

Knowledge Pro Series

Private Credit: Bridging Financing Gaps

Private credit is a versatile instrument in the investment toolbox. While the Reserve Bank of India (RBI) permits Indian banks to finance working capital or capex, it restricts their ability to finance acquisitions of equity shares. NBFCs and Mutual funds are also bound by regulations and hence the availability of funds becomes restricted. And so, the role of private credit is becoming even more significant as this flexible capital provides tailored financing arrangements to meet the distinctive business requirements, unmet by the traditional sources.

Exhibit 1: Traditional Sources of Capital

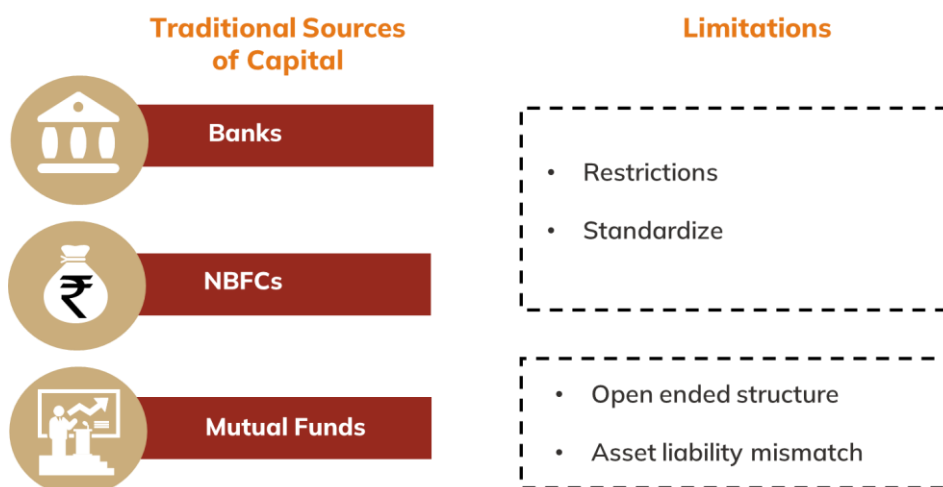
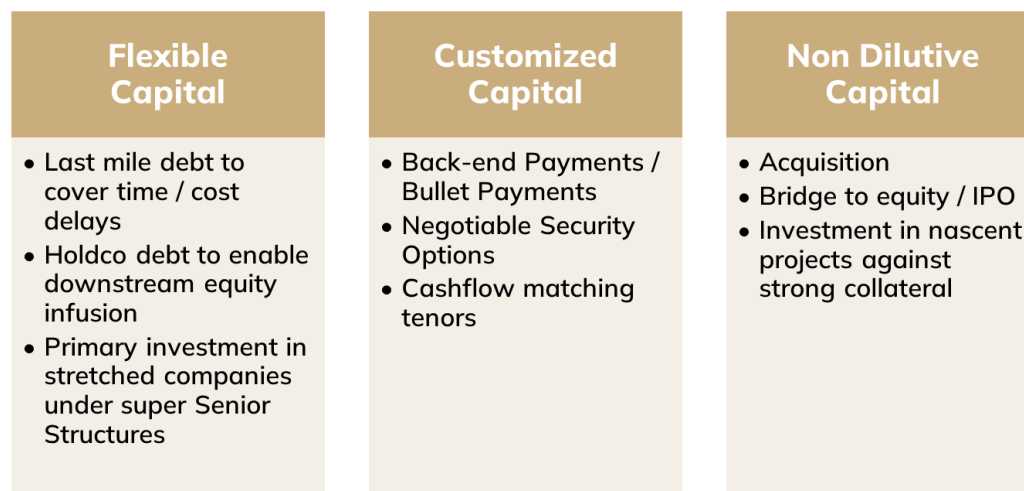


Exhibit 2: Private Credit - Increasingly Becoming Relevant

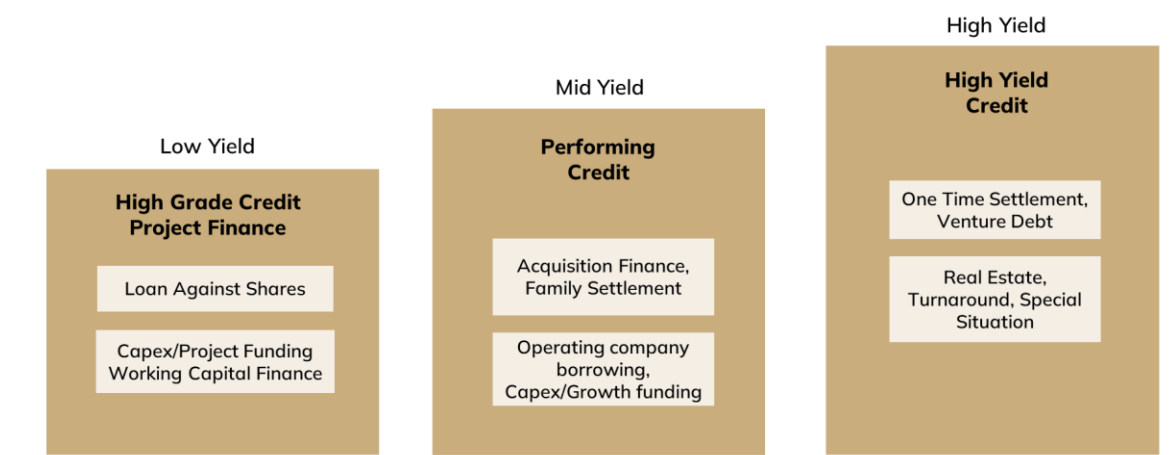


Private credit provides flexibility to investee company in terms of loan structures, repayment options, and risk levels, making it an attractive option for investee companies needing customized financing arrangements, which traditional sources of capital would avoid. This flexibility may allow investee companies to cater to various capital needs, such as growth, acquisitions, or working capital.

Strong risk assessment, a fundamental need for private credit

The private credit market in India is far from homogenous. A credit which is available at 14% yield differs from a credit available at 18% yield, and both the credits would be very different from a credit that is available at 20% yield. Hence, a thorough due diligence of the group/entity seeking credit is essential. This requires a certain level of experience within this space and the investment credit teams must follow a rigorous investment process and due diligence. Typically, as an asset class, private credit is illiquid, however for average duration of 24-30 months the exits are available especially in performing credit space. Further down the duration path, availability of secondary market is likely to help in better churn and reduce Asset Liability Mismatch (ALM) risk.

Exhibit 3: Indian Private Credit Market Segmentation



Source: Internal estimates | The details above is only for reference and information purpose only. Past performance may or may not be sustained in future. No assurance or guarantee of any return is being provided. The yield mentioned above is the current yield is indicative and may change due to market factors.

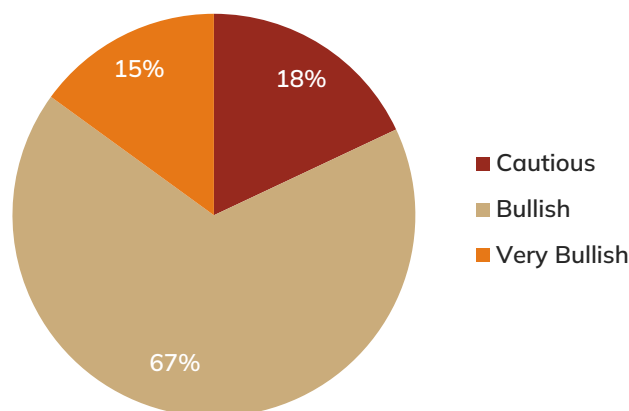
Private credit funds evaluate the opportunities based on business vintage, management experience, debt repayment history and capital structure¹. While the risk profile of the deals may vary, the structuring, fundamental analysis and risk assessment processes of credit deals are very crucial, further, covenants and pricing are important aspects of it as well.

However, credit risk cannot be ruled out due to adverse economic events which may have an impact on the business. Typically, in such scenarios, the Investment Manager along with the investment team aims to work out a resolution with the promoter/company. If there is no cooperation from the company, legal means could be used to recover/mitigate the losses.

India presenting a positive sentiment for private credit

As per the survey* conducted by EY, for the next 2-5 years, 82% of the fund managers** are positive (bullish and very bullish) on private credit investments. The performing credit funds show a positive sentiment as well. Overall, the trend is consistent with the past surveys.

Exhibit 4: Private Credit Sentiment



Source – Private Credit in India – H1 2024 Update – EY, Dated 10th Sept 2024

The private credit deals² in H1 CY24 has been recorded at USD 6bn vis-à-vis USD 8.6bn in CY23. From a run rate point of view, the deal data suggests that H1 CY24 is substantially ahead of the deal flows in CY23 which shows the increasing activity in the private credit space.

Further, the increasing share of domestic funds as compared to the global funds is primarily due to increasing awareness of this asset class in the country and higher domestic fund raise from high-net-worth Indian investors. As awareness about private credit is increasing, the trend of it is expected to remain robust.

¹ The aforesaid factors/process is only indicative, there may be other factors/process considered for investment.

² Data does not include deals less than US\$10 million and offshore credit raise. However, based on select deals tracked from public sources, these would amount to at least an additional US\$174 million and US\$1.9 billion, respectively. Source - Private Credit in India – H1 2024 Update – EY, Dated 10th Sept 2024

*Source – Private Credit in India – H1 2024 Update – EY, Dated 10th Sept 2024

**This includes senior leaders from 28 funds out of 36, from prominent Indian and Global high yield and performing credit funds – EY Survey, Source - Private Credit in India – H1 2024 Update – EY, Dated 10th Sept 2024

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