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FMP Crisis: What should investors do?

Renu Yadav April 12, 2019

Debt fund investors have again fallen in the soup. In September last year, investors in liquid funds took a hit on their net assets value (NAV) as some of the IL&FS group companies defaulted on their debt payment, leading to ratings downgrade. Now, Kotak Mutual Fund has denied investors full payment in six FMPs (fixed maturity plans) set to mature between April and May 2019. Meanwhile, HDFC Mutual Fund has given investors the option to rollover the scheme or extend the maturity of one of its FMPs by 380 days, which is due for redemption on April 15, 2019. Both fund houses have exposure to Essel group companies- Edisons Utility Works Pvt Ltd and Konti Infrapower and Multiventures Pvt Ltd, which have defaulted in their debt repayment.

Kotak Mutual fund has shared a statement regarding the event. "The three-year FMP scheme, which matures in April-May 2019, has invested in debt securities, money market instruments and government securities. Among other investments, the scheme also invested in Non-Convertible Debentures (NCDs) issued by Edisons Utility Works Pvt Ltd and Konti Infrapower and Multiventures Pvt Ltd (both are Essel Group companies - secured by equity shares of Zee Entertainment Enterprises Limited) and IL&FS Transportation Networks Limited (Credit Enhancement by Parent Support Agreement of IL&FS). The three firms are facing headwinds due to company and sectoral-specific issues. We are working closely with the Essel Group for optimal recovery from Konti and Edisons for the benefit of our unit holders and believe that such recovery will take place albeit with some delay. For IL&FS Transportation Networks, Kotak Mutual Fund has made a 100 per cent provision for this investment as the company has been classified in the Red category, where recovery is uncertain and will be dependent on the resolution plan achieved by the new board," said Rohit Rao, Chief Communication Officer, Kotak Mahindra Group.

While HDFC has issued a statement to its investors saying that "The purpose of rollover/extension is due to current interest rate scenario and portfolio positioning, the yields prevailing in the short maturity bucket present an option for investors to lock in their investments at current prevailing yields."

As per data provided by Value Research, mutual funds were holding debt papers worth Rs 823 crore as per March 2019 portfolio in two Essel group companies, which have defaulted on interest payment. While the exposure to all group companies is around Rs 5,700 crore across the mutual funds. In total, eight fund houses are invested in 13 companies of Essel group.

The investments in NCDs of the Essel group companies are secured against the shares of Zee Entertainment, which means if the value of the shares fall below the agreed limit, lenders including mutual funds have the right to sell the shares of Zee Entertainment or pledge more shares as guarantee.

However, when on January 25, some of lenders tried to sell their stake, shares of Zee Entertainment and Dish TV fell by 26 per cent and 20 per cent, respectively. Therefore, in February this year, mutual funds along with other creditors gave time to Subhash Chandra-led Essel group to repay the debt until September 2019.

"A liquidation of about Rs 200 crore worth of Zee shares resulted in a price drop of more than 30 per cent. In the collective wisdom of more than 40 lenders, who have lent more than Rs 13,000 crore, it was decided that if all of us exercised the option of selling the shares, the likely recovery of our dues will be far lower than actual dues. By panic selling we will convert notional loss to actual loss. Most of the lenders have collectively decided to give time to Essel group promoters for making an orderly exit of their assets to repay our debt. Hence we opted for giving time allowance," said Rao of Kotak Mutual fund.

Kotak AMC is claiming that giving time to promoters to clear the dues was the most reasonable course of action. "We have taken personal guarantee of Mr Subhash Chandra, promoter of Essel Group over and above the shares of Zee for better security. We have also secured upside sharing on a graded basis on stake sale in Zee over and above the coupon rate of existing debentures. We are better secured and better rewarded than before by allowing more time to Essel group promoters to repay our debt," said Rao of Kotak Mutual fund.

What investors can do?

Experts say it was bound to happen as the Essel group issue was highlighted two months ago and it's not a new problem. There is nothing much that investors can do. In a case where the investors have been given part payment, they will have to wait till September 2019; by then Essel group companies are expected to repay the debt. In HDFC's case, investors have been given the option to rollover. "The investors who do not need access to money, its fine for them to opt for rollover," says Vishal Dhawan Founder & CEO, Plan Ahead Wealth Advisors.

Wait and watch could be a good strategy for investors. "This is a rough patch. I would advise investors should take counsel of a good advisor. If you stay calm, stay with your fund manager and do not panic. This phase will also pass," says Suresh Sadgopan, founder, Lader7 Advisories. However, he also believes that fund houses should have more robust credit department to do the credit evaluations of the companies rather than relying on rating agencies.

Investors should always keep in mind that high return comes with high risk. Debt funds carry credit risk, which is the risk of default in the payment of either interest or principal by the company in whose debt paper the fund has invested. There is no guaranteed return from debt funds like fixed deposits.

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