

Andrei Stetsenko: [00:00:00] My name is Andrei Stetsenko. I am with Farley Capital, a firm that's been investing in India for over a decade. And I have been writing a blog called Dispatches from India about a variety of topics that we find interesting to investors in India. I have traveled to India, met with hundreds of companies, invested in over a hundred and one of the companies in which we've been delighted to be investors is Prudent Corporate Advisory Services. It's a roughly \$1 billion US market cap company. That is one of the top five distributors of mutual funds in India, and we're very honored today. I'm very honored to be interviewing the founder, chairman, and managing director of that company, Sanjay Shah.

Andrei Stetsenko: Sanjay, welcome.

Sanjay Shah: Thank you. Thank you very much.

Andrei Stetsenko: And for the sake of disclosure, just to reiterate, Prudent is one of the businesses in the portfolio of Gymkhana Partners, which [00:01:00] is the India dedicated fund that I co-manage. And everything we're discussing here, it's meant to be educational. It is not investment advice. And without further ado, Sanjay, thanks again for joining.

Andrei Stetsenko: Why don't we dive right in?

Sanjay Shah: Thank you.

Andrei Stetsenko: So as I mentioned in a blog post a couple years ago, called the Financialization of Indian Savings. there's a big change happening in India, right where it used to be that gold and real estate where the dominant ways to save and suddenly, well, it's been a long time coming, but it's really accelerated the last few years where, stocks and stock funds have become an increasing, increasingly attractive avenue for Indians to deploy their savings. And even after doubling the share that equities represent of the overall savings pie over the last decade, it's still less than 10%. And that compares to stats [00:02:00] that are

Andrei Stetsenko: much higher in other countries. I mean over 50% in the US, just to cite one example. So why is the percentage low, or why has it historically been low in India and why is it getting higher?

Sanjay Shah: So I think, first of all, thank you very much for having me on the call and it's a privilege to talk to your audience and thank you for being a value investor. And it's a very genuine question because if you look at India has

always been a savers economy and to be very frank, if you look at historically, Indians have always saved money rather than invested money.

Sanjay Shah: So their historical preference was always safety and liquidity was first parameter. So if you look at, I think loads and loads of money has gone towards the bank equities and I think the Public Provident Fund, and to a large extent, Indians hold large amount of money in the gold. So if you look at, I think globally, India has the largest household savings just gone into gold and then probably

Sanjay Shah: real estate, and I can tell you to a [00:03:00] large, actually, even money in circulation, which is a cash which you keep in your pocket was also very large money. So India has always been the savers economy and probably the vibrant equity market has probably, I can tell you frankly, if you look at the entire capital market, uh, cult of investing through mutual funds has happened only in the last 20 to 25 years.

Sanjay Shah: So I think. Probably if you look at on a global parameter, India is a very, very young investor as far as the entire wealth management piece is concerned. And probably the reason would be I think a lot of I think the issue, the transparency was not that the vehicle were not available, only option was investing into direct equity.

Sanjay Shah: And then a lot of IPO related issues has happened in past, a lot of scam has happening in past. So I think the confidence of the people was not that great. Plus another major reason was the per capita itself was very low, right? Because the people do not have the huge disposable income. So a lot of people, a lot of reasons where [00:04:00] probably you can attribute for low participation or no participation of people in the capital market.

Sanjay Shah: However, I think important change, which if you look at in last 20 years, a lot of structural changes has happened. So if I can, if I can tell you frankly, the entire industry has grown through a multiple growth drivers phase in last 10, 15 years. So I can see that probably this new government, which has came in power, so they call it as the major drive, the growth drive.

Sanjay Shah: We, I think

Andrei Stetsenko: The Modi government.

Sanjay Shah: Yeah, government. I think the, if you look at the, the most important focus, which they had in mind was to formalize the economy. So first

change we, they brought was, soon they came in power. It was, we call it gem other and the mobile movement, which has happened, right?

Andrei Stetsenko: so Digital India, where where it became easier, it became easier to open a brokerage

Andrei Stetsenko: account.

Sanjay Shah: exactly, So their first objective was that they want to open as many as possible people's bank account. So they call it the movement. If you want to open the bank account because hurdle was the KYC [00:05:00] newer customer, right? A lot of paperwork. You meet the client, you take the documentary evidences. So I think they say that if you want to create the digital identity of all the Indians, so the first step was, the other moment we call it is other, right?

Sanjay Shah: So other was the identity of an individual, which was biometric and the your eyes and everything was linked

Andrei Stetsenko: So in, instead of, instead of filling out reams of paperwork, you could go in, have one biometric confirmation of your identity and open a, an account the same day.

Sanjay Shah: Perfect. Perfect, perfect. So I think that was the first target of this government. So they used, they created the other. Then they targeted that the maximum people should open the bank account. You know, the actual idea was that they actually wanted to do all the social benefit transfer to the people directly to the bank account.

Sanjay Shah: So their original object was direct benefit transfer DBT, because there are huge leakages of social security money, which are going to be ground level people. And once

Andrei Stetsenko: Middlemen, middlemen

Andrei Stetsenko: taking it. Exactly, exactly. So frankly, if you look at this entire Han a movement, there were 10 [00:06:00] core fake beneficiary which has been removed from the system.

Sanjay Shah: So I think that was the original objective. So that Han A and these both the thing were linked to a mobile. So these, all the three put together has created a very robust framework for. People to do any, so the mobile was

not used only for the purpose of communication, but for any kind of investments.

Sanjay Shah: Buying, selling, everything has been available on the, on the, on the mobile app. So there was, there was the first step of Gem Trinity. Second biggest thing was the demonetization Right, 2017.

Sanjay Shah: Yes, yes. November, 2017, government did a de monetization drive wherein they wanted to bring all the money, which were in circulation, which either accounted uncounted money into the banking system.

Sanjay Shah: So once the other entire Gen 20 was ready and when money came into a system, so the, the people do not want to vitro that money again and make it unaccounted, right?

Andrei Stetsenko: And, Just to summarize for American listeners who might not be familiar with what the significance of that was, which. Correct me if I'm wrong, but until [00:07:00] demonetization, it was, uh, very easy, let's say, uh, to, uh, not be a, uh, fully tax compliant investor when you're buying real estate or gold.

Andrei Stetsenko: Uh, and uh, by contrast, when you're buying an equity or, or a fund, there's a a lot of paperwork that has to back that up. There's, you're going to be taxed, and so the compliance burden has always been there. And what demonetization was a step towards is putting everything on a level playing field so that there were no longer, there was no longer a tax disadvantage to being an investor in, in, uh, securities.

Andrei Stetsenko: Is that correct?

Sanjay Shah: Perfect. Perfect, perfect. And psychologically, because once you brought that money into official system, you don't want to bring, take money out and make it again, the unaccounted money. Right? So that was the biggest, uh, drive, which government did. And, you know, these are apart from other movement and the uh, and the, what do you call the demonetization.

Sanjay Shah: Another [00:08:00] big thing happened was from the sebi. If you look at it in 2017, the mutual fund was not accepted by a lot of people. They came out with a, so the sebi said that we are allowing you to use two business point from the A VM for creating the awareness about the mutual funds

Andrei Stetsenko: so so Sebi India's, SEC essentially mandated that asset

Andrei Stetsenko: managers allocate a certain fraction of their income towards advertising. And it's not, it's not necessarily advertising, uh, that's saying invest in our fund. Our fund is better than all the other funds. It's more along the lines of investing for the long term is good.

Sanjay Shah: Yeah, so they, they came out with a campaign called mutual funds. Meaning of that mutual fund is the right choice. For investing from a long, long-term perspective. And then they use the all because the India is the economy where people love the cricket too much, right? So they use all the youth Icon were available, uh, for, uh, social media marketing and creating the awareness about long-term investing.

Sanjay Shah: So if you look at three fourth thing happened together, entire infrastructure was [00:09:00] created, digital and physical. Then the demo monitors happens. So money came in, and then the A was created. So all put together. You know, the significant drive, people started accepting wholeheartedly of investing into the mutual fund.

Andrei Stetsenko: I imagine that the biggest transformation has come not necessarily in South Mumbai or, you know, uh, the, the, the best parts of Delhi where people have always been, had money to invest and, you know, they, they, if they didn't want to fill out paperwork, somebody would do it for them.

Andrei Stetsenko: The big transformation has been among middle class people, people who are rising into the middle class, who, uh, are becoming investors for the first time. All these. Powerful trends you've, you've discussed, they've enabled that person to, uh, finally access these savings products, right?

Sanjay Shah: And then the major change, well, major adoption has happened during the COVID time. So these, all the things happened before COVID. Before COVID, there were two crore investors, post COVID, another three and a half crore investors came by this time.

Andrei Stetsenko: Just to translate for our Americans, [00:10:00] a crore is 10 million.

Sanjay Shah: Absolutely, absolutely. So from 20 million, it has now moved to 56 million investors. So the COVID has given a lot of scope to the people to explore these investment vehicles. So people started investing into a direct equity, future options, then the intraday. And the SIP cult has become real post COVID. So now we have almost about, uh, 56 million people who are mutual

of investors. But if you look at it from a percentage point of view, it's hardly about 5% of India's working age population between 14 years to 64 years.

Andrei Stetsenko: When Indians go to invest, when they decide conceptually, okay, I'd like to become an investor. How do they become a customer? Like someone in a second or third tier city who's just learning about all these things for the first time? How do they end up approaching one of your distributors?

Sanjay Shah: My distributor on the ground was always looking for the investors and a lot of awareness was there, so they [00:11:00] also approached them. On the other side, the people has also started investing through a FinTech platform. Uh, significantly better because there was a huge, because if you look at the entire infrastructure was so easy.

Andrei Stetsenko: An online broker.

Sanjay Shah: Yeah. So all the zero zero cost broker was doing a lot of advertisement for acquiring the customer, the mutual fund. So mutual fund campaign created a pool and they created a lot of advertisement by them also. So if you go to a website for example, Zerodha or you go to a Groww or you go to a there lot of platform which provide the direct plan of investing into a mutual fund where because the convenience, they enter there and with one or two or three clicks, your account is open and they start investing.

Sanjay Shah: So both the side thing has happened. The people who were not having an access to the advisor, they were not knowing how to do this thing. They just enter the FinTech platform and they started investing. And wherever my advisor was available, I think they also got a huge money after COVID.

Andrei Stetsenko: And how much of the job of your distributors is education more than sales? Just informing people about why they should be doing this and not gold.

Sanjay Shah: [00:12:00] So I think they probably, if you look at in the entire journey of helping investor to create wealth, normally we have always told them that your first job is to meet the customer, explain about the power of a mutual fund, and start with SIP.

Andrei Stetsenko: To explain to our American listeners and viewers who might not be familiar with the acronym SIP, Systematic Investment Plan. Would it be accurate, the analog in the US would be a 401k? It's an automatic

monthly deduction that feeds into an investment a certain amount. It could be a hundred rupees, it could be a thousand rupees.

Andrei Stetsenko: It varies according to what people are able to contribute. But the point is to establish this, culture of saving into equities. And, it's gone from zero to billions of dollars US per month.

Sanjay Shah: Absolutely, absolutely. So if you look at, because it this structurally why we did much better with a large number of people who cannot be addressed on a [00:13:00] day-to-day basis, right? Because you cannot meet every day, understand the regulatory requirements, so easiest thing would be if you want to cater to the masses, put them into a system where whatever they earn regularly should go systematically into a particular diversified kind of a fund, and they're not required to be bothered. They will not be bothered about the market volatility. So, frankly in last 10, 15 years, it has really worked in favor of them because in spite of there being a lot of volatility, we have seen market going into a one direction, which has been upward and if you look at today

Sanjay Shah: the country has roughly about, what about a hundred and, about 10.6 crores, roughly 106 million live SIP accounts. And the industry collects roughly about 33,000 crore or roughly about 30,000 crore per month out of this SIP account. And the average SIP value is roughly about 30 US dollars.

Sanjay Shah: So you are about 28,000 to 33,000 rupees roughly about. So you can look at the power of India, that about a [00:14:00] hundred million people investing, or a hundred million transaction happening every month of \$30 per month.

Andrei Stetsenko: That's very sizable. One thing that I think has been the result of everything you just described is that foreign investors used to drive flows in India. If the Indian market was down, it was because they were withdrawing money and, and vice versa.

Andrei Stetsenko: And I started noticing this during COVID. In March, 2020, foreign investors started panicking and Indian, the SIP flows, they maybe didn't grow much, but they didn't stop. And during this past month with all this war and Iran turmoil, I've been observing the same thing where foreign outflows have been very large.

Andrei Stetsenko: I think 11 billion this month US, but domestic institutional flows have been even bigger than that. So they've more than offset the foreign money that's leaving. And a lot of that is thanks to SIP.

Sanjay Shah: Yeah. Yeah. Fully agree. [00:15:00] Fully agree. So if you look at in a percentage terms, I think the foreign investors used to own about 20 to 23% of the Indian equities. Now they are about 18%. And the domestic institution investors, DI, were probably less than 20%. Now they have moved to 22%. And then the SIP has become a counterbalancing force.

Sanjay Shah: Whenever the outflow comes from FI, there is a retail guy who are going to buy this. So if I tell you another way, if in last two, three years the way FI has exited India, if you would not have seen the retail money coming into the country. I think my market would've been down by 30, 40% easily from the current level.

Andrei Stetsenko: So the pillar holding up the Indian market is now Indians themselves. And I understand that there's there's not total capital freedom, especially for very high net worth investors in India, but if you're a middle class investor in India, you have options about where you can invest. And yet, would you agree that for the most part, Indians are choosing to invest in [00:16:00] Indian companies and Indian funds?

Sanjay Shah: All the options are becoming available and the government is also giving, reasonably some relaxation for investing. But you have to understand that people before, few were not investor in the equity, right? And now we are trying to bring them to the equity you want to give them a comfort.

Sanjay Shah: So it's always very natural that you have a very, first of all, you need to convince them you please move away from fixed deposit and move to. So one was a guaranteed or the fixed return, you are moving to a dynamic market return kind of a product. Then you want to give them a comfort. So naturally you'll, they'll look at the, uh, name of the company, which are very known to them, right?

Sanjay Shah: Like L&T or Reliance or HDFCs or SB of the world. So I think it is very, very natural that any first stage when you are trying to embrace equity, probably give them a very. Comfortable name where you have a trust. So now we have been seeing in the last three, four years, like probably GIFT City, which is very strong, area which is emerging for the NRIs and the domestic investor.

Sanjay Shah: Also to use the foreign [00:17:00] capital for investing in board and outboard both. So same way, probably last two years, we have seen that H&I has started looking at investing into global equities. But retail still, we believe that if somebody's starting with \$30, you should not give him the other asset class other than the Indian equity.

Sanjay Shah: We let them understand the nuances of asset creation. Once they reach to a reasonable level, you definitely offer them the diversification to grow.

Andrei Stetsenko: As a foreigner who puts in an enormous effort to visit India twice a year and build a portfolio of Indian companies, I think the logic that you're outlining for Indian investors is very sound. They have a home market that is, where there's a virtuous cycle. Part of it is thanks to them, right?

Andrei Stetsenko: So if you are an Indian investor, you used to stow your wealth in gold and real estate, the gold, especially a totally non-productive asset, right? By contrast, now you're buying shares of listed Indian companies, these Indian companies have greater access to capital, so they [00:18:00] can fund more factories, hire more employees.

Andrei Stetsenko: They accelerate the growth of the economy, which means that their earnings grow, which means that their share prices perform well, which means that more investors are attracted. It's one of the few things in economics that's truly good for everybody involved.

Sanjay Shah: There's a very, very positive cycle which will emerge to the economy. That is probably, we believe that India has always been starving of the capital. It was always dependent on the FII .Still FIs are needed, we are not saying no for that matter, but at least now the domestic investors are also participating in the India's growth story because we always say that if you not invest in equity, even India might grow, but you will not be a part of that growth story.

Sanjay Shah: So now, we have at least, from an equity market perspective, I can tell you there are about, 120 million people who has Demat accounts and about 56 million people who has the mutual fund accounts. Still, this number has to grow double, at least my belief is in the next five, seven years. But people have started looking at, and people started testing the result of [00:19:00] this.

Andrei Stetsenko: So over a hundred million investors, that sounds very significant, but in a country of 1.4 billion, still a lot of room to grow, right?

Sanjay Shah: Of course. Undoubtedly, yes, yes, yes.

Andrei Stetsenko: Could we dive in a little bit about a Prudent specifically and just talk about your strategy. So, when you think about where the value is in your ecosystem, you have all these distributors and they're independent, right? In the sense that they don't have to just be with you.

Andrei Stetsenko: They don't have to distribute a certain mutual fund. Their point is to get people to invest. It's not necessarily to sell a particular fund. Right?

Andrei Stetsenko: How does that relationship work? Your relationship with the distributor and the distributor with the end investor? Where is the trust and kind of the stickiness?

Sanjay Shah: Before that, I'll just give you the background of the entire ecosystem of the distribution. So today, if you look at the [00:20:00] country has roughly about 0.2 million MFDs, which are distributors in the country. It's a very large particularly populated country, but the number of distributors are even hardly about 0.2 million. And another most important part is that out of these people, I can tell you roughly, probably about 70% people are not a full-time in this profession

Andrei Stetsenko: Did I hear right? 200,000 distributors?

Sanjay Shah: Yeah. India as a country has 200,000 distributors, and out of that, almost 70% would not be a full-timer. So they might be working somewhere else. You might be an accountant, chartered accountant, insurance agent, or X, Y, Z work.

Sanjay Shah: Right. So because they're not full-timers and because the income is not that great, they always need some support. As far as the infra is required, tech support is required. So probably when we started the business in 2000, by 2005, we realized that there is a strong need for somebody to provide all support and become a very strong bridge between manufacturer and the distributors.

Sanjay Shah: So I think our [00:21:00] role is always to make sure that whatever is required to be done by the distributor and the interest of client should be done by us. What is required by manufacturers to bridge the gap between manufacturer distributors that will be done by us. So, if you look at the offering from our side, we provide this significant tech, whether you talk about the entire backend, frontend, everything. So every entire full tech support is

brought by us. Whether you talk about the customer related KYCs, customer onboarding, customer portfolio reporting, customer portfolio analysis, automated reviews, entire all CRM tools.

Sanjay Shah: Then you talk about these research related and the training related, everything. We provide everything, all kind of research, all kind of support on the ground. Every month we do a physical meetings also to explain them about the adoption of forward tech because you create the tecg system, right?

Sanjay Shah: But essentially it has to be adopted by these people. If they will not adopt the tech, they'll not be able to bring this to the customer end users, right? So we do a regular training to explain about the tech. We also explain about [00:22:00] the how to create the portfolio of the client, keeping in mind their risk appetites and their requirement.

Sanjay Shah: There are various tools available. So probably, from the tech point of view, do everything. Then it comes to a multiple product basket. So we believe that over a period of time, we realize that mutual fund is not the only product which will survive you. Now you need to become a wealth manager of masses.

Sanjay Shah: Don't remain only a mutual fund distributors, so whatever is required by them, whether they require the PMS & AIF or stockbroking activities or insurance business or third party product. So I think large third party products are available with us and we have trainers who drive them. So that is the second piece.

Sanjay Shah: Third is, we believe that these are the people who always need leadership kind of a drive. You need to provide them leadership qualities, so motivate them, drive them, sit with them to do their business planning, explain them that, how can you move your AUM from X amount to a 10X amount in next five years?

Sanjay Shah: Then what are the things which you require? And we'll help you to create the entire business plan so that business plan will be created, monitored, [00:23:00] driven, and we'll be reviewing also. So if you look at it at multiple level, we do multiple activities and I think that is the biggest thing. We also do a lot of activity, like NISM, we, we create a National Institute of Secondary Market, which creates the examination.

Sanjay Shah: So we help creating new people joining the industry. So we bring a lot of people to the industry and we make sure that they are able to grow faster because of working with us. That's always in our DNA and we have demonstrated, if you look at my investment deck, in last 10 years, what we did is we analyzed one data that all those MFDs are working with me and all those MFDs who are not working with me.

Sanjay Shah: So we identified top thousand MFDs of the industry who are not part of Prudent and 2000 MFDs of Prudent. In last 10 years, if the people outside the industry grew at 17% CAGR, my advisor grew at 35% CAGR. So almost double then the rest of the world, right? And that is what we communicate, that we will at least bare minimum, help you to [00:24:00] increase our productivity at one third.

Sanjay Shah: Here it is demonstrated double.

Andrei Stetsenko: My next question was going to be why would a distributor choose to be a Prudent distributor? Rather than go with one of your rivals? And I think you've just answered it. Essentially, you have a value proposition that gives them the assurance that they will be more productive.

Andrei Stetsenko: That you'll be an enabler of their success.

Sanjay Shah: And then we also understand that as you grow in the AUM, so frankly, if you look at our, so we always tell them that if you work with Prudent, you might get 5% or 10% lower than if you go to the MC directly, but against that 5% or 10% lower, because that's our additional margin.

Sanjay Shah: But then against that you'll have a huge growth driver because of the regular support which we provide. And then once you become reasonably large or probably once you reach a threshold, it is difficult for you to leave the system because your entire customer base one time systematic mandate are there because entire business is through SIP, right?

Sanjay Shah: [00:25:00] So let's say some client has a hundred client and that 300 SIPs are going on, all the mandate would be in my favor. The SIP would be continuously going on. We'll provide them the SIP reconciliation, SIP instrument doesn't get hit, then we would probably give the reminder. So there are a lot of things which you do for customer also.

Sanjay Shah: And the partner also then, so once you are reaching that certain threshold, you cannot think about going anywhere else because you wanted to

make sure that I don't disturb whatever festival I'm enjoying. So normally I have seen that the exit route is literally closed and people remain very stick with us.

Andrei Stetsenko: Given all that, it's not surprising that your number of distributors, it's grown something like tenfold over the last decade?

Sanjay Shah: Yes, yes, yes.

Andrei Stetsenko: And same thing with your number of end customers. You have I believe close to 2 million

Andrei Stetsenko: end customers. And when you think about your growth over the next decade, what would you expect to be [00:26:00] the primary driver? Or is it kind of all of the above? When we talk about is it gonna be growth in the number of distributors and the AUM per distributor? What's more important?

Sanjay Shah: if you want to project the growth of wealth management industry for next decade, first hypothesis would be that India is going to grow phenomenally from here onwards, number one. Number two when you talk about the India is growing, we believe that today we are at \$2500 kind of per capita, or \$2000 kind of per capita, we assume that this number might go reach to a \$4,000 per per capita income in next about about a decade. So I think the naturally, the disposable income of my existing customers should increase number one. Number two is country is about 0.2 million or 200,000 distributors. MFI, which is the parent body, which is handling our business.

Sanjay Shah: So MFI has projected that in next decade they want to move this number from 200,000 to a million. So I think we have been able to maintain our [00:27:00] market share in the overall MFD numbers to about 18% to 20%. So today we have about 35,000 people working with us out of let's say about 180,000. If this number grows to, let's say 500,000 or 600,000, I think I should be able to maintain that market share.

Andrei Stetsenko: You'll at least get your portion of the expanding pie.

Sanjay Shah: Yes, yes, yes. So the number of distributors should increase. Then we are always working on making my existing distributor productivity. So we always make sure that you reach to a certain three, like probably, let's say your minimum AUM has to be a crore, which is about, 10 million, right? Or probably you go to a hundred million, which is a 10 crore kind of a thing, which becomes very productive for my distributor.

Sanjay Shah: So we work on that segment also. And another thing is we are trying to add the multiple product basket, right? So if you look at the growth of the country per se, increase in the per capita income, number of distributors are increasing, which will help me to increase my number of customers. [00:28:00] Then the AUM per distributor has to increase and the product basket.

Sanjay Shah: All this together, probably we believe that definitely next decade bearing this sort volatility, I think we are into golden, I think probably you got a golden era of wealth management industries growth will come in next one or two decades. That's, that's

Sanjay Shah: what we built.

Andrei Stetsenko: And I think that's something that is hard to fathom for an investor who's used to a slow growth developed economy where everyone's market share is pretty much fixed, the market grows 2% or 3% per year, is that in India when things are growing by double digits, you can have a business like yours that has multiple complimentary growth drivers and the end result is a growth rate that is much faster than if you look at one of the drivers in isolation.

Andrei Stetsenko: So, your number of distributors is set to keep growing, AUM per distributor is set to keep growing, the addressable customers, like you said, their disposable incomes are growing and so the money they have available to invest is expanding. [00:29:00] And something that took me until recently to fully understand is, when someone's per capita income goes from \$4,000 US to \$6,000 US. Their overall income might grow, that's 50% growth, but their disposable income is growing much faster because the portion that they are spending on shelter and food on bare necessities, once they satisfied that the remainder is now available to invest, to spend on, consumer goods and so that's very fast growth there.

Andrei Stetsenko: And then, you know, no guarantees in investing that stocks will always go up, but layer on top of that, that probably at least over the long term we expect Indian equities to appreciate. And so you really have three drivers, right? More distributors, more AUM per distributor, and rising values of the accounts.

Sanjay Shah: I'll give one another example, which is very strong for my business driver. We have a monthly SIP book of [00:30:00] 1200 crore per month, and internally we always have a target that if my total is, let's say my current AUM is like 125,000 crore, where in equities is roughly to 120,000 crore, it's 120,000 crore. I wanted to maintain 1% of my AUM as the SIP book.

Now I can give you one statistics. Historically, if I'm collecting 1200 crore by way of SIP, every month, my gross sales is normally double than this. That means lump sum money will be another 1200 crore. However, if you look at any three year period, my net sales is equivalent to my SIP book.

Andrei Stetsenko: So you're saying the SIP flows are the sticky ones. They're the ones that stay.

Sanjay Shah: Or, probably some lump sum might come, some might go away.

Sanjay Shah: But overall, these nature would be equivalent to my SIP book. So if you assume that my SIP book I'm able to maintain between 8% to 10% of my annual, or about 10% of my AUM annually. So that 10% should be my net sales. And second thing you rightly said, we are normally assume that Indian market will generate a [00:31:00] return for investors in the range of 10% to 12%.

Sanjay Shah: So I think it's a very strong 20% compounder as long as we maintain the SIP book and the UNKOWN tradition.

Andrei Stetsenko: just to anticipate or preempt anyone who might comment, oh, these guys expect India to always do well, just because it's been doing well, and until very recently, short term but definitely in the long term, India does not need PEs to expand in order to do well, because the underlying earnings are growing very robustly.

Andrei Stetsenko: So you need no multiple expansion for performance to remain robust. When you think about the outlook for your company, what could go wrong? I mean, this all sounds so promising, but the obvious thing that comes to mind is passive investing. So if anyone is listening or watching from the US they're probably familiar with ETFs and how they've really arrested a lot of share over the last couple decades from [00:32:00] active investors.

Andrei Stetsenko: That's not really happened yet in India. And, you know, ETFs are available, but why hasn't that taken over there like it has here?

Sanjay Shah: So I think, but still probably my belief is that advisors or the distributors are able to create the portfolio wherein the, they don't see a need for getting the ETF or the passive. Because if you look at three-year, five-year cycle, if I was just going through the data yesterday, almost 60% of AUM is able to beat the index so they're able to generate the alpha in all segment, whether you talk about a large-cap or even small-cap or the mid-cap.

Sanjay Shah: So as long as you're able to generate the alpha, I think there is no dire need or pressing need for you to offer the passive, number one. Number two is probably rather than looking at the particular asset class, my belief is the entire portfolio construction and the asset allocation would be more relevant because Indians are still unable to understand between passive and the active.

Sanjay Shah: So I think you need to understand, when customer will ask about the passive people will give the passive. And in that stage [00:33:00] has not come. Still, I see that at least another 3, 4, 5 years you'll see that. I think the active will continue to grow, but as people become more and more knowledgeable, they'll start questioning that why you're not giving the passive or why these fund is not performing compared to the benchmark.

Sanjay Shah: But I think still the financial education and literacy has not percolated to a retail level. They don't even understand what is CAGR and the absolute return.

Andrei Stetsenko: They're just getting started.

Sanjay Shah: That's getting started. So still I see it another five, six years away. So gradually you'll see that people will start asking, you'll see some adoption, but my belief is that growth itself is going to be so better that if you are passive and contribute 10%, your AUM rate is negligible

Sanjay Shah: in my system. I mean 125,000 crore, I think passive is even technically zero. So if I move from 125,000 to 250,000 crore kind of AUM, and if passive start contributing 5%, 7%, 10%, then I think it's okay.

Andrei Stetsenko: that ties back to the point I made a few minutes ago about how that's just a fundamentally different situation from [00:34:00] what we're used to in developed markets where if a competitor is growing very rapidly, all of a sudden that's a scary thought. That implies that I'm not growing.

Andrei Stetsenko: But you're saying in India, because the overall market's expanding so rapidly. It's okay if the passive guys get 10% of the market in a few years. But one other factor that I think it's important to mention is that the number of stocks, so India has over 4,000 listed companies, but the number of listed companies that are a large enough, with enough free float, liquid enough, for an ETF to own, there's maybe 100, 150, maybe 200 on a good day. And so to the extent that someone really wants to be exposed to the really what here at Gymkhana, what we think are the most exciting businesses, the large caps of

tomorrow, you can't get exposure to those through an ETF just for structural reasons.

Sanjay Shah: perfect, perfect. perfect. And second, if you look at India's ETFs except one [00:35:00] or two funds, or if you take away the Nippon, I think liquidity is not there. So if you look at buy and sell spread, it is almost about 1.5%, 2%. So there is also biggest concern when you talk about the ETF. Liquidity is not there.

Sanjay Shah: Passive liquidity, there is one is funds, which are passive funds, but if you look at the ETF, liquidity is a big concern.

Andrei Stetsenko: I know that we shouldn't say anything negative about asset managers because they are your partners, but why would, when you talk to prospective investors, what differentiates you from one of the many asset managers who are competing to be the actual managers of the funds who collect the fees.

Andrei Stetsenko: Why? Why is Prudent a better bet than those businesses?

Sanjay Shah: So I think first and foremost, probably our positioning is altogether different than, so if you look at the entire wealth management industries driven by the relationship management model, right? Whether you're talking about 360 or Andrati or anybody for that matter. The entire model is driven by B2C where you hire the [00:36:00] relationship managers and they'll handle the businesses of the customer directly and we are into a pure B2B2C.

Sanjay Shah: So our role is to make sure that the ground level guy are driven properly so that he brings the business. So in case of both the model, we deal with the entrepreneur, another people deal with the RM. They're not the entrepreneur, right? So here I'm not bought because I need to just motivate them to leave them and they on disproportionately higher than RM model because the moment you reach to a 10 crore, if you look at, I think their earning would be easily about 0.7 million or roughly about right. Roughly about 700,000 per year. So once you reach to that threshold, automatically you have the huge advantage of compounding. You work harder. So that's the basic difference. Second is, because we are dealing with the bottom of the country, right? We are about as you said 2 million investors and roughly about four millions SIPs.

Sanjay Shah: So this construct is not there with any wealth manager. They deal with the guy who has 500,000 or [00:37:00] more than that, right? So they try to manage the H&I and the ultra H&I of the country. We try to manage the

absolute retail of the country. Another positive point between others and us would be the SIP book, because today in the country has, roughly about 30,000 crore.

Sanjay Shah: We have 4.5% market in the entire SIP book. And that is very, very sticky. So we did not to mark the mark that we do not require to do a timing right because that in the lean phase and the bad phase, if you look at the one data point we have provided that we considered bear market is one where in last 12 months, NIFTY has given a return less than zero.

Sanjay Shah: So during that phase, industry didn't grow. We grew at about 7% to 8% because of my SIP book, this continues to come with me. So I think these are, we are more predictable. Even in the market cycle also, that does not mean that in future it'll happen. I'm not giving any future statement.

Andrei Stetsenko: I guess you also don't have to worry about, well, what if this star fund manager goes away? Or what if suddenly this track record is no longer good and people wanna switch away? [00:38:00] You are there to provide a platform for people to invest. You don't care about which fund.

Sanjay Shah: Yeah. Yeah.

Andrei Stetsenko: While you've grown.

Andrei Stetsenko: So your number of distributors has grown, the average assets has grown. Are those economies of scale, why you've also been able to increase margins over time?

Sanjay Shah: I think the margin has remained more or less because my payout ratio to my partners has been in the range of 67% to 70% of what I earn. So if you look at my gross profit has remained more or less very, very steady. But you got a huge operating leverage because your administrative expenditure has not grown significantly as you grow on the AUM side.

Sanjay Shah: So I'll have good operating leverage story available, but at the gross margin level. Because now we are also growing faster. The tier also gradually coming down, so I'll not have a, I'll not probably try to earn out of compression in the margin for my distributors. Rather, I'll work on the operating side.

Andrei Stetsenko: if you're compressing what the, the share of the economics that you're sharing with your distributors, [00:39:00] that's kind of a, that's a

trick you can only pull up to a point. At a certain point, your distributors will be unhappy, and that's the whole core of your business. But it sounds like the opex leverage, that's something that can continue as you grow?

Sanjay Shah: So I think the operating cost is not growing more than 10% to 12%. My bottom line is growing about 15% to 20%. So I think that math, if as long as it continues, I think I'll be able to enjoy the operating leverage, but you might have a lean phase where the profit, your top end may not grow, but I think the operating cost might continue to grow at 10% to 12% because that's, you have to give something which impression, adjusted growth to the team.

Andrei Stetsenko: as you're growing, as your business continues to generate cash, you're a capital light business, you don't need a lot of money to build factories. So how do you think about where all that capital that's being generated? Can you reinvest it in your business to get good returns or is there a point where you just, there's more cash than you can use?

Sanjay Shah: because it's a very, very asset light business and when you talk about [00:40:00] reinvesting into the business, I need to expand my geographical reach. I need to invest significantly into a tech. So I think that's a very regular expenditure, but I think we have never shied away in expanding my branch network or expanding into our tech investment, but that's a part of my routine administrative expenditure. So the question which I think all the analysts ask us that you are generating huge cash, what are you gonna do with this? So we have been looking for inorganic growth by way of some acquisitions. If you remember a couple of years we acquired, there is asset of Karvy, then we acquired iFast, which is Singapore based company, which they exited India.

Sanjay Shah: Very recently, we acquired a small company from Pune, which is another city of country called Indus Capital. They had about 2000 crore of AUM and the deal was about 8.5 PE multiple. It was a good deal and it was a good quality asset which we acquired. So we had

Andrei Stetsenko: You paid 8.5 times earnings?

Sanjay Shah: 8.5 times of funding. Yeah, it was a pure, pure cash, but it was a cash deal, a hundred percent cash we paid.

Sanjay Shah: So we are sitting on a huge cash probably by this, by end of this year, we'll have [00:41:00] about 600 crore of cash. So that's a genuine question. But, I believe that there'll be some good opportunity, which will be on the way, not now. And so I want to preserve cash until I reach 1000 crore of

cash. And if I'm not able to identify some acquisitions, then because I can also understand that cash brings down my return on equity.

Sanjay Shah: So it's a pressure from the investor that, why are you keeping cash? If you do not want to do anything, give it to us. We'll, invest in some other stocks. So I think I'll just take a liberty for a year or so. Otherwise I'll reach out to the board for drafting the policy.

Andrei Stetsenko: I think investors get nervous when they see a management and a board that feel like they have to do something with the cash because that's when overpriced acquisitions tend to happen, but at least to date your acquisitions have seemed pretty targeted and not too big.

Sanjay Shah: So Andrei I will never do that because 60% is owned by me. So I'll never be under any pressure to do anything wrong because finally, [00:42:00] if my investors are hurt I'm also going to be hurt.

Andrei Stetsenko: One thing I frequently try to make clear to our prospective investors in the States, they say, well, don't you worry about corporate governance in India? You know, like, how do you know that these people are gonna treat you well as a minority shareholder? And I say, first of all, some of the worst corporate governance I've ever encountered has been at US companies that are professionally run, where no one really owns the company.

Andrei Stetsenko: The board has very little financial interest, it's not their money. Whereas there are companies like yours, as you just exactly mentioned, where you do not misuse the capital because you think of it as your capital. And so it's, you feel very comfortable. You sleep very well at night, being partners with someone who is that rigorous about the capital.

Sanjay Shah: And Andrei, we realize that if you are good in corporate governance, people trust you and if you do anything wrong, people will punish you significantly, right? So, and I think I've been so happy because virtually I was a professional, I [00:43:00] was a chartered accountant by profession and I think God has been so kind enough that I could be able to create a billion dollar company.

Sanjay Shah: And I don't, I have a very frugal life I'm doing, so I'm happy what I've created and I'll not do anything hanky panky for sure.

Andrei Stetsenko: I was reading an article yesterday as I was getting ready for this interview about how you made a gift to your employees.

Sanjay Shah: Oh yes. That's not something you see very often in the corporate world. Can you just mention briefly what was that, what was the intent of it? What was your thinking?

Sanjay Shah: Oh, thank you. So actually last year when we completed 25 years of Prudent, there was a very strong thought going on in my mind because, I wanted to I think share my fortune, which has been created with the help of my team. So we thought I'll gift share from my personal capacity to all those who has completed three years.

Sanjay Shah: And I just give some, because the background I want to tell you, the day I thought about this, I talked to my compliance guy. He said that, sir, there is a regulation from SEBI, which is a listing obligation and requirement. So it says that if [00:44:00] the promoter gift any shares to somebody, they all become a quasi promoter.

Sanjay Shah: So today we have a list of five people. As a promoter, if I give to 640 people, 645 people will be sitting as a promoter. So I said, I think this is something which is not expectable because my intention is genuinely I wanted to part with my wealth to the people who has contributed. I reached out to the SEBI.

Sanjay Shah: You would not believe the guy who was handling this file was so excited, he says, Sanjay, sir, nobody has done this in the country ever. I will make sure that you get a special exemption from this. He worked on the file for three months. He reached out to BSCNSE for the clarity and the confirmation that yeah, everything is clear as far as the organization's concerned, and they gave us the one time exemption.

Sanjay Shah: And, yeah it's given me a huge satisfaction because when we gifted 251 shares from my account, it was equal to everybody. Somebody who was a driver or somebody who is the Yeah. very senior most guy of the organization and it was valued about some 45 crore on the day we [00:45:00] gifted. So yeah, I think that has been the, I can tell the biggest satisfaction which I carry in my life that I could be able to part with small token is basically, but it is a small amount which I gifted.

Sanjay Shah: Right, But I think it gives huge satisfaction to me.

Andrei Stetsenko: it is both, reflects very well on you and I think on your business and about how you think about the long term because people who feel valued, it's easier to retain them, first of all, and they feel better about their

mission at your firm and they feel like your partners rather than just employees. So, thank you so much for spending some time with me this afternoon in India, this morning in New York. I hope it's been illuminating to the viewers and listeners just to understand the kinds of people we seek out when we go to India to meet with managers, promoters, founders.

Andrei Stetsenko: We're honored to be invested in Prudent through Gymkhana Partners, our India fund. You can check us out at gymkhanapartners.com. You can check out Prudent Corporate [00:46:00] on their website. And thank you again for your time.

Sanjay Shah: Thank you. Thank you, Andrei. Thank you very much. Thank you,