Corporate Bonds-Emerging Opportunities

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Corporate bond markets in India can be broadly divided into 2 parts – **Liquid, AAA flow bonds & Others**. While there's a lot of demand, liquidity & wider participation for the former, the latter only has select participants, mainly mutual funds and is shallow and illiquid.

In this paper, we are looking at debt markets in 2 phases – one before the credit events & the changed market dynamics post these events.

Pre-credit events:

The corporate bond markets were relatively mature, with bonds across the rating spectrum, various structures, tenors (including long tenor bonds) being placed regularly. While the volumes weren't very high compared to liquid bond market, still there was adequate activity in this space.

Structures such as acquisition funding, promoter funding against shares, lending to smaller, new-age/nascent NBFCs or balance sheet funding for corporates across credit ratings, long tenor bonds by infrastructure entities, holdco debt financing for lower rated sponsors were widely placed.

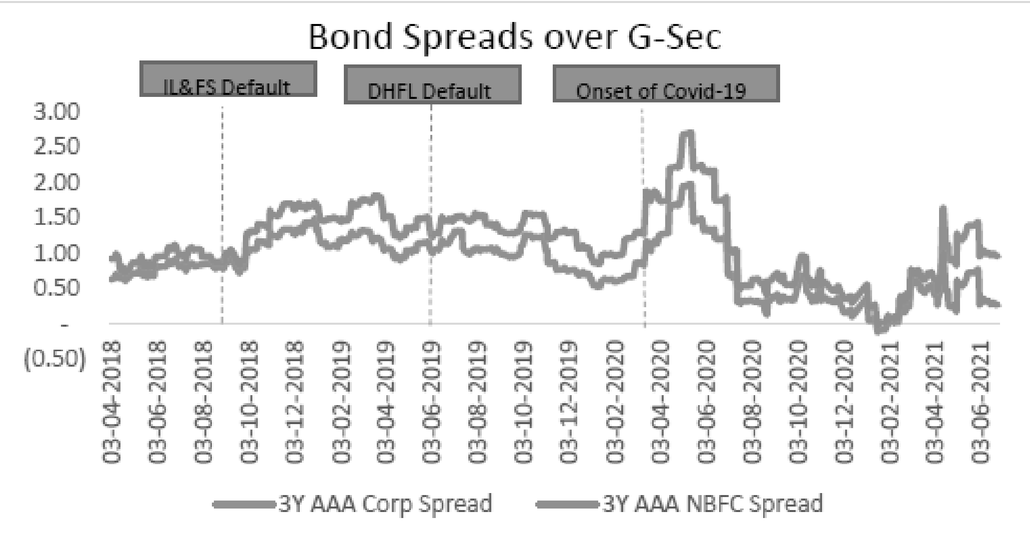
Some of the notable examples would be

- NHAI annuity road projects (rated AAA) - Shapoorji Pallonji Jammu Udhampur Highway (SPJuhi) with tenor ranging upto 15 years
- Transmission projects - ENICL (long tenor), BDTCL,
- Non-AAA - Holdco funding - Renew Group, Greenko group, Sterlite group, Hero group
- Obligor/co-obligor structures - Greenko group & Renew group
- Loan against shares from various groups
- NBFCs – Sub-debt/Perpetual bonds/NCDs rated AA- & below
- State govt. guaranteed bonds – UPPCL & APCRDA

However, the momentum of the market was broken completely when IL&FS – the then largest infrastructure lending institution in India, defaulted on its debt in Sep'18. Being rated AAA & having marquee shareholders, its debt was widely distributed & hence its default affected Banks, Provident funds & Pension funds, NBFCs, Mutual Funds, Insurance Companies et al.

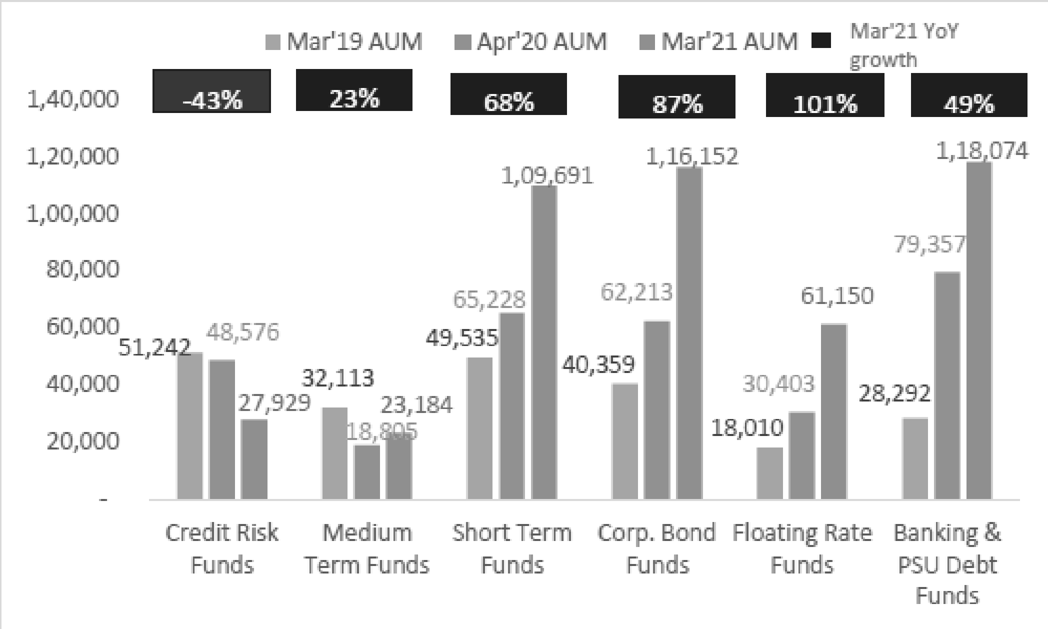
Post IL&FS, the markets witnessed further credit shocks – the key ones being DHFL, ADAG group, Zee LAS & Yes Bank Tier 1 bonds, leading to extreme risk-off sentiment in all non-AAA bonds.

The onset of Covid-19 pandemic on the back of these large credit events, combined with a lack of liquidity, led to a sharp spike in corporate bond spreads. The extent of lack of liquidity can be gauged from the fact that Franklin Templeton Mutual Fund had to shut down 6 of its open ended schemes in April, 2020 owing to their inability to service redemptions.



Source:Bloomberg

This led to the credit-oriented mutual funds experience a surge of outflow. The last 1-1.5 years has seen a clear trend of investors staying away from credit-oriented funds & large inflows coming into AAA oriented funds.



Source: AMFI

Current market scenario (Post credit events)

With significant policy support over the last 1.5 years from the RBI in form of rate cuts, maintaining comfortable liquidity regime through various liquidity management tools, policy announcements such as TLTRO, corporate bond activity has picked up significantly and has enlivened the market sentiment to a great extent.

However, the corporate bond activity is very much skewed towards better rated AAA/AA+ securities & shorter tenor. The nature of such skew is of course bolstered by the large flows coming into the 'AAA oriented' mutual funds and also a reasonable carry available in some of these AAA rated assets over other AAA rated PSUs & vanilla bonds.

Having said that, corporate bond markets are currently looking robust and we are seeing a surge of demand for a wide variety of credits, some of the key ones being:

REITs & InvITs have found appetite in capital markets over the last 2 years. There have been multiple NCD issuances from Embassy REIT, Indigrid Trust, Indinfravit Trust, Mindspace REIT. Being backed by strong sponsors, well-regulated platforms with largely operational assets, superior credit rating (AAA) and good spread over vanilla AAA bonds, these NCD issuances have attracted wide market participation.

With allowance of new class of investors such as insurance companies & pension funds to invest in such bonds, it would further boost liquidity hereon.

InvIT/REIT (NCD Issuer) (Source:Prime DB)	MF Holdings (As of Jun'21)
Embassy Office Parks REIT	7,051
India Grid Trust	3,749
Indinfravit Trust	2,549
Mindspace REIT	271
Total	13,620

Hybrid annuity model road assets are another issuer class that are recently gaining popularity amongst bond investors. With completed projects & healthy cashflow visibility, receipt of 1 or 2 annuity payments, such projects are expected to continue seeing demand from capital markets. Varanasi Sangam Expressway Ltd. – a HAM road SPV of GR Infraprojects Ltd. raised ~784 crores in Jun'21 by way of listed, rated (AAA) NCDs with tenor of 13.5 years and put/call options at end of every 3 years and many more such projects are in pipeline.

Obligor/Co-obligor structure - Global Infrastructure Partners in its renewable energy SPVs has raised bonds from a pool of 6 SPVs with strong counterparties (such as NTPC, SECI). The bonds by each SPV were secured by charge over movable assets, plant & machinery, share pledge (51%) and corporate guarantee of each of the other SPVs. In addition to financial covenants & DSRA of 6 months, the structure was further strengthened by restricted payment conditions & waterfall mechanism for all cashflows from these pooled SPVs to before being paid out to Sponsor. A lot of deals are in the pipeline for similar structures.

Covered Bonds & MLDs – NBFCs who bore a large brunt of the illiquidity post the credit events have been issuing MLDs to capture the HNI wealth segment. Also, action has been seen in Covered bonds as it not only gives an enhanced credit rating to investors, but also has extends dual comfort in form of balance sheet recourse as well as access to exclusive pool of assets, in case of pre-defined trigger events. Covered Bond structures have also opened up capital market doors to the Issuers who have been largely relying on bank funding given their lower credit rating. Additionally, we also expect demand for PTCs to increase, considering the superior rating & bankruptcy-remote structure.

In conclusion, while we continue to see robust demand for plain vanilla AAA assets, structured AAA credits still have very limited appetite outside Mutual funds. The need of the hour is to have a wider participation from all debt market players like banks, insurance companies, FPIs, PFs & pension funds etc. into such papers which would boost their liquidity. Currently, the markets are largely dominated by select investors viz. mutual funds, NBFCs, & HNIs, where bulk of the demand is for tenor upto 3 years, thereby making placement of long tenor bonds difficult.