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2020

THE BOTTOM LINE

Exploring Alternative Investments



FOREWORD

Dear Readers,
Greeting from the editorial team.

We humbly present to you the first edition of “The Bottom Line”, a joint initiative of the Finance Clubs at IIM Ahmedabad, Bangalore, Calcutta and Lucknow. The monthly magazine would be an aggregation of the thoughts of professors, students, bloggers and industry leaders. While the world grapples with pandemic-related incursions in their lifestyle, we bring to you our unique perspective on various economic and financial issues facing the world in the near and long term.

While the pandemic dominates conversations and policy space, we aim to bring certain long-standing yet unresolved issues back to the forefront of our reader. In a messy world which has taken a turn for the worse with the healthcare crisis, devoting our mind-space exclusively to the pandemic would be myopic at the very least. As a species, we are facing a very real existential crisis stemming from climate change, as well as a social crisis driven in large part by economic inequalities which have only gotten steeper since the Global Financial Crisis. Closer home, we were faced with issues like a declining automotive sector, which forms 7.5% of India’s GDP, the social issues like economic inequality, lack of access to quality healthcare and education and the inability of the government to act as the magic wand to solve such problems which have plagued the country since independence.

We look around as we see the disintegration of globalisation in the world. The US-China crisis has resulted in to-and-fro trade restrictions, forcing businesses across the world to re-align supply chains to the whims of a Twitter account and an autocratic ruler. Closer home, we are seeing rising signs of protectionism stemming from foreign policy reactions rather than economically weighted

decisions. Our aim is not to deride any of these decisions. We believe that this magazine itself is a sign of the perspective and the quality of work that can stem from the sharing of knowledge and mutually respectful interaction between students of institutes which are bound by their thirst for excellence and success, something, that countries all over the world claim to be. A unique combined initiative of Beta at IIM-A, Networth at IIM-B, Finance and Investment Club at IIM-C and Credence Capital at IIM-L aims to bring together not just the best minds and writers to create a resource worth reading, but also expand the reach of the above writers to students and readers interested in the world of business.

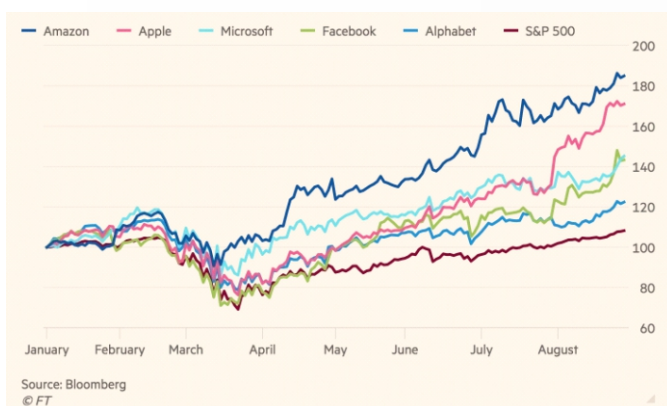
We hope that leaders of the world watch and take notice. If not the current leaders, but you the reader, the future leaders of the world.

P.S. – Any feedback from our readers, be it topics addressed, quality of content, potential topics which should be discussed etc. would be welcome. We hope that every subsequent issue is better than the last.

Happy Reading!!

GLOBAL MACRO TRENDS

“Stocks only go up” – if this year’s speedy downfall and recovery in the global stock markets has led you into believing this statement, you may not be the only one. It took US stocks 6 months to completely erase the pandemic bear market, with the S&P500 at 3508, its All Time High, well past the highs of 3380 reached in February 2020. Much of this rally has been fuelled by the technology stocks that have been resilient in this pandemic with all of them reporting better than expected earnings, beating analyst estimates. The sector now constitutes 38% of the S&P500. Below is the representation of how the tech behemoths have performed vis-à-vis the S&P500:



Fed’s ‘QE infinity’ has been particularly instrumental as it has helped lower bond yields, flattened the yield curve boosting equity prices as investors flock to equity in search for yield. Moreover, the excess liquidity has been in play as there still seems more room for upward moves when we look at the Fed’s M2/S&P500 ratio. S&P 500 has had its best August since 1986 while the short positions in the US stocks have dropped to their lowest levels since 2004 – short interest as a percentage of market capitalisation has fallen to 1.8% from 2% at the start of the year and is lower than 2.4% average of last 15 years. The Emerging Markets Index has erased all of its losses for the current year while India’s Nifty 50 is down only 4.4% for the year. Though the world covid new cases graph seems to be flattening with a

vaccine expected before year end (though the same has been priced in by markets considerably), the positive sentiment seems hard to be subdued.

Let’s take a look at some recent important themes and events that have and will be instrumental in shaping market direction in the upcoming months:

Resignation of Japanese Prime Minister Shinzo Abe:

On Friday, Japan’s equity markets fell (TOPIX fell by more than 1.5%) and the Yen strengthened (from 106.8 to 105.6 per \$) in the last 1 hour of trading after the country’s national broadcaster reported that the it’s longest serving prime minister, Shinzo Abe was resigning due to health concerns. While the kneejerk reaction arose due to uncertainty about the continuance of Abenomics, the emerging consensus is that the risk of reversal of Abe macro policy (including the corporate governance reforms) remains low, with political stability remaining a bigger concern as PM Abe, the longest serving prime minister has achieved a very high degree of political stability in Japan through internal politics, favourable economic conditions and diplomacy. Though LDP’s majority in the parliament, lack of a strong opposition and a huge probability of continuity of the same policy mix are positives that indicate reversals of the knee jerk market reactions in the short term, the next prime minister’s leadership will play a key role in driving political stability and further market action in the long term.

Fed Chair Powell’s Jackson Hole message:

On Thursday, Fed Chair Powell said that the Fed will tolerate higher inflation to boost growth and employment in the US, moving policy making framework from inflation targeting to averaging out inflation of 2% over the longer term. It means that the Fed will tolerate periods of rising prices to compensate for periods when inflation is falling short. The Fed also adjusted its thinking on the labour

market as it will now base its decisions on “assessments of the shortfalls of employment from its maximum level”, rather than “deviations from its maximum level”. The Fed’s policy essentially implies that low interest rates are here to stay for longer which will boost equity prices as S&P 500 welcomed this move with a 0.5% up move. US Treasuries sold off due to rising inflation expectations after Powell’s remarks as the yield on the 10-year rose to 0.73% (up 4 bps) while the yield on the 30-year rose to 1.5% (up 7 bps). The yield curve became steeper as the short dated treasuries barely budged with the 2-year steady at 0.15%, supporting a rally in the banking sector that tend to benefit from the steepness in the yield curve – as the S&P 500 Financial stocks were up 1.5% and we also saw some of that action in India with Bank Nifty up 3.9% as of Friday close.

Upcoming US Presidential Elections 2020: While Biden was almost 10 points ahead of Trump in the Five Thirty Eight’s average of national head-to-head surveys almost a month ago, the lead has been narrowing of late especially after the Republican national convention, especially after the recent riots in Kenosha and a weak response from the Democrats furthering Trump’s agenda. With 2 more months to

go, I think the elections will be very close. Two key sectors that are expected to benefit from a Democrat win include clean energy and infrastructure. While a Democrat win is supposed to be bad for the markets particularly because of their pro-tax policies that will eat into corporate profits, some experts also feel that the stock markets should reach newer highs irrespective of whichever party wins because of the enormous amounts of fiscal stimulus that governments will shower to sustain the economies.

Taking cues from the above macro trends, we now delve deeper into this month’s theme ‘Alternative Investments’ which will be followed with other interesting articles from finance and economics domain.



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ALTERNATIVE INVESTMENTS

What is Alternative Investment?

Alternative investments are those asset type that differ from traditional investments on grounds of liquidity, complexity, regulatory mechanism and mode of fund management. As these are assets with a niche investor base, the trading in these is infrequent as compared to the traditional investments. Due to the low volume of trading and absence of public market, these investments cannot be sold off quickly. There is sheer lack of interested investors. This is in contrast with the mutual funds, fixed income securities or equity stocks which are constantly being bought and sold due to a much wider investor base.

Truth is Alternatives can be an integral part of nearly every investor's portfolio. It not only brings diversity into the portfolio but also mitigates risk. With diversification as its underlying element, it is gaining popularity among retail investors now. It is no more the arena of the wealthy investors.

Types of alternative investments

There are various types of Alternative investments. These include Private Equity Funds , Hedge Funds, Venture Capital, Commodities and Tangibles like Wine/ Art/Stamps. Real Estate is also often classified as alternative investment. Each of these have their own risk and reward profile.

Why Alternative Investments are preferred?

• Less Market Co-relation:

With a low co-relation between -1 to 0 , Alternatives are less susceptible to systematic risk or market-oriented risk element. This is one of the major advantage of Alternatives over traditional asset classes like equity markets and fixed

income markets. When most of the stocks or funds fail during recession alternative investment magically performs well.

• A strong tool for diversification:

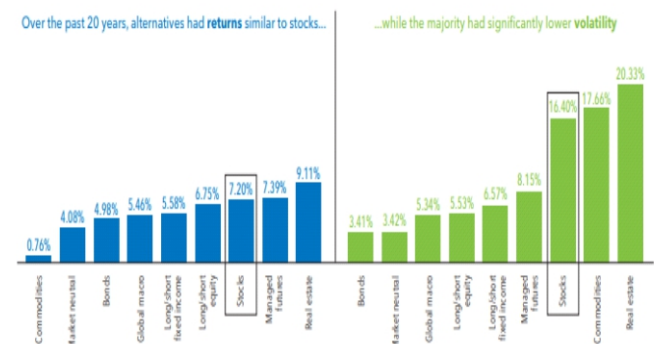
Alternative investments offer better diversification benefits with enhanced returns by virtue of their lower co-relation co-efficient. These assets perfectly complement the traditional investments and when a stock or bond underperforms, a hedge fund or private equity firms can cushion the extent of losses over the long term. One can add or replace the alternative assets based on individual investment goals and risk appetite.

• Active management:

Alternative investment calls for active management of funds as opposed to passive indexed investment. The complex nature of the assets, volatility and elevated risk level of these investments require constant monitoring and recalibration of investment strategies as needed.

Potential for lower volatility and enhanced returns

Returns and volatility of major asset classes (1998-2017)



As interpreted from the above diagram, Alternatives have almost performed similar to stocks in the past two decades. In future as their popularity will grow, returns will be growing more.

Conclusion

While this asset class is certain to provide diversification, it does require expertise in selection and sound judgement-backed investment. Without thorough research or study of market trends, investing in them are often a risky bet. But if done properly it can generate fortunes.

There are lot of myths around within the market related to alternative investments which is restricting people immediately to have trust on

alternative investments, so it's necessary everyone should remember of the right facts.



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OPPORTUNITIES IN ALTERNATIVE INVESTMENTS

Those days are gone where one could invest through stock exchange only. Now a days there are more ways to grow money and these alternative ways are known as alternative investment. This article will provide an overview of alternative investment and related potential benefits and risks therein.

An alternative investment may be a financial asset that doesn't fall under one among the traditional investment categories or conventional investment. Conventional categories include stocks, bonds, and cash. Most alternative investment assets are held by institutional investors or accredited, high-net-worth individuals due to their complex nature, lack of regulation, and degree of risk.

One of the key differences between traditional and alternative investments is that the liquidity. Assets put into traditional investments tend to be easily accessible at any time, by the investor. Usually, one can take advantage of the bonds or stocks once they got to . Alternative investments tend to be illiquid, this suggests it is unable to liquidate an asset so as to urge some quick cash. If you were to get a house, for instance , that house would wish to be sold before you'll access the funds.

Alternative investments tend to supply a greater return, even when the market is hard . During the 2008 financial crisis, alternative investment options held their own, predominately. Traditional investments didn't do so well. Alternative investments tend to grant higher minimum amounts, which is that the only drawback when it involves new investors. If the investor don't have tons of cash to take a position , then he'll be waiting a short time for giant returns. Traditional investments require smaller minimums, but even have a lower return on investment.

The world is collectively and individually grappling with an unprecedented event of a pandemic in modern times. In the past couple of months, there was an increase in fund raising efforts. In February,

2020 alone, there were at least 12-13 new filings for registration as Alternative Investment Funds, as posted by SEBI on its website.

To enable ease of doing business, the taxation framework for Alternative Investment Funds (AIF) provide pass-through status to profits of the AIF to the investors under which any income, barring business income, earned by AIFs would be exempt in the hands of such AIFs, and taxable directly in the hands of its investor(s).

Alternative investments are supplemental strategies to traditional long-only positions in stocks, bonds, and cash. Alternative investments include investments in long-short public market strategies and such less common assets as private equity, real estate , infrastructure, and commodities. Often these investments are made via limited partnerships and special purpose vehicles.

Alternative investment strategies are typically active, return-seeking opportunities that have different risks from those in indexed public markets. When compared with conventional investments, its lower liquidity, less regulation, lower transparency, higher fees, and limited and potentially problematic historical risk and return data. These opportunities are attractive to investors because of the potential for portfolio diversification (reduced risk) and higher portfolio returns when added to a portfolio of .The risks associated with alternative investments must be factored into the investment decision-making process.



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ATTRACTIVE ALTERNATIVE INVESTMENTS INTO INDIAN DISTRESSED DEBT : WHAT MORE WILL IT TAKE?

On June 23, SEBI came out with an operational framework for transactions in defaulted debt securities.¹ In a market where 97% of the corporate bond activity is in securities rated AA and above, it definitely is a big breakthrough.²

But is it enough?

Ever since RBI began its AQR in September 2015, resolution of stressed assets has been seen as an opportunity for the AIFs but Indian PEs, ever since Warburg Pincus' early investment in Bharti Airtel, have remained focused on early stage companies.

There are a number of reasons for this.

Historically, uncertainty over legal outcomes has prevented entry into distressed debt. However, with the coming of IBC in 2016 and subsequent amendments to it, this problem is being countered.

Secondly, once the IL&FS crisis meant Indian NBFCs could hardly finance themselves after late 2018, NBFC arms of global and Indian PEs, which jumped into the space, found the going tough.

KKR India Financial Services Ltd. faced significant write-downs on debt, and its India boss and a top-deck shakeup before a \$150 mn infusion into the NBFC arm³ and more recently, Edelweiss group's ECL Finance Ltd. announced it was done with wholesale lending.⁴ The NBFCs model are failing to provide high returns on debt while setting aside the prescribed 15% risk capital.

But why do AIFs need to register an NBFC?

SEBI has defined a debt fund AIF as one which invests primarily in debt or debt securities of listed or unlisted investee companies. It has expressly clarified that the amount contributed by investors

shall not be utilised for purpose of giving loans.⁵ Hence, to directly finance a company, an NBFC is to be setup and registered with the RBI. With limited availability of debt securities, the PEs like KKR and Edelweiss had to setup their own arms to enter the market.⁶

Groups like Edelweiss and Kotak also setup Asset Reconstruction Companies (ARCs) to recover and/or securitise bad debts on the bank books. However, even the ARC business failed to take-off. With provision requirement being based on age of bad loans, group ARCs of banking companies became a balance sheet to hoard the old loans to prevent incremental provisions. Once RBI tightened its regulation in 2016,⁷ the group ARC business became defunct. And rightly so, they were generating today's fees at the expense of future losses which could be socialised. The ARCs could never be allowed to make a profit, else the bankers' prudence could be questioned in court.

As the loans which had turned bad in 2016 attract 100% provision starting 2020, talks of a bad bank have become loud. If the proposed structure under the Indian Banks Association (IBA) comes into place, it will at least become the securitisation engine for AIFs to participate in debt under the current SEBI regulations.

The IBA has, historically, had limited say beyond fixing wages and the success of an IBA-led ARC appears remote. With NPA ratios of the banking system projected to rise to 12.5-14.7% by March 2021⁸, we are already neck deep in mud. While firms like Northern Arc and Vivriti Capital have setup tech platforms to make the market, they can only access the tip of the iceberg unless the banking books are brought within the bounds of AIFs. This requires

concerted efforts from the PSB dominated banking system, weighed down by fears of CBI, CVC, CAG and courts. Also, the action must be swift- before global QE tapers and before Indian PEs find comfort in alternatives like real estate.

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IMPACT INVESTING - TOO GOOD TO BE TRUE

The investor's ability to recognize the key and unique drivers of the anticipated risk and return on investment is a key factor in the financial success of the investment. Financial analysts and portfolio managers are expected to be aware of the potential factors that can influence the value of the investment. Lately, plethora of issues, that are difficult to quantify in quantitative terms and which typically, do not form part of conventional financial indicators, are beginning to have a profound impact on the risk and return on investment. They are commonly referred to as environmental, social and governance (ESG) issues. The key question which is generally asked here - Is it really possible for investors to achieve social impact along with market rate returns? This is a never-ending debate in the financial markets with strong argument on both sides. Traditionally, socially conscious investment was most strongly connected to avoiding morally dubious companies and has been around for many decades, at least since the creation of the Calvert Social Investment Fund in 1982.

Are impact investors different from normal investors?

This space is dominated by confusion over basic principles, dubious practices that invite cynicism, and biases against large companies. Firstly, the typical market return investors are seen as different category of investors from the “impact investors”. While the former is perceived to be a greedy investor, guided by only financial returns; and therefore, invests only in high margin/ high volume blue-chip businesses. The latter is more motivated by “social returns”, and invests in businesses with potentially large social benefits, such as reduced income inequality or slowed global warming. What people forget is that those socially beneficial goods and services—be the rural roads, solar panels, seeds, or

medicines—are, after all, the “purpose” of businesses. Impact investing is definitely not charity, its rather investing in businesses who are achieving commercial returns along with impact. It is not difficult to find examples of firms providing market (or even better than mainstream commercial) returns while still having outsized impact on livelihoods, job creation, or access to essential basic services. Impact investors can actually invest on a spectrum ranging from risk-adjusted market returns at one end to highly concessionary investments at the other. However, it's pretty obvious that concessionary investments can have a much larger investment impact, because concessionary investors are willing to engage in some degree of philanthropy by taking higher risks or accepting lower returns than the commercial market would. Another very interesting school of thought, believes that trying to define who is and who is not an impact investor is an unhelpful diversion. Their analysis focuses not on the investor, but on the impact of a particular investment. And whether any particular investment has impact may depend on the context in which it is made. Going forward, one thing is sure, more and more, institutional and retail investors are expected to gradually insist that a higher percentage of their portfolio be evaluated based on ESG considerations.

What cannot be measured can't be achieved

Impact investors sincerely want to believe that their investments “make a difference.” They are attracted to the thought that the financial and social benefits of an investment would not have occurred without their participation. The most common complaint about impact measurement is almost total lack of consensus on indicators that could be standardized across investments within a sector, let alone across sectors. Even more profound problem is the expectation that an observed change in an indicator

can be reliably attributed to a particular investment or company. This is a recipe for disappointment that over time will increase the already pervasive cynicism about “greenwashing” or “impact washing.”

Big Companies are not always Sharks

Impact investors fully appreciate the many challenges to investing in underperforming sectors in low-income countries: it's extremely difficult to meet requisite payback periods or break-even benchmarks; the required investments are big and inevitably have high transaction costs due to regulatory uncertainty. Large companies, not small ventures, can handle such complex undertakings as they have the production capacity and skills to manage the scope and scale of these investments profitably. Moreover, they have the reach, through trade and global supply and value chains, to address problems of market access and inconsistent regulatory implementation. They have the scale to handle the high marketing and first-mover costs to reach bottom-of-pyramid market segments. And last, but not the least, they have excellent access to short and long-term financing at the lowest available

rates, as well as internally generated capital.

If the discourse around “impact investing” continues to drift along with muddled ideas about rates of return, impact indicators, cynicism towards large global companies, it will invite more negative responses. It may also fall short of its potential in financial markets, where reputation is extremely fragile. Moreover, If it keeps attracting financial resources without demonstrating its effectiveness, it may well be the reason for a large-scale misallocation of capital on the basis of well-meaning intentions.



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REITS HAVE A LOWER RISK BUT ARE NOT RISK-FREE

An REIT or a Real Estate Investment Trust is a company that owns and operates real estate properties. REITs gained prominence in India after the listing of Embassy Office Parks in 2019 and Mindspace Business Parks REIT backed by the Raheja Group in 2020. REITs allow pooling of investors similar to mutual funds to generate returns from real estate assets.

Investors earn returns on REITs from 2 primary sources:

1. Dividend Income: SEBI mandate requires the transfer of a minimum of 90% of the taxable income in the form of rent or interest as dividends to the investors. SEBI regulations additionally require REITs to ensure 80% of the portfolio is completed and revenue-generating. In the Indian context this creates an interesting value proposition for investors due to the following factors:

- a. The two REITs that have been introduced are both focused on commercial office spaces in prominent cities. Mindspace has commercial offices in prominent cities such as Mumbai, Pune, Hyderabad, Chennai. Embassy Office Parks has 4 office buildings totaling 32.7 million square feet as on Dec 31st, 2018 amounting to ~87% of the total portfolio.
- b. Indian office spaces remain some of the most affordable globally, with the most expensive Indian office market (Delhi/NCR) ranking only 84th out of 215 according to data from 2017.
- c. Commercial Office Space absorption in the top 6 cities has grown by 22% in 2019 compared to 2018.
- d. India remains one of the top outsourcing locations and ~65% of Grade A commercial office space is leased by foreign MNCs (40-45%

from the US, 10-15% from the EU, and 5% from APAC). Commercial leases are generally long-term i.e. 9 years or 15 years in duration thereby ensuring a degree of predictability due to the quality of tenants and the long-term nature of contracts.

2. Capital Appreciation: REITs are traded on the stock exchanges like any other stock. Embassy Office Parks and Mindspace Business Parks were listed at Rs 300 and Rs 274/unit with 22.87% and 11.36% capital appreciation (since listing) respectively.

The combination of a steady income in the form of dividends from rent and interest and the capital appreciation of REITs on the stock exchanges has made REITs an incredibly lucrative investment option.

REITs, however, are not immune to risks and I attempt to highlight some of these in the following section:

- 1. Vacancy:** REITs generate income primarily by the way of rent from tenants. An important clause in corporate leases is the option of termination at the notice of the tenant (after the expiry of the lock-in period) known as the one-sided break clause. As highlighted earlier a majority of the tenants for REITs are MNCs, most of whom have implemented Work from Home policies for their workforce. With many companies observing work from home as a highly viable option for certain factions of the workforce, it could adversely impact demand for commercial office space.
- 2. Portfolio Composition:** REITs can have a variety of properties in their portfolio and it is thus imperative to ascertain the composition of the

portfolio. While Embassy REIT has a majority share in commercial office space it also has ~5.5% of its portfolio in the form of Hotels (e.g. Hilton at Embassy Golf Links) and renewable energy (Embassy Energy). REITs can have up to 20% of the asset value invested in properties that are complete but not rent generating, properties under construction, listed and unlisted debt of real estate firms. Retail investors need to be cognizant of the composition and weightage of sectors as they may have vastly different drivers and affect overall returns from the REIT.

3. Portfolio Quality: Finally, It is important to evaluate the quality of the underlying assets that the REIT holds to ensure regular dividend income and capital appreciation. Continuing with the example of the two listed REITs that are primarily in the commercial office space it is important to understand the quality of the clientele, average lease tenure, market rent vs in-place rent, and location of properties. Embassy Office Parks had

recorded a rent collection of 95% in April 2020 which showcases the quality of the underlying assets.

REITs allow retail investors to diversify their portfolio by investing in real estate without owning the underlying property and inconvenience of prohibitive upfront capital. Listed REITs also carry the benefits of mitigated liquidity risks and allow for transparent pricing, a risk borne by traditional investment in real estate. However, investors should exercise caution as they are subjected by various risks as highlighted above in addition to the omnipresent market risk.



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ENTREPRENEUR'S GUIDE TO PRIVATE COMPANY VALUATIONS

Private company valuation is arguably one of the most important and often, opaque term in a private market transaction. Especially in early stage private market transactions wherein performance data is limited, the valuation can be a lot big function of the investment climate – it could be ‘entrepreneur wish’ (bull run) or the ‘investor wish’ (bear run) or somewhere in between. Having witnessed the valuation challenge from both investor and entrepreneur’s perspective (portfolio CEOs, close friends who are entrepreneurs etc.), I wanted to use this blog post to provide some thoughts around understanding some of the opaque aspects of a company valuation – (1) Highlight the risks of over-valuation – little has been said about this and I wanted entrepreneurs to appreciate the burden of unreasonably high paper valuations (2) Provide a rather simple framework around key parameters that determine the company’s valuation. While valuation will continue to remain at the intersection of art and science, having said that, this framework should give you enough to have a more intellectual conversation, with potential investors, around valuation while reducing the effect of the investment climate! This framework should also help you in identifying the right investors / board members.

Consider the following scenario – you are ‘hot’ start-up that had some of the best names in the investing industry line up outside your door. Your valuation expectations are met or even exceeded as you have chosen the highest bidder to invest in the company. The company raises more capital than initially planned. The media is ready for a front page splash. All is well! This is a great scenario for a company, having said that the valuation maximization mindset might have some consequences that many founders are ill-prepared to navigate –

1. Little room for error – the new investor wants you to grow at break-neck speed. Her intentions are obvious and justified, she wants you to raise more capital at a higher valuation (needs to justify to her

investment committee that the valuation was justified or even cheap for that matter!). Just in case, the business is not ready for break-neck acceleration, you will still have immense pressure to press forward (– the board, the employees, the media etc.) – which might look good in the short run but could harm in the long run. Imagine the pain you might have to take if the company needs to pivot!

2. Down round to bring multiple complexities – investment climate has soured, you missed plan, competition raises capital, unit level profitability is back in vogue! You manage to garner capital but at a down round. Apart from the additional dilution that existing investors and you as a shareholder experience, high-quality employees will question the value of ESOPs – the trust loss can result in tricky situations with the firm finding it very difficult to attract high-quality talent.

3. High valuation with ‘crazy’ terms – you attract a higher valuation but with ‘crazy’ terms with respect to high & / or senior liquidation preferences, guaranteed IRR returns etc. While the terms might look innocuous, to the inexperienced founder, in light of the higher valuation but these terms can create value for new investors even if the valuation of the company is well below the headline number. In my experience, these terms complicate future financings with new investors either inheriting the same terms or just not investing.

4. ‘Cheer Leaders’ in the board room – existing investors have recorded the high valuation to their performance – you are golden for them and they can’t think beyond multiplying the value of their stake with the last round headline number. They stop asking important questions and the answer to all your thoughts is a resounding YES. High quality board members can definitely not save a poor business but can definitely have a multiplier

effect on the outcome of good business and execution (it's a 5-8 year relationship please choose carefully!)

5. If you have a hammer, everything looks like a nail

– high valuation rounds are often accompanied by large capital infusion – makes 'sense' for the entrepreneur given the high price and the investor is aligned given she is trying to reach a target ownership. This overcapitalization causes founders to solve problems that do not exist or lower their bar in making new investments or acquisitions.

Well the next logical question is how does the founder (assuming she is not as sophisticated at valuing companies as investors around her) assess if the round is over-valued or not? Hard to answer this but following are some of the things to keep in mind –

1. Huge disparity in valuation offers across investors – try and understand the basis of the disparity. If there are some high quality investors at significantly lower valuation offers, you should be doing a deeper analysis of your projections and your ability to achieve them.
2. You miss internal plan (consistently!) but are still being offered a huge step up in valuation.
3. Internal investor is looking to sell or not participate in the round – internal investors who could have potentially participated (barring those who have tapped out) in the round are not participating or are looking to sell.
4. Global comps – check for valuation multiples of similar listed companies and understand where and why you lie on this spectrum – existing investor/ banker should be happy to do this exercise for you.

VALUATION FRAMEWORK

At the cost of oversimplification, the company

valuation is a function of 'Growth' and 'Capital efficiency' (I underline 'capital efficiency' as this is easily forgotten during the good times!). Double clicking on this, growth is a function of market opportunity, business model & business model scalability and competitive advantage while capital efficiency is simply how much capital will you burn to reach the desired market share and profitability numbers. Essentially investors are asking the following two questions before they come out with the valuation metric –

(1) "How do the numbers / key operational metrics look like when the company runs out of this round's capital?"

– the basis of this exercise is the founder's near term financial projections. This a great opportunity for entrepreneurs to judge the investor and also educate themselves of the potential pitfalls – does the investor really understand what will it take to reach there? Does she appreciate the challenges? Has she seen such situations before? Does she call out pitfalls that they have not thought of? In my experience, highly sophisticated investors can call out some the aggressive or not so aggressive assumptions in those numbers. I believe this is the 'science' part of the valuation exercise wherein investors and founders can engage on assumptions that support or not support the 'growth' and 'capital efficiency' projections before the company runs out of capital. In my experience, investors love it when founders can provide for strong basis (inside or outside data points) for their assumptions – expect a valuation bump up if you can defend your strategic positioning and plan!

(2) "If all goes well, how do the numbers look like at scale?"

– this exercise typically happens without the founder and this is the 'art' part of the valuation which involves investors taking a leap of faith on multiple metrics basis potential market opportunity, market share at scale, profitability and a valuation outcome. I am yet to see anybody getting this absolutely right (forget getting it right consistently!) – the idea is not be accurate but be directionally correct – as vague

as it may sound, the believability of the 'entrepreneur's vision' and 'historical execution prowess' play a key role in helping the investor getting comfortable with these numbers.

It's NOT entirely true that valuation is a zero sum game – If you create outsized returns for your investors, they will be happy to create more incentives for you in terms of salary, bonuses or MSOPs to take care of high dilution that you must have to absorb early on (this is not to say that as founders you become in-sensitive dilution because existing investors will compensate) This giveback could be very valuable for you as an individual! For example, 0.5% of \$ 2 Bn valuation doesn't dramatically alter the cap table but will create \$10 million value for the founder! – having said that, this can't happen till you have proven the fact that the company has created real value through a liquidity event (secondary sale of shares, M&A / IPO).

To Summarize –

1. Balanced approach towards maximizing paper valuation key to eliminating any turbulence / nuisance (down round complexities, crazy terms, poor board composition) from issues non-core to the business. (Keeping in mind that business issues will create enough turbulence already!)
2. High quality board members cannot save a poor business or execution but can have a multiplier

effect on the outcome of a good business and execution

3. Work closely with potential investors, to understand their perspective on both near term and long term scenarios – apply judgment to what you wish to keep and what you wish to discard. These interactions should give you a sense of the intellectual depth of the investor which should form the basis of which investor to let onto your cap table (it's a 5-8 year relationship choose carefully!). Highest bidder in the round might not be the best addition to your board.
4. It's NOT entirely true that valuation is a zero sum game – if you create value, investors will be happy to give back amounts that will be substantial for individual founders
5. Everything starts from nothing!



The above article has been taken from the blog "The Network Effect" written by **Mr. Raghav Bahl**.

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any organization. For more articles authored by Mr. Raghav, please visit <https://thenetworktheeffect.com/>

THE LENDING CONUNDRUM

One of the hardest decisions that Indian banks have faced since the lockdown is the ability to lend in a risk-calibrated manner.

Let's look at a few data points to understand this better. As you can see from the figures below, almost all major banks have shown a de-growth in their loan book since the beginning of lockdown (March).

bankonbasak.com	June '20 vs March '20	
	Investments	Advances
Axis Bank	19.5%	-1.8%
Bandhan Bank	5.4%	3.5%
Federal Bank	-3.2%	-0.8%
HDFC Bank	-3.2%	1.0%
ICICI Bank	17.2%	-2.2%
IDBI Bank	2.6%	-3.1%
IDFC First Bank	0.3%	-0.1%
IndusInd Bank	-0.6%	-4.2%
Karnataka Bank	4.2%	-4.8%
Kotak Mahindra Bank	36.8%	-7.2%
RBL Bank	9.6%	-2.3%
South Indian Bank	-3.6%	0.2%
Yes Bank	-12.2%	-4.0%
Total	8.6%	-1.5%

At the same time, their investments seem to be growing at a healthy rate. We will understand the context and reason for both these phenomena.

Why are banks not lending?

- How do you evaluate a borrower during a time when his business is not performing? With no clarity on how moratoriums are going to turn out after it ends on August 31st, banks are essentially playing safe by not doling out fresh loans.
- Banks take time to lend from money raised through fresh deposits. Since March, a lot of people have kept their money in banks since it is predominantly

considered "safe". Even in an ideal situation, banks would take time to assess these under asset-liability management (ALM) framework.

Now that we've understood the context, we need to understand where they're investing this money. Banks invest primarily in two types of securities

1. Corporate Securities: Recently, RBI had introduced a scheme called TLTRO [RBI, Frequently Asked Questions on TLTRO¹ (Targeted Long Term Repo Operations). On a simplistic level, this scheme allows banks to borrow long-term money from the RBI at short-term rates. The idea is to force banks to use these funds to invest in corporate bonds. This indirect way of lending to corporates by the RBI is to ensure they do not run out of funding amidst the crisis.

2. Government Securities: This is an investment avenue that needs no prodding from the RBI. Considering the inherent safety of these instruments, banks are willingly investing in government bonds until they tide over this crisis. Between 27th March and 31st July, banks have raised fresh deposits worth ₹5.95 trillion. Out of this, a whopping ₹5.32 trillion (or 89.4%) has been invested in government or other similar approved securities.²

To make a rational judgement on this situation, we need to be aware of the arguments from both the stakeholders.

RBI and the Government:

On 29th July, 2020, our Honourable Prime Minister Narendra Modi held a consultation with stakeholders from several banks and NBFCs. In the meeting, the Prime Minister advised banks not to treat all borrowers in the same light – essentially, they should proactively identify "bankable proposals" so that

they get funding based on merit and not get shooed away due to past NPAs.

RBI, on the other hand, had undertaken a slew of measures to motivate banks to lend. One of them was cutting the reverse repo rate by 25 basis points³, while keeping the repo rate unchanged. Reverse repo is the rate at which RBI borrows money from commercial banks. By reducing it, it was expected that banks would find it less rewarding to stash their excess money with the central bank.

It is to be noted that our economy was already reeling under a slowdown prior to the lockdown. When banks do not lend, economy stalls further, a concern which both the RBI and the Central Government share.

Banks:

One of the counter-arguments that banks had offered during the meeting with the Prime Minister was an assurance on cash flows from projects, especially from the infrastructure segment. As per the RBI Financial Stability Report (July 2020 issue), construction sub-sector has one of the highest GNPA (Gross Non-Performing Asset) Ratio of 24.3%. As a whole, scheduled commercial banks have a GNPA ratio 8.5%

Sector-wise GNPA ratio	
Agriculture	10.1%
Industry	14.1%
Services	7.2%
Retail	2.0%
Total	8.5%
bankonbasak.com	

(Source: RBI)

Apart from sector-specific issues, RBI has imposed a dual bonanza of moratorium (delay in loan repayments) and restructuring (change in repayment terms). In fact, this was the first time ever that

restructuring for retail/personal loans was introduced. Banks are thus grappling with collections from existing customers, which inhibits their focus on new loan book.

Who is winning?

It is unclear whether banks are benefiting from this move. They are merely shifting their risk away from credit risk (in loans) to market risk (in bonds). Amidst this conundrum, we notice new NBFC players growing⁴, who are offering loans at competitive bank rates and taking the pie away from traditional players. A true picture will only emerge when the lockdown ends and banks get the courage to lend out their fresh deposits.

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By Anirudha Basak

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WHERE'S MY LP?

It has become common-place to see private equity (PE) managers raise multi-billion dollar funds in their pursuit of super-normal investment returns. To give a bit of context, PEs raise these funds primarily from limited partners (LPs) such as pension funds, insurance companies, sovereign wealth funds (SWF) – entities that manage enormous wealth, which sometimes may run into trillions of dollar. When we read that a PE fund will invest \$1 bn in Jio Platforms, it essentially means that an ex-Govt employee's pension or, in some cases, a Government's surplus wealth will be invested in such mega-deals. But now Covid-19 has played pauper to PE funds' plans on fundraising. It is not that the pandemic is the only one to be blamed for it, the perception of a slowing economy had deterred LPs from making long-term and illiquid bets in PE/VC space. However, Covid-19 could well mark the inflection point. Here I attempt to enumerate how the fundraising landscape may change for PEs in the coming months (or maybe years).

Pension contribution and withdrawals

The labour market has seen one of the worst upturns this year. Layoffs, salary cuts, etc. have become common. This reduces the contributions which fill up the coffers of a pension fund. Not to forget that pension funds suffer a double blow when people start withdrawing funds from their retirement plans for current sustenance. With a reduced corpus, it is no rocket science to guess that pension funds will have to curtail their commitments to the PE kitty. Apart from the stress on their corpus, their allocation towards alternative assets will change, and many of them will wait out to see how the pandemic pans out for the PEs.

Enter the Dragon

Chinese LPs have been one of the major sources of private investments not only in India but also globally. Global buyout funds floated recently by the likes of KKR, TPG, Carlyle, Blackstone, etc. have 20%

to 35% allocation coming from LPs based in China or Hong Kong. Presently, major economies do not hold a positive view of China or anything Chinese (including Hong Kong). Capital flows emanating from China (read: beneficial ownership) will undergo stricter scrutiny – case in point India's recent changes in FDI and FPI rules. No wonder this class of alternative asset managers will have to look beyond the traditional funding taps.

Shifting priorities for SWFs

With Govt coffers draining at a pace never seen before, Govts may turn to SWFs to offer some respite from this bloodbath and ask them to look inwards. Russia has already tasked its SWF (Russia Direct Investment Fund) to fund the development and manufacturing of its self-approved vaccine named 'Sputnik V'. Another pertinent point is that most SWFs have been built from the proceeds of exploitation of natural resources, mainly crude oil. Lower realization per unit and subdued demand for oil in the foreseeable future will further dent the ability of SWFs to function as a fund of funds.

The apprehensions mentioned above are further validated by this new phenomenon. Recently, a new term is gaining prominence in the global PE industry – permanent capital. Generally, a PE fund raises funds, invests in companies, divests after a few years, and returns the proceeds to its LPs – hence this is temporary capital. Under this new route of permanent capital, PEs do not distribute proceeds to its LPs and close down funds once all investments have been exited from. They rather re-invest from this pool than raise a new fund. Pioneers of this industry – KKR, Apollo, etc. have already taken this route by buying out large insurance companies. The basic idea is to dip into the AUM of these insurance companies and divert some funds to their PE vehicles. So the source and the destination will be controlled by the same entity – hence capital becomes permanent.

Finally, I wanted to pose this question which has been bugging me ever since I saw this chart.



Comparing 10-year trailing returns from PE and public markets, it can be easily concluded that the delta between PE and market returns has

diminished, and recently it turned negative. If the idea is to diversify and earn higher returns by investing in private companies, does the fundamental assumption of superior returns hold? Do illiquid PEs remain a really attractive investment destination?

Let me know your thoughts on this. You can write to me at shikhars2021@email.iimcal.ac.in.



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LARGE CAP MUTUAL FUNDS - SAHI NAHI HAI?

The mutual fund industry is in a state of crisis. Indian equity mutual funds saw a net redemption of Rs. 2,480.35 crores in July, the first in more than 4 years.¹ While one of the reasons might have been the Covid-19 pandemic and the ensuing economic crisis, data from the stock exchanges tells a different story. Account openings at brokerage firms and direct retail participation in the equity stock market have witnessed a sharp upward trend. It is therefore clear that retail investors have opted to discontinue and redeem their equity mutual funds investments and instead enter the stock market directly. So what has led to this?

A major reason behind this could be the prolonged underperformance of equity mutual funds vis-à-vis their benchmark indices. Large-cap mutual funds, in particular, have been a serial offender. An analysis by ICRA (Table 1) shows that more than 85% of large-cap mutual funds have underperformed the BSE Sensex in the 1 year, 2 years, 3 years and 5 years timeframe.

Table 1: Performance of large-cap mutual funds v/s the Sensex Total Returns Index²

	1 Years	2 Years	3 Years	5 Years
Sensex TRI	3.70%	7.70%	11.60%	8.10%
Total no. of large-cap funds	31	30	30	29
No. of large-cap funds that underperformed the Sensex TRI	27	29	29	25
% of large-cap funds that underperformed the Sensex TRI	87%	97%	97%	86%

Data as on May 29, 2020

I, therefore, decided to study the reasons for such a sustained and uniform underperformance across large-cap mutual funds. As a part of my study, I decided to analyse the performance and composition of 5 of India's biggest large-cap fund by average AUM as on July 31, 2020: HDFC Top 100 Fund, ICICI Prudential Bluechip Fund, Axis Bluechip Fund, SBI Bluechip Fund and Aditya Birla Sun Life Frontline Equity Fund. These funds constitute ~11.5% of the average AUM of equity funds in the country. I looked at their portfolio at intervals of 6

months from Jan 2016 to July 2020 to understand the number of stocks invested in and the pattern of allocation of stocks (Figure 1.1 and 1.2). To simplify matters, I classified the stocks based on their weights in the portfolio (<3%, 3%-5% and >5%).

Figure 1.1: No. of stocks in each bucket

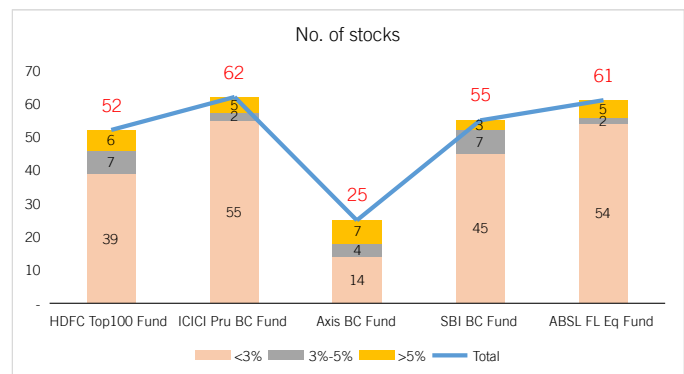
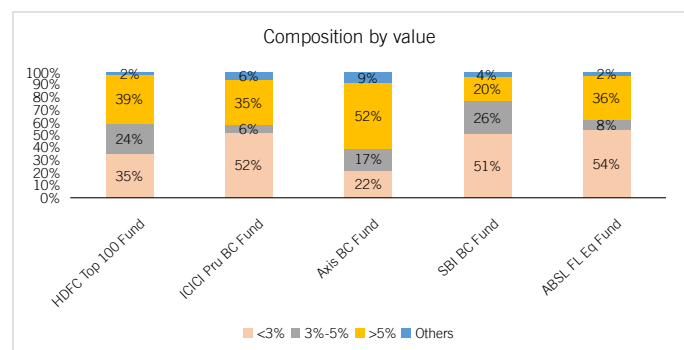


Figure 1.2: Value. of stocks in each bucket



On looking at these charts, one can observe that majority of the stocks owned by mutual funds have a weight of less than 3% of the portfolio. This trend is reflected in the value of stocks as well, where low weighted stocks constitute a majority of the portfolio value. Such portfolio construction is an inefficient approach to value creation. Assume a portfolio A of Rs. 10,000, consisting of 50 stocks, each of which has a 2% weight. Assume that the price of the HDFC Bank stock doubles, other prices remaining constant. The value of the portfolio shall now be Rs. 10,200 and your return would be 2%. On the other hand, portfolio B consists of 10 stocks, each of which has a 10% weight. The return on the HDFC Bank stock price doubling would result in returns of 10%. It implies that for Portfolio A to earn as much return as

Portfolio B, a greater number of stocks need to double.

Extending this argument to our sample study, the ABSL Frontline Equity Fund requires many more stocks to perform well as opposed to the Axis Bluechip Fund. This is, of course, much more difficult than relying on a few well-researched stocks to deliver higher returns.

A common argument that these large-cap funds use is that they are diversified which means that the risk for its investors is much lower. There have been enough studies and research papers which indicate that there is a steep drop in the risk-rewards tradeoff after a certain number of stocks, though there is no agreement on this optimal number of stocks. Benjamin Graham, the father of value investing and mentor to Warren Buffett, in his book “The Intelligent Investor” has written that 10-30 stocks should be enough to ensure sufficient diversification.

Another argument against this style of investing is that investors pay an extra fee (in the form of higher expense ratios) to the mutual fund houses for their knowledge and expertise in picking stocks. If the investors were interested in owning such a large number of stocks, they would be better served investing in index funds or ETFs.

Let us compare the performance of these mutual funds with ETFs (Table 2).

Table 2.1: Rolling returns

Period	HDFC Top100 Fund	ICICI Pru BC Fund	Axis BC Fund	SBI BC Fund	ABSL FL Eq Fund	SBI BSE100 ETF	SBI SENSEX ETF	BSE100 TRI
YTD	-17%	-9%	-6%	-9%	-10%	-8%	-8%	-8%
1 year	-14%	-1%	5%	-2%	-3%	0%	1%	1%
3 years	-3%	2%	9%	1%	0%	2%	6%	4%
5 years	3%	6%	9%	5%	4%	6%	7%	7%

Table 2.2: Risk measures

Particulars	HDFC Eq Fund	ICICI Pru BC Fund	Axis BC Fund	SBI BC Fund	ABSL FL Eq Fund	SBI BSE100 ETF	SBI SENSEX ETF	BSE100 TRI
Max Drawdown	-49%	-45%	-50%	-40%	-41%	-44%	-46%	-46%
Beta	1.01	0.92	0.82	0.91	0.92	0.97	0.97	1.00
Standard Deviation	13%	12%	14%	11%	11%	12%	12%	13%

Other than Axis Bluechip Fund, all the funds in our

sample have underperformed passively managed funds across timeframes. At the same time, data does not support the arguments of those who believe the high diversification in these funds have resulted in lower risk. The maximum drawdown, betas and standard deviations of these mutual funds are also not significantly different from the ETFs.

So what should we, the small investors, do? If one is adept at judging the quality of the fund manager and the portfolio construction of funds, he/she may opt for more focused large-cap funds such as the aforementioned Axis Bluechip Fund. However, for a vast majority of us, it makes a lot of sense to invest in a cheap and liquid ETF or index fund with low tracking error. This would help one achieve the twin objectives of high returns, achieved through high weightage in quality stocks (the top 5 companies – Reliance, HDFC Bank, TCS, HUL and Infosys – constitute 50% of the Sensex), as well as risk diversification, achieved through a collection of 30 companies.

Disclosure: The author is invested in the Axis Bluechip Fund.

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PRIVATE EQUITY (PE) AND VENTURE CAPITAL (VC) FUNDS

Private Equities are generally structured as Limited partnerships and are involved in buying and restricting privately held companies. PEs are funded by Institutional Investors, High net worth individuals, other PE Firms, Pension Funds, etc. So, What do PEs do? Do they just invest in a company, sit back and relax, waiting for a return? Well, no. While some PE firms do make passive investments, Mostly, PEs invest intending to make some positive change in the company. PEs can restructure the firm or change the management or plan expansion of the business or utilize its platform to create synergy for the company. Now, What does utilizing the platform mean? Let us understand this with the help of an example. A PE with an investment in a dairy company would want to invest in an ice cream company to provide a backward integration opportunity and lower raw material costs for the latter. Since these investments are mainly into well-established businesses and often involve a value-adding strategy, the ticket size of Investments is large. Generally, it ranges between USD 50 mn – USD 500 mn. PEs emphasize on the historical numbers while making these investments, and typically invest with a horizon of 5-7 years and a target IRR of 25-30% p.a. PE Investments are made with a view to exit a later stage in the form of secondary stake sale, buyback, or through an IPO. The common saying used in PE firms is 'No visible exit, No Investment,' which explains the importance of a good exit for a PE Firm.

Now, Let us understand VCs. Like PEs, VCs are also Investment vehicles. The difference lies in the approach and the kind of investments that they make. They generally invest in early-stage start-ups with high growth potential. They help the development of new products and services and take active participation in their portfolio companies. Since the extent of judgment and trust is much more significant, the risk involved is significantly high. The Ticket size of Investments by Venture capital is very small compared to PE. Due to the unavailability of

detailed historical numbers, VC Firms bet on the growth potential of the venture. In his book 'Zero to one,' Peter Thiel says, 'The biggest secret in venture capital fund is that the best investment in the fund equals or outperforms the rest of the fund combined.'

If we were to put it in layman terms, in terms of odds, VC investments are similar to lottery tickets; high risk and high returns. In contrast, PE Investments are similar to playing the roulette wheel; moderate-risk and moderate returns. In the Indian scenario, the distinction between PE and VC Firms is less strict. VC Firms like Sequoia Capital have made investments of PE nature like Indigo Paints, and Prataap snacks, which are traditional, positive margins and positive cash flows businesses. On the other hand, PE Firms like Warburg Pincus have made investments in start-ups like Quikr and CarTrade.

While PEs are extremely restricted in terms of access to retail investors, VC Firms have comparatively become open to Retail investors during recent years. VC Firms require a minimum investment of INR 5 lacs per individual. There are various platforms like Angel Kings, Wefunder, Gust, etc. for Individuals to invest in VCFs. Due to the dramatic slowdown in GDP Growth and depreciation of Indian currency, The coming few years will be challenging for PE/VC Firms in terms of achieving their desired return. Only the course of time will tell how well they can handle the situation.



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THE CURIOUS WORLD OF INVESTMENT IN PAINTINGS

On November 15th, 2017, a painting named 'Salvator Mundi' by Leonardo da Vinci, was sold for 450 million USD at Christie's auction house in New York, making it the most expensive painting sold till date. This was only among the paintings which have been sold by their owners: some of the paintings, such as 'Mona Lisa' by Leonardo da Vinci, or 'The Starry Night' by Vincent van Gogh, are even considered priceless!

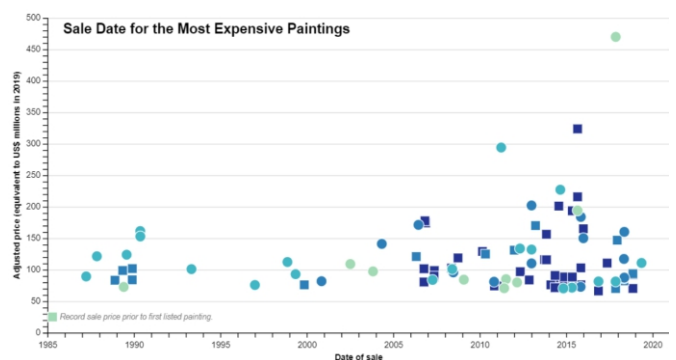
Why do such great paintings have astronomical value? This is because of their extreme scarcity and illiquidity. Think about it. There are expensive commodities and stocks, but you can buy them in the market at a high price. But paintings from famous painters are not that readily available for purchase.

Investment in painting has some similarity to investing in oil. Oil supply is limited. You cannot produce it but can only extract it. You can trade whatever is available. While the quantity of oil is huge, and it is almost homogenous throughout the world, the same is not the case for paintings. Each painting is different, you cannot produce it, and the availability is even scarce.

Similarly, Investment in paintings also has similarities with venture capital. Some companies have unique business models and moats that make it justifiable to invest in them at high valuations. Most of the start-ups are also different from each other. Investment opportunities in certain start-ups are not readily available in the market. Only if the company wants to raise money, or some investor wants to divest, and then if they chose you, you get to invest. Similarly, in paintings, willingness of the owner to sell it to you is necessary, even though you are ready to pay huge bucks to buy it.

There is a major benefit of investing in paintings as compared to Oil or Companies – there is no replacement for paintings. Alternative energy sources can replace oil. One company will do bad, and another will win the competition. But painting is

unique and cannot be replaced. The average selling price (adjusted for inflation) of paintings and number of paintings sold have also been increasing as can be seen from the below graph, suggesting that the demand has been rising.



Inflation adjusted average selling price and number of paintings sold have been increasing over the years (Source: Wikipedia)

Art also makes people 'irrational' because they enjoy it. They are passionate and want it at any cost. The sellers are price takers. No one knows the actual value of a painting. It will depend majorly on the painter's reputation and general economic condition, which also makes the arts an excellent way to diversify your risk. Your portfolio possibly does very bad, but your paintings are appreciating because the economy, in general, is doing good, or just because someone somewhere in the world wants the art, and you are the only one who has it.

Investing in paintings has its pitfalls which arises from the benefits it offers. It is easy to fool a naive person to invest in a replica of the original artwork. Knowledge of art is a significant hurdle that stops more people from investing in it. Maintaining art is also expensive and requires expertise. This investment is not liquid, and there is no guarantee that it will appreciate in the future. Even if you want to sell it, it is difficult to find the right buyer, and you most probably will have to resort to dealers and galleries to broker the sale, the fees for which are significant (~10-15% of sales).

So, although it is very lucrative, invest in paintings only if you understand the investment, and more importantly, if you are passionate about arts. For the rest of us, even if you cannot distinguish between enamel and acrylic paint, you can also invest a small portion of your portfolio in funds that invest in arts. That will be a unique way of diversifying risk, and who knows, you might get your hands on the next 'Salvator Mundi' if you are lucky!



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UNDERSTANDING THE GOLD RALLY

Join Finshots (<https://finshots.in/>) and get your daily dose of the latest, most important financial developments in plain english

As coronavirus stalls imports and crushes income across the board, we've seen a sharp decline in the physical demand for gold. China and India, the world's biggest buyers of gold bars, coins and jewellery, are staying put on the sideline. The demand drop is so bad, that precious metals consultancy, Metals Focus Ltd. believes Chinese and Indian gold jewellery consumption will likely decline by about 23% and 36% respectively.

But don't let this grim outlook fool you. Because the pandemic is also driving the biggest, baddest rally the gold market has ever seen. Globally, gold prices have risen over 18% in 2020 — the highest since 2011. At one point yesterday, it was trading at a whopping ₹ 5,200 per gram. That's never happened before.

So, how did we get here and why is this happening now?

Well, to make sense of this gold rush, let's look at the investors doing all the buying.

Investors search for yield. They want to park their money. Redeem it in a few years and want to see it appreciate quite a bit by then. Now obviously, if you have a higher risk appetite you'll chase higher yields. But when you're trying to cushion your portfolio during a pandemic you're looking for something more nuanced. So your priorities change.

You'll start targeting safe havens. Something that can retain its value. Something that will help you weather the storm. Something like a US Treasury— promissory notes issued by the government of the United States of America in exchange for money.

Treasuries, as we already noted, come with a promise. You lend \$99 today and the government pays you back in full with an extra \$1 on top. The effective yield, in this case, is $1/99=1.01\%$. That's what you're expected to make if you hold a 1-year Treasury Bill (T-Bill) until maturity.

And it's almost certain that you'll make this money considering the United States government has never defaulted on its obligations to pay. It has never, ever

missed a payment. So when investors seek certainty, they usually turn to the T-Bill.

However, yields on 1-year T-Bills have been falling so precipitously that it's now fast approaching 0. And this is the handiwork of the US Central Bank aka the Federal Reserve.

On March 15th, the US Federal Reserve lowered its federal funds' target to a range extending from 0% to 0.25% in a bid to cushion the financial system from the pandemic. It's a barometer that gives you some idea of what banks expect to make whilst lending money to each other.

And while this rate doesn't directly influence consumer lending rates, changes here will ultimately trickle down into everything — home loans, auto loans and even US treasuries. Because if the banks only expect to make 0.25% at best, a regular investor can't expect to make much more whilst lending to the government. They will have to fall in line. So whilst the Federal Reserve tries to make borrowing more accessible, it's also influencing the yield on T-Bills, pulling it down to near 0%.

And since there is very little money to be made on arguably the most secure asset on the planet right now, investors are looking elsewhere.

Remember — this next asset has to be an excellent store of value. It has to protect your downside. It must also serve as an effective hedge against inflation — meaning it has to appreciate in value and keep pace with the basket price of goods and services that most people consume on a daily basis.

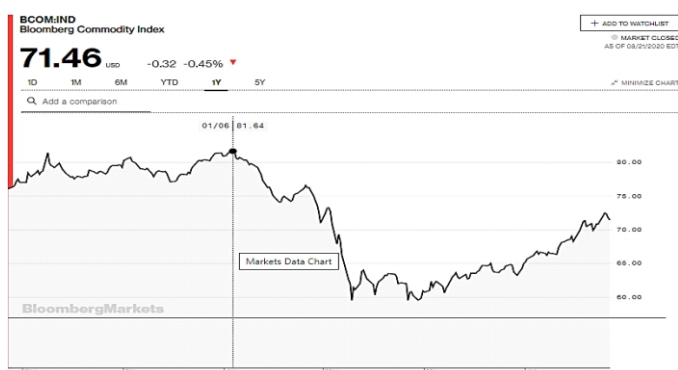
But more importantly, it must offer you psychological comfort at a time when geopolitical tensions are high. At a time when a virus looms large. At a time when uncertainty lurks around every corner. It has to shine and it has to shine bright.

By **Finshots**,
a platform for daily financial news

COMMODITIES MARKET: INVESTMENT OPPORTUNITY DURING COVID SCENARIO

Commodities are divided into two types: hard and soft commodity. Hard commodities are typically natural resources that must be mined or extracted such as metal and mining, oil and gas, etc. Soft commodities are the agriculture products.

In this article, we will discuss the impact on covid on the commodity market on both: hard and soft commodities. The spread of coronavirus has exposed risk across the value chains. Lockdown of nations, liquidity crisis, decreasing demand, falling price and increased volatility are leading to slow down in the majority market. Let's look at this perspective of the commodity market through the Bloomberg Commodity Index.



“Bloomberg Commodity Index (BCOM) is calculated on an excess return basis and reflects commodity futures price movements” as mentioned in Bloomberg. It is evidently seen that the Index price of USD 81.6 has reached as low as USD 59.48 and is currently at 71.46.

Oil and Gas (Hard Commodity)

Reduction in air travel, marine trade and domestic transportation across the globe has led to a plunge in oil demand and negative gross margin on products. Trading entities have amended their course slightly and area unit refraining from affecting long exposures to their physical books. Matured traders are leveraging on the ‘price optionality’ clause in

their physical contracts throughout these volatile times. VLCC (very large crude carrier) chartering rates have shot up by two hundred percent, amid multiplied demand from oil producers and traders to carry oil and gas briefly and await value recovery. Let's look at movement of oil price



Oil prices have been on a wild ride in 2020. After reaching historic lows in April, the commodity attracted widespread attention from investors. Those market participants who are currently thinking of buying USO should keep a close eye on the legal developments of USO as they occur. Those who are bullish on the liquid commodity may consider investing in another exchange-traded fund.

Agriculture Commodity (Soft Commodity)

Most of the agro commodity markets square measure seeing major impacts from short to mid-term supply and demand fundamentals with exceptions. Prices of agricultural commodities like perishable vegetables, grapes and sugar have fallen 15-20% as bulk demand from hotels and restaurants has nosedived and due to uncertainty over exports, varied trade bodies, as well as those representing textile and poultry, have started approaching the govt., seeking loan restructuring and monetary incentives to survive. Traders across the country are struggling to combat rumors about closure of markets and attempts to create artificial shortages. Globally, food supply chain is a complex web that

involves producers, consumers, agricultural and fishery inputs, processing and storage, transportation and marketing, etc. So for investing, emerging market growth and climate change favors the decision while market slowdown, advancement in green energy sources and heavy subsidization affects the investment decision.

So, the effect of Covid on one of the alternative investment- commodities has been discussed in the article. This effect was different for hard and soft commodities. Although high fluctuations are being witnessed in the short term, from a long term point

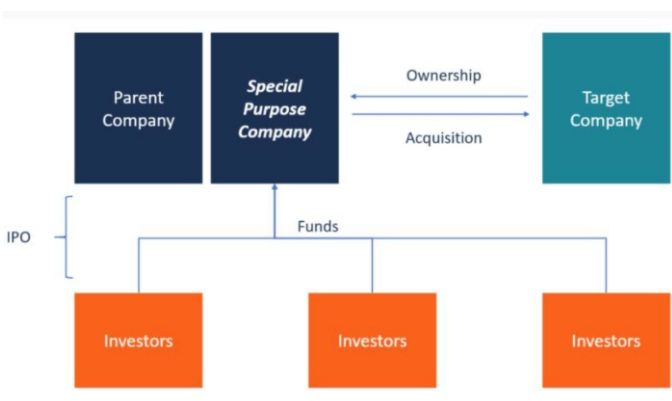
of view, commodity markets seem to be an important alternative investment.



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SPECIAL PURPOSE ACQUISITION COMPANY - SPAC ARE BACK

A Special Purpose Acquisition company also known as blank cheque company is an entity with no operational business of its own. It is formed with the sole purpose of raising money from retail and institutional investors through an IPO to go shopping for a private company and in turn bring it public via the listed holding company. A simple question here would be why I would trust a company with no operating business. Most importantly why does the regulator allow the company to list on exchanges given it has no past track record? To understand this, think of industry veterans like Sachin Bansal & Binny Bansal (also called sponsors) who plan to form a SPAC with an aim to invest in a growing sector by putting 20% of their own money and raising 80% through an IPO. Wouldn't you trust their judgement given you are ensured of not losing your money unlawfully? The exchange protects the interest of the investors by mandating to keep the raised fund with a trust until an acquisition is made and returning the money to the investors if there is no transaction within a stipulated time (~18 to 24 months).



SPACs were popular before but after the financial crisis leading to greater regulatory attention led to their downturn. Since past 2 years According to SPACInsider, there have been 39 SPAC IPOs and that

have raised \$25.5 billion in 2020 till date compared to 58 SPAC IPOs and \$13.6 billion raised in 2019.

To understand why is there a growing interest in SPACs recently, it is imperative to understand the benefits SPAC provides to the sellers & investors:

- Lesser regulatory issues, lower cost facilitating a Fast-Track 'IPO'
- Protects the seller against potential downside due to market volatility and provides significant upside through stock holdings
- Sellers doesn't lose control as in Private Equity financing and at the same time also get access to best in class sponsors
- Investors can gain high returns with downside protection through ring-fenced trust fund and liquidating options

Basis the benefits there are three major reasons for the potential increase. First, current geo-political tensions and future uncertainty increasing the market volatility which has hurt IPO valuation and performance of major companies like Uber, Wanda Sports. To hedge this risk companies are now turning to SPACs to go public. Second, success of many companies like DraftKings (up 84%), Nikola Corp (up 67%), Virgin Galactic (up 62%), who opted the SPAC path for their IPO has increased the popularity and interest in SPACs. Third, increased interest of private equity and hedge funds to turn to a SPAC offering and also changing retail investor sentiments to bet on the jockey rather than the horse has contributed to the increased acceptance of SPACs.

A single buyout firms such as KKR have raised \$102 billion in 2020 compared to SPACs which have raised approximately \$25 billion in 2020, suggesting the new investment vehicle have a long way to go. But SPACs will remain a way for investors to bet on a leadership team's ability to find a smart acquisition.

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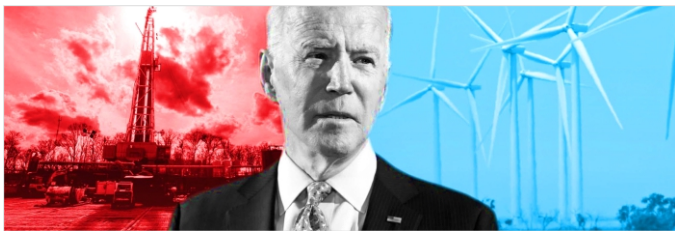
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GREEN ENERGY AMIDST CHANGING POWER DYNAMICS AND COVID-19

Multilateral organizations and nations must ideate creative ways to incentivize green companies and penalize fossil fuel usage

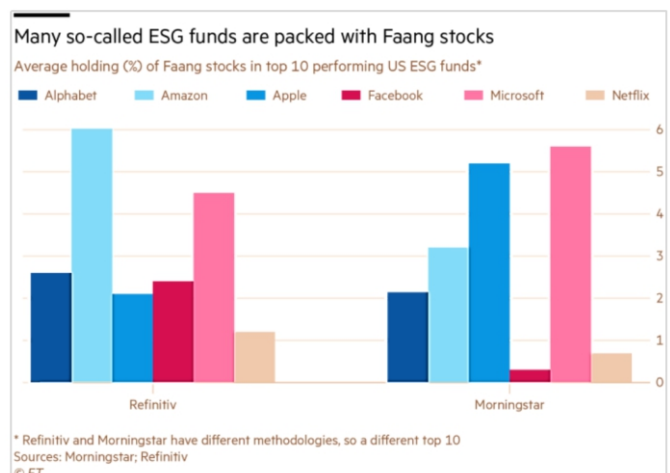


Trump administration is set to approve an oil drilling program in Alaska's Arctic refuge. That President Trump is a climate change skeptic, is a no-brainer. In 2012, he tweeted that climate change was created by and for the Chinese to make US manufacturing non-competitive. Under him, the US withdrew from the Paris Climate Accord. He also replaced the Clean Power Plan (CPP) by a weaker Affordable Clean Energy (ACE) rule that only calls for efficiency improvements in the existing status quo.

However, Mr. Joe Biden, the Democratic Presidential Candidate, asserts he would lead the world to address the climate emergency by ensuring that the US achieves a 100% clean energy economy and net-zero emissions by 2050. He plans to execute it by establishing an enforcement mechanism for clean energy by 2025. His government would make a historic investment in clean energy and climate research innovation- from a federal investment of \$1.7 trillion over the next ten years to leveraging the private sector and state and local investments up to \$5 trillion. This Biden plan will be funded by reversing the excesses of President Trump's tax cuts for corporations and ending subsidies for fossil fuels. The federal procurement is likely to increase by \$400 billion in his first term to purchase essential clean energy requirements. Such targeted investments will have far-reaching consequences in the field of infrastructure, auto industry, public transport, and housing. Mr. Biden would also re-enter the 2015 Paris Climate Accord on Day One of his Presidency.

The US under Biden plans to integrate climate change agenda into their foreign policy and national security, as well as in their approach to trade with nations.

This herculean push towards climate change (the US was never a massive enthusiast of climate change until the Obama administration), if Mr. Biden becomes the US President, will put Green Investing again in the spotlight for global firms. As we are increasingly subject to a bipolar world order arising out of the fiefdoms of China and the US, decisions taken by these nations have global ramifications. China's leadership is steering green initiatives to cleanse its fossil fuel sins. China leads the world in Green Investing by adding 56 gigawatts of wind and solar capacity in 2019 (although a 15% drop compared to 2018). Still, it is also providing equal freedom to coal plant establishments to achieve its growth. Fossil fuel surcharges offer funds for investing in clean energy. Due to less demand for electricity in the first half of 2020, surcharge collections will be depressed. Covid-19 could shrink economic stimulus and dedicated investments in clean energy in mainland China. However, the ambitious Belt and Road Initiative (BRI) serves as a use-case for Green Investing. In the years to come, we could witness a prototype of an entire region driven by clean energy, away from the complement-to-fossil-fuel paradigm.



A fiscal stimulus to this theme could see a drop due to Covid-19. Governments must transfer the financing function to established banking channels and fintech firms and explore new financial instruments for fighting climate change. Regulators could initiate exchange-traded green funds for better retail participation. The mandate of Green Climate Fund, the largest global fund to fight climate change, must widen to mobilize resources across nations into specific sectors to target the reduction of greenhouse gas emissions. There must be a seamless flow of capital across green funds globally through minimal foreign exchange restrictions and single-window clearance for fund houses to invest across firms registered in nations that are a part of the Paris Agreement. Luxembourg Green Exchange could act as a transparent and credible channel for effective price discovery for the same. Central banks across the world could purchase green debt issued by corporates. To take a step ahead, central banks can also guarantee those green debts fostering investor confidence and change in the paradigm of Green Investing. At the national level, funds can be earmarked for clean energy investing by commercial banks, thereby increasing the flow of credit to this sector. Trading in carbon credits should not be left to the free forces of the market. An international agency must strictly regulate them, and any gains from trade must be centralized at the national level. It would serve two purposes- the existence of a floor price for carbon credits and proceeds from the sale of carbon credits that will directly reach the government. They could be used to subsidize consumer spending on clean energy. The premise of green practices should be encouraged through creative penalties on fossil fuel usage. Timelines must be set for companies to reduce fossil fuel usage in a staged manner, and any failure to comply should result in a partial or full restriction to access financial markets. Fund managers managing green funds must steer the mandate of investee companies towards

green practices. Green milestones should be achieved, failure of which should lead to a withdrawal of funds.

2021 should shift clean energy and green funding from the policy playbook to the core processes of corporations. In developing nations, green practices require government handholding in the form of tax breaks and credit availability to accelerate reforms. Green practices need to be democratized by multilateral organizations to reach multitudes of people in different nations through novel use-cases. The success rate of these use-cases would determine the change in consumer and corporate behavior towards fossil fuel. For a faster generation of use-cases and adoption of green practices, ESG funds need to direct funding to firms genuinely experimenting in this space and not move away from its stated mandate. In the green area, returns would accrue but will take time.

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