

Rupee depreciation will hit returns of overseas investors in PE funds

TOUGH TIMES. Funds that raised dollar-denominated commitments need to demonstrate returns

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The rupee's depreciation against the dollar could impact overall returns of domestic private equity funds and pressure fund managers to generate higher returns to meet the returns expected by foreign investors.

Rupees are reconverted into dollars when foreign investors exit and long-term rupee depreciation can diminish dollar IRR (internal rate of return) at the time of repatriation.

Funds that raised dollar-denominated commitments will need to demonstrate returns in the current environment, said experts.

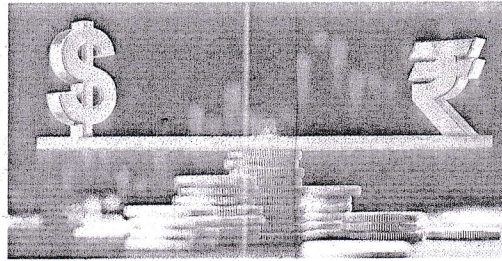
"Investors look at net cash in hand, factoring in forex and tax impact, which is why

managers will have to ensure higher rupee distributions from investments," said Sha-goofa Khan, a consultant.

Mature funds in exit mode will be impacted the most as these would have invested when the rupee was stronger. Funds that have called up monies and are sitting on significant dry powder as well as those with longer life-cycles, such as infrastructure and real estate funds, could bear the brunt.

TWEAKING STRATEGIES

"LPs may insist more on a dollar-based hurdle, shifting the currency risk on funds. Fund managers may be asked to demonstrate the performance in both currencies and provide clear metrics that separate the impact of exchange rate fluctuations from the underlying invest-



FACING THE HEAT. Rupees are reconverted into dollars when foreign investors exit and long-term rupee depreciation can diminish dollar IRR at the time of repatriation

ment performance," said Nandini Pathak, Partner, Bombay Law Chambers.

Investment managers launching new funds will have to tweak their overall investment strategy.

"Fund managers will have to revise the commercials with the overseas investors in terms of increasing the

hurdle rates in dollar terms, calculating the same in rupee terms (on equity risks basis), asking the investors to hedge their rupee exposure at their end and timing the exit of such portfolio companies to offset the depreciation in the rupee as much as possible," said Yashesh Ashar, Partner, Illume Advisory.

Alternative investment funds are not allowed to hedge their portfolios, except for Category III AIFs.

PORTFOLIO HEDGING

According to Ashar, funds operating portfolio companies that are more export-oriented may be able to offset some of the depreciation loss with a natural hedge at the portfolio level.

However, portfolio companies that are either domestic market-focused or import-oriented may have a further indirect negative impact. Global investors may rethink their India allocation and domestic investors may look to globalise their investment exposure to overseas portfolio investments, in addition to INR instruments," said Vivaik Sharma, Partner, Cyril Amarchand Mangaldas.