INVEST YOUR MONEY & **SEE IT GROW!**

NCDs

SUPERIOR FIXED RETURN INVESTMENTS

If you are looking for ways to earn a regular income from fixed return investments you would normally come across options such as Provident Fund (PPF), National Savings Certificate (NSC), Bank Fixed Deposits (FDs) and Non-Convertible Debentures (NCDs). Each type has its own merits and limitations. For e.g., though returns from PPF is tax free, the investment in a year is limited to Rs.1.50 lakhs and the money is locked in till the end of a 15 year period.

Most people think of tax benefits, interest rates or security while considering such investments. However, an important decision that involves your hard earned money should not be made on the basis of just one or two indicators. NCDs issued by corporates have gained significant attention from retail investors in the recent past and it is worth your time to study the various factors involved before making a well informed decision.

WHAT IS A NCD?

Non-Convertible Debentures (NCDs) are debt instruments that companies registered under Companies Act 1956/2013 issue to raise money for their business. The period of these instruments is fixed and usually it ranges between 1-10 years. NCDs cannot be converted into equity shares at a future date. Buying equity shares of a company helps you become a shareholder of that company. However, in the case of NCDs, you are only a lender. As an investor of NCDs you can choose to receive fixed interest regularly during the term of your investment. The other option is to choose to enjoy the benefit of compounding at a fixed rate and receive a lump sum on maturity. Further Companies may offer an option to investors to withdraw the amount at a pre-determined date called 'Put Option'. Company may also reserve the right to redeem the NCDs at a predetermined date called 'Call Option.' NCDs may be listed on the Stock Exchange. This will facilitate easy sale or purchase of NCDs on any day and for quantity as small as one unit.

SECURED AND UNSECURED NCDs

An NCD is secured when it is specifically mentioned as backed by the issuing company's assets to fulfil the obligation. Secured NCDs are backed by the assets of the company and are secured by a charge on such assets. The particulars of charge created is registered with the Registrar of Companies in India. An UnsecuredNCD is issued solely on the credibility of the company issuing it and are not specifically backed by the issuing company's assets. Secured NCDs are safer and superior than Unsecured ones. However , Unsecured NCDs offer interest rates higher than Secured NCDs. Where Bank FDs are concerned, they are insured only to the extent of Rs.1 lakh regardless of the depositor's total deposits with the bank.

INTEREST RATE

Interest Rates on NCDs are generally decided based on the credit rating of the Company. Lower rated entities tend to offer higher interest rates to compensate for the higher risk the investor is taking. Higher rated entities offer lower interest rates as the risk perceived on such entities is much lower.

CREDIT RATING

Credit rating is a process of providing an opinion on the relative probability of timely payment of interest and principal on the rated obligation. It is an unbiased, objective, and independent opinion as to the issuer's capacity to meet its financial obligations. It is indicated by symbols and each symbol has a standardised definition prescribed by Securities & Exchange Board of India (SEBI). However, rating is not a recommendation to buy, hold or sell a debt instrument. In India credit ratings for NCDs are given by agencies such as CRISIL, ICRA, CARE, India Ratings and Brickwork. A Listed NCD must be compulsorily rated by at least one credit rating agency.

RATING SCALES

Rating scales are awarded based on the duration of the debt instrument. NCDs are mostly issued with a maturity of more than one year and hence the following rating symbols are applicable:

- **AAA**- Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.
- **AA-** Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
- **A-** Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.
- **BBB-** Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.
- **BB-** Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
- **B-** Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.
- **C-** Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations.
- **D-** Instruments with this rating are in default or are expected to be in default soon.
- Further, **"+" (plus) / "-"(minus)** can be used with the rating symbols for the categories AA to C to reflect the comparative standing within the category.

HOW DOES CREDIT RATING HELP AN INVESTOR

Credit ratings provide an investor with critical information to enable him to take an informed investment decision based on his risk-return preferences. These ratings also help investors to select the appropriate investment opportunities from a large range of options available.

TAXATION

Bank FDs and NCDs give you interest which is added to your total income and hence both are taxable as per income tax slab. Earning interest from Bank FDs and NCDs are beneficial, especially for those who are in the lower tax brackets. Here's an example of how the taxation for this works:

		Bank FD*	NCD*
Interest Rate		7%	10%
Post Tax Return if Tax @	5%	6.65%	9.50%
	20%	5.60%	8.00%
	30%	4.90%	7.00%

*Interest rates and Tax rates are indicative only

For a Bank FD, interest earned (across branches) over Rs 10,000 a year will attract Tax Deducted at Source (TDS), unless Form 15 G/H is submitted. However, if you have NCDs held in Demat form tax will not be deducted at source. Here it is the investor's responsibility to pay income tax and file returns as per his total taxable income. So investor in an NCD do not have the hassle to file income tax returns if he is not having taxable income and claim refund of tax deducted at source which otherwise would have required in case of Bank FD where TDS is deducted.

PERIOD

Bank FDs are available for a period as low as 7 days to as long as 10 years. Longer period offer higher rates of interest, though not significantly higher than the shorter period. Most NCDs offer periods ranging from 1 to 10 years. NCDs with longer periods offer a substantially higher return.

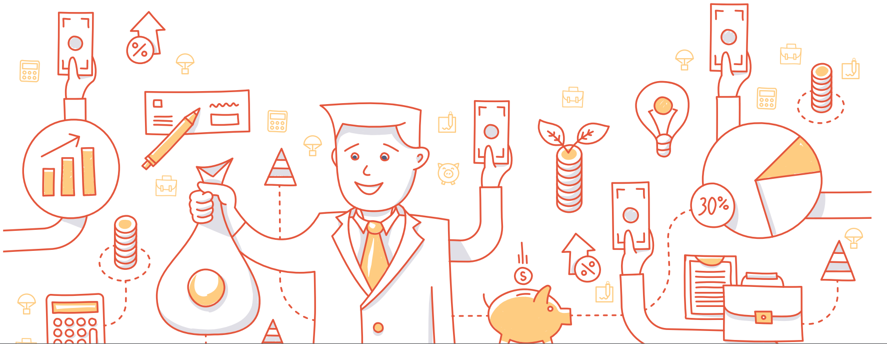
LIQUIDITY

Most bank FDs have more liquidity, one can withdraw the amount before maturity by paying a penalty. There are also some bank FDs which do not allow any premature closure.

NCDs mature according to their original period and therefore you should invest in them keeping long-term goals in mind. However, it is possible for listed NCDs to be sold in the debt market through the stock exchange platform. They can also be sold fully or partially in units by the investor. Debentures are therefore tradeable instruments that can be converted into cash at the prevailing market price at any time. In certain scenarios if the market demand is high for the NCD or in the event of fall in general interest rates subsequent to the issuance of NCD, there are chances the customer may get premium for his NCD, which is a profit over and above the principal and interest.

HOW TO INVEST IN AN NCD

If you are interested in investing in an NCD, you will need to have a Demat account with any SEBI registered broker. NCD issue is kept only for certain period and will not be on offer all through the year. It is important to note the dates of the NCD offer and invest before the offer closes. However, the particular NCD will be available in secondary market if there are any sellers after the allotment and post listing in Stock Exchange. The buyer can buy the NCD through the broker where he has demat account by offering the quoted price on the Stock Exchange.



HOW TO CHOOSE IN AN NCD

While deciding to invest in the NCD issue of a Company, the following factors may be assessed:

1. Track Record of the Company
2. Line of Business Activity
3. Management
4. Listed in Stock Exchange
5. Profits made by the Company
6. Credit Rating
7. Assets Size of the Company
8. Asset Quality of the Company
9. Promoter Holding/Interest in the Company

CHOOSE THE PERIOD OF INVESTMENT

Once you have decided to invest, you would first need to choose the period you want. This choice will depend on when you need the money and what your long term and short term goals are. If you want to have more stability in portfolio returns, you need to hold the NCDs till maturity. For the purpose of regular income, you can choose an option which will give regular interest. If you are not in need of regular income, it is advisable to choose the accumulated interest option since compounding results will give you a better yield. In a falling interest rate scenario, by choosing a longer tenure you can lock in at a higher interest rate for the entire period.

EARN MORE THROUGH NCDs

The regular income gained through NCDs can be instrumental in increasing your earning if it is used wisely. The surplus money after meeting your expenses may be parked in your savings bank a/c so that you earn some interest and could be accumulated. You may wait for an opportunity to subscribe to the next NCD issue of a Company and lock in at a rate of interest higher than bank fixed deposit. If the surplus money is not adequate to form a minimum lot of Rs.10000 in an NCD issue, you may approach your broker for buying NCDs from the stock exchange for as small quantity as one unit. This way you can compound your returns rather than locking your investments in bank fixed deposits at a lower interest rate.

DREAM BIG!

If you are sure you want a brighter future for your family and yourself, it is better to plan your investments wisely. Investing in fixed return investments such as NCDs from highly credit rated companies with a good reputation is a good way to ensure a good future for you and your loved ones.

To know more – Ask Branch Manager or Call

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My Dreams Are
Reachable!