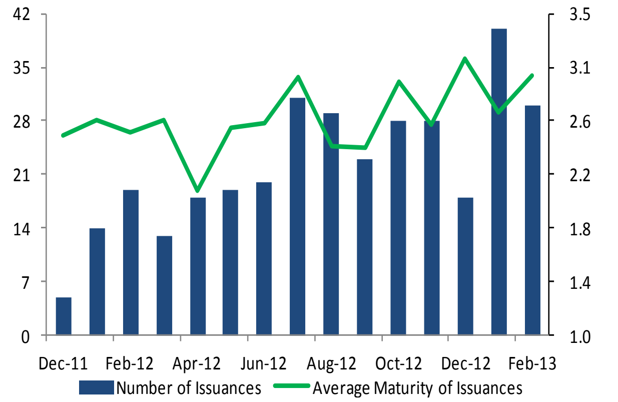
CARE Research
A division of CARE Ratings

& the subsequent cuts: Issuance moderates; in pursuit of apt underlying assets

Issuances of PPMLD moderated in February 2013

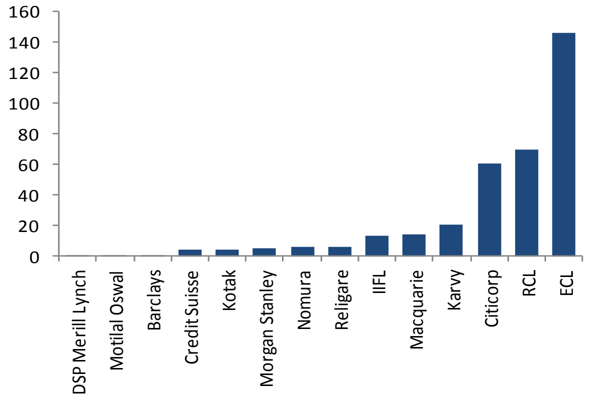
The total issuances moderated to 30 in February 2013 with the average maturity of 3.0 years v/s. 40 issuances in Jan 2013 with average maturity of 2.7 years. The number of issuances in February 2012 was 19 with the average maturity of 2.6 years. The issuances in February 2013 were primarily led by Edelweiss Capital Limited (ECL), Reliance Capital limited (RCL), Citicorp, and Macquarie. **CARE Research** finds that ~316 PP-MLDs term sheets have been issued in the market during February 2012 to February 2013. In February 2013, ECL led the issuance with 15 term sheets, followed by RCL with 7, Citicorp with 4, IIFL with 2 and Macquarie with 1 term sheets. **Our channel check** suggests that the total fresh issuances in PPMLD market hovered around Rs. 2,700 crore in FY13.

Issuances of PPMLD during Dec-11 to Feb-13



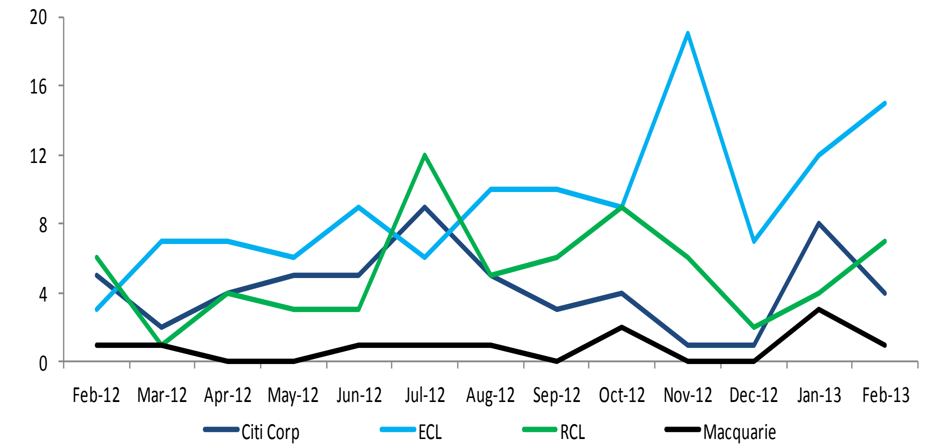
Source: India's Credit Rating Agencies Websites

Issuer-wise no. of Issuance (Dec-11 to Feb-13)



Source: India's Credit Rating Agencies Websites

Lead issuer's issuances improved during Feb-13 v/s. Feb-12



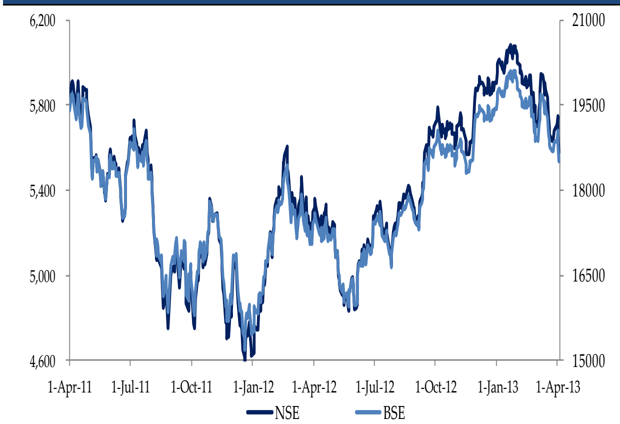
Source: India's Credit Rating Agencies Websites

Investors prefer bullish underlying index: sectoral indices as underlying?

CARE Research observes that Investors' medium to long term outlook on markets remains inherently bullish. In fact 99% of the structures that have been issued in PPMLD space give returns linked to positive performance of the reference underlying. Also, ~96% of the structures have CNX Nifty Index as underlying index and the performance of the same has been lacklustre so far during 2012-2013. The other Index which has been used, is the CNX Bank Nifty, a structure with this index as underlying has recently been issued by Reliance and ECL. It is pertinent to note that defensive sectors index (FMCG/Pharma) have outperformed the broader index is last 2 years (when the economic sentiment have remained uncertain). CNX-FMCG/CNX-Pharma has generated a return of 62%/33% v/s. -4% return of broader index (BSE/NSE) during 1April 2011 – 1April 2013. However, there are some constraints with respect to having such sectoral-index as the underlying of any structures:

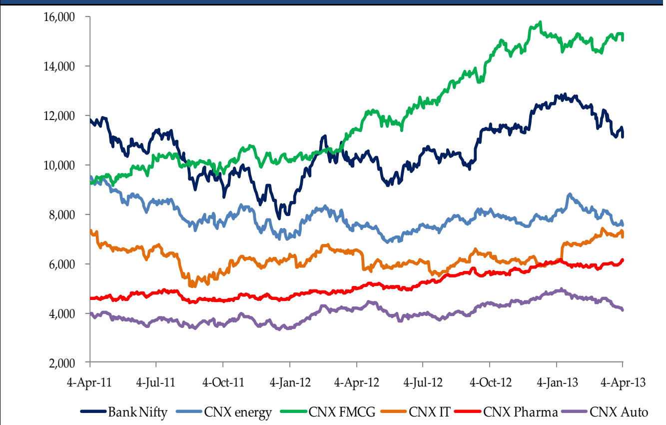
- ✓ Very low or negligible liquidity in the futures of these indices
- ✓ Absence of long-dated exchange traded options also make hedging these products difficult for issuers

The momentum yet to sustain?



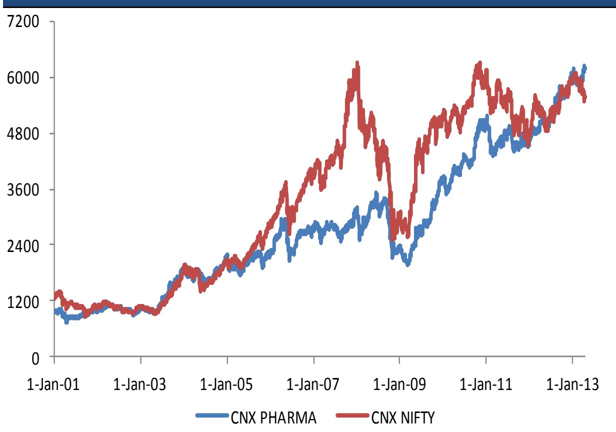
Source: NSE/BSE

Defensive sectors have outperformed (FY11-13)



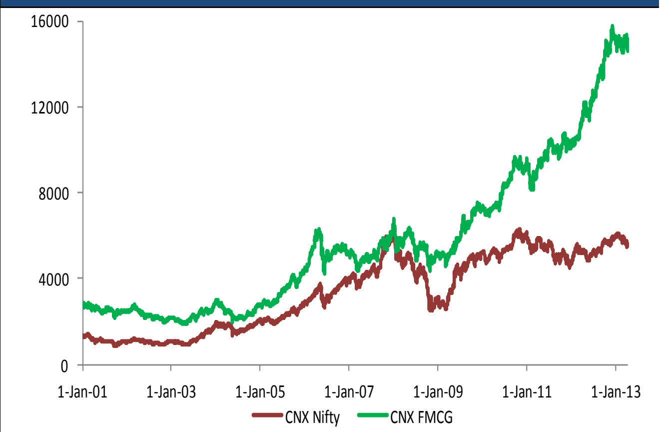
Source: NSE

Trend Analysis: Pharma v/s. Nifty



Source: NSE

Trend Analysis: FMCG v/s. Nifty



Source: NSE

Our channel check suggests that except CNX Bankex all other major sectoral-indices lack adequate liquidity in F&O segment. The defensive sectoral indices have performed well over various business cycles during FY01-13 and it is believed that investors would prefer defensive stocks/sectoral indices (v/s. cyclical stocks/index) during uncertain economic scenario. In order to counter the liquidity related issues associated with sectoral indices, but offer an alternative to the nifty fifty, issuers have been looking at selecting 'stock baskets' as underlying.

Issuers like Reliance, CITI, Edelweiss, Macquarie etc. have been already issued basket of stocks as underlying index for few structures. These structures have the most liquid stocks as part of the underlying basket. For instance, stocks of companies such as RIL, SBI, Infosys have adequate liquidity in the F&O segment and enables issuers to manage the risk of the structured products. After witnessing a decline in gold prices of around > 20% in last 1 month and broader market being lacklustre, we believe that basket of stocks/individual stocks as underlying assets would see more investors' acceptance. This basket can be further more customized in order to align it to investors' preferences.

CARE Research understands that using basket of stocks/single stock as underlying assets will invite higher risk concentration v/s. Nifty where the risk concentration is low due to diversification on account of combination of various sectors. However, the selection criteria of stocks while creating a basket of stocks as underlying needs more involved analysis by investment advisors/wealth manager to ensure that the basket selected is optimally suited to the investors' risk profile. Our channel check suggests that investors would be happy to have the options to go beyond the shelf and can customize the instrument according to their preferred indices/underlying.

To conclude, the suggestions of sectoral indices/baskets of stocks as underlying apart from nifty fifty, can be a turnaround story for MLD market as investors will be empowered with various structures of different underlying assets/sectors. This will enable the wider acceptability of such instruments/structures in investors' community as it would be more customized and aligned to their preferences of sectoral-index/basket of stocks/individual stocks as underlying.

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