EDELWEISS – INVESTOR DAY 2018 – Question & Answer Session

Attendee 1: Rashesh ji, thank you for your presentation. The first question is you’ve explained the upside very well on the ARC business, but what about down side, what if you are not able to recover the debt itself, at that stage, what happens to our P&L?

Rashesh Shah: So if you see, in India, on an average, the recovery rates have been between 45-50% for a lot of the project loans but that is on the overall amount while… so our hypothesis is let us say we have bought things at about say 50 cents to a dollar, if we get 50 cents then we make our 16% yield, no upside. If we get more than that, I explained what is upside. If let us say, we bought it at 50 cents and we recovered only 40 cents then the 16% yield becomes a 12-13% yield. If you recover say only 30 cent out of 50 cent, let us say you were down because ultimately, there is nothing which goes to you know zero (0). As the portfolio as a whole, when we have bought at 50 cent, when we underwrite, we expect to recover about 55-60 cent out of that, but if you buy it at 50 cent and settle at 40 cent, you will make about 12-13% return. If you buy it at 50 cent and settle at 30 cent, you will make about 4-5% return. If you buy it at 50 cent and settle at 25 cent, which is half the money, then you will just break-even because in the way it works is because you get some fee income, so the fee income protects you on the downside because no matter what happens, you will first get the fee and the way these structures work is first you get the fee and then whatever is remaining is actually shared between people who are holding the units, the SRS as they are called.

Attendee 1: My second question is regarding as we are going to see some slowdown in growth and that is the right risk management move, as you rightly said, going forward in the credit business, uhh do you think there will be a rise in NPA because of that because a lot of our growth have been very fast? So, are the NPAs back-ended because we don’t know the seasonally adjusted NPAs like what what if like what is our NPA for the 2-year-old book, right, so…?

Rashesh Shah: We actually track all that, so as you would have seen, a lot of our businesses, we were doing for 5-6 years, so we do 1-year lagged, 2-year lagged, 3-year lagged. We have currently not seen any deterioration in quality, not only in our books but we also you know talked to other players in the market and all, and the reason for that is like if you look at home prices have been stable, in fact, they have started inching up a little bit. The economy is doing well, people are not losing jobs. Actually, SMEs have come through GST, demonetization, those were the hardships. Now, in the last 1 year, after GST, demonization, all have been out of the equation, the SMEs and all also are much stronger now, so the economy is much stronger today and that is the good news for all of us that while all this turmoil in the mutual fund market or the liquidity crunch that may happen, it is not accompanied with any fundamentals getting deteriorated. Even the Rupee going to 72-73 has not impacted; in fact, more industries are benefited out of that because our entire tradable sector, our export sector has become lot more cost competitive as a result of that, and we are not seeing that huge pressure. Inflation is one pressure but that has been transmitted into higher interest rates and all already. So, currently as of now, and and you know, I think our promise to everybody has been, “We will say it as we see it,” so if you see it, we will come out and say it. Currently, there is no asset quality deterioration. As I said L&P has gone from 2.1 to 2.3 as gross NPA and all that for the industry as a whole, so if you look at all the CRISIL reports, look at all the others you know industry players with their report and numbers and all, and we all go through RBI inspection, we also talk to the RBI Team that comes for inspection to find out what is going on in the industry, asset quality deterioration is not currently the challenge. So if you are pricing it well, I don’t think that is the larger… I think the cost of funding, the availability of funding, how careful you are in terms of holding more cash on your balance sheet, all those will impact your growth strategy a lot more.

Attendee 1: Rashesh ji, one last question. In our mission **(inaudible 4:31)** do we have Edelweiss as a bank or do we still continue to be an NBFC? (chuckles)

Rashesh Shah: (chuckles) It keeps on changing. Currently, there is no decision made because there are pros and cons of both, and I think at this size at which we are and all, we currently feel we can continue with this because also remember, even a bank about your entire CASA and FD is actually time deposit while as an NBFC or something, if you’ve borrowed 3-year money, 5-year money like when we did a retail bond couple of months ago, we raised Rs. 2,000 crore in a housing finance company, a lot of the money **(inaudible 5:09)** is how many years, 10 year… ? About 10 years or so and these are non-callable. So there is a higher cost of liability for NBFCs but the tenure can also be managed. If you are not using commercial paper and using the bond market or bank term loan market, your ALM is actually much stronger than a bank because banks can also… a large part of, almost 2/3rd of the bank’s liability is actually on demand.

Attendee 1: Thank you.

Attendee 2: Rashesh, what will be the effect of the ARC business going forward in view of the new RBI guidelines because now you have to put in 50% upfront for getting an asset against previously 5%?

Rashesh: So, actually, in a way, your ability to deploy capital is improved because you are still looking for the same yield. So as I said, you know, 16-18% yield is what we aim for with future upside if you recover more that is the standard model. When we underwrite, we look at the asset value, we look at what is the you know pricing available, lot of these companies are already paying interest. A lot of companies are NPA, not because they are not generating cash flow, they are not generating enough cash flow to pay full interest and repay the loan, so when you look at your pricing, you calculate it on that basis. In fact, as I said, for this week, if you really go to the banks and you negotiate, you can get 20-25% yields also, if you want to deploy money. But as I said, you know, the decision we have made is we will be more careful and not currently be brave in trying to scale up the book very fast. So, on an average, you can get about 16-18%, so whether you buy 15% or you buy 40% or 50% or even 100% cash deal, the yields expected are between 16-18%, so you will do fewer deals but you will still put the same amount of money, that’s why I keep on repeating that that the most important parameter is how much capital is at work.

Attendee 2: Right.

Rashesh Shah: And the other thing we have done is we have this asset management funds, what you know Nitin and Venkat were talking about, they all co-invest with us. So now, if you do a Rs. 300 crore deal, only Rs. 100 crore goes from our balance sheet, the other Rs. 200 crores comes from the funds and that we have with our real estate book, that we have with our corporate books. A lot of our wholesale businesses also now have co-investment funds along with that, which allows us, and with this current turmoil, that is another comfort we have is we have the funds and those funds will keep on deploying money, so we don’t have to use and extend our balance sheet all the time.

Attendee 2: Sir, one more question, the current cost to income ratio is 47%. Going forward, what are we benchmarking cost to income ratio?

Rashesh Shah: Our current target is about 40 when we get to steady state because the portfolio businesses we have like you know mortgage should operate at about 20%, the retail credit should operate at 30%, corporate credit should be about 21-22%, so when you add up all of that, our current estimate is that we should get to 40%. How fast we get to is the effort that keeps on going in. I think we will take 2-3 years to get to there, but I think 40, given the advisory businesses we have and all of that is a good number to shoot for.

Attendee 2: And the blended average ROA, going forward, what would be the aspiration…?

Rashesh Shah: For the credit book or for…?

Attendee 2: Overall, as Edelweiss, ROAA blended average.

Rashesh Shah: I blended ROA of 3% will be good. We currently average between 2.4-2.5 and all, 3 will be a good number because if you are 3 and you are geared 5-6x, you will get your 18-20% ROE.

Attendee 2: Right, okay, thanks.

Rashesh Shah: Thank you.

Attendee 3: Sir.

Rashesh Shah: Yeah.

Attendee 3: Hi. Sir, what is your view on this distribution commissions coming down? As a distributor, you have such a large AUM and industry as a whole is also looking at lower trail and upfront fees going.

Rashesh Shah: Yeah, actually upfront will go down, trail will be the normal one. We are also seeing I think that coupled with what I spoke earlier, you know, this entire credit turmoil that is going on in the markets, we think that AIFs will take off much faster. And what happened earlier when the mutual fund commissions came under pressure, PMS started taking off for equity side. Increasingly, the distributors will try and push products where at least you know they make a good income on that. We will also see more insurance because now actually ULIPs have become much more competitive or attractive for distributors as compared to mutual funds. So we will see a change in that, but overall this is good for the mutual fund industry because it will go… it will adjust on a trial basis and that overall will be a lot more good because the artificial churning and all will go down. So, I think in every business like what we have seen in capital markets also, you should see yield compression, higher scale, and more efficient cost management because of technology and scale. So across I mean you will see every industry in advisory side will go through that that your yields will come down, your cost will also come down, but scale will be many, many fold.

Attendee 3: But Sir, initial impact on the P&L will be there?

Rashesh Shah: For us actually, it’s a small part. As Nitin was explaining on our wealth management, we have got you know broking income, we have got distribution income, we have got interest income, the spread that we make on the margin funding book and all that, so overall I think we are more correlated with capital market activity. Mutual fund, this change in that is going to be very low in fact for us, it is…

Ashish: Hardly anything.

Rashesh Shah: Hardly anything. Ashish is also there, Ashish?

Ashish: Hardly anything.

Rashesh Shah: Hardly anything. In fact, until somebody asked me on that day in the market also, it had not even crept up in our internal communication.

Attendee 3: Yes, Sir. Thank you.

Sunil: Hi, Sunil from Credit Suisse. Two questions, Sir, so one, firstly on the company, you just prefer to a 5-6x leverage that should be normally taken, but currently your leverage is you know higher than that, it’s almost **(inaudible 11:41)** where it was when you know when you last raised capital in a much more exuberant market. How do you think about you know your leverage on capital requirements, given not just your credit business what is required to deploying your ARC to your insurance, etc.?

Rashesh Shah: So, currently, on the credit business is the main leverage we look at, we are at 5x because we have tertiary asset, but as I said, a lot of that is a liquidity management, liquidity cushion management and all. So, I think the x tertiary assets, we are still at 5 and I think we will stay between 5 to 6, we last time raised and I think we went back to 4.6 or 4.7, we are back to 5 and we will not cross above 6. In fact, our covernance with most of the mutual funds and banks that we borrow from is that 7 is the cap for the credit x tertiary, which is mainly credit, 7 is the cap. Our internal cap is 6 and we are currently at about 5ish on that because tertiary assets are very optional for us. As you would have seen, even in this, we can easily take them off the books and we maintain it more for liquidity management and just this entire ALM control.

Sunil: Yeah, and second one is on the industry and your **(media ? 13:08)** macro perspective, so related to a question on you know slow down and NPAs coming up from that, not for NBFCs like you but more for the broader economy, the real economy, if refinancing becomes tough, can that lead to NPA problems, you know, small companies, SMEs, who may now be… till recently would have been flourishing well because liquidity was available easily to them, you know does that you know…? And I don’t know how the Government would behave in terms of payment cycles when elections are approaching, I mean how do you see that, how should we look at that in this context?

Rashesh Shah: I think in terms of liquidity, we have seen the last 3-4 years have been… actually, last 2-2 ½ years have been fairly bad for that because I think GST also initially took almost Rs. 2,00,000 crores, all the refund which was stuck, but approximately Rs. 2,00,000, we believe half of that has come back but another Rs. 1,00,000 is still stuck. If you look at all the NHAI arbitration and all that, another Rs. 1-1½ lac is stuck, so that is all… I don’t think that is getting worse anymore. At best, it will just improve or it will remain the same. Overall, as I said, the key test for the economy was GST and demonetization because those are much more stronger impact you know things. The other thing that is you must have seen that the bank credit growth has improved from 8% to 13%, and banks are 85% of the credit market, NBFCs, HFCs are about 15% of the credit market. So as long as bank credit is robust and bank, you know, even the deposit growth is fairly robust, we don’t think there will be a systemic non-availability of credit. It could happen for specific players and all, but the good news has been the bank credit growth last I saw was about 13% and that itself is okay, so I don't see this really becoming a contagion than neither banks… I think as I said, 2 years ago, where the PSU banks and other banks were cleaning up their NPAs and were not focused on growing credit; it was a much bigger challenge. But now I think as long as real estate prices are not going up, gold is not going up as much, household money has to flow somewhere. If it is not going into mutual fund, it will go into Bank deposits, it will go into insurance, it will come into retail bond market. Somewhere households need to deploy money because this $500 billion is the household saving and 50% of that is in financial assets. In fact that financialization will continue but whether it comes into Mutual Fund, which was the trend for the last 2 years, go more towards banks, go more towards insurance companies, come more into retail bonding, somewhere it has to go, it can’t, it can't stay in cash. So I think that is what gives you more confidence that all this will adjust itself because in the economy, debt will flow somewhere or the other. But I do think the banks and non-banks, the banks were growing at average all banks put together, the credit growth was about 8%, the non-banks where growing at 25-30%. I think banks have gone back to 13-14% then non-banks will come to 15-18%, as I said, so I think that convergence is underway but when you add that up, overall, I am not worried about availability of credit. In fact, last 4-5 years, we have gone through the worst of the… I mean in hindsight if you look at it, we had real estate market which had huge amount of inventory, we had real estate prices which were not going up, we had a lot of projects in real estate which were stuck, we had huge amount of projects in the real economy in terms of infrastructure which were stuck, we had NPA crisis, we had GST, we had demonetization. Those are the big changes that the economy went through. Currently, oil prices up, you know those are the problems we are familiar with, this is our known friend who has come back after sometime because you know bad macro and good micro has been India’s story for 25 years. Only last 3 years ago, we had good macro and bad micro that we don't know how to handle, this we know how to handle, so as long as the micro is good, as long as we have absorbed the impact of all of these. In fact, election, I think will be beneficial because it will unleash a lot of consumption spending. So it might have an impact on inflation but that we have already priced in now because oil price has taken care of that, I am not too you know worried about that.

Attendee 4: In asset management section, there was a slide which compared returns and risk, FD, mutual funds, and alternates. It almost suggested that alternates are giving you higher than equity returns than at lower than equity risk. Do you think that is sustainable or how long before competition takes it away? If we go back 5-6 years, we had a similar situation in LAP, right, where LAP yields were very attractive but over a period of time, market conditions have brought it down, so that mix of risk versus return, how long do you think that is sustainable?

Rashesh Shah: See, I think it will sustain, again it's not… See, you get higher return for two things, for higher risk and that we all understand, we have all done what is called capital asset pricing models and all that, that higher risk is equal to… but you get higher return also for higher effort. So what has happened, equity market investing has got fairly effortless in the sense, you have lot of instrument, market is efficient, research is available, all of those has happened in equity markets, so it has become more efficient, but this inefficiency in credit market is there because we are going through this transition, what I spoke earlier of the private credit getting transformed, banks can do something, banks can’t do something. And by the way, this is not just in India, the private credit growth is a global phenomena for the last 10 years. Just a week ago, if you search, FT had done one big, one full page article on private credit in the world and all the PE firms like Kalayil and Blackstone and KKR, which all started as private equity, have now equally big private credit funds. So the private credit growth is a global phenomena because the one advantage the private credit funds have is they don't have capital adequacy requirement, they are not borrowing in the market so they are not used to this same you know credit rating and other regulatory norms all over the world. So your ability to price, your ability to structure, your speed, all of that in private credit, it really stands out. I would strongly recommend that that FT article is actually worth reading, we will be happy to forward it, I think we have. You know, we will be happy to forward that article, but this is a global trend. So it’s not that it is an arbitrage, it is just a lot more effort. I think investing in equity market, if you are a global… if you have Canadian Pension Fund and you would invest in equity markets in India, it’s very easy, you can sit in Canada and invest. If you want to invest in a credit opportunity in India, you can’t sit in Canada and invest, you have to be on the ground. Also, the private credit needs a platform approach, you need to have a legal team, you need a collateral management team, you need enforcement, you need constant monitoring of collateral, while equity is a lot in that sense easier from an effort point of view. So this extra return is there because there is higher effort involved but once you set the platform, I think to about 12, 13, 14% return on private credit in India is not tough at all.

Attendee 4: And what is your assessment of the real estate sector in the country, separately across Tier-1 and Tier-2? Do you see developers being stressed or you believe there is still good amount of cash flow happening because media reports, if you seem to read, they seem to suggest otherwise?

Rashesh Shah: Actually, media reports are very confusing (chuckles) because very often on the same I think event, I will see different media headlines, so sometimes I also get confused whether SIBI relaxed something or SIBI tightened something because the same event will have different headlines. But on real estate, I think there is some good news and some bad news. The good news is inventory has come down; this year inventory is almost at a 4-year low of unsold apartments and all that, so we are at almost a 4-year low on inventory, yeah, Sanjeev - he runs our real estate business. On the cash flows, they are slower because customers are not paying as much and as quickly as they used to earlier, so your cash flows have got elongated, your sales are happening, in fact sales have been very robust. As I said, GST, demonetization was a bad phase for the real estate you know market. Currently, sales are happening and most of the sales are actual user sales, the investor market has completely gone away, which is also good news because these are genuine buyers, but earlier when people paid 30% when they bought a flat, now they are paying 10-15% only and balance on completion and possession. So your cash flows are stretched, your sales are happening, customer demand is for real. I think India, 2-3 million houses get sold every year and that continues, there is still 20 million housing shortage in India, so there is an automatic demand because housing is a demand, I mean given that people are getting married, people are getting jobs, all of that, housing demand is for real. The Mumbai market has been also a little bit stuck because the approvals are not coming for the last 3-4 years. Last 1 year, approvals have got streamlined and they have started coming also. So I think some of the bad stuff, I was the most actually worried about the real estate market after demonetization and with GST, I think those were the really tough headwind periods for that industry. Last 1 year, things have improved but are they out of the woods? No, but sales are happening, demand is back, inventory is down, and we think another 1 year, the industry should be on a good… on a stable footing.

Attendee ?: Commercial **(inaudible 23:51)**

Rashesh Shah: And commercial is actually doing well, so commercial is also keeping balance.

Attendee 4: Lastly, what is your realistic assessment of NCLT list to cases getting resolved? These days, we focus on List 1 and resolution happening there, what is the progress being made on cases which were there on List 2, and realistically, how long before we start seeing resolution from there?

Rashesh Shah: I think on average, NCLT people expected 180 days to 270 days, I think people should expect at least 360 to 500 days range now on an average case. The good news is a lot of this, the legal stuff that is going on, it is also you know basically creating you know precedent for the future ones, so hopefully, those will be faster, but the speed at which the Supreme Court like Essar, the Supreme Court is already hearing and 3 days, fath, fath, fath hearing happened, so whether it’s NCLT, whether it’s NCLAT, whether it’s Supreme Court, this speed we are not seeing in any other part of our economy where the courts are responding, but it is taking time because the law is getting tested in courts and Indian Corporates are using legal system also to thwart competition. I mean I was with somebody about a couple of weeks ago and he said, “I’ll keep on doing it, I know I won’t get the deal but I’ll make sure at least another 6-6 months go away you know before my competitor can close the deal,” but this is all normal market practice in an economy, competition will use every means to get an edge on that, but I don’t think there will be huge delays. And as I said, because the economy is improving, the pricing is much robust. What we are seeing for Essar, the last offer from ArcelorMittal, at Rs. 42,000 crore, just I would like to remind you, in this NCLT bidding itself, the first offer from Essar and the Numetal Group which was about 4-5 months ago was at Rs. 19,000 crores, so we had Rs. 19,000 crores, 5 months ago, which is now at Rs. 42,000 crores (chuckles) for the same asset in 5 months. So, I think this competition in NCLT is actually working very well. In fact, earlier there was a fear that for the large assets, there won’t be any buyer because who will be able to afford a Rs. 30,000-40,000 crore acquisition, but for large assets, we are seeing… I think it’s a good news. I think the IBC and NCLT process and all is the inflection point for our credit market, it will change credit culture, it will change credit behavior, it will eventually change even the bond markets in India. Hard to see now but the way equities happened in 25 years, how it changed all of us, I think the same thing over the next 10 years, we will see in credit markets.

Attendee 4: Thank you.

Rashesh Shah: Please?

Attendee 5: Hi, thanks. So just a couple of comments first, one is it’s really heartening to see that you know 2 years ago, you also spoke of making the organization more simple, so best wishes for that because it’s really, really good if you guys can achieve that. Number 2 was the amount of OPEX that you guys are doing, that’s also really, really heartening to see because we are setting the stage for a better long-term platform. My question was on **(inaudible 27:26)** on the credit side, one was the IBC and NCLT, do you see stark change in borrower behavior when they are coming to you? And #2 was that almost everybody seems to be moving away from wholesale credit, so is that really happening or is that really opening up avenues for primary capital deployment for companies like us?

Rashesh Shah: So, I think 2 things, on the 2nd one, I think you are very right, I think wholesale retail is a very artificial construct in the market, it’s like in real estate, we go through commercial and residential, there are times, commercial is very good; there are times, residential is very good, the same thing happens in wholesale retail, but one of the things we have learnt is you should fund whether it’s wholesale or retail, but especially wholesale, you should fund it with long-term money, you should ideally have 3-year, 5-year money. So if your average loan tenure is 3 years, you should ideally take 4-5 year money because cash flows on wholesale can get haywire, though the asset value and collateral value, so you will not lose money while on retail. If it’s a home loan or a mortgage or an SME, EMI business loan, your cash flows can be a lot more predictable, so especially, that is why, on wholesale we have moved to the fund structure where your ability to manage cash flow erraticness is a lot higher. So I think wholesale should be funded with as long-term money as possible.

Attendee 5: But are you seeing enough demand for primary money from the market?

Rashesh Shah: Yes, I think wholesale, there is a lot of… in fact, what is happening right now in the market, there is lot of opportunity, but at least our internal decision has been for the next couple of months, we will wait and watch and we will scale it up only with long-term money, and up till now, we have never funded our wholesale book with any short-term money. In fact, wholesale, our internal rule of thumb is at least to have a 1-year positive ALM. So a 3-year loan should be funded with 4-year money, you will pay extra cost of that, but you have to… that is why wholesale gives you the extra return also because on a risk-adjusted basis, your yields are very good, so I think on that basis, I would say… and I forgot your question was on NCLT, the borrower behavior?

Attendee 5: Yes, yes, is it changing sufficiently?

Rashesh Shah: It has already changed. I think the larger part more than IBC has been 29A; I don’t know how many of you are involved in understanding the nuances of that. So first they got IBC, but after IBC, they got something called 29A, 29A is the clause where the promoters cannot bid for the asset, they are actually barred and that has created a big fear with the promoters because 29A is… now, the promoter is saying, “If I go to NCLT, I will lose my company because I can’t even bid, I can’t even restructure, I can’t do an OTS also.” So we are seeing cases where promoters are coming 5-6 months in advance, they are at SMA-1 level or SMA-2 level, which is early stage of delinquency, and they are coming and saying, “I know I might become an NPA, I have got this farmhouse and this bungalow and this other asset, can I borrow against it to avoid getting into the NPA itself?” So what was NPA was early a bank’s issue, have actually now become the promoter’s issue, which is how it should be. Earlier it was… if it becomes an NPA then the banks used to worry that it is my issue because I have to manage my books and I have to manage RBI, and the promoters used to actually (chuckles) actually play on that. Now that has gone away because now the banks also hardened, banks are saying, “Abhi humne itna dekh liya,” when you have gone through Rs. 1,200,000 crores of distress, I think another Rs. 5,000 crores… so I have seen bankers also becoming very blaze, saying, “Theek hai, aur Rs. 5,000 crore gaya, jayenga, abhi itna gaya hai, to some more will go.” So bankers are not actually worried about NPAs anymore but promoters are worried, which is how it should be and that culture is a change in culture and that will lead to risk-based pricing and that is why Deepak spoke about pricing is very important. But one of the biggest change that will happen is we had relationship based pricing, there were projects and there were borrowers who were getting much cheaper credit than they should have got and that was actually polluting the market culture, that is all going to change and that is why we had still remained very bullish on the credit opportunity because of this risk-based pricing, this entire culture of you know ability to enforce, ability to take something to NCLT. NCLT is a big risk for most of the promoters because earlier the biggest risk for them was giving personal guarantee. So a promoter will say, I will not give personal guarantee, and they will say, “Ye dekho, Vijay Mallya ko kya hua by giving personal guarantee,” but now they are more worried about NCLT because you will drag them to NCLT and they will lose their company and that is a big, big, big, I mean you go and ask the Ruia’s and Essar’s and all that. Essar Steel is made with their you know blood, sweat, and tears, and in 2015, the steel industry went through a bad cycle which is currently going through very good cycle. Essar Steel is doing very well by the way, it is doing phenomenally well, the company, but at the bottom of the cycle, you got dragged into NCLT and now you can’t bid for it, so promoters have become very, very careful.

Attendee 5: Thank you.

Attendee 6: Good evening Sir. Sir, the per capita consumption on the mutual fund or your wealth management verticals, bank insurance, general insurance, can you throw some light that in next 3 years, how do you see your company you know evolving these sectors and taking the stories of under consumption?

Rashesh Shah: Sorry, I didn’t understand, on the insurance side or…?

Attendee 6: Insurance, like on portfolio management, PMS, your future plans.

Rashesh Shah: So, our own idea is that the asset management, basically, households have got 2 sides, they have got the liability side and the asset side. Household borrow more home loans, car loans, all kinds, and households… In India, households and SME go hand-in-hand, so there is going to be a lot more borrowing. We had spoken about that credit and democratization of credit and truly credit worthy borrowers will get. In fact, last few years, the MFI sector has now given loans to almost 100 million people, where the banks had given loans to only 40-50 million people after 40 years. So, we are now seeing really democratization of credit, so that one part will continue, but on the other side, households also have a lot more savings which they want to deploy, so it will be asset management, wealth management, there will be hunger for yield, so they will want alternatives for that, they will come to insurance because insurance can give you yield over a long-term, so all these… and our idea is we have seen that most of the financial services have all the products – insurance, mortgages, asset management, wealth management, capital markets, have for the last 20 years grown at about 18% per annum and we think that growth should continue broadly.

Attendee 6: Thank you.

Anchor: We are down to our last 2 questions. We have talked a lot about hunger for yield, but I think we need to break for dinner soon, so if you could just go through the last 2 questions…

Rashesh Shah: Yeah.

Attendee 7: Hi Rashesh, just a follow-up question on the fund structure that you are talking about. So, realistically what proportion of your incremental credit growth in the structured credit and developer segments can you fund out of this structure?

Rashesh Shah: So, our current internal target or wholesale book which is about Rs. 20,000 crore should not grow at more than 14% on our book. So if you take say Rs. 20,000 crore, it should not be more than Rs. 2,000-3,000 crore incrementally on our books and that should be equal to about a 1/3rd of the total one, so if we add about Rs. 8,000-9,000 crores a year, a 1/3rd will come on our books and 2/3rd will go in the fund management structure. So currently, we are looking at a 1/3rd, 2/3rd growth on the… so we are still growing, we are still harnessing the opportunity because wholesale is still an opportunity, in fact, it will become more stronger as all these things settle down, but ideally, it should be done with long-term money, it should be done with close-handed money and with qualified investors because even… see what happened, the flexibility you had from bank to NBFC was of a certain kind, but for NBFC to fund, so if you see the credit in the economy, first we had PSU banks then we had private sector banks then last few years we had NBFC, HFCs, now we will have funds also, and we think about 10% of credit flow will happen through funds. Currently, it’s only 3-4% but incrementally, the 10% of the credit flow into the economy will come from funds, the same thing happened, if you go back 10 years ago, only 10% of credit flow happened through NBFC, HFC. Now, almost about 30-32% of incremental credit is flowing through NBFCs and HFCs, but I think there are scale issues with all these events which are happening, some of the more structured one where you need more flexibility, more you know more back-ended stuff, all that will go into the funds. So I think you will be able to do more exotic stuff but that you will do in the fund structure. So like in the real estate book also, we do construction finance on our book, which is more plain vanilla, and we do developer funding, more in the fund structure.

Attendee 7: And the revenue booking on this, is it typically back-ended or how does it work?

Rashesh Shah: On the asset management?

Attendee 7: Yeah, on say **(inaudible 37:23)** done through this fund structure.

Rashesh Shah: So, what you do in the fund, you are an asset manager, you are pure and simple manager, you get your fee which is between 1-2% of the corpus. Unlike a private equity fund, where you earn fee on commitment, here you earn fee on deployment, so as you invest money, you start earning that fee which is usually 1-2% depending on the strategy and all, and then you get a carry. And the carry is what, Venkat, usually 8% hurdle and above?

Venkat Ramaswamy: 15%.

Rashesh Shah: Above 8%, so average you get 15%, what you make above 8%. So if you make say about you know 16% return of the extra 8%, you will get another 15%, which can be 1.2%, so that comes as a carry, that only comes as exit. But unlike private equity where exit is about 6-8 years, in private credit, exit is about 3-4 years, these are 3-4 year structure, so as you exit, you get carry. Currently, we are not getting carry because we are still deploying the money, but I think after 2020-2021, the money in the fund that we deployed will start exiting and the carry will start accruing.

Attendee 7: Yeah, and a couple of questions on regulation. So any impact you see of potential extension of the February 12 circular for banks to NBFCs as well, that was one? And as a resentment of the fallout of the events of the last few days, do you think that you could expect any regulation from RBI on NBFCs on the ALM side just to, and more from a medium-term perspective?

Rashesh Shah: So, actually RBI has got rules for ALM, even housing finance companies have ALM and all, right, so housing finance companies also have ALM rules and all. In fact, they allow 15% of your long-term assets to be funded with short-term borrowing, which I think is very liberal (chuckles) because you don’t want 15% also to be funded, that ALM mismatch. So I think a lot of housing finance companies have been funding their long-term assets about 15% of that with short-term which NSB allows, I think all that should go away. So I don’t know whether it will go away or not, but I think it should all go away. So, for the larger systematically important NBFCs, last 3-4 years, RBI has been closely… we get inspected every year, they look at you know all accounts, all of that, so the way they inspect banks is what it is. I don’t think the Feb 12 circular, currently, RBI wants to impose on NBFC; NBFCs are very small players in that. The RBI’s primary purpose was to clean up the banks, and for banks, RBI has always felt that they needed rules out there. NBFC… NPA issue is not big, and in fact, one of the interesting thing that happens when banks lend to NBFC and NBFC is eventually on-lend, it’s actually a lot more what I would call risk from a risk management point, which is a very strong structure. I don’t know how many of us have done the Math, but if you think about it, when a bank gives Rs. 1,000 crore to NBFC, the banks will keep Rs. 100 crore aside as the equity capital. The same Rs. 1,000 crore as an NBFC, when you on-lend to your SME customers, you put another Rs. 140-150 crore aside. So between the banks and the NBFC, you have now put Rs. 250 crores aside for a Rs. 1,000 crore exposure because you are double you know providing the equity for that same this thing. So that is why banks lending to NBFC has been one of the safest one, many people have realized that this is because there is double the equity that is I hope…

Attendee 7: Yeah.

Rashesh Shah: There is double the equity that is allocated, the banks allocate equity and the NBFCs then allocate equity all over again, and as a result of that, I don’t think RBI… and RBI understands this. In fact, in the morning, I was with RBI and we spoke about this point also and they said, “We want to keep it the way it is, we don’t want to reduce…” [chuckles] Ideally, since the NBFC is keeping equity aside, the banks should not keep equity aside on that portfolio, but RBI is going to keep this and that is why the NBFC sector is not a big risk from the asset side for RBI, and that is why the Feb 12 circular will apply. On the liability side, I think RBI will hopefully come out with some stuff because RBI also wants the bond market to be promoted because of that 25% large corporate borrower and these events, recent events will be setback on that, still come out with some stuff. And overall, I think as these things settles down, the industry will becomes stronger. I think the mutual fund industry I think they first time broke the buck was when… in 2008, where the liquid funds marked down and after 2013 also, people… we had Amtek Auto, all of that got absorbed, so eventually, things just become stronger when you go through this.

Attendee 7: Thanks.