RBI has opened its tap but liquidity has to flow in from banks: Rashesh Shah

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Rashesh Shah, Chairman & CEO, Edelweiss Group, is of the view that 'exaggerated fear of the unknown' has gripped the markets currently as doomsday predictions have reached a feverish pitch. Credit is tight but non-banking financial companies (NBFCs) are kicking and alive. None of the large NBFCs have had to shut shop in the past 13 months since the IL&FS fiasco led to credit woes, he said. In an interview with *Business Line*, Shah explains how Edelweiss is navigating through the challenging market. Edited excerpts:

Edelweiss has seen significant investment coming in through institutional investors like CDPQ and Kora Management and also alternative investment funds. What is next on the cards?
We are looking at an AIF-type structure for the wholesale business. Globally, private credit is the new business opportunity, akin to what Blackstone and Apollo are doing.

Private credit funds or AIFs come under the advisory business, which also includes AMC (asset management company), wealth management and ARC (asset reconstruction company). We are planning to list our investment advisory business that currently contributes about 75 per cent of the PAT, and we have seen high levels of interest from investors for this business. We are looking to raise $1 billion through a Performing Corporate Credit fund by March 2020, apart from our ESOF funds which have been doing well. US-based Kora Management has already invested in the advisory business.

Another significant investor, with whom we had signed up in May, AJ Gallagher, has just received approval from the IRDAI for investment in Edelweiss Insurance Brokers Limited, which is also part of the advisory business.

How is your credit business doing?
We are changing the mix between retail and wholesale. It is about 50:50 at present. Three years ago, it was 30 per cent retail and 70 per cent wholesale. We expect that in the next three years, it will move to 70 per cent retail and 30 per cent wholesale.

Is the worst behind us in the NBFC sector?
We have all adjusted to the new reality in the last one year. Bank lending is lower and the cost is slightly higher even though interest rates have come down. So, banks are charging NBFCs more. But it is coming. Profitability has got impacted. We have consistently increased our long-term borrowing, something we have been working on for the last few years now.

Has the PMC Bank crisis created another round of concerns for investors and shaken their confidence?
Of the top 200 companies in India, very few have had problems of corporate governance. There won't be more than 10 such companies. Cycles will happen. Prices will come down but very few have corporate governance issues and bad behaviour. Unfortunately, it is those 10 companies that become 90 per cent of our focus. Government, regulator, participants and media have to create a strong system. Instances like PMC Bank will happen but systems have to be in place to ensure that the economy does not pay the price.

What should be the response in terms of policy and action?
It should be counter-cyclical instead of pro-cyclical. It should be more pragmatic. Commentary itself should calm down the market. Also, enforcement action on auditors, rating agencies and all others can create fear psychosis. It has to be done but not in a knee jerk manner.

How can we build confidence?
There are four to five things. If not positive, then at least there should be balanced commentary. At present, it is very negative. September car sales are not bad. The economy is stabilising, green shoots are seen taking shape. If PMC Bank had not happened, we were actually on an upward trajectory. We are just adding to the frenzy. Enforcement also has to be more balanced.

Do you think there was also a problem of over-leveraging?
It is a risk-return problem. Every country goes through leverage and de-leverage. That's a credit cycle and you can't have an economy without cycles because you need optimism and some people will over-reach. Half the projects in India were NPAs between 2001 and 2003 but now they are profitable. We are all part of the cycle. But why deleverage with so much fear psychosis and drama? That adds to the problem.

Deleveraging is underway and it started about eight months before IL&FS happened. IL&FS happened because of deleveraging as liquidity dries up in such an environment. Between March 2017 and April 2018, CP issuance was on the rise.

When demonetisation happened, it took out money from the system and put it in banks, not with the RBI. So, about Rs 13-lakh crore was taken out from the system and was parked in banks. Banks had excess liquidity of $200 billion, banks were lending, putting money in Commercial Paper and in liquid schemes of mutual funds. About $100 billion went back into the market while the rest was in the banking system for one year between March 2017 and March 2018. In our economy $10-$20 billion is the swing factor between excess and deficit liquidity and we suddenly had $100 billion sloshed around in the system. In March 18, RBI tightened liquidity and there was already liquidity seeping out of the monetary system, post demonetisation.

How has reporting for NBFCs increased after last year?
RBI is asking for a lot more reports, they are asking questions. A little bit of rigour is always good for business. Our credit markets have grown faster than our supervisory, coordination and regulatory systems. Insurance companies, mutual funds, bond markets, NBFCs, banks and HFCs are all involved in the credit market and then there are tax laws where the Ministry of Finance has to be involved. Better synergies between the regulators will provide a boost to the credit markets in India.

As a confidence-building measure, should the government start providing some percentage of guarantee?
Credit enhancement is a sore requirement of the economy. Slightly more controlled enforcement, especially criminal enforcement, more positive or at least balanced commentary, and more liquidity will help. In India, liquidity is only through the banking system. So, when the banking system gets frozen, there's no other channel. The RBI has opened its tap but liquidity is stuck in banks. So, we need to find alternate liquidity measures. We need to cut rates more aggressively. The regulator has been proactive in cutting rates, but there is scope to do more.

Has the high interest rate business model of NBFCs created a problem?
Very few NBFCs charge 18-24 per cent rates, except micro-finance companies but they are doing well. If you look at our average yield also, it is about 16.2 per cent. This is the real interest rate. Home loans are 10 per cent. NBFCs' overall cost is also high as they are borrowing at higher costs. We are a high-interest-rate economy. The problem is not pricing, it is liquidity, which has almost dried. NBFCs fund all kinds of assets from one year to 10 years. The funding available is only for three to four years; so there is some mismatch. So, either stop funding all the long-term assets like housing, infrastructure and only do short-tenure loans. If there is long tenure, then the cycle has to continue. Growth can stop but the rolling over can't stop. People are asking customers to prepay the money, which is creating pressure on the customers and their businesses. People who give the money are always at the short end globally and those who get the money are at the long hand. That's how the banking system works. Credit works on

that. There is a little bit of ALM (asset-liabiity mismatch) that all of us have managed. NBFCs get about 60 per cent new to credit customers. We have signed co-origination agreements with a number of banks as NBFCs can be more efficient in some segments for origination.

How big is the asset-liability mismatch?
There is not a very huge ALM in the system. Customer interest payments are sometimes not timely but could come a few days later than the due date, which is again due to the tight liquidity scenario, among other reasons, as customers' cash flow is affected. Would you consider that ALM? There is contingency cushion for this too. The market has elbow room to handle that. But as a result of such erratic market pattern, uncertainty has gone up as everybody is just holding more cash.

Where are we in the real estate cycle?
Real estate has not gone from bad to worse. Data states that sales in the sector for the first nine months were equal to the same period last year. New projects are not being launched, so the demand-supply equation is correcting by itself. Inventory now is lower than what it was a year ago. Commercial real estate is now doing well, which actually complements the housing market. Both segments have corrected. Every job created in the IT sector is 100 square feet of commercial demand. This 100 sq ft of commercial demand translates into 500 sq ft of housing demand. There is a recent JLL report, which shows that commercial sales have picked up. Retail housing sales is slow for products priced at Rs 3 crore and above. It is faster for products between Rs 1-2 crore. Affordable housing is usually out of the city, but that is dependent on various kind of infrastructure. So, affordable projects are struggling to sell, until there is infrastructure.

How is the real estate book of Edelweiss doing?
Out of a balance sheet size of Rs 55,000 crore, only about 20 per cent is real estate. They are spread over 160 projects pan India, catering to the mid-segment buyers, where the unit size is under Rs 1 crore and is seeing good interest. Projects are evenly distributed with low concentration risk and good asset quality. Of these 160 projects, around 10-20 per cent are under watch, they are largely dependent on last-mile financing and Edelweiss's focus is on project completion, thereby unlocking value. While most players in this sector concentrate on originating and underwriting real estate projects, we also have a large team that is entirely focused on collection, resolution and recovery. That's also one of our core capabilities. (This is) similar to project completion experts globally. We are seeing projects that were under stress four to six months ago now completed and receiving bookings on the day of launch.

Currently, there is fear psychosis but nothing bad has happened in the real estate sector. It has been 13 months (since the IL&FS fiasco highlighted the NBFC woes) but there have been no big defaults or nothing worse has happened. Nobody, as of now, is increasing the loan book aggressively but the ones that are there are being managed. It is being ensured that projects are getting completed. Cash flow for companies is slow but recent tax cuts have ensured that profitably will improve.