

INDIA MOVES INTO THE FAST LANE

Although concerns exist for the investment case for India around the dearth of information and the lack of process so far in accurately gauging past performance and the future risk return pay off, a recent *Investment Magazine* roundtable showed there is a palpable desire to bridge that divide, and increase the allocation of super fund money to an economy that has grown at an average of 5.8 per cent annually over the past 20 years.

DAVID ROWLEY REPORTS

Until recently there was ready access to fairly priced infrastructure in developed markets. Investors are now looking to other markets such as India, but one of the barriers to entry is a relative lack of data on the risk of such assets.

“The key question with investing in Indian infrastructure is ‘are we accurately pricing the risk?’” asks Andrew Killesteyn, head of direct investments at JANA, pointing out that projects in India have had mixed fortunes. “Does the quality of data coming out of the region allow us to conclude that 20 per cent is the right return for infrastructure in India?” he said.

What domestic investors at the discussion generally accepted was that investing in India would not have the same characteristics or experience of developed world infrastructure.

Andrew Major, general manager of unlisted assets at HESTA, says his fund traditionally held core infrastructure as a defensive growth

position. Such assets, he says, typically have an operating history, relatively established cash flows and dividends, with the opportunity for capital appreciation.

With such new assets now less attractive, he accepts his fund would have to broaden its scope to markets such as India. “Maybe you need to challenge the role of infrastructure in your portfolios having just a core orientation and look at it more like property which has got core, core plus and opportunistic,” he says.

Michael Sofer, associate consultant at Frontier Advisors, sees the case for investing in India as compelling, but echoes the need for greater data and reasons that the best place for an investor new to the country is on the lowest part of the risk curve.

Dania Zinurova, senior investment consultant at Towers Watson, raises the issue of whether investors should be taking a single country risk with India, and whether managers such as IL&FS should be more broadly spreading the risk in its funds to

a variety of Asian countries.

In 2009, post the GFC, IL&FS had a pan-Asian fund that offered diversification of geography risk; but now, in 2015, IL&FS prefers to focus on India alone as it feels, with the new government and overall positive macro-economic environment in the country, India offers much a better risk-reward compared to other emerging markets.

Archana Hingorani, chief executive officer and executive director, IL&FS Investment Managers, urges investors to think of India as more of a continent with different regions, similar to the European Union, rather than it being one country. “We don’t want to play the China card since we’re not comfortable taking that kind of risk any longer, and moreover we have a greater opportunity in India today,” she says.

Regulation

One of investors’ greatest risks in infrastructure is that of local regulation



▲ Milind Patel, IL&FS

▼ Dr Archana Hingorani, IL&FS



You need to challenge the role of infrastructure in your portfolios having just a core orientation

PARTICIPANTS

Andrew Major
general manager
for unlisted assets, HESTA

Milind Patel
joint managing director,
IL&FS Financial Services

Dania Zinurova
senior investment consultant,
Towers Watson

Michael Sofer
associate consultant,
Frontier Advisors

Ben McCaw
portfolio manager, JANA

Krishna Kumar
senior managing partner,
IL&FS Investment Managers

Peter Ironmonger
trade manager, Austrade

Andrew Killesteyn
head of direct investments, JANA

Bill Hartnett
head of sustainability,
Local Government Super

Dr Archana Hingorani
chief executive officer and
executive director,
IL&FS Investment Managers

Simon Cheung
partner, global infrastructure,
QIC

changing and hurting the returns or development. Here, Killesteyn sees India favourably.

“Arguably, investing in regulated assets such as electricity transmission in India may actually present more favourable risk-adjusted returns than in the UK or Australia, as regulation is generally more favourable when significant capital investment in the network is needed. We have seen the impact regulatory decisions can have on a business. The recent price determinations for the NSW electricity transmission and distribution network companies are a perfect example of that,” he adds. “The issue in India is that getting access to these investments can be difficult, given the networks are largely government-owned”.

Dr Hingorani responds that on account of lack of adequate financial resources to fulfil the funding needs of infrastructure, the government has consciously ensured a stable policy and regulatory regime to attract the private sector. Hence, the track

record on policy reforms and regulation in India goes back almost 20 years. And IL&FS, which was founded in 1987, has been a key player in collaborating with the central and state governments towards putting in place a more investor-friendly policy and regulatory framework.

Krishna Kumar, senior managing partner, IIML tells how such reforms have led to private capital funding 22,000 kilometres of roads, 40 per cent of port capacity, 71 GW of conventional and renewable energy projects and the country’s four metro airports. The share of private capital towards infrastructure spend has gone up from 25 per cent in 2007 to almost 40 per cent currently.

Local manager

One common agreement in those seeking an investment in India was the importance of a local team. This was backed up by the domestic investor with the biggest track record of Indian investment.

QIC invested in a boutique Indian

infrastructure private equity fund in 2007 and has been pleased with its returns. Simon Cheung, partner with QIC, says the experience emphasises the importance of having local managers in emerging markets. This might be with reputable local companies or multinationals that have established a presence.

“It’s very hard for a foreigner to just land on the ground and make an investment,” says Cheung.

Peter Ironmonger, trade manager at AusTrade, asks whether QIC had become more comfortable now there were more conglomerates becoming active internationally.

Cheung says that India was the emerging market where QIC is most comfortable, particularly in respect of its legal system. By comparison China’s legal system lacks transparency on property rights.

Andrew Major suggests that an investor’s partner for investing in India might be most easily found in their existing portfolio of managers. “The important thing is to make sure that if it’s a foreign partner they’ve got the right kind of domestic presence and the right kind of people who understand the culture of your fund manager, and that your fund manager has the skill to blend those two cultures,” he says.

Milind Patel, joint managing director, IL&FS Financial Services emphasises that not only should an investor want a local manager, but one that had strong relationships with government entities and official bodies including local administrators.

Ironmonger questions the vulnerability of a local manager to a relationship with a local government contact. “From our experience helping companies in India with some of the government ministries, they seem to have almost a system of rotating people,” he says.

Patel says this is overstated, as managers such as IL&FS have built up a track record with such institutions. “Political parties change, bureaucrats change, but once you have established a decent rapport with a particular bureaucracy of the government,



▲ Dania Zinurova,
Towers Watson

as long as you’re very transparent about what you want to do and how it benefits the larger population of the state, people are willing to continue to support you and take the relationship forward,” he says.

Several panel members agree that China and Russia had much greater key man risk where a relationship with a single individual was highly important, but open to the danger of that individual being replaced.

One comfort for the international investor in India is the acceptance of international arbitration. IL&FS has experienced arbitration in London, and, of late, Indian companies are also accepting arbitration in Singapore.

Standards

The *Companies Act* of 2013 has been a game changer in Indian business, with its greater level of culpability for company director to malpractice, fraud and bribery.

In addition, it has given greater scope to class actions, greater power to the Serious Fraud Investigation Office, mandated a third of

independent directors on boards, and sought for some companies to have at least one woman director on its board.

IL&FS pointed towards the long history of its high profile shareholders, which have included HSBC and GIC Singapore and now include India’s largest banks and insurers, and foreign institutions such as the Abu Dhabi Investment Authority and ORIX of Japan.

“For 25-plus years we never had any reason to participate in a process that would encourage such an activity,” she says. “Over the years there has been, absolutely, a massive change and it’s also a matter of choice, where as an institution we have not participated and have yet thrived.”

Kumar adds that there are numerous examples wherein projects have taken six or seven years to go through their entire lifecycle, from concept to commissioning.

“We did not engage in any activity which could fast track the project, but instead we have worked with the system to ensure there is a robust contractual framework in place,” he says.



▲ Michael Sofer,
Frontier Advisors



National highway road projects take somewhere between six to nine months to sign the concession agreement

IL&FS emphasises the growth of transparency in bidding processes in India, pointing out that certain aspects of bidding for infrastructure projects are now almost always done online.

As infrastructure manager at Local Government Super and also in charge of ESG, Bill Hartnett says his expectation of any investment in an emerging market was that the manager would have higher standards than just the legal minimum.

Krishna Kumar says that since the new guidelines also makes independent directors accountable, there is an active

monitoring framework at the board level to ensure that regulations such as labour laws, environment laws and health and safety standards are complied and followed. Moreover, IL&FS is one of the first non-banking financial institutions to establish a comprehensive environmental and social governance framework.

Hartnett also highlights the extra hurdle of investments in emerging markets – not promoting the use of carbon emissions.

“This is a huge leap-frogging opportunity for technology,” he says. “This is what I’d be recommending to my board. I don’t think we’d be interested at all in projects in emerging markets where we are just trying to replicate the same sort of technologies that we have in terms of energy provision in the western world.”

Hingorani points out that IL&FS is one of the largest wind power generators in India with an operating portfolio of 750 MW. IL&FS has taken advantage of the latest technologies available in the renewable energy space to efficiently roll out its portfolio.

Investment structure

IL&FS offers investors access to 10-year plans that, from an Australian context, appear to be slightly aggressive from a fund life perspective.

The first is raised by Zinurova, who sees currency volatility as the most significant risk – a risk she believes is ameliorated best over a longer horizon, such as 20 years – a strategy QIC agreed upon from its experience in India.

Hingorani says given India’s inflation premium to the US dollar, while working on any investment opportunity, the business plans factor in a 3 per cent devaluation into the price paid at the outset for a 10-year fund.

“If you pick any period of time – 10 years, 20 years – the currency devaluation has been fairly consistent and has been in the range of 2.75 per cent to 3.5 per cent”

Zinurova also raised the issue of the impact of project risk over the short lifespan of a 5- to 10-year fund.

Kumar responds that in the 1990s when the private sector first became involved in PPP infrastructure projects, there were some delays towards signing of concession agreements, and land acquisition negotiations. Over the years, most of these aspects have been streamlined and the project development timeframe has reduced considerably for most infrastructure sectors.

“Today, national highway road projects take somewhere between six to nine months to sign the concession agreement and achieve financial closure,” he says.

Killesteyn raises the issue of closed end 10-year funds, when Australian investors were more used to open ended funds such as those run by Hastings and IFM.

Krishna says the lack of a “vibrant” secondary market in India was the cause, and that as such it was more efficient to have a closed end fund. ■

 | Private Equity

IL&FS Investment Managers Limited

4 Fully Divested Funds

72 Divestments | 20% Gross Return *

* In INR Terms

www.iimlindia.com | sanjay.mitra@ilfsindia.com