India Fixed Income Investing for Foreign Investors

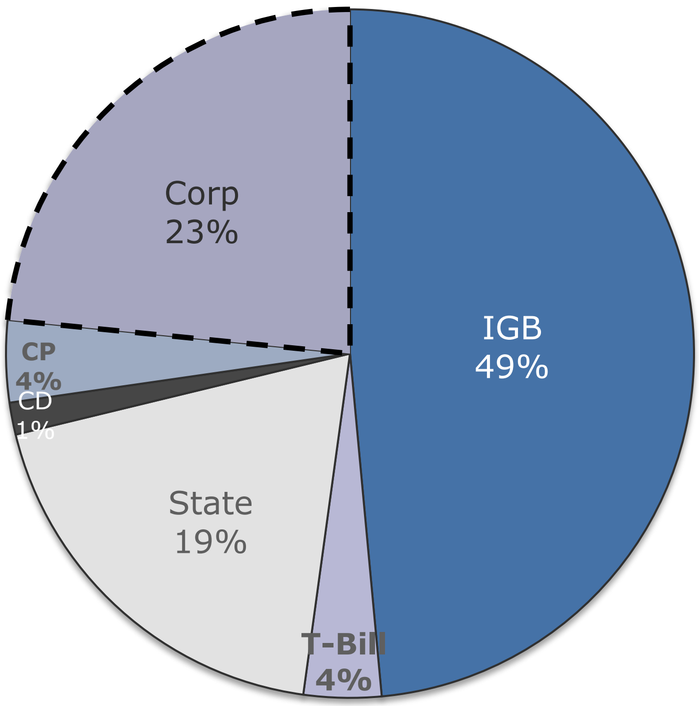
April 2017

Edelweiss
Ideas create, values protect

INR Debt Product Landscape

Indian Fixed Income Market Overview

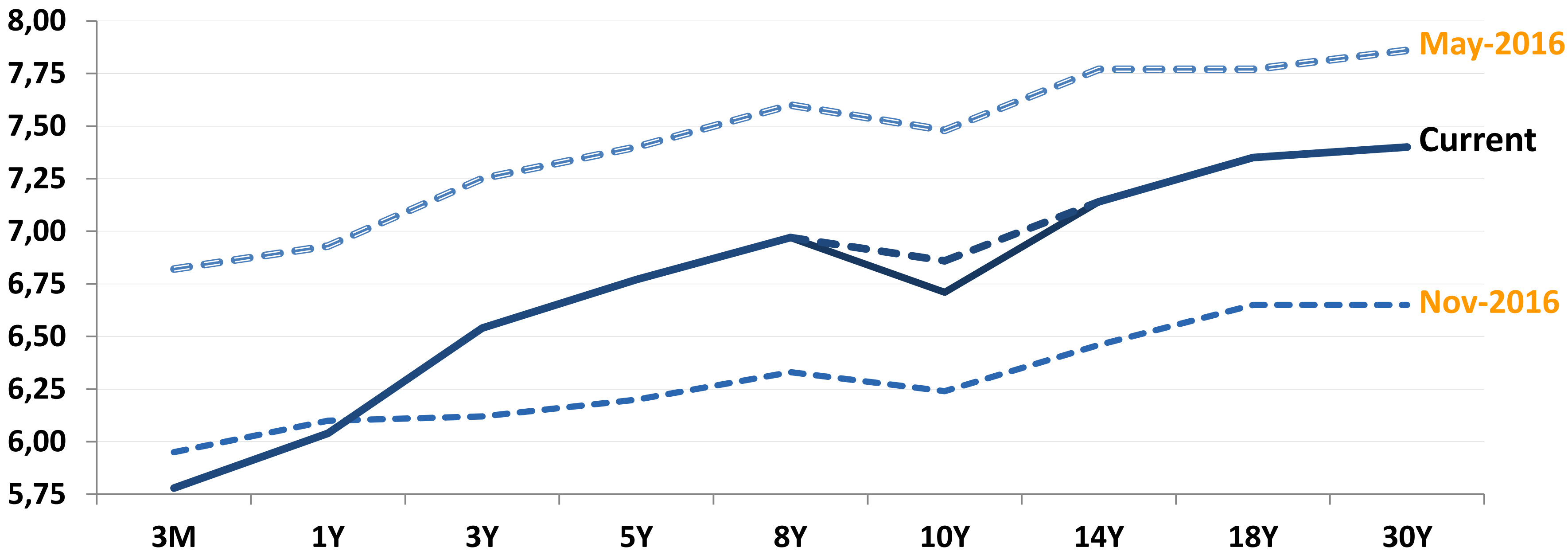
Total INR Denominated Bonds – USD 1.5 tn



	Outstanding (USD bn)
G-Sec	725
T-Bill	55
State*	285
CD	22
CP	57
Corp Bonds	350
Total	**1500**

- IGBs & T-Bills make up 53% of local currency bonds
- As yields continue to drop, corporate bonds will receive greater attention in the quest for higher spread
- **Expect corporate bond outstanding to grow to at least USD 500 bn by 2020**

Sovereign Debt Yield Curve



- Curve has steepened after policy review
- FPI preference has also moved to the 5-10Y segment
- Spread of liquid off-the-run options had widened initially, now contracted due to buying momentum

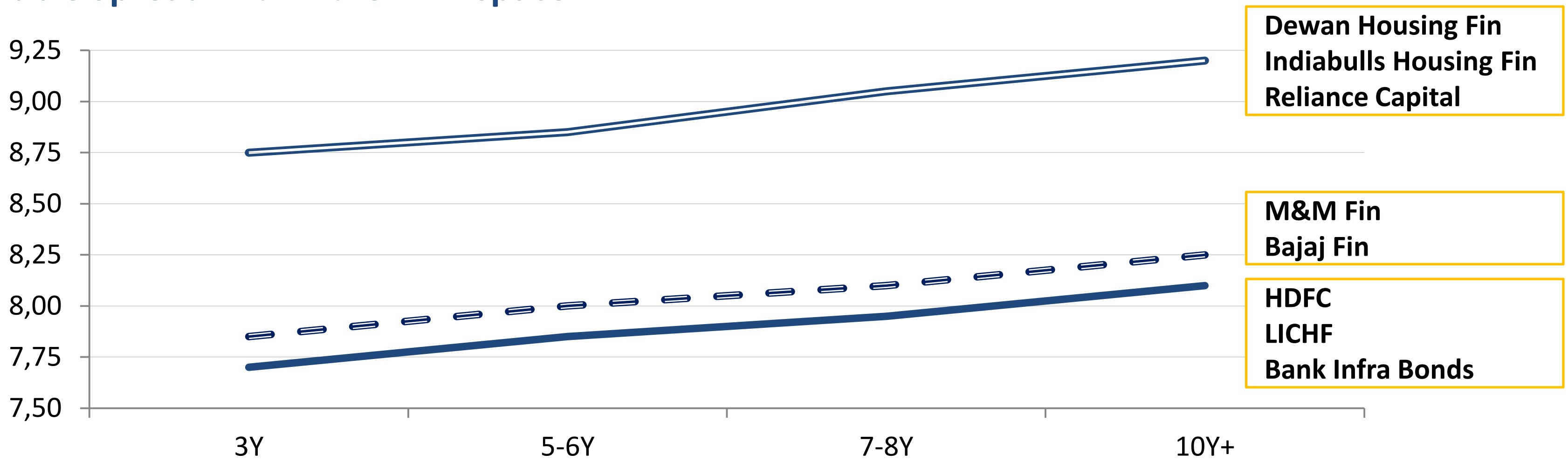
Corporate Debt Yield Curve – Quasi-Sovereign

Issuer	3Y	5Y	10Y	10Y+
EXIM Bank	7.15	7.40	7.62	7.65
Nuclear Power Corp	7.15	7.44	7.64	7.70
Power Grid Corp	7.17	7.44	7.64	7.67
Rural Elec Corp	7.20	7.50	7.72	7.75
Power Finance Corp	7.25	7.54	7.75	7.77
Indian Railway Fin Corp	7.14	7.38	7.62	7.65
National Thermal Power Corp	7.17	7.42	7.65	7.70
Steel Auth of India	7.85	8.10	8.15	-

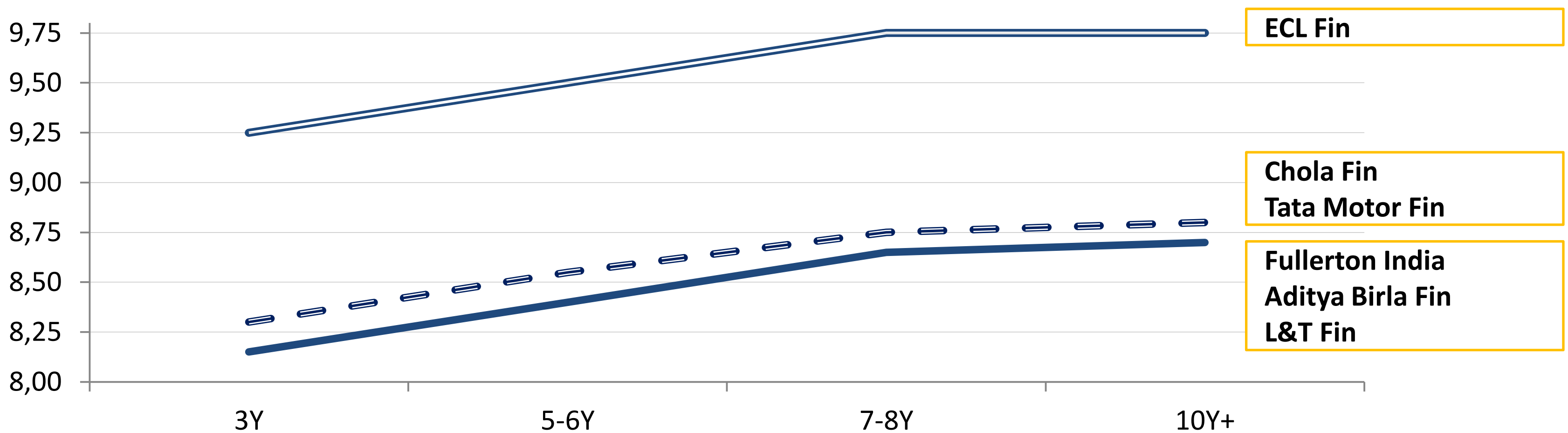
- Domestic appetite in 3-5Y segment
- Curve steepens in 5Y to 10Y portion

Corporate Debt Yield Curve – Private Sector

Sizable Spread within the AAA space

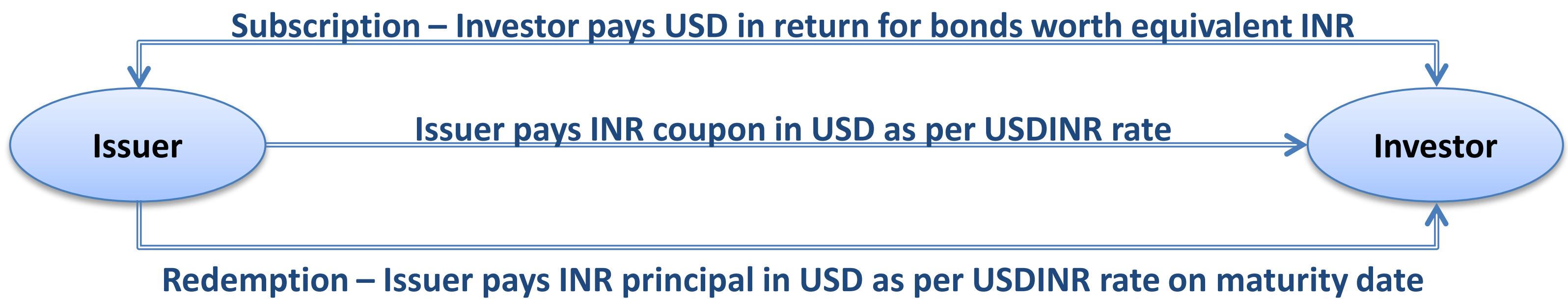


AA+, AA Yields



Offshore Rupee Bonds *[Masala Bonds]*

Parameter	Criteria
Denomination	INR denominated – offers local currency exposure for investors
Settlement Currency	Subscription, coupon payments & redemption may be foreign currency settled
Instrument	Plain vanilla bonds
Borrowers	All Indian corporates (public & private sector) permitted to issue such bonds
Investors	Any investor from a FATF compliant jurisdiction
Maturity	Minimum of 3 years (put / call not permitted within 3 years)
All-in-Cost	Commensurate with prevailing market conditions
Issue Size	INR 50 bn per year under automatic route. RBI approval required beyond this limit
Withholding Tax	5% – On par with onshore bonds and other ECB borrowing



Masala Bonds [contd.]

- After a slow start, investor appetite picking up for offshore rupee bonds
- Issuers lining up with non-deal roadshows to tap this market
- Completed deals:

Issuer	Size	Tenor
HDFC – Tranche I	INR 30 bn	3Y 1m
NTPC	INR 20 bn	5Y
Adani Transmission	INR 5 bn	5Y
HDFC – Tranche II	INR 20 bn	4Y
Indiabulls Housing Finance	INR 13.3 bn	3Y 1m
Fullerton India	INR 5 bn	3Y 1m
ECL Finance	INR 5 bn	3Y 2m
Shriram Transport Finance	INR 11.5 bn	3Y 1m
HDFC – Tranche III	INR 33 bn	3Y 1m

Cash Settled Interest Rate Futures [Bond Futures]

Parameter	Specification
Contract	Futures contracts based on • IGB 6.84, 2022 • IGB 7.68, 2023 • IGB 7.59, 2026 • **IGB 6.97, 2026** • IGB 7.88, 2030
Trading Hours	Monday to Friday 9:00 A.M. to 05:00 P.M. IST
Expiry Day	Last Thursday of the month
Contract Cycle	Monthly - 3 serial months, Current, Mid & Far months Quarterly – 3 serial quarters
Contract Size	Face Value per contract = INR 200,000 equivalent to 2000 bonds with face value of INR 100 each
Price Quotation	Similar to the quoted price of underlying GOI security
Contract Value	Quoted price * 2000

Salient Features

- Cash settled, exchange traded
- Single traded liquid bond is the benchmark as against a notional basket in the earlier avatar
- Underlying is the most liquid instrument – hence no pricing uncertainty
- Low margin requirement (< 4%)

Strategies

- View based
- Arbitrage
- Portfolio Hedging

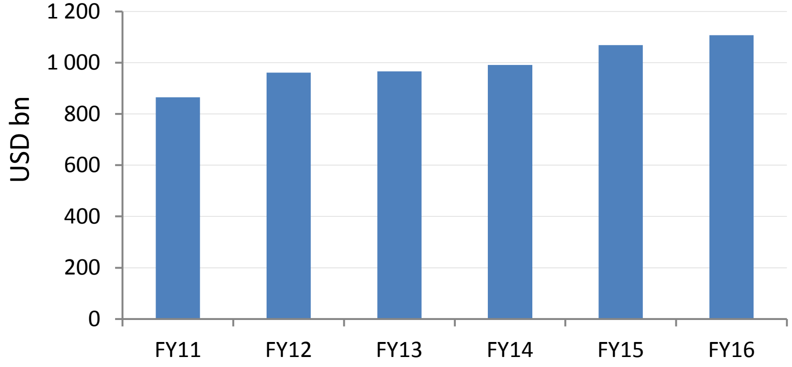
Trading Statistics

- Average Daily Trading Volume: INR 15 bn
- Current Open Interest: INR 45 bn

Market Outstanding

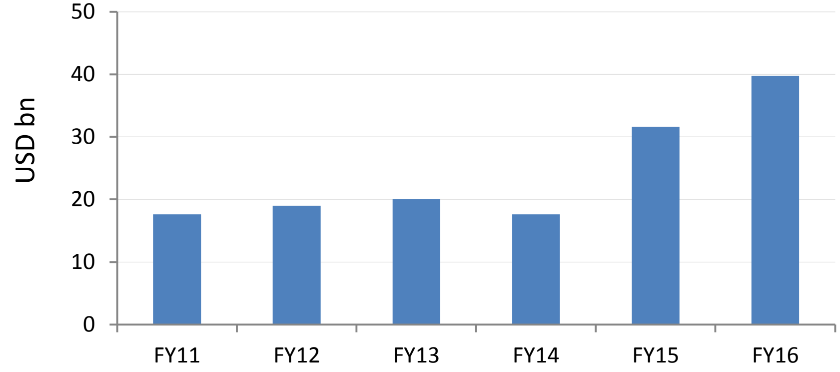
Bank Credit - Outstanding

Source: RBI



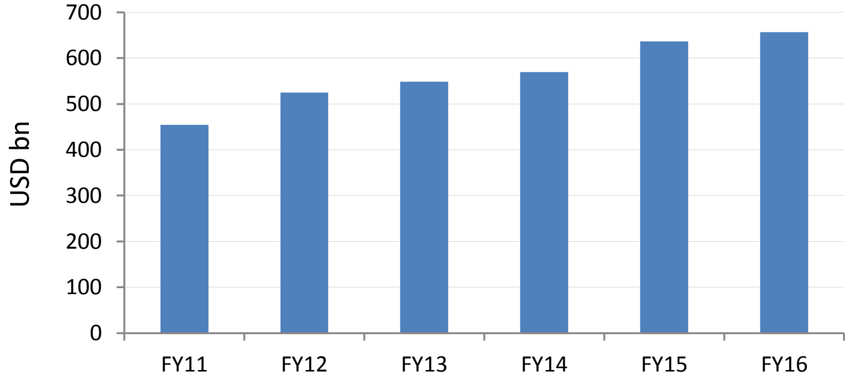
Commercial Paper - Outstanding

Source: RBI



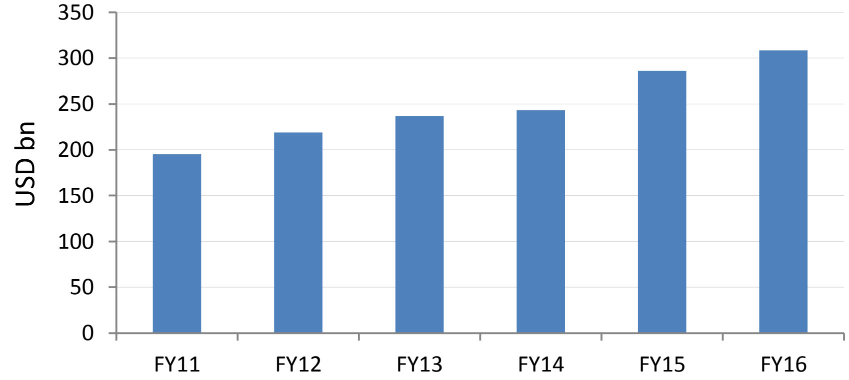
Government Securities – Outstanding

Source: RBI



Corporate Debt – Outstanding

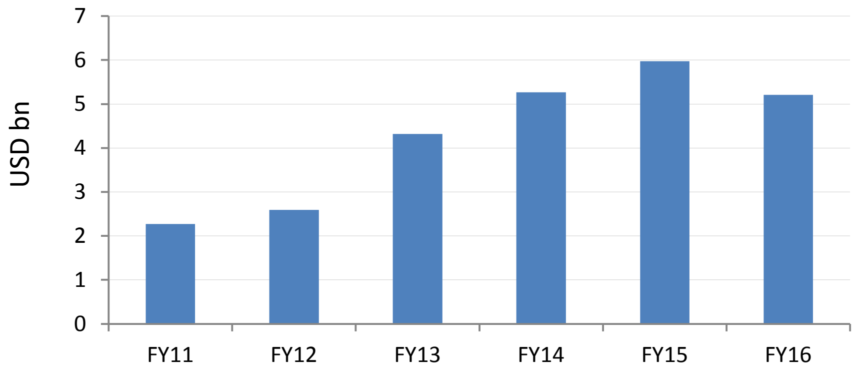
Source: SEBI



Market Activity

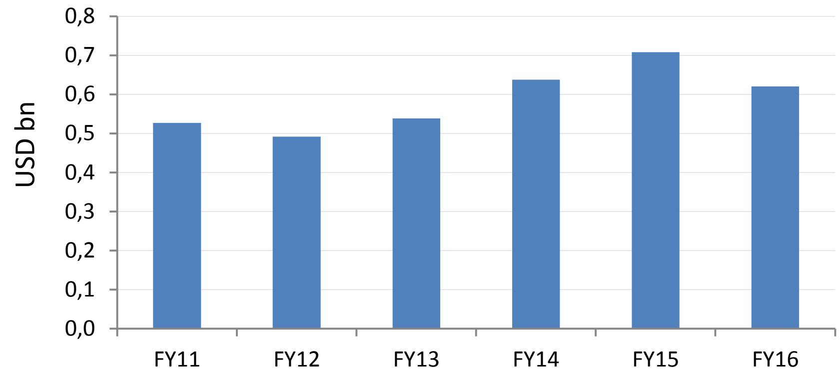
Government Securities – Secondary Market Transactions

Average daily traded volume in G-Secs, Source: RBI



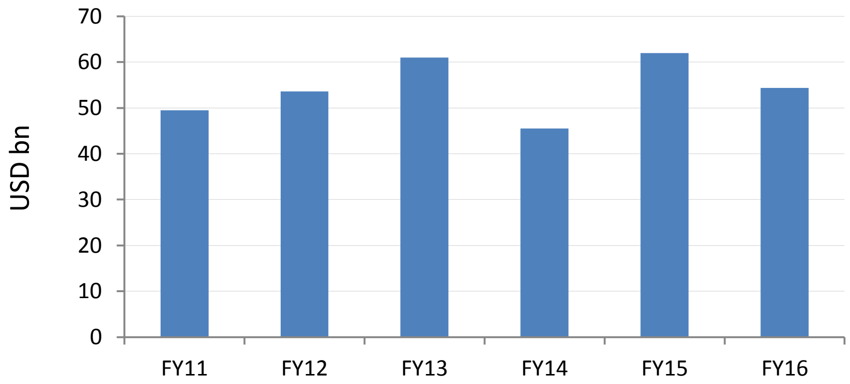
Corporate Debt – Secondary Market Transactions

Average daily traded volume in Corp Debt, reported on NSE & BSE



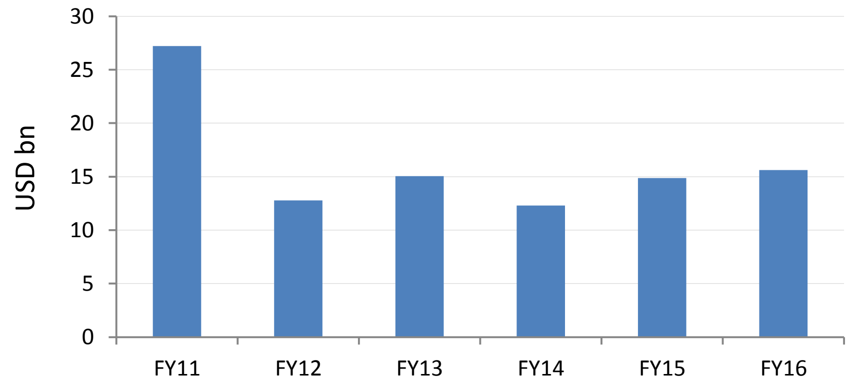
Corporate Debt – Primary Market Issuance

Private Placement + Public Issue, Source: Prime Database



Equity – Primary Market Issuance

Source: CMIE



Regulations, Limits & Trends
in
FPI Debt Investments

Overview

Who can invest?

- Any investor registered with SEBI as Foreign Portfolio Investor (FPI) can invest in the Indian Fixed Income space

How can they invest?

- FPIs can invest "on-tap" in Government & Corporate bonds (when limit utilization below 90%)
- Appoint a local custodian bank to settle the trade
- **Settlement Cycles: IGB – T+2, Corp Bonds – T+0, T+1 or T+2**

Eligible Instruments

- Government Securities (dated securities with residual maturity > 3 years)
- Listed Non Convertible Debentures & bonds issued by Indian Companies (residual maturity > 3 years)
- Units of Debt-oriented mutual funds – except Money Market MFs

Taxation

- Interest and Capital Gains are subject to taxation
- Base tax rates are as follows:
    - Coupon: **5% withholding tax**, for interest accruing between Jun 2013 and Jun 2020 (eligible only if coupon less than SBI base rate + 500 bps)
    - Short term capital gains: 30%
    - Long term capital gains: 10%
- Favorable tax rates will override the above rate in case of applicable tax treaty with the country of domicile

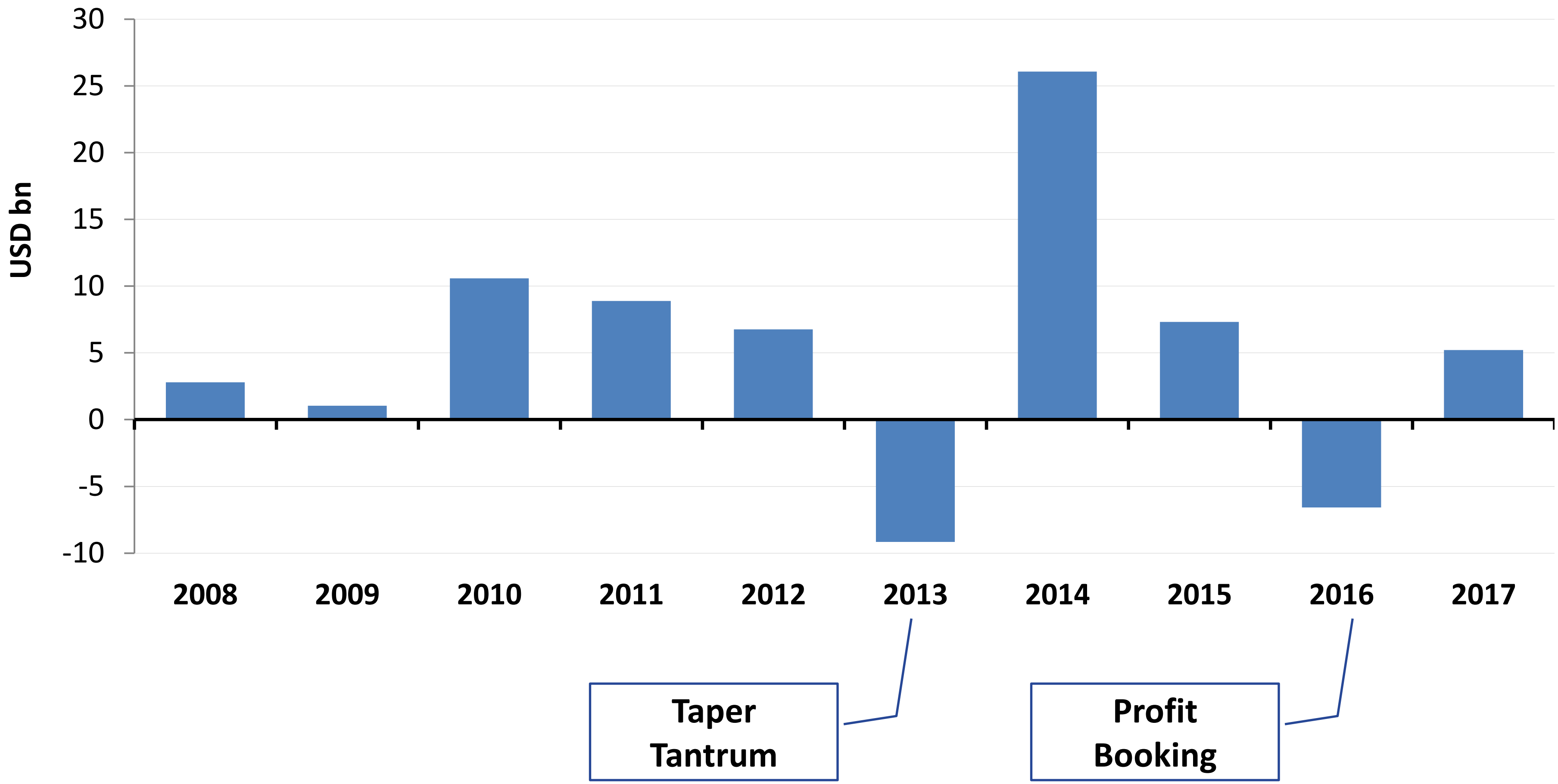
Investment Limits for FPIs

Category	IGB [All FPIs]
Current Limit (INR bn)	**1,520**
Current Investment (INR bn)	**1,230**
% Free Limit	**16%**

- **Residual maturity to be 3 years or higher at the time of investment in all categories**
- Limits to be announced / fixed in rupee terms
- Limits will be increased to 5% of outstanding IGB stock by Mar-2018 in phases
- Increase in limits will be announced half yearly in March & Sept and released every quarter
- **Limits available on-tap till 90% of limit is utilized; Auction mechanism to be followed post 90% utilization**
- **Unutilized limits under long-term FPI category to be transferred to generic FPI category at end of Mar-2017**

Foreign Investor Inflows into INR Bonds

Net Debt Flows into India (Source: SEBI)



Key Trends to Look Forward To

- Majority of foreign investor corporate bond investment is in quasi-sovereign names and HDFC / LICHF
- Incremental inquiries on top rated NBFCs / mortgage finance companies – Inflow is picking up

- As US Fed rate hikes gain momentum and EM yield spreads narrow, shift along the credit curve is likely
- Due diligence & credit analysis will be crucial

- Appetite in form of Masala bonds (offshore rupee bonds) also anticipated despite liquidity concerns
- Access to a wider pool of foreign capital → Diversified investor base

- **If Indian macro remains stable, financial services companies will be leading issuers and drivers of liquidity in both onshore and offshore markets**

FPI Checklist

- FII registration with SEBI (Securities and Exchange Board of India) ✓
- Appointment of custodian (for trade settlement) ✓
- Investor registration with clearing houses of exchanges (for Corp Bonds) & CSGL (for IGBs) ✓
- Appointment of intermediaries / counterparties for trade execution ✓
- KYC formalities with counterparties ✓

Edelweiss Financial Services – An Overview

CREDIT BUSINESSES

Present across the spectrum of

Wholesale

- Structured Collateralized Credit
- Real Estate
- Distressed Assets Credit

Retail

- Mortgages
- SME & Agri-Financing
- LAS & others

NON CREDIT BUSINESSES

Strong product franchise serving diverse client needs

- Capital Markets
- Wealth Management
- Asset Management
- Balance Sheet Management Unit
- Agri Services & Others

INSURANCE

One of the fastest growing Life Insurance companies

One of the top 5 Diversified Financial Services Firms

On Balance Sheet Assets	~ 321 bn
Assets under Management	~ 321 bn
Assets under Advice	~ 295 bn
# of clients	~887,000
# of employees	~6,227
# of offices	237
# of client touch points	4,500

Data as of Mar 31, 2016

Key Institutional Investors

Fidelity International, BIH SA, SAIF Advisors, AMANSA, ADIA جهاز أبوظبي للاستثمار Abu Dhabi Investment Authority

Comprehensive Research Support

Periodic Updates

- Daily report, briefly covering day's activity along with key data points
- Monetary Policy Preview and Review
- IRF Weekly Tracker

Analytic Update

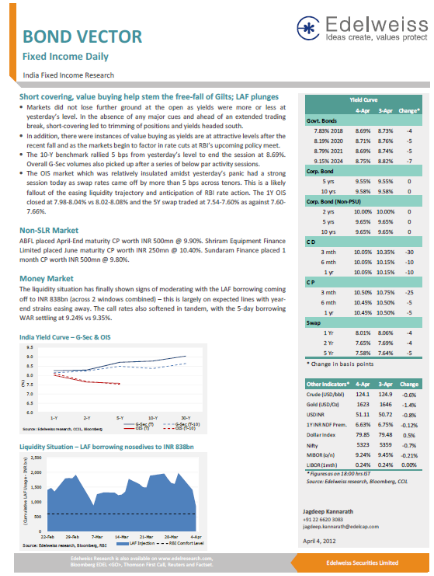
- Weekly Statistical Supplement (WSS) to understand changing deposit, lending and investment pattern of the banking system

Special Reports

- Liquidity Jigsaw - Analysis of the systemic liquidity deficit drivers
- State Development Loans – A trend analysis
- Tax-free Bonds – Landscape & Outlook
- US Fed Rate Hike – Timing, Implications, Hangover
- FII Debt Flow Monitor
- G-Sec Auctions: Key Influencers

Macroeconomic Research

- Macro data analysis - Inflation, IIP, GDP, Budget


BOND VECTOR
Fixed Income Daily
India Fixed Income Research
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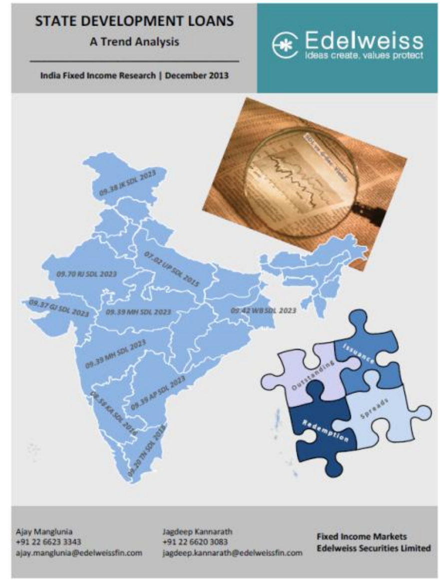
STATE DEVELOPMENT LOANS
A Trend Analysis
India Fixed Income Research | December 2013
Edelweiss
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MONETARY POLICY PREVIEW
Hawkishness might translate into another repo rate hike
India Fixed Income Research
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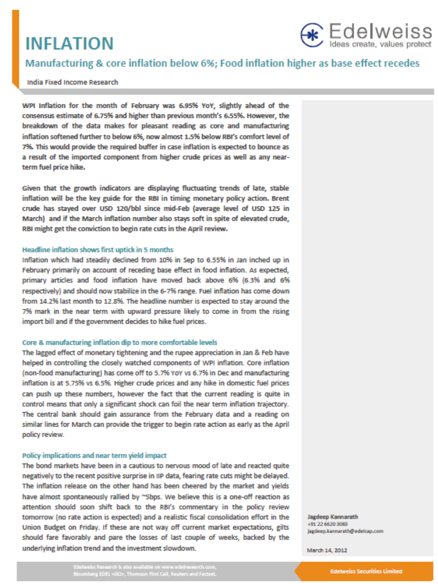
INFLATION
Manufacturing & core inflation below 6%; Food inflation higher as base effect recedes
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Thank You

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