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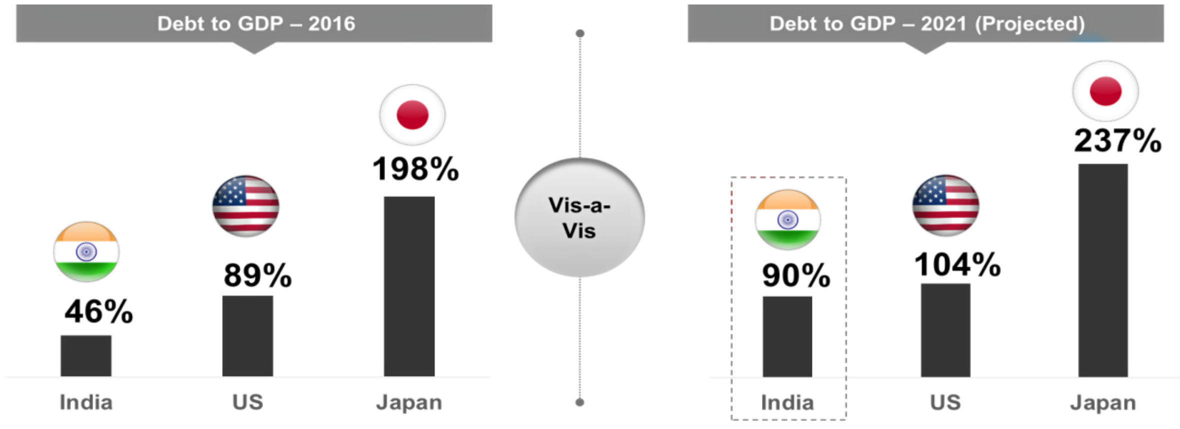
INDIA'S INDEBTEDNESS REACHING AN INFLECTION POINT – IS THERE A SILVER LINING?

The festival season may have masked underlying fears for our economy, and our equity markets may have rebounded amidst pandemic woes, but a looming worry is that Covid-19 will distort India's Debt : GDP ratio to record high levels. As per Moody's, amongst large emerging markets, India will have the highest debt burden by FY 21. A fall in tax revenue due to depressed economic activities coupled with an increase in public spending is expected to cause a steep 17 % points rise in India's Debt : GDP ratio, stretching it to nearly 90%. That should ring alarm bells for policy makers.

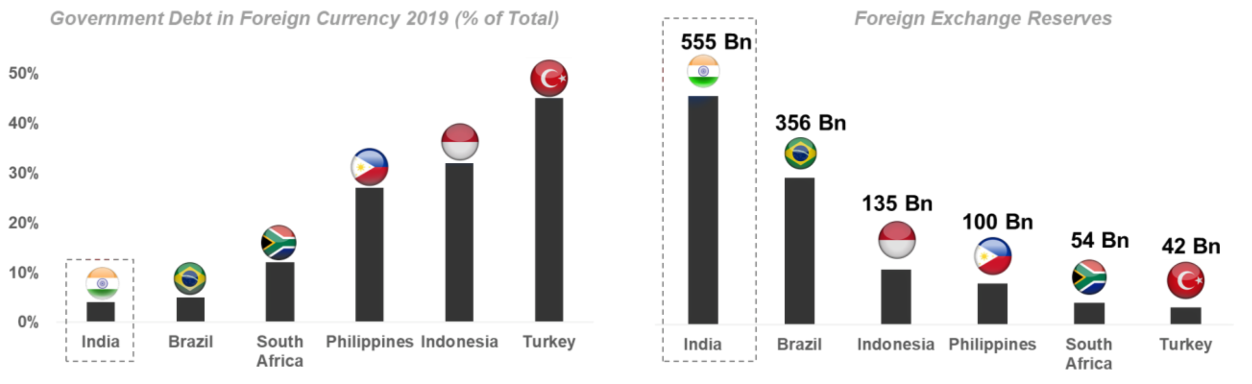


Source: IMF, Trading Economics, Acquisory Analysis

India has consistently maintained a stable Debt : GDP at ~70% over the past decade. With real GDP growth rate hovering around 6.5% between 1991 to 2013, India has successfully lifted millions of people from extreme poverty and has grown its real GDP per capita by over 4X during that period. Over the years, India has made astonishing progress in many areas including Education enrollment, Infant mortality, access to clean water and sanitation and has achieved the millennium development goal of halving poverty by 2015 from 1991 level.

As the pandemic deteriorates fiscal dynamics, India is expected to shave off the progress it made over the years as the country's overall debt is set to tailspin to an unmanageable level. The World Bank reports that Debt : GDP above 77% can significantly impact the long-term growth rate of a country, its credit ratings which in turn may affect foreign funds inflows. A rising Debt : GDP ratio can at times have more severe consequences to the country's sovereign rating compared to the fiscal deficit ratio. India is already at a negative outlook at Baa2. Any further increase in Debt can translate into widening the gap between India and other countries rated in BBB category which have a median Debt : GDP ratio of 42%. Our government introduced Fiscal Responsibility and Budget Management (FRBM) Act in 2003 and adhered to the caps set in there on Fiscal Deficit (~5% of GDP) and Debt : GDP ratio (60%), which now seems to be unravelling.

India's Silver Lining – Low Government Debt In Foreign Currency & High Foreign Exchange Reserves



Source: IMF Staff Report, Trading Economics, Acquisory Analysis

Government should spend, but how?

Despite concerns about the economy and growing debt levels, a possible silver lining exists for India. The country's overall external debt increased from USD 345.8 Bn in 2012 to USD 558.5 Bn today. However, India also increased the share of INR denominated external debt from 21.4% in 2012 to 31.9% in 2020. A higher proportion of debt denominated in INR helps India mitigate its forex risk.

Also, India is blessed with record high foreign exchange reserves which are sufficient to meet any current external debt obligations. Sustainable external debt levels largely depend on the country's future growth rate. A country can comfortably maneuver and control its Debt to GDP level if it grows faster than the interest rate paid on the external debt.

With the private sector still struggling to get a grip in a post-Covid era, the onus to stimulate the economy lies on the government. Kick-starting large infrastructure projects (on the lines of Sagarmala or surface connectivity projects) can have positive spillover effect on the economy. According to McKinsey's report, Bridging Global Infrastructure Gaps, every dollar invested in infrastructure can earn up to 20% incremental economic return.

Another step would be to create further platforms or investment vehicles (on the lines of NIIF) which could attract foreign capital either in form of equity or low-cost debt. India can make use of the current low global interest rate environment by forming such vehicles that can create income generating assets which may in turn deliver higher returns once the economy steers back on the recovery track. Global Financial Institutions have amassed large sums of capital to the tune of USD 120 Tn. Tapping a small fraction of these funds could help bridge India's financing gap. A further step could be to increase indigenous manufacturing so that import bills can be brought down.

Whichever path India may opt for, policymakers need to move fast as India is not the only country within the emerging market basket offering lucrative returns with similar perceived country risks.

Supratik Mukherjee, CFA, FRM

Author's views are personal

A Few Large Transactions Have Been Announced In October

A. Large Commercial RE transactions boost confidence

- **Brookfield invests USD 2 bn in RMZ**
  Brookfield Asset Management will buy RMZ's commercial properties for USD 2 billion. Brookfield is acquiring 12.5 mn sq. ft. of rent-yielding offices and co-working space. This will be the largest transaction in the real estate space in India. The alternative asset manager, which owns and operates 22 mn sq. ft. of office properties in India, has picked advisors for an IPO of its India REIT that could raise at least USD 500 million. The addition of commercial space from RMZ in Bengaluru and Chennai will accentuate Brookfield's existing plans.

- **Blackstone in talks with Prestige for USD 1.6 bn acquisition of commercial properties**
  6 months after launching its 2nd India REIT IPO, Blackstone announced a preliminary deal to purchase USD 1.6 billion worth of commercial property in south India from Prestige Group. Prestige revealed that it had signed a non-binding LoI with Blackstone for the sale of Prestige's office, retail, and hotel properties. The deal estimates that Blackstone would be acquiring 8-10 properties, spanning a total of 15- 20 mn sq. ft. including both completed properties and brownfield assets.

B. Tata Group in talks to acquire majority stake in Big Basket for USD 1 bn

Indian online grocery startup Big Basket is in advanced talks to sell a majority stake to the Tata Group. The deal, which is still evolving, could see the company sell around 50% stake. China's internet giant Alibaba, which holds around 26% stake in Big Basket, is expected to sell its entire shareholding in the company along with a group of early backers in the e-grocery company including Ascent Capital, CDC Group and the Abraaj Group.

C. Edelweiss raises USD 900 mn for structured credit fund

Edelweiss Alternative Asset Advisors announced the final close of its USD 900 million alternative investment fund, Edelweiss Special Opportunities Fund (ESOF) III, its third fund in the ESOF series launched in 2010. The fund will provide structured credit to Indian firms. Foreign investors including Ontario Teachers' Pension Plan Board, Florida's State Board of Administration and Sweden's National Pension Fund AP4 have committed significant funds for this.

D. Adani Port acquires controlling stake in Krishnapatnam Ports for USD 1.6 Bn

Adani Ports & Special Economic Zone (APSEZ) announced the acquisition of Krishnapatnam Port Company (KPCL) for an enterprise value of INR 12,000 crore (USD 1.6 Bn). APSEZ will own 75% stake in KPCL from the CVR Group and other investors. In FY21, the port is expected to generate an EBITDA of approximately Rs. 1,200 crores, resulting in an acquisition EV/ EBITDA multiple of 10X. This acquisition will accelerate APSEZ's stride towards 500 MMT or cargo handling by 2025 and is another step in implementing APSEZ's stated strategy of cargo parity between west and east coasts of India.

E. Home First Finance Company India raises INR 700 crores from Warburg Pincus

Affordable housing loan provider HFFC on Friday said it has entered into definitive agreements with PE investor Warburg Pincus, for an investment of INR 700 crore. The Warburg investment will be a combination of primary fundraise and secondary sales by existing shareholders. Warburg Pincus will join existing PE shareholders True North and Bessemer Venture Partners. Amidst reports of possible upheaval in the HFC market, Warburg's commitment to HFFC indicates that global PE confidence in India's financial services sector is still alive.

F. Festival Season boosts consumer spending, but can this sustain?

- **GST collection crosses Rs 1 lakh crore mark for first time since February 2020**
  GST collections for October grossed INR 1.05 lakh crores, the highest so far in the current fiscal and 10% higher y-o-y. During October, revenues from import of goods was 9% higher and the revenues from domestic transaction (including import of services) are 11% higher that the revenues from these sources y-o-y. We hope the uptick in collections of almost INR 10,000 crore over last year show possible revival of consumption and festival spends across the economy. However, we would also like to caution that some potential reasons for this surge could be the splurged demand because of festivities and input tax credit/ other similar reconciliations which were due for businesses at half – yearly close.

- **Car sales soar in October – Recovery or pent-up demand?**
  India's automotive sector is showing possible signs of recovery with retail sales going up during the festive season. After months of negligible sales, car companies are finally able to take advantage of pent-up demand and showing signs of growth for the next months.

  However, for the auto industry in general, it is still early days, and the recent spurt in sales may not reveal the full story. We believe that some of the main reasons behind this uptick is
  ✓ pent-up demand,
  ✓ festive discounts by companies, and
  ✓ a growing preference for personal mobility as people are now uncomfortable using public transport in both urban and rural markets.

  The question remains whether this in any way indicates a long-term growth trajectory for the ailing auto industry. SIAM believes that automobile sales across segments are expected to fall in the range of 25-45% in FY21. That two wheeler sales have been abysmal bears testament to this apprehension. More than 300 dealerships across the country have already been closed in the last many months. There is worry in the market also about the scenario once the festive season recedes. We are apprehensive that this trend may not be sustainable for the long haul as the industry needs economic catalysts after the festive period to sustain the optimism.

OUR VIEW

After months of severe uncertainty prevailing in the country, last month has given some sense of hope to most.

✓ We believe that the worst of the economic fallout of the pandemic may be behind us.
✓ We have witnessed a surge in demand for small cars, a satisfactory collection of GST and renewed consumer confidence in October 2020, with a possible contribution from the festival season.
✓ Months of "wait and watch" policy by global investors have now given way to renewed interest in several sectors in India. Online retail / E-commerce, logistics sectors and grade A commercial real estate could lead the way towards economic recovery. We also foresee interest continuing in edutech and fintech platforms.
✓ However, as uncertainty prevails for the foreseeable future, we must exercise caution as these sudden upticks could be the result of the *"splurge demand"* creation during the ongoing festival season. We need to maintain caution and watch for the economic winds in the remainder of this fiscal.

GLOSSARY

EV	Enterprise Value
FRBM	Fiscal Responsibility and Budget Management
GDP	Gross Domestic Product
GoI	Government of India
GST	Goods and Services Tax
INR	Indian Rupees
IPO	Initial Public Offering
PE	Private Equity
RE	Real Estate
REIT	Real Estate Investment Trust
Y-o-Y	Year on Year

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IT Risk, Forensics

- Information Security Management Services
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- Technology Risk Solution
- Security Risk Management
- Creative Training Solution

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