# Are junk bonds gaining ground in India?

Rating agencies say retail investors need to be cautioned about the risk involved in investing in such bonds

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**Mumbai:** Bonds rated below-investment grade, known as speculative or junk bonds in rating parlance and mostly a characteristic of Western markets till now, are slowly gaining ground in the Indian market.

Such bonds are debt instruments that carry higher risk of default on repayments compared with top-rated papers but, at the same time, offer higher returns.

Though a junk bond market is prevalent in many developed countries, public issues carrying speculative rating are a rarity in India, even though regulations do not prevent them.

There have been at least two such public issues of debt with non-investment grade ratings in recent months. Both were by Kerala-based non-banking financial companies (NBFCs): a `200 crore issue of **Muthoottu Mini Financiers Ltd** and a `100 crore issue of **Kosamattam Finance Ltd**.

These NBFCs, both of which are in the business of lending against gold, hit the markets to finance their operations including refinancing of existing debt, and received good response from investors.

Both the issues carried BB+ rating from rating agency **Credit Analysis and Research Ltd** (**CARE Ratings**).

Kosamattam's issue, which closed on 13 May, was subscribed 1.58 times and offered returns in the range of 12-13% to investors on tenures ranging from 390 days to 66 months. The retail investor portion was subscribed 2.06 times, according to information from the stock exchanges. Muthoottu Mini's issue, which closed on 19 April, was oversubscribed by two times.

As a point of comparison, **Tata Motors Ltd** is planning to issue AA+ rated 4-year 11-month maturity bonds that will offer 10% to raise `300 crore, *Reuters* reported on 25 March.

Emails sent to Kosammattam and Muthoottu Mini seeking their responses on the rationale of raising funds via non-investment grade bonds remained unanswered.

Typically, bonds assigned a speculative grade offer 4-5% yield above the government securtities (G-Secs) than top rated bonds with A+ or AA+, which offer 1-2% higher than G-Secs.

**Raters caution**

While junk bonds help deepen the bond market and are an opportunity for investors with a higher risk appetite, retail investors need to be cautioned about the risk involved in investing in such bonds, say rating agencies.

"We are witnessing a different trend of retail investing in BB category. BB category investments come with a higher degree of risk to capital, and their appropriateness for retail investors is questionable," said **Ramraj Pai**, business head (large corporates) at **Crisil Ltd**, the Indian subsidiary of global rating agency, Standard and Poor's (S&P).

**Abizer Diwanji**, partner and national leader (financial services) at **EY** India, added that retail investors get attracted to the higher coupon rate without understanding the risk involved.

"Such issues could put retail investors at risk since, in India, the risk-reward perception is weak," Diwanji said.

However, the emergence of BB rated papers could also be seen as a sign of depth in the bond market.

**Rajesh Mokashi**, deputy managing director at CARE Ratings, said a good financial system has bonds with various risk profiles.

"Historically, the Indian financial system has seen issuers typically with low risk approaching the market. By definition, BB bonds are relatively much more risky than AAA bonds. But there are investors with different risk tolerances and these give them the option of higher returns commensurate with their high risk," Mokashi said.

Until 2007, India did not allow companies to issue junk bonds. In 2007, the Securities and Exchange Board of India relaxed norms allowing companies to sell bonds rated below investment grade and said, "It should be left to the investor to decide whether or not to invest in a non-investment grade debt instrument."

Despite the relaxation, there weren't too many issues of junk bonds.

In May 2013, **Rolta India Ltd**, which provides software for engineering design, raised $200 million (around `1,170 crore today) in overseas bonds carrying BB- ratings from S&P and Fitch.

Internationally, some countries have taken steps limiting the issue of junk bonds.

In December 2013, the Colombo Stock Exchange made it mandatory for debt issues to have ratings one notch above investment grade, following concerns that the failure of such issuances could turn away investors from the debt market.

**More junk bonds**

"You will see more speculative bonds coming up. In a developing country like this, where do small companies get finance?" asked **Vivek Kulkarni**, head of **Brickwork Ratings India Pvt. Ltd**, a credit rating agency.

Kulkarni added that he was worried small investors would "suffer" and said "there is a need to share more information on such issues".

Small-sized companies are finding it difficult to secure funding in Asia's third largest economy, where interest rates are high and banks are reeling from the pain of bad loans accumulated over years due to a slowing economy, careless lending and long delays in project implementation, which, in turn, impacted the cash flows of companies.

Bank lending to medium-sized companies have hardly grown in the last two years, with banks significantly reducing lending to risky borrowers.

As on 21 March 2014, bank lending to medium-sized companies stood at `1.27 trillion compared with `1.25 trillion a year ago and `1.25 trillion a year before that.

"I would prefer companies come (for issues) with whatever ratings they get with adequate disclosures and let investors take a call on whether to invest in their bonds or not," said **Naresh Takkar**, managing director and chief executive officer of **Icra Ltd**, in which Moody's Investors Service holds a significant stake.