EDELWEISS – INVESTOR DAY 2018

Deepak Mittal: Once again, a very, very warm welcome to all of you. A very, very warm welcome to all of you and thank you for joining us today. I think Rashesh spoke about the schizophrenic existence and bifocal vision. I still remember, I was fairly new in Edelweiss and there was a team of young leaders, we used to call them Young Turks at that time and we had done a presentation where we came out with a term called Edelweiss Paradoxes, you know, things which are unique about Edelweiss and that is where you know a lot of feedback or lot of insight we got around how while we are long-term oriented, we do spend a lot of time in making sure the short-term trajectory is also right, and I think over a period of time, we have actually started taking pride in that because there is no way you are going to reach the long-term unless you manage the short-term, especially in the Indian context. So I think, beginning on credit, I think Rashesh has already put some of the disclaimers around how even in these presentations, we will keep on shifting between what are the long-term trends we are seeing and we will love to have your inputs into that and how we are trying to position ourselves to capitalize on some of these long-term trends.

So, I think Rashesh spoke about the entire **(Everest ? 1:31)** journey, and as part of that journey, one of the things we have been concentrating is getting around an industry landscape for each of the business verticals which we have and this is fairly interesting in the case of credit. So if you look at FY2004, and you know it’s almost 15 years back, we had a nominal GDP of Rs. 28 lac crores or Rs. 28 trillion and we had a credit of only 9 trillion, and if you look at today, the credit market has actually grown more than 10x, almost 11.5x. So broadly, we are looking at two important trends, of course, one is the growth in GDP and I think that is a common phenomenon across most industries, across most service sector you know place in India, but second, for our GDP growth to continue, credit expansion or higher penetration of credit into GDP is equally essential. And if I fast forward to FY2025 where you know by all stretch of imagination, we should be crossing a $5 trillion mark; no economy has crossed a $5 trillion mark, there are only three which have crossed with a credit to GDP penetration of less than 100. In fact, if you look at the $2 trillion to $5 trillion transition, whether it was Japan, whether it was China, whether it was US, all of them actually happened on a massive credit expansion; all these economies went through massive credit expansion for them to achieve the $5 trillion market. So, you know, if you extrapolate nominal GDP growth of 11-12%, a higher credit to GDP penetration, from a longer term point of view, a 16-18% credit growth is fairly strongly baked in the Indian Economy.

If you look from a supply side, and I think this is not peculiar to only financial services or credit, I think it has played out in Telecom, it has played out in Airlines, what you may have heard Rashesh called earlier, Privatization by Stealth, but one big trend has been in India, a shift away from public market share to Indian private market share. So if you look at this data point also, the public sector banks used to account for 73% in FY2004 and now they account for only around half, so 57% of the total credit market. I think the other part which you know may have come under some amount of questioning over the weekend is how this point has shifted between private banks and NBFCs and housing finance companies on another side. So, housing finance companies and NBFCs put together, they have been growing much faster than private banks as a whole over the last 15 years. So just adding up, you have the tailwind of the economic growth through GDP, you also have you know increasing credit to GDP penetration and then a shift from public to private and within that, the diversified financial services companies, the non-bank and HFCs taking a higher market share.

I think this is on the overall credit market size and supply, but if you try and you know segment the industries in the market, credit market overall, of course, I think the first one which we look at is between corporate and retail, very roughly it’s a 55-45 mix at an Indian level, but interestingly, you can keep on segmenting and sub-segmenting these segments. At an Edelweiss level, we actually you know map and track around 60 different credit segments, each of these credit segments have their own unique peculiarities, the customer segments are different, sometimes the security structures are different, the market participants in each of these you know segments are fairly different from each other. And as a result of that, you can have actually have 60 components, some of them as small as maybe 20 trillion, sorry Rs. 20,000 crores and some of them as big as Rs. 6-7 lac crores and each of them with their own competitive characteristics and their own profitability structure.

We also try and bucket each of these credit segments across a range of return on assets and we truly believe ROA is the best form to look at the profitability of any particular credit segment or a product segment; of course, from ROE point of view, multiply by the leverage ratio and you get the ROE. So, you know, you have the ROA, typically more than 3% segment and there are quite of a few you know microfinance on the wholesale side, real estate loans, consumer durable, personal loan, credit card receivers, a lot of these products are under high ROA. Typically, high ROA would also mean either a very significant infrastructure investment or very, very specific capabilities for you to make sure that you get those ROAs. So if you look at most of these markets, you will have very specialized players, you know, bringing in a lot of the market share, who will be with very, very specialized skill sets in each of these markets. You have the medium ROA businesses, your affordable housing loans, your commercial vehicle loans, mid-market corporate loans typically fall somewhere around 2-2.5% ROA, and then a lot of large markets where you have fairly intense competition across both banks and non-banks, lot of scale, huge amount of liability advantages, but the ROAs tend to be lower, closer to 1.5-1.8%. Home loans, loan against properties are typical portfolios under this.

If you look at Edelweiss, we actually started around 2006, our credit journey. There were two segments we understood well, coming from investment banking perspective, we understood the corporate needs, especially the sponsor needs, and we also understood the securities market. So loan against shares which was a product largely targeted at HNI investors and retail investors and structured finance which was targeted at the larger corporates, their specific needs of structured credit solutions were the two products we started. But even at that time, when we were drawing up the credit footprint of Edelweiss, we were very clear, we will build a diversified credit book and if you, you know, circle back to 2006, I think Rashesh talked about it in an overall Edelweiss context, but from a lending context, it was very rare to see a non-banking financial services company trying to create a credit footprint across multiple verticals. So, we had the likes of HDFC which were very, very strong on housing finance, we had some other companies which were very strong on commercial vehicle, very, very few companies, if any, on the non-banking side which were looking at a credit expansion across multiple verticals, this was supposed to be reserved only for the banks, but given our schizophrenic existence and our need for diversification because we have always believed, diversification is the best risk management tool or one of the best risk management tools, we are always envisaging even at that time that this will be a multi-book or a large diversified credit book.

So if you look from 2009 to 2011, there were number of products we added, including home loan and LAP on the retail side. Our distressed credit and our real estate loan book also started around this book, 2009, so on both of these books where we have some amount of market leadership today, **(distressed ? 9:41)** we are largest player, actually have a 10-year vintage with us. You know, these are not books which we started 3 years or 4 years back, and we continue to add new product lines. But looking at you know this map, we now believe we are fairly well diversified from a range of books perspective and I think a lot of scale-up will now happen through capacity expansion and not necessarily through addition of new product lines.

So where are we at an overall level? If you look at our total book, it is around Rs. 45,000 crores, our retail book is almost now inching towards the same size as our wholesale books around Rs. 18,000 crores, our corporate book is Rs. 20,000 crore, and the distressed book is around Rs. 6500 crore. And if you look at you know these books, you will also see that across these books, we have got product segments in each of the three categories of ROAs, some of them are in the high ROA segments, some of them are in the mid ROA segment, and then we also have some products in the low ROA segment, so we look at our overall ROA by balancing the portfolio mix, not necessarily by you know stretching a lot on any particular product or an asset class.

So, one very important thing for us, and as said, it’s for us very important even from a risk point of view as well as from a growth point of view, when you are diversified, it also means you have choices, so if you are seeing risk headwinds in a particular product segment, in a particular credit segment, if you have choices for growth, you can always shift your growth focused from one vector to another vector. And if you look at some of the best credit houses in India, they have actually managed portfolio allocation very well, so when there was overheating in a particular sector, they were able to shift their growth focus from one sector to another sector, which is very difficult if you are concentrated only in one vertical.

I think this is extremely important, how do you price risk, how do you create a feedback loop into your pricing looking at what are the events happening, how do you monitor risk and how do you provide for risk. I think Rashesh spoke at length around how we have always been very clear when it comes to trade, balance sheet is more important than P&L. I don’t think any business is a truer representative of that than the credit business because this is where typically you have many more choices at play. So very clearly, when we see any trend in a risk in a particular business, the feedback loop, how fast you close the feedback loop both on pricing of that risk as well as on monitoring on that risk plays a very important role in our choices in terms of both growth as well as in terms of pricing and that has truly been the heart of almost all credit businesses we have scaled, whether it is structured finance, whether it is real estate, whether it is distressed credit. How do you price risk given the feedback you get and how do you monitor and manage those risks and provide for those risks, this has been a big strength for all our credit businesses right from the first business we started to the latest business we have started.

I think another important trend and more so as we are getting into retail in some particular segments of wholesale, using both analytics and technology, and here I would want to distinguish between two uses of technology and analytics. I think one there is a very big need today to simplify processes, I’ll give you one example, we run a particular SME loan product, where generally the approval rates are low because quite a few of these products go to you know customers who are in the micro segment or new to credit segment and it creates a huge capacity issue, right, because if you are originating 4 files, processing 4 files and disbursing 1 loan, that means for every loan, you are processing 4x over. When we looked at our score card and we looked at rejection rates, we found there were very few parameters which were accounting for majority of these rejections and we were able to take it on to the frontend, so what we call a quick no-product. So, when the relationship manager from that particular product team goes to the customer, he is able to input 6 you know key parameters which the customer can hand it over very easily and 85% of the reject get rejected on the spot, so it’s not a quick approval process, it’s a quick no-process, but what it does is it actually improves customer experience because a lot of customers actually feel if they have spent 1 week sending multiple reams of paper and then rejected, they do feel short-changed, a quick no always helps them and more importantly, it also creates a huge freeing up on your capacity because if 85% of the rejects are getting done, your approval rate on follow-through moves from one end to 4 to almost 2/3 or 2/4, so it serves both in terms of making sure OPEX ratio is improved, you capacity gets expanded by leveraging technology and it also gives a much more superior customer service experience. And one of the important things, especially on the retail side and we have some very good examples also on the corporate lending side, and maybe after the meeting, when we open up for Q&A, we will discuss some of them, we are finding new and new uses of both technology and analytics to deliver both, superior customer experience and improving our own you know capacity augmentation through better use of data.