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Special Edition

India's growing allure as an infrastructure investment destination

- Sunil Kanoria interviewed by Sung-Yun Kim and Sunny Goel -

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Executive Summary

India's infrastructure development environment is steadily improving in the wake of the Modi Government's economic reforms over the past three years. What challenges do Indian infrastructure projects pose? How should foreign investors approach Indian infrastructure investments? Such questions were among the topics discussed in NRI's conversation with Mr. Sunil Kanoria, Vice Chairman of the Srei Group, a leading Indian infrastructure financing conglomerate.

Sunil Kanoria

Vice Chairman, Srei Infrastructure Finance Limited

Co-founded Srei Infrastructure Finance with his brother in 1989; acting as Vice Chairman. Appointed Director of Srei Equipment Finance in 2007 and Non-executive Director of India Power Corporation and Grupo Empresarial San Jose in 2010. Former President of Associated Chambers of Commerce and Industry of India (2015-17), Council Member of Governing Body of Institute of Chartered Accountants of India and Member of Governing Body of Indian Construction Industry Development Council.



Sung-Yun Kim

President, NRI India

Joined NRI in 2003. Worked as Management Consultant specializing in trading companies and real estate, energy and financial industries while researching real estate market, asset management, institutional investor analysis and corporate governance. Attended University of North Carolina for MBA in University of North Carolina at Chapel Hill. Seconded to NRI India in 2015; appointed to current position in 2016. Author of book on investment real estate market research (2013).



Sunny Goel

Division Head, Investment Strategy, NRI India

With around 9 years of experience, worked largely around mergers and acquisitions. Areas of work include making acquisition strategy, acquisition screening, commercial due diligence, joint venture making, feasibility studies, go-to-market strategy and integration programs. Holds a bachelor's degree in engineering and master's in business administration.

Srei Group: Indian infrastructure financing conglomerate

Sung-Yun Kim: Srei Infrastructure Finance has long and close ties with Japanese companies as a key partner in their Indian operations, but it may not be well known to ordinary Japanese. Could you first share some background on Srei?

Sunil Kanoria: Srei is an infrastructure financing conglomerate headquartered in Kolkata, India. It was founded in 1989 as a construction and mining machinery leasing company. At the time, the Indian economy was languishing and the machinery market was small.



The market has since grown rapidly in tandem with the economy, expanding from US\$25 million in 1989 to US\$5 billion in 2011.

Kim: That's a 200-fold increase in 22 years.

Kanoria: That's right. It subsequently shrank to US\$3 billion but should grow substantially in the current fiscal year as the economic environment improves.

Since its inception, Srei has been a driving force behind the infrastructure financing and machinery leasing industry as a market leader. In the construction and mining machinery market in particular, we currently command a market share of over 30%.

We have expanded our product offerings into leasing and financing of non-CME machinery including healthcare and technology equipment, rural equipment, port and electric power equipment and warehouse equipment. Any equipment that contributes to economic growth of the country is a business opportunity for us.

Kim: Srei finances not only such assets but infrastructure projects also, right?

Kanoria: Yes, we're involved in a broad range of infrastructure projects, most notably toll roads power plants, airports, seaports, industrial parks, water & waste management and so on. Over the past decade, we've started investing in infrastructure projects ourselves instead of just financing the projects.

By cultivating expertise across the entire spectrum of Indian infrastructure, we are pursuing growth opportunities with a business model that encompasses financing, leasing and investment. Depending on the situation, we may use our own balance sheet or utilize a fund. As we've expanded our operations, we've sometimes encountered adverse economic conditions, but through our almost three decades of experiences in infrastructure, we've become adept at risk management.

Sunny Goel: In terms of your relationships with Japanese companies, I heard that Srei started out financing Komatsu construction machinery.

Kanoria: Yes, Srei has been financing construction machinery since its earliest days. We have relationships with several Japanese construction machinery OEM, including not only Komatsu but also Hitachi, Kobelco, etc.

Besides financing construction machinery, Srei has relationships with a wide range of Japanese companies. For example, Srei has been increasingly investing in B2B technology businesses and has partnered with NEC as an IoT solution provider in the logistic space.

Kim: What's your impression of Japanese companies?

Kanoria: They take time to make decision. But I think making steady progress, even if somewhat slowly, is better than rushing. Srei wants to build long-term relationships with its Partners. It seeks Partners with a long-term perspective on India's economic development.

How has India changed under Modi Government?

Kim: What's your view of the Indian infrastructure market today?

Kanoria: The Modi Government has been in power for almost three years. It has done a lot to fix past problems, and the infrastructure market environment has changed substantially.

Government projects were previously plagued by frequent improprieties and corruption, partly due to governance deficiencies. Additionally, projects undertaken by the government were often stalled due to environmental assessment problems.

But I believe it's safe to say that such problems have been largely resolved. The current government has demonstrated strong initiative and therefore, governance has improved with roll-out of transparent policy. Both the government and private sector have been working to sort out many infrastructure-related issues over the past few years.

Many stalled infrastructure projects have restarted. Infrastructure investment is growing at a double-digit pace. I doubt there are more than a handful of countries where infrastructure investment is growing as fast as in India. The Indian economy is expected to grow in excess of 7-8% annually over the next 10 years. It's a great macro environment with strong emphasis on infrastructure development.



Kim: Indian banks' NPA (nonperforming asset) ratios have been rising recently, leading to economic concerns. Infrastructure loan delinquencies are particularly pronounced. What's your take on this situation?

Kanoria: Most delayed infrastructure projects were financed with bank loans. Infrastructure lending previously had several structural problems.

First, there are no long-term lenders in India. Infrastructure projects with 20-25 year concessions were financed with 8-10 year loans. Projects already had a cash-flow mismatch at the financing stage.

Second, many projects were canceled or halted due to land condemnation or environmental assessment difficulties. With interest rates at 12-15% in India, a three-year delay increases project costs by 40-50%. The difficulties take a long time to resolve. In the meantime, banks bear the brunt of the delays.

But the next few years may present opportunities for investors. With banks needing to offload NPAs, investors may be able to buy assets at bargain prices.

Kim: Last year, India enacted its first national bankruptcy law. It's expected to expedite bankruptcy proceedings. Will it help resolve NPA problems also?

Kanoria: Yes, I believe it will help a lot to resolve NPA problems faster.

Banks previously took their cues from the government. Unable to make decisions independently, they made no progress in dealing with NPAs. Now, if banks comply with the bankruptcy law's procedures, their claims will be handled transparently by the courts. They will be able to restructure debtors' assets or sell them to investors pursuant to a rational court ruling. In my opinion, this bankruptcy law is the strongest and best economic law in India's post-independence history.

Kim: If so, banks should be able to make great strides toward resolving their NPA problems this year.

Kanoria: Yes, I expect the situation to start to improve.

Having said so, the bankruptcy law is completely new. India needs to build the capacity to utilize the new law. Bankruptcy proceedings require knowledgeable practitioners which is severely lacking. It needs to be cultivated, which will take time. The NPA situation will take perhaps 1-3 years to improve significantly.

Demonetization's economic impact

Kim: Last November, Prime Minister Modi suddenly demonetized 500- and 1,000-Indian Rupee banknotes (then worth roughly US\$7 and \$14, respectively) in the aim of eliminating "black money." Chaos ensued, including long lines of people queuing at banks to exchange the banned banknotes for new ones. Japanese companies in industries such as autos and consumer staples were concerned about the impact on their businesses.

From your view point, how has the cash ban affected the infrastructure sector and, in turn, India's economy and society?

Kanoria: Thankfully, I don't think the infrastructure sector was materially affected. Cash doesn't play much of a role in infrastructure projects, many of which are government financed.

What I personally find most significant about the cash ban is that nearly all of the banned banknotes have returned to the financial system as bank deposits. Considering how much cash was previously stashed away in people's cupboards,



I believe the amount of money circulating in the financial system has increased dramatically since the cash ban. This incremental liquidity should support economic growth going forward.

Other major benefits of the cash ban include a reduction in illicit transactions due to more transparent circulation of money and increased interest in digital payment channels in response to shortages of new banknotes coupled with restrictions on cash withdrawals from banks.

Kim: One of the Indian government's top policy priorities is to broadly popularize digital payments. The government is promoting financial inclusion to make financial services available to all Indians. A huge number of people in India are now using mobile payment services such as PayTM.

Kanoria: Indian FinTech is advancing at a stunning pace.

The Indian government also is actively promoting digital banking in the aim of financial inclusion. It has created a new banking model called payments banks, which specialize in processing payments. It has also launched the Unified Payments Interface (UPI) to enable consumers to make interbank funds transfers via mobile platforms.

Additionally, the government has recently been discussing a universal basic income (UBI) to ensure that everyone has at least a minimum subsistence income. If the government decides to actually provide a UBI, the only way it could do so would be through digital means. So a UBI would be conducive to further financial inclusion.

Kim: The vast majority of Indians do not use ATMs and have never seen a debit or credit card, yet everyone now conducts financial transactions on their mobile phones. In this sense, India is unlike any other country I've ever seen.

Kanoria: Indeed. The government's promotion of such IT-enabled financial inclusion was what prompted Srei to launch Sahaj e-Village in 2007 as one component of India's National e-Governance Plan. Sahaj e-Village opened IT-equipped service

centers throughout rural India. The centers provide local residents with access to e-governance, e-commerce and e-learning. The e-commerce services, for example, include payment services, bank account origination, cash withdrawals and life insurance sales. We have opened over 60,000 service centers throughout India, mainly in villages with populations below 10,000.

The centers are set up in collaboration with local entrepreneurs so that village residents can access such services without having to travel to the nearest big town.

Infrastructure investment opportunities for foreign investors

Kim: You said earlier that you expect government infrastructure projects to pick up going forward. I presume interest in Indian infrastructure is on the rise among foreign investors also.

Kanoria: That's right. Many foreign investors have already started investing in India. For example, the Bangalore airport's biggest investor is from Canada.

Even with valuations already rising in India, I expect the next couple of years to still offer stellar investment opportunities.

However, in India you have to clearly distinguish between greenfield infrastructure development projects and brownfield infrastructure projects already in operation.

The government's forthcoming infrastructure projects are expected to include many large-scale greenfield projects, but I personally believe brownfield assets are more suitable for foreign investors who are new to India.

India has many investment opportunities in brownfield assets that offer lucrative long-term returns without construction risk, including airports, seaports and toll roads. Even such brownfield assets often deliver double-digit returns in India. I believe they are extremely attractive for long-term investors like Pension Funds.

Additionally, India has historically utilized Public Private Partnerships more actively than other countries as an infrastructure development model. The private sector has invested over US\$400 billion in India's infrastructure over the past 15 years. Even excluding greenfield projects, I expect this \$400 billion of investment to give rise to lots of investment opportunities for secondary investors.

Kim: How should investors approach greenfield projects?

Kanoria: Investors should try to evaluate greenfield projects in favor of proactive states such as Gujarat, Madhya Pradesh, Andhra Pradesh and Telangana. Many states move slowly on infrastructure projects, but I am certain that the situation will improve as states start competing amongst each other for greater pie of investors.

Kim: So you'd recommend that investors initially cut their teeth on relatively worry-free brownfield assets and then broaden their horizons to include greenfield projects in progressive states?

Kanoria: Exactly.



Goel: Lastly, is there any message you'd like to convey to Japanese investors and companies interested in India?

Kanoria: India is a rapidly maturing society with a big population. Low-risk investment opportunities that did not exist five years ago are popping up all the time. Economic reforms also are underway. The Indian economy should continue growing at a growth rate of 7-8% annually for next decade. Given India's US\$2.5 trillion current GDP, I expect huge investment opportunities to continue to be available for Japanese investors.

I feel that Japanese investors tend to be passive and risk-averse. I encourage Japanese investors to proactively pursue Indian investment opportunities. They can work together with local partners to assess and manage risks effectively.

Kim: There may never be a better time to invest than now. Thank you for sparing your valuable time to speak with me today.



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