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“Right now, we have a problem of plenty”

Tenure and asset-liability match are at the core of lending policies. Yet, private banks are looking at various options to enter, or reinforce their presence in, the infrastructure sector. Dipak Gupta, Executive Director, Kotak Mahindra Bank, explains to SHASHIDHAR NANJUNDAIAH how his bank has stepped up its corporate lending and is manoeuvring the tenure and asset-liability mismatch issues.



How has lending been post-downturn? To what would you attribute the 86 per cent jump in your PAT ending Q2FY10?

That trend is true for most banks. I think the banks benefited in the short run out of this steep nosedive on interest rate. I think that will even out now, once the rates stabilise. So it has less to do with us than the marketplace. And that may be true for most banks. Of course, each one of us has some amount of contribution, more of a protective contribution in terms of tightening belts to ensure costs are reduced in line with what is happening in the marketplace. I think there is very little positive growth oriented action.

When do you see the stabilising happening—what kind of a time frame are you giving?

It is difficult to say because the marketplace views are divergent and still not very clear. And basically they stem from the difference arising out of the position, whether we think this recovery is in the shape of a V or a W curve.

Which point of the curve are we at now?

At this point of time it is at the upper curve of the V or the W—the first part of the W—and that is why there is hope and optimism that it will eventually be a V. The environment at this stage is fragile, and we have to be cautious to that extent. The caution is also directed more by the downturn which happened last year. The pendulum just swung too fast and sharp to the negative side. That was extreme. Interestingly, when you look at the directional change of the V curve, the growth has been very fast. You could ask anyone about a year back, anyone would have said it's going to be a recession.

Did that have something to do with the stimulus?

Of course it had to do with the stimulus. The problem really is, putting it nicely, everyone thought this is as bad as, or worse than, 1929, so the mechanisms were the ones that worked really well in 1929, so the medicines are the same. One doesn't know if the circumstances are the same.

So the speed was also to do with the speed at which we administered the medicine since we knew what it was going to be?

Yes. But you don't know if the viruses are of a different strain, so yes it is worked up now. But who knows what we are into.

Do you think these QIP's had anything to do with the recovery?

Less so, I think. See, it has eased up. The way we look at that is very interesting: we are heavily into retail as compared to corporate. Like most banks would have 30-70 mix between retail and corporate, in our case it is 80-20 (80 per cent retail in terms of value). And you always think of retail which diversifies your risk, really, that is what we thought too. But in a downturn, retail gets impacted the first. As the downturn deepens, it moves from retail to SME and then to the corporate. So by the time it hits the corporate, it is big time recession. It's what happened the last time in 1999-2000.

This time around, by the time the downturn could touch SME and corporate, all the good programmes were in place. Governments were pumping in money; there were fiscal concessions, ease of capital, and so on. The corporate sector was benefited by the ease of capital availability. QIPs helped in ensuring that it did not touch the corporate sector, and by that time there was recovery.

True, but that could have resulted in some oversupply, right?

That is the worry. The worry is that if you have an oversupply situation how it will manifest itself, going forward. So the fact is, it is again a different virus strain and we will only know in course of time, not now.

What do you think about finance ability of, and funding options for, infrastructure today?

There are 2-3 critical considerations for infrastructure financing, which are relatively different from financing a lot other sectors. Firstly I think it is important for us to recognise that this financing is long term. The longer the tenure obviously

risks are commensurately higher. So you need a very different understanding of the risks. The moment you go beyond five years there is an unpredictable area. You don't know what's going to happen 3-5 years down the line. So there is a sort of a black hole after a five-year period, generally. This is relevant also is because if you look at our country's lending practices, while the funding requirement is more than five years, money availability beyond five years is very limited.

Ultimately we get our money from our deposits. Our banks don't have money availability of more than five years because our customers do not put their money in for more than five years. And we still don't have structures in our country where you will get infrastructure bonds for 10 or 15 years—they are still not very popular. So there is an underlying element of mismatch between the asset requirement and available liability. This is a base position to take: let's call it the 'asset-liability mismatch position'.

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So you're working on the liability side to address that mismatch?

It is difficult to work on it; you have to live with that mismatch. You can only take a certain amount of mismatch and not more. So first is the added risk of the tenure and second is the mismatch.

Have you been able to quantify this mismatch?

No, the way you quantify the mismatch is different. I am not willing to take risks beyond a certain amount of my balance sheet. I am not willing to go beyond that.

What would that figure be, in your case?

It won't be more than 10 per cent. Now

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these two factors [tenure and mismatch] define comfort or discomfort on financing infrastructure. Now within infrastructure are what I call average-ROI projects, because there is a reasonable element of unpredictability in returns. These are typically more to do with things like roads, tolls, and such. Then you get on with the next category wherein the ROI is above-average—such as power—because the return is reasonably determined. When a company assures the shareholders of a 16 per cent post tax (PPA) return, there is a reasonable predictability. The pricing will get adjusted automatically, so the risks are moderated.

And then you have the third category of return which are the newer infrastructure segments like telecom, where the returns at this point of time seem better than the other ones. That's good ROI. They are growing much faster, with a lot of money getting pumped into some of those businesses.

So would you consider telecom as a priority in your lending spectrum?

We are uncomfortable with above-five year lending. Telecom falls in the 5-7 year category. And we are more comfortable in that shorter range lending.

The other way of financing infrastructure is you don't take a large position. You just take a small position in sub-components. That is something like equipment—which is required by the infrastructure business. Now that makes it semi-retail, but I would still consider it as infrastructure. We intend to go a lot more into that than the term loan category.

The third category is building construction, because again the collaterals are more deterministic, the tenures are shorter. So that's how we have gone about it.

The other way we have tried to approach infrastructure lending is, we can fund the non-fund sector which tends to be of a shorter duration. For example, a power project may require equipment. Now there may be a term lender comfortable funding the project for 7-10 years. But, say, Rs 200 crore worth of the equipment may need to be imported. In such cases we can open letters of credit

(LCs) or a bank guarantee (BG) for shorter-term lending. We have tried to sort of find a good marriage between the tenure and the risk.

What would be your recommendation to infrastructure developers or investors on how best to obtain project finance?

There are some lenders who will be comfortable with long tail project financing while others are comfortable with short term lending. A borrower who may not have the ability to wait for a project report to be completed can bridge the gap, by approaching banks that are more comfortable operating in the shorter range. So at least the project is off the ground and you keep tying up funds as you progress.

Do you think the proposals themselves are risk-prone given that 40 per cent of our projects in infrastructure suffer delays because of unrealistic planning? How do you manage that kind of a risk?

The possibility of costing going wrong is low. Costing will go wrong normally if there is a serious design problem. It can also go wrong when the tenure gets extended for several reasons like approvals not being in place, environmental clearances, etc.

The possibility of returns not being as per planned is higher, because they are determined by the elements which are sort of fuzzy. For example, you don't know what the traffic will be on the road you just built. And that is why we try not to take the risks we don't understand.

What is the volume of your infrastructure lending?

At this point we would be, in totality, about Rs 3,500 crore. We are also large investment bankers. This can mean we can pick up the entire money and then redistribute it to five other lenders.

Your lending has gone up. Is there a change in your lending strategy?

Yes there is. It is more increased and focused on the non-retail side. The proportion of retail to corporate is more like 70:30 now [as against 80:20 earlier]. Basically

retail could not grow last year, where corporate offered a lot more opportunities. There is a move to increase it more and make it more reasonable, say, 65:35.

The problem today is there is there is a surfeit of money and shortage of appropriate assets.

You also provide advisory services. Does infrastructure figure in that spectrum?

Yes, it does happen. For example, we started advising Hutch about 15 years back when they had come to India. It continued for a very long time. Of course, now they are mature and are largely on their own. But we have offered them investment banking support for 15 years. We have a reasonably successful infrastructure investment banking practice.

What would you see as the salient features of an infrastructure credit proposal?

It is not very different from any other

project proposal. We look at the three 'C's of credit':

- The first is the customer.
- The second important thing is the collateral. The value of it builds up over a period of time—not necessarily a liquid collateral.
- The third is cash flow—and its predictability.

What do you think about ECB auction? Is the government taking enough advantage of it, particularly in our sectors?

Back to the V and W phenomenon. There is a reasonably high degree of liquidity in our system. We are also looking at an environment where you will have strong capital flows. And hence, its implications are on money supply and exchange rate. There is a need to bring about an appropriate balance so as not to risk of high inflation or exchange rate. When it was relaxed last year, it was more to ease the liquidity. But at this point of time you don't need that. Right now, we have a problem of plenty. So you need to impose restrictions so that the flows are not more than you can digest. Brazil actually imposed a two per cent tax on

capital inflows recently. The auction is only a mechanism of getting money in but with a good price, so there is no major impact on the system.

If you look at the last six months there has been a crazy flow of NRI money. There is a problem of appropriate liquidity so you need the ECB from the liquidity point of view. It's not that money is not available, it is going to be likely for a reasonable period of time. The problem today is there is there is a surfeit of money and shortage of appropriate assets.

Do you think there is going to be a hike in the interest rates by January?

There is no expert in the world who can answer that comfortably. Had you asked me the same question a month back, I would have said that expect interest rates to go up in the next 30 days, but what has happened is it has actually been the other way down. Today, the parameters are so many and so highly controlled. But having said that the expectation still is that they will inch up. That is why I am saying capital flows will keep coming, because money will keep finding its own levels which ever way you try and dam it.

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