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Edelweiss Group's Hemant Daga on post-COVID outlook, distressed opportunities

In a pandemic hit year, Mumbai headquartered Edelweiss was among the few financial services groups that raised capital for new funds in the infrastructure and credit segments. The fundraising momentum is expected to continue over the next two years, with the group eyeing another infrastructure fund, a real estate fund, in addition to putting in place a strategy for newer growth verticals.

In an interview with VCCircle, Edelweiss Asset Management CEO Hemant Daga spoke about how limited partners are looking towards India to deliver growth, how the opportunity set is changing post-COVID and why the firm prefers yielding assets over growth investments.

Edited excerpts:

What were the chief concerns of limited partners (LP) during the pandemic?

For global LPs, the Indian market is an oasis, in a world where 85% of the global bonds are trading at yields of less than 2%. India, in fact, is one of the few large economies globally which offers attractive yields for the long-term. Investors can make 18-22% rupee returns over the long term across different strategies, which is attractive when compared to other geographies, where there is very little yield.

During the entire period of the pandemic, our offshore investors have been extremely patient. They've seen these cycles play out in their countries. The good thing is that most LPs are providers of patient capital and they see such market disruptions as great entry points -- they are counter cyclical in their approach and India currently offers a good countercyclical entry point especially in credit markets.

We closed our performing credit fund while COVID-19 was at its peak. Almost all the money came from repeat investors, in addition to two to three new large investors. Our second fund was at $345 million and we were able to close our third fund at $890 mn, which means, there is a tremendous appetite for this asset class and LPs are satisfied with the returns.

For LPs, the other key aspect which they consider while evaluating a manager and conducting an in-depth due diligence on is governance.

How are your credit, distressed and infrastructure funds shaping up?

We see opportunities in two big buckets - private debt and real assets.

Private debt has three strategies — performing credit, real estate credit and distressed credit.

In our view, performing credit is a $4-$5 billion opportunity set every year in India. Many of the people who were in the business of performing credit — such as mutual funds and NBFCs — have vacated the market. So, the current supply of capital is only around $1-2 billion.

We have just closed a $890 million fund for performing credit, out of which we have already identified an opportunity pipeline of $200-300 million across sectors. This is the highest deal flow we have ever seen. Systemic risks for credit have come down and credit spreads still remain elevated.

In addition to performing credit, distressed credit is another big opportunity in India.

Given the stock of distressed assets in the banking system, we feel the addressable opportunity set for distressed assets is around $30-$35 billion. In addition to this, if you add the distressed assets that will get added every year, (2% of performing credit generally turns to NPA each year), this can translate to an opportunity set of $4 billion to $5 billion annually for the next several years. There is very little capital chasing this opportunity as well compared to the size of the opportunity.

In addition to performing credit and distressed credit, India also presents a large opportunity for Real Assets and Yield Generating Assets, such as operating infrastructure projects as well as commercial real estate.

Globally, 45% of operating infrastructure assets are owned by pension funds. In India, this number is a measly 2%. This provides a huge opportunity for pension funds, insurance funds and long-term funds like us to invest in operating infrastructure assets in India.

We've raised $450 million for our first infrastructure fund. We closed it in June 2020, during Covid times. The fund will be close to 60% deployed by early CY 2021 — into operating roads, transmission lines and renewable assets. We are looking to raise another infrastructure fund by the end of 2021 and that should be a bigger fund raise.

How do the post-COVID opportunities for these funds look?

On the performing credit side, post the recent credit crisis spreads are far higher. We see both refinance and growth opportunities at both holding and operating companies.

On real estate, we are seeing a lot of last mile or completion financing opportunities.

On the distressed side, we are seeing increasing opportunities including buying portfolios from NBFCs and banks which are looking to downsell exposures, providing capital to corporates for one-time settlement with banks prior to banks taking them to NCLT.

On the infrastructure side, the push by the Government for monetisation of assets, the laying down of the National Infrastructure Policy and deleveraging by mid-size developers are some catalysts for the medium term.

Most alternative investors in India have a consumer focus and are banking on the Indian consumption story and its demographic dividend to deliver returns. With your focus on yielding assets, would you say that Edelweiss Group is betting more on the Indian corporate expansion story?

Asset management strategies can either deliver growth or yield to the customers. India is a growth market, but India is also a large and under-penetrated credit and yield market. Globally and in India yields are coming down and most investors are actively looking for such opportunities.

While both strategies are good and have an allocation in the client's portfolio, at Edelweiss Asset Management, we feel we are better placed and want to focus on the credit and yield space. This is because we have built expertise and competence in this strategy over the last decade and an ecosystem which is robust to originate, underwrite and manage credit investments. At more than $4 billion of credit alternative funds, we are the largest domestic alternative asset manager.

In our view, there is a $350 billion to $400 billion yielding assets and credit opportunity over the next decade in India. There are very few players operating in this space in India as asset managers. As India becomes a $5 trillion economy, credit will have to grow. Historically, credit has grown at a CAGR of 15% p.a. and is very closely linked to the growth of the economy. When we look at our performance post Covid, we feel our strategies have been extremely resilient and that has been very heartening.

We think of all of these as our flagship strategies - performing credit, real estate, distressed credit, infrastructure yield -- and we will keep going deeper into them, as the space to grow and the opportunity is massive.