Samena rides India's growth cycle for a high-yield bonanza

Explosive expansion in India's corporate credit space highlights the attraction of the asset class and offers plethora of opportunities for the Samena India Credit Fund

Akash Mehta, the highly experienced manager of the high-yield-focused Samena India Credit Fund, brims with easy confidence and eager optimism when he tells investors they should load up more on Indian corporate credits. "Credit has emerged as one of the more compelling ways to invest in the country and we are seeing tremendous opportunities," he says.

The Samena India Credit Fund, an Indian corporate credit fund, successfully launched in November last year with a $45 million seed capital from Samena Capital and independent Swiss private bank Reyl & Cie, thus becoming one of the very first regional offshore funds with an experienced credit team to specifically target the rapidly growing domestic Indian corporate bond space after the market was opened by the Indian government to scalable participation from foreign institutional investors.

India shining

Mehta's bullish assessment on Indian credits tallies with the fact that India is very much on a roll these days. Its stock market has roared back to life with a robust 25% gain in the first nine months of 2014 and amply highlights the country's soaring optimism. The same positive outlook is evident in Indian credits following the decisive election victory of prime minister Narendra Modi's government in May.

In recent months, a deluge of new offshore launches targeting INR credits has highlighted the growing attraction of the asset class. It also helps that India's economic situation has vastly improved compared to the considerable hardships endured a year ago, when the Indian rupee tumbled sharply against other currencies.

All these factors in turn have helped to boost the number of Indian corporate bonds that are enjoying a credit rating upgrade this year, and so far they have outnumbered those that have suffered a downgrade. It has been a while since that has happened and that was way back in 2011.

Mehta, who before joining Samena's credit team in 2012 worked at Ashmore, the highly regarded special situations and credit specialist, describes the size of the opportunity in the INR corporate market as "quite immense" and far beyond Samena's current financial capacity to effectively take advantage of, prompting him to market the fund this summer much earlier than originally planned to outside investors in the hope of seeing it scale to $200 million in assets next year.

Akash Mehta

The fund's initial capital, explains Mehta, mostly came from its anchor investors. "We have enjoyed strong engagement from our LPs but much still needs to be done in that area. We do not market to Indian LPs as per regulations, but can and do target the non-resident Indian market."

The strategy offers two classes of shares. The first provides quarterly liquidity and charges a 1.5% management fee and a 15% performance fee; while the second has a 12-month rolling lock-up and charges a similar management fee on a reduced performance fee of 10%.

The Samena India Credit Fund has already delivered a robust 8%-plus return in US dollar terms in the first nine months of this year, bringing it within sight of the targeted 12% net return in US dollar terms that Samena's credit team views as being achievable every year. The strategy has generated most of those gains so far from yield-compression plays on US dollar-denominated Indian credits.

While working at Ashmore in India, Mehta helped to build the group's Indian Foreign Currency Convertible Bonds (FCCBs) book. He also played a pioneering role in the early evolution of foreign participation in India's local currency credit markets, and was a sponsor investor in one of the first dedicated wholesale non-bank finance companies.

In Samena's India credit team, Mehta works alongside Ashmore India's former CEO John-Michael Lind, who as executive director provides support in fund management, credit sourcing and business development. The team's other members include two analysts in Mumbai and another senior vice-president who recently joined in Mumbai.

Growing corporate credit space offers significant opportunity

Mehta says the rapidly growing opportunity in Indian credit space is undeniable as the INR corporate bond market, which now has $227 billion in outstanding issuances, is growing at a remarkable 18% rate annually.

Rating agency Standard & Poor's also sees the volume of corporate credits rapidly soaring in the years ahead and forecasts new demands for loans from corporates to grow as high as $553 billion in the next five years.

Mehta notes that the improving sentiment for Indian credits coincides with the start of a new growth cycle for capital expenditure among Indian corporates and so could quickly translate into even more vibrant opportunities in the credit space. "The opportunities are considerably attractive since many secured senior Indian credits deliver returns ranging from the mid to high teens annually," he says.

It is also significant that INR credits are more easily accessible to foreign investors, he adds. "It was difficult to get meaningful access to INR credits for foreign investors in the past since they were restricted by quota limits. These quota limits have been significantly expanded from $20 billion to over $80 billion in the past five years."

The enhanced access is predictably drawing more institutions into what is still an esoteric space in INR credit investing, including, of course, Samena Capital and Reyl & Cie.

When it was set up in 2008 in the midst of dislocations across global financial markets, Samena Capital's founding members were mostly business people and entrepreneurs who were already convinced that the global economy was on the threshold of a new era and that the most attractive investing opportunities would be coming from emerging economies such as the Indian subcontinent, the Middle East as well as North Africa (SAMENA).

The group, which was seeded with $50 million in shareholders' equity in 2008, has succeeded in growing its assets under management to more than $700 million today, with investments spread across the length of the SAMENA region. All things considered, its principals have proven their acumen in identifying attractive opportunities in the various markets within the region and delivering solid returns to investors despite the concomitant geographical challenges.

While India has been part of Samena Capital's focus since the very start, most of the fund's exposure to the country was through listed and private equities. Mehta says that balance could change in the years ahead as the INR market expands and credit investments gain more prominence.

At the fund, Mehta and his team follow a fundamental, bottom-up, research-driven investment approach that emphasises in-depth credit analysis. They invest across an array of local currency and US dollar-denominated Indian credits, as well as in credit-linked instruments including non-convertible debentures, foreign currency convertible bonds, Indian government securities and foreign listed bonds of India issuers. "While our allocations are typically in US dollar and Indian rupee, the strategy's exposure is fundamentally in local currency. We apply a macro overlay into the strategy, take a view and then hedge the positions," says Mehta.

Currency risk remains a key challenge

What remains the trickiest challenge about investing in India, Mehta explains, is how to manage currency exposures given the rupee's

> *"Credit has emerged as one of the more compelling ways to invest in the country and we are seeing tremendous opportunities"*

considerable volatility against major currencies in recent years.

"People are a bit more wary of local currency exposures following last year's sharp depreciation," he says. "Overall, the INR has averaged 2.5% depreciation every year since India liberalised its financial system in 1991. At the moment, however, India's stronger fundamentals and steady central bank leadership bodes well for medium-term relative stability from the currency."

The strategy enjoys relatively better liquidity compared to other INR-focused funds that have launched recently because it specifically targets a segment in the corporate bond market made up of blue-chip corporate issuers that offer returns in the mid to high teens.

The fund targets senior secured credits from issuers that are mostly from sectors of the economy, which are severely restricted from accessing bank financing, such as holding companies, acquisition finance and real estate, and they have to source their funds instead through non-bank finance companies (NBFCs). Mehta says a significant advantage that Samena India Credit Fund, an offshore fund registered in Singapore, enjoys over an NBFC, is that it only pays a 15% withholding tax on interest gained, unlike the 30% that is charged to the latter.

When it was launched last year, the India-focused strategy mostly allocated to US dollar-denominated bonds issued by Indian corporates such as Bharti, Tata Power and well-established Indian financials such as ICICI and Axis. However, that proportion went down from as much as 80% of the portfolio to just 50% in the first half of this year as the exposure shifted more toward INR credits. "We are increasingly becoming more local currency and yield-focused."

The strategy can also invest in distressed Indian debts, but Mehta prefers to ignore that space for now to focus his firepower on secured credits from companies with strong cashflows and juicy yield pick-ups. "We need first to protect our portfolios and will avoid taking unnecessary risks just to generate incremental returns," he says.

Positives ahead

The team anticipates that the effect of a widely expected US rate hike later this year will be more muted in India, which draws more heavily from equity flows. Additionally, India has already gone through a massive rate hike cycle to contain inflation. "We actually expect local rates to compress in the next 12 months, which will likely result in a local currency bond rally," predicts Mehta.

And while he cautions that a sharp climb in US rates could result in short-term INR volatility, Mehta feels that any depreciation of the Indian rupee is not likely to be as drastic as the one experienced last year.

"We have a very good Reserve Bank of India governor in Raghuram Rajan, who is focused on ensuring stability instead of just taking a particular view on whether to maintain a weak or strong rupee," he says.

The RBI, adds Mehta, has also been successful so far in stemming the currency's appreciation at a time of strong foreign currency flows and has built a comfortable buffer of foreign exchange reserves — equivalent to nine months' imports cover.

Mehta says one of the biggest worries over India's economy continues to be structural inflation mostly arising from constraints in the supply side. "It does take time to build the necessary infrastructures such as new ports and roads to ease the infrastructure bottlenecks and so we will probably see elevated nominal rates persist for quite for a while, given the persistent structural limitations of the economy," he says.

The firm believes that this constraint, combined with a very tight credit-to-deposit ratio in the banking system, even as corporates and the government revive spending through the current capital expenditure growth cycle, will present very compelling credit opportunities in the months ahead.

CV: Akash Mehta

- Thirteen years of transactional and principal investment experience in special situations, high yield and real estate across Asia.
- Mehta was the former chairman of Indian housing finance firm Indo Pacific Housing Finance, previously known as AIG Home Finance. He acquired the latter from AIG in a partnership with Hong Kong-based Pacific Century Group, but subsequently sold the company to L&T Finance.
- Mehta was also executive director at Ashmore India, where he focused on special situations investments and helped build its Indian FCCB book.
- Before Ashmore, Mehta was a portfolio manager at a large family office in Hong Kong and was initially responsible for a Japan portfolio focusing largely on real estate – but subsequently managed a series of successful private equity investments in India.
- Mehta holds a BA from Haverford College, Pennsylvania, and an MBA from Harvard Business School.

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