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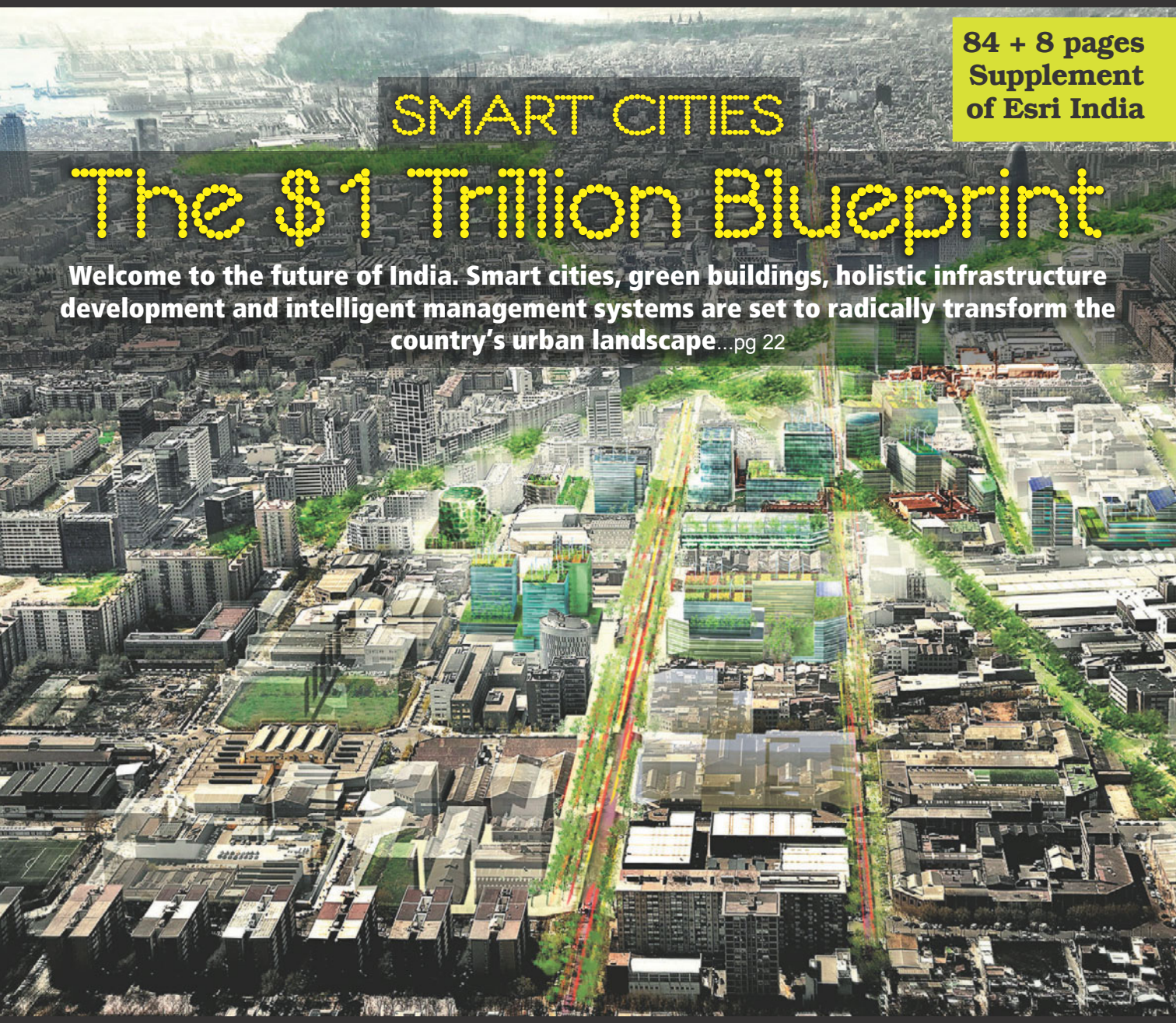

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BANKERS TALK

"Global pension funds have both liquidity and appetite for long-term investments"

In a freewheeling conversation, **Moses Harding, Group CEO and Chief Economist, Srei Infrastructure Finance Limited,** says that he is bullish over the prospects of the infrastructure finance sector.

What kind of credit enhancement schemes would you feel are appropriate for the country's infrastructure finance market?

An investor will look for credit enhancement as added comfort if the project viability is in doubt or in the absence of adequate cash flows to support interest/debt servicing. The added comfort can be from credit risk upgrade from third-party guarantee or higher margin on underlying asset collateral or from additional margin comfort from cash/approved securities. While PSU entities derive comfort from government ownership, private sector borrowers need to cut their leverage or pay high credit risk premium. While the government can at best generate appetite and ensure flow of liquidity at affordable cost through its favourable policy/regulatory prescriptions, it will be the borrower's responsibility to provide comfort through better financial performance in the balance sheet and through lower leverage, thereby increasing the equity stake of the promoter-borrower in the company's business.

Global pension funds are looking for good long-term options to grow their investments. What can be done to make the infrastructure space lucrative so that these funds look at India as an option?

Global pension funds have both liquidity and appetite for long-term investments which provides

better risk-reward interest return. The factors in play are country risk, promoter risk, business risk and product risk. All taken together and if seen as a better risk-reward proposition, it would lead to higher allocation to infrastructure sector specific investment allocation for India. While public sector and investment grade private entities find it easy to exert the pull-factor, others need to trigger the push-factor through higher coupon rate at low leverage.

The US has a $3.7 trillion municipal bonds market, which is an important source for infrastructure funding. Where does India stand on the municipal bonds market and what can be done to broaden and deepen this segment?

In India, government bond market exists at the Central and State levels and bonds are issued to fund the fiscal deficit, which means that government entities borrow for consumption to meet excess expenditure over income, rather than productive investment or asset creation. In India, existence of municipal bonds market as support to infrastructure is non-existent and it has a long way to go!

The RBI has recently said that issuance of long-term bonds for funding loans to the infrastructure sector has not picked up at all. Do you believe that the scenario will change now after the revised norms?

When the outlook on the infrastructure sector was not good with lack of optimism, it is not fair to expect private investor appetite for long term funds. The support was mainly from public institutions. Any investor will look for decent risk-reward returns and liquidity in the secondary market for exit ahead of maturity. Yes, I firmly believe that the build-up of hope and optimism by the new government enjoying political majority and decisive leadership will translate into ground-level execution to attract investor appetite; the icing on the cake is the benefit from pass-through of CRR/SLR/Priority sector premium to investors that would shift investor appetite from plain vanilla bank FDs/Corporate bonds to higher coupon infra-bonds.

The Budget allows certain concessions to banks on their SLR/CRR requirements as far as infrastructure financing is concerned. Do you feel that banks would start eating into your share of the infra finance business because of this relaxation of norms?

The intent of the concession is to provide better return to the investors at premium over the fixed deposit rates of banks and to lend at discount to borrowers creating infrastructure assets. The RBI has given up what I call the "social cost" (of CRR/SLR/Priority sector lending at discount) to be passed on to the investors/lenders into the infrastructure sector and support borrowers who create infrastructure assets. This will ensure investor-pull and borrower-push for revival of the infrastructure sector, which is the first step to ignite the animal spirits in the economy for shift to higher growth trend. The major source of funds for Srei is from banks, financial institutions and retail/wholesale investor community. Srei being a borrower from banks will obviously get the benefit of 50-75 bps interest cost reduction in the incremental disbursement from rest of FY15 onwards. Moreover, Srei complements a bank's access to the infrastructure sector given the expertise in end-to-end infrastructure domain from project advisory to project development to project finance across all sectors of road, sea/airport, SEZs, power, telecom, oil & gas, etc., including equipment engaged in infrastructure asset creation. Banks see Srei not as a competitor but as an extended arm in accessing infrastructure project assets and related equipments.

> "Banks see SREI not as a competitor but as an extended arm in accessing infrastructure project assets and related equipments.

The Budget promises a lot for the infrastructure sector. In specific reference to infrastructure finance, what does the current Budget bring to the table?

The major beneficial impact is from reviving the investor and lender appetite for the infrastructure sector. The monies invested (and lent) into infrastructure are either stuck or not providing desired results. The issues are across the board, from policy to regulatory to administration bottlenecks and irritants. The comforts from this Budget are manifold – hope and optimism that policy paralysis, regulatory irritants and administrative bottlenecks will be removed at project implementation (and execution) level to prevent cost over-run, better access for project promoters to access equity and debt capital market and financial sops to banks for enhanced financial intermediation through better return for investors and at a lower cost to borrowers. Overall, the momentum has been set up, and it's obvious that there can be no overnight revival; I believe results will be visible on the ground from FY16 onwards.

Apart from the measures announced in the Budget, do you feel the government can come out with any additional policies to boost the infrastructure sector?

The role of the government is to ensure smooth

facilitation of projects from ideation to execution, cutting the time lag across policy to regulation to administration to prevent delay and cost over-run. In this process the Central & State governments have to complement each other without any kind of friction whatsoever to make doing business easy in the infrastructure sector. The present government enjoys the critical advantages of political majority, decisive executive leadership, consensual approach limiting conflicts and high level of commitment to catalyse quick revival of the infrastructure sector; ideation of 3S by the Prime Minister – skill, speed and scale – says it all. If this is done, there is no reason why the investor and lender community will not rush to get its pound of flesh from the huge opportunities in the infrastructure sector which is the pivot for scaling up of the manufacturing and agriculture sectors. It is a long-term strategic once-in-a-lifetime opportunity for investors and lenders. The execution risk is not seen as a hindrance at this stage.

> "The present government enjoys the critical advantages to catalyse quick revival of the infrastructure sector.

The infrastructure finance industry in India suffers from lack of depth in the financing market and absence of innovation in financial instruments. Your comments?

When there is confidence on sustainable prosperity of any sector, liquidity will flow; the need is to set up the pull-effect from investors into the infrastructure sector. If this is established, everything else will take shape. The liquidity in the primary market is from the growth (and the need for funds) and in secondary market from larger number of investors participating. At this point of time new issuance in primary market is less with near zero activity in the secondary market from lack of stakeholder participation. Product innovation is nothing but bridging the expectation of investor and borrower, development of which is linked to cost-yield of borrower/investor which would get aligned balancing demand-supply dynamics.

Do you think that enough is being done to ensure that financial savings are being channelised towards infra projects? Are there enough savings options in the form of pension and insurance instruments, through which funds can be routed to the infrastructure sector?

The financial savings of the economy are channelised indirectly into any desired sector through government, Development Financial Institutions, banks & FIs and retail participation in primary issuances. Now, most of public savings sourced by banks, public/private pension/provident funds are invested in Central and State government bonds. I see two reasons for this – number one, the financial savings of the system have to fund the huge fiscal and current account deficit and there is general risk aversion to infrastructure sector from the private sector. The immediate agenda of the government should be to divert the financial savings from investment into Government SLR bonds into desired sectors of infrastructure, manufacturing and agriculture.

Are public insurance companies doing enough to fund the infrastructure sector? Or do you feel that they invest mainly in publicly-listed infrastructure companies for meeting their mandated minimum infrastructure obligations?

Public insurance companies like LIC and GIC do support the infrastructure sector through direct subscription to primary issuances and providing liquidity in the secondary market. But this is chicken-feed compared to the huge appetite of the infrastructure sector. They do invest directly in infra companies and also subscribe to bonds issued by banks/FIs engaged in infra-lending. But given the huge appetite, they need to do more and lead the way for other investors to follow.

Why do many infra SPVs suffer from low ratings?

The value of the SPV is derived from value and earning capacity of the underlying assets owned by the SPV. It is not a surprise that the rating of the SPVs is low when the performance of the assets owned is not good. Believe me, the worst is behind and good times are ahead!

How favourable is the Indian equity market for financing infrastructure projects?

The debt burden on the promoters of infrastructure projects is huge with high leverage. This means that downside risks largely rest on the debt investor while upside gains accrue in full to the equity investor/ promoters. There are signs of hope for revival in the equity market with relatively better valuation for promoters to access the equity market. The first round of re-rating is already done since May 2014 and there will emerge appetite from investors to participate in subsequent rounds of re-rating for much higher valuation into 2019-2024. It is believed that the next 5-10 years of the Modi regime is for companies engaged in infrastructure, manufacturing and agriculture sectors.

You have been quoted in a few reports expressing confidence that gross NPAs will come down in the infrastructure sector, a couple of quarters down the line. What makes you so bullish on this front?

The fact is that the worst is behind us and the light at the end of the tunnel has been sighted! The benefits will be two-fold – one, cash flow efficiency of projects that are running at below capacity will improve and two, projects that are stuck will see hope for cash generation for repayment of loan obligations. Given the optimism and importance given to the development and scale-up of the infrastructure sector, there is no reason whatsoever to stay worried over the future. The combination of significant pick-up in new opportunities and tremendous improvement in existing portfolio will trigger down-trend in gross and net NPA from FY15 onwards from lower NPAs (on the numerator) and higher assets (on the denominator).

You had initiated an interesting joint venture with the Indian School of Business for grooming leaders for India's infrastructure industry. How has that venture progressed?

This is the third year of partnership with ISB. The student-run professional club at ISB christened as "Srei Infrastructure Club" sponsored by Srei Group is extending guidance and mentorship in connecting the students to a broader group of infrastructure experts and forums across the country in addition to providing hands-on practical exposure on Srei's projects across road, power, oil & gas, telecom, seaport, aviation, rural infrastructure, SEZs, waste management, etc., to give better understanding of government policies and PPP models of the infrastructure sector. Srei takes pride in nurturing young talent and attracting them into the infrastructure sector.

> "Given the optimism and importance given to the development of infrastructure, there is no reason to stay worried.

What is the status of your 500-acre Special Economic Zone near Kharagpur in West Bengal?

It is an auto and allied industrial zone of 551 acres of land and the park has locational advantage being on the NH6 connecting Kolkata, Mumbai and Chennai at 25 km from Kharagpur. It is a JV with WBIIDC (West Bengal Industrial Infrastructure Development Corporation). In this zone, project land is either not cultivated or single cropped, hence land acquisition is not a concern; land purchases are underway and expected to be completed soon. An independent valuation on project viability and feasibility is already done with the engagement of Bengal Engineering & Science University (BESUS). The project implementation preparation is a work-in-progress and is expected to pick up speed from now on. IT

- DEVARAJAN MAHADEVAN