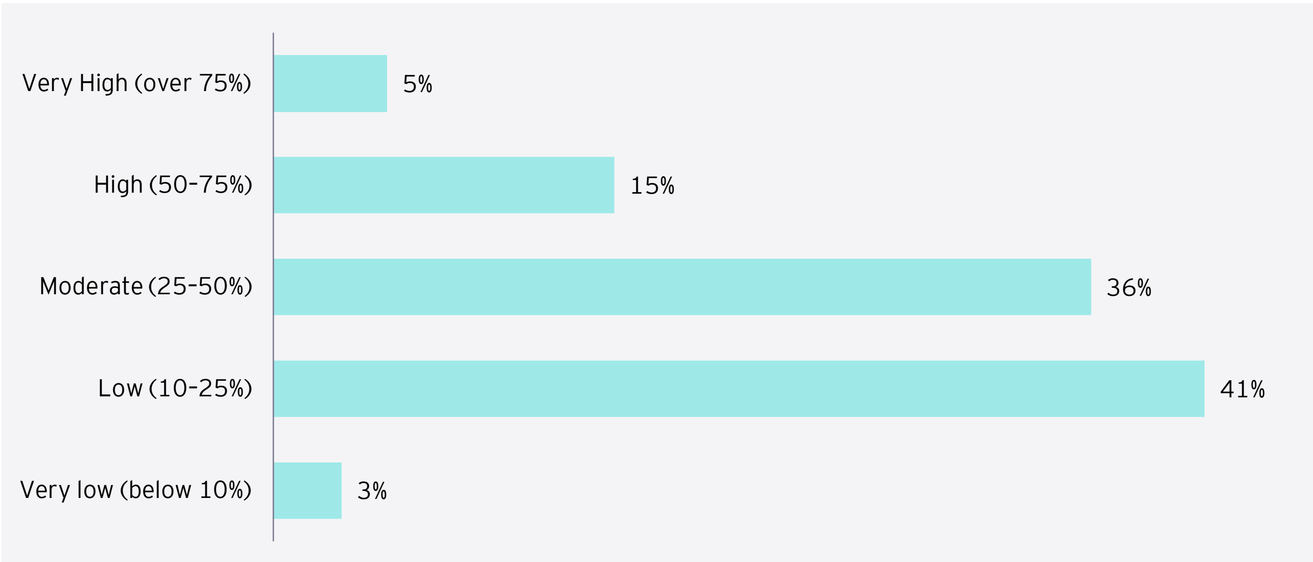
Consistent with previous survey findings, fund managers identify real estate as the riskiest sector within the present private credit portfolio.

Q9. What do you think will be the estimated total investment by private credit in CY 2024?



The prevailing viewpoint is that the overall investment in India by private credit players will lie within the US$5-10b range in CY 2024.

Q10. What proportion of the private credit fund flow in India is contributed by investments from domestic family offices?



77% of fund managers perceive a low to moderate contribution from domestic family offices to the overall private credit deal flow.

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9. Glossary

Term	Full Form
AIF	Alternative Investment Fund
AMC	Asset Management Companies
ARC	Asset Reconstruction Company
AUM	Assets Under Management
b	Billion
B2C	Business-to-Consumer
CCD	Compulsorily Convertible Debentures
CIRP	Corporate Insolvency Resolution Process
CPI	Consumer Price Index
CY	Current Year
ECB	External Commercial Borrowings
FDI	Foreign Direct Investment
FISPs	Financial Institutions Service Providers
FPI	Foreign Portfolio Investment
FY	Financial Year
GDP	Gross Domestic product
GFCD	Guarantee Fund for Corporate Debt
GNPA	Gross Non-performing Asset
GoI	Government of India
IBBI	Insolvency and Bankruptcy Board of India
IBC	Insolvency and Bankruptcy Code, 2016
ICC	Infrastructure Credit Companies
IFC	Infrastructure Finance Companies
IPO	Initial Public Offering
m	Million
MSME	Micro, Small & Medium Enterprises
N/A	Not available

Term	Full Form
NARCL	National Asset Reconstruction Company Limited
NBFC	Non-banking financial company
NBFC - ICC	Non-banking financial company - Investment and Credit Companies
NCD	Non-convertible debentures
NCLT	National Company Law Tribunal
NIIF	National Investment and Infrastructure Fund
NNPA	Net Non-performing Asset
NPA	Non-performing assets
OCD	Optionally Convertible Debentures
PE	Private Equity
PSU	Public Sector Undertakings
RBI	Reserve Bank of India
RE	Regulated entities
RERA	Real Estate Regulatory Authority
SBI	State Bank of India
SCB	Scheduled commercial banks
SEBI	The Securities and Exchange Board of India
SIDBI	Small Industries Development Bank of India
SOFR	Secured Overnight Financing Rate
US	The United States of America

All INR amount converted to US$ at INR83 per US$.

Notes

Notes

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