"Shriram Transport Finance Company Limited Q3 FY '20 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the STFC Ltd. Q3FY'20 Earnings Conference Call. As a reminder, all participant lines will be in listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and '0' on your touchtone phone. I now hand the conference over to Mr. Umesh Revankar – Managing Director and CEO, STFC Ltd. Thank you and over to you, Sir.

Umesh Revankar: Good Evening to the participants from India and Good Day to those of you joining from overseas especially from US and West. Let me begin with brief overview of macroeconomic scenario and ongoing development before I cover performance for the quarter. Amidst slowing global growth, India's GDP growth decelerated to multi-year low of 4.5% in Q2 19-20. This was primarily due to subdued private consumption and continued weakness in the credit growth. The other key engines of growth mainly Government spending, investment, and exports have also slowed and are believed to be at cyclical lows. However, there have been some green shoots in this challenging environment with a bit of revival witnessed in infrastructure, mining, and construction. Moderate revival in industrial activity post the monsoon has resulted in pickup in demand for cement, steel, and other industrial material. The IIP numbers for the month of November grew by 1.8% compared to de-growth of 3.84% in October. Mining output growth stood at 1.7% in November against contraction of 8% in October. Manufacturing output growth stood at 2.7% in November compared to the contraction of 2.1% in the preceding month.

The country experienced vigorous monsoon in 2019 with rainfall at 110% of the long period average. The trend of uneven distribution continued as 15% of the geographical area of the country faced deficient rainfall even as many areas received excessive rainfall. On the whole, it has been favorable monsoon as a large proportion of reservoirs across the country have reported increased storage level. This bodes well for agriculture sector and we are already witnessing some buoyancy in the rural and semi-urban markets. We believe that rural credit demand is good due to reasonably good Agri output in the current season as well as optimism about next one.

Improved Agri output will also contribute towards moderation in inflation, which at 7.35% in December spiked to five year high. This is largely driven by food articles and expected to ease off during Q4. In its December meeting, RBI revised CPI inflation projection for the second half of the 2019-20 to 4.7% to 5.1% range from earlier forecast of 3.5% to 3.7% range. This has necessitated a pause by RBI after already undertaking multiple rate cuts aggregating 135 basis point. In the interim, the financial system will benefit from RBI effort towards transmission of lower rates.

Coming to the CV sales data:

There has been lower volume both in heavy and LCV year-on-year basis. Volumes in Heavy vehicles were hit little hard, lower by 40% year-on-year , whereas, volumes of LCVs moderated by around 15%. However, the LCVs were all-time high in the last year so 15% seems to be quite reasonable. This has been impacted due to last year's axle load norms and also extended monsoon and delay in construction and mining activity, and also because of the discounts around BS4 to BS6 change, the BS4 inventory levels which were quite high in the last year, manufacturers were quite eager to clear the inventory, therefore, the discounts were little high and making it little difficult for the customers to choose which is the right time to buy both new and used.

However, pre-buying which we expected to pickup in the Q3 did not happen and we expect Q4, it should pick up even though till now in January we did not see much pick up, but we hope to see that pick up in February and maybe in the first two week of March. Post March, BS4 vehicle will not have any demand because it cannot be sold and registered in any of the registration offices. So we do expect manufacturer to announce the price hike of around 10% to 15% depending upon the various models and we expect the used vehicle prices to improve subsequent to that. We have always focused on customer's profitability and sustainability in the business, and therefore, customer success is our victory. Our new products such as fuel credit to customers jointly with HPCL and BPCL is well received as combined outlet of 30,000 fuel pump are giving us big reach. We also tied up with tyre majors just to give tyre credit and we are getting a very good response. On liquidity, we continue to be well placed. In January, we raised four successful USD bond issuance amounting to US $ 500 million, this is a part of US $ 3 billion global medium term note program. The issuance received an overwhelming response from subscribers and was oversubscribed four times.

We have also steadily witnessed better pricing and were able to seal this issuance at a coupon of 5.1% which is 85 basis point below that of our first USD bond issuance and 60 basis points below that of our third, that is the last USD bond issuance. The specialty of this particular issuance is this is a social bond under the frame of social framework and part of ESG group. We believe that keeping this under and qualifying this under USD group will have benefit to us for the period. We continue to diversify our sources of fund and combination of global bond issuance, securitization, public issuance have allowed us to reduce our dependence on wholesale funding. We remain on track to reduce credit cost, some of you may recall that couple of quarters ago we lowered LTV of loans and also focused on used assets while de-emphasizing financing of new assets. These initiatives have strengthened our book and along with steady trends in collection and helped us to reduce our credit cost. We should be able to maintain it around or below 2% going forward.

Coming to the headline numbers for this quarter, AUM grew by 4.92% year-on-year to Rs. 1,08,931 crores against Rs. 1,03,818 crores. Net interest income stood at Rs. 2,055 crores compared to Rs. 2,028 crores. The net interest margin was 7.14% compared to 7.44% last year and 7.19% compared to previous quarter. Profit after tax went up by 38.35% year-on-year to Rs. 879.16 crores against Rs. 635.45 crores in Q3 FY '19. EPS stood at Rs. 38.75 compared to Rs. 28.02. Stage-III NPA stood at 8.71% in Q3 FY '20 against 8.78% in Q3 FY '19. Overall credit cost which was around 2.24 has come down to 1.54. We expect a rise in volume in Q4 on the back of pre-buying and trend remains favorable for the quarters ahead given strong monsoon. However, on the back of weaker than expected first half of the fiscal, we trimmed expectation of our growth to 8% to 9% for the full year. T hat brings me to the end of the opening remarks. I have with me Mr. Sunder, Mr. Parag, and Mr. Sanjay to answer specific questions. I would now request the moderator to open the floor for question and answers.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, we will now begin the question and answer session. We have our first question from the line of Jaikishan Parmar from Angel Broking. Please go ahead.

Jaikishan Parmar: My first question is relating to the borrowings. If you can give us the incremental cost of borrowing for last three quarters and our foreign borrowing went up from 3% to 13% comparing to last year same quarter, so just some color on like what is the maturity cost of borrowing and total cost of borrowing of that foreign borrowing? One data point that how much percentage of AUM that vehicle we finance have age between 5 to 10 years and greater than 10 years?

Parag Sharma: The overseas borrowing as per regulatory requirement nothing can be less than three years and the bond what we have currently done is bullet 3.5 years maturity. The coupon on the overseas bond was 5.1%. The landed cost will be around 9.6% range. When it comes to the domestic borrowing, the bank borrowing is some spread over the MCLR which comes to around 8.68% to 8.75% range. We do have a retail program, the deposit rates have been reduced and the minimum tenure, what average tenure what we get in retail deposit is also more than three years and the coupon is around 8.75%. When it comes to securitization, which is another large resource for us that because it is a priority sector assets do get a lower rate. We are able to do at between 8% to 8.5% range, that is the incremental cost across all sources. Apart from that, we are also looking at the capital market bonds and CP, but that in the last quarter has been a smaller number. So liquidity is good across different sources. When it comes to your other question, **Umesh Revankar**The age of asset breakup is around 73%-74% between 5 to 10, 5% more than 10 years, and new and newer that is less than four years is around 21%.

Moderator: Thank you. We have next question from the line of Karthik Chellappa from Buena Vista Fund Management. Please go ahead.

Karthik Chellappa: Sir, my first question is if we were to look at our ECL provision especially in Stage I and II, that has come down a bit this quarter both QOQ and year-on-year, what would explain that?

Umesh Revankar: Basically, if you look at last quarter there has been some increase from Q1 to Q2, the increase was mainly due to delayed and extended monsoon and many of our customers who were from the rural market, their activity got little postponed. I do not say as hit it only postponed because the normal agricultural cycle got changed, and therefore, there were some delays and there was a significant improvement post rain being stopped, that is from November and it also was the festive period. So overall the rural economy improved significantly, and therefore, the improvement was there in the Stage-II accounts. As far as Stage-III accounts, the improvement was just 9 basis points, but it is quite significant in this kind of a situation.

Karthik Chellappa: So this current ratio of about 2.72 is what you would assume the normal range to be?

Umesh Revankar: Yeah, it is a normal range. There was little increase, but now it is normalized and we are confident of improving further depending upon the economic activity and condition of the environment.

Karthik Chellappa: My second question is on the domestic funding environment per se. There was this news report I think about a week or so ago that one of the NCDs of transport that was subscribed almost close to the base size of about 200 odd crores, so although there was an option to upscale it because of moderate appetite or demand, they settled to be at about 200 odd crores. Any thoughts on that particular issue and how is the domestic funding environment in general for Shriram Transport?

Umesh Revankar: We normally come out with two to three public issue in a year and this is focused only on retail and typically retail inflows are ranging between 10 to 15 crores in a day, so this time around we kept it open only for 15 days and normally we keep it open for 30 days and our inflows are basically only from retail and there was very less participation from HNI, it totaled around 200 crores and that was on the expected level and there is nothing of unexpected event. We also lowered our rate from the previous issue both on our normal deposit and also on the NCD program. So we were quite comfortable with this kind of subscription and it is not out of our imagination or out of our plan, so we are quite happy with the kind of participation and we will continue to come out with this kind of issue because we are always focused only on retail, we do not focus on institution participation or in large way HNI participation.

Karthik Chellappa: In conclusion although this year the guidance that you have given is around 8% to 9% looking into next year, if growth were to revive, let us say to a 12%-15% kind of range, you believe that even the domestic funding would be comfortable for you to meet that growth?

Umesh Revankar: We are very much comfortable with the funding because we have a significant part of our portfolio that can be securitized for a priority sector and on top of that we also are now getting on lending from priority sector pool of bank, so funding there is no challenge, it depends upon the demand from the market and the environment. If the demand environment is strong, we would like to grow as much as we can. But however, we have a program on which we grow. We typically would like to grow 15% even in the best of the condition and this kind of a condition depending upon the environment, we will plan our growth. As of now, we are planning for the next financial year a low double-digit growth.

Moderator: Thank you. We have next question from the line of Ankit Shah from White Equities. Please go ahead.

Ankit Shah: Sir, can you help us better understand the increase in cost of funds this quarter which has moved up slightly?

Parag Sharma: There will be some impact because of the overseas borrowing what we did, this was done previously. Also we have increased some of the liquid reserve, so there will be a carrying cost for excess security on balance sheet also.

Ankit Shah: Sir, can you help us with the number for Stage-II assets?

S. Sunder: Stage-II from 22.21% in the previous quarter, it has come down to 20.4%.

Ankit Shah: Sir, can you give us the absolute number?

S. Sunder: The current Stage-II absolute amount is Rs. 21,991.

Moderator: Thank you. We have next question from the line of Aakash Dattani from HDFC Securities. Please go ahead.

Aakash Dattani: My first question is what is the quantum of securitization done during the quarter?

Parag Sharma: We did close to around Rs. 3,000 crore we did, Rs. 2,930 odd crore we did in this quarter.

Aakash Dattani: What is the quantum of loans written off in this quarter?

Parag Sharma: We wrote off Rs. 530 crore of loans and we got a write back of Rs. 86 crores because of the improvement in the asset quality, so net provisions and write off was Rs. 444 crores.

Aakash Dattani: Could you quantify the amount of fuel credit and tyre credit in your AUMs please?

Umesh Revankar: Amount wise it is quite small; it should be around 1% of the total volume, that is around Rs. 1,000 crores.

Aakash Dattani: Could you possibly elaborate on any steps or measures taken that have helped keep your Stage-III assets stable quarter-on-quarter giving that a couple players that operate in the vehicle finance space also, although not exactly in the segment that you operate, have seen some stress?

Parag Sharma: Let us understand, we are basically into used vehicle lending and our reach is mostly in the rural market and the used vehicles are basically used for day-to-day consumption, agricultural output, and for maybe short distance transportation and these are not impacted by the overall industrial activity, so the new vehicles are typically used for industrial transportation including raw material to finished goods, so there has been little slow down there and some challenges, but as far as our segment is concerned which is for day-to consumption, Agri, and local transportation, there has not been big challenge or change, so I think there is not much of impact to us and on the ground actually it is improving, the rural markets are improving because of good monsoon, good output. Kharif has already announced highest output in the last five years, plus the Rabi crop is again, considered to be very good because of cold atmosphere in the North and also it is because of the better water storage because of the good monsoon.

Aakash Dattani: Did you face any difficulties because of any civil unrest in any part of the country?

Umesh Revankar: No, most of the unrest were in the cities and it was not in the semi-urban and rural market, and the prominent cities in few maybe it would have impacted some passenger transportation, it has not impacted the normal business.

Moderator: Thank you. We have next question from the line of Pranay Rajani from B&K Securities. Please go ahead.

Pranay Rajani: I want to run through a quick question, can you please repeat the UCV like you said 5 to 10 years and 10 years and above the percentage terms once again?

Umesh Revankar: 5 to 10 years 73% and more than 10 years is 5%.

Pranay Rajani: Also Sir where do you see, like you have already provided with AUM growth guidance. Where do you see the NIM for next financial year, NIM target as we have seen in the last couple of quarters, NIM has been consistently coming down?

Umesh Revankar: As I explained earlier, there is some carrying cost because we are carrying little higher cash in this environment, but I feel we should have some expansion in the NIM in the next financial year mainly because we feel that better transmission would be there from the bank and I understand banks are having high liquidity and they would be able to lend to us at much lower rate and we are able to attract term loan now from the bank on a continuous basis, so over the period the borrowing cost should come down and NIM we should be able to expand.

Moderator: Thank you. We have next question from the line of Sneha Ganatra from Subhkam Ventures. Please go ahead.

Sneha Ganatra: Sir, first wanted to know on the merger front on the corporate restructuring part, what is the status as of now?

Umesh Revankar: Merger, we have been discussing for nearly one year with various options which gives us best synergy benefit and also stakeholder value, so the discussion is on continuous basis. As and when we feel we arrived at the best option, we would be able to take this to the Board and post Board approval then we will make the announcement.

Sneha Ganatra: Any timeline to this?

Umesh Revankar: No immediate timeline but we would like to make it as early as possible because it is there in the public discussion for nearly one year, we would not like to postpone or increase the speculation. We would like to announce as early as possible depending upon the comfort we have from all the stakeholders.

Sneha Ganatra: Second question is on the network expansion and the employee expansion, and how do you see your cost to income ratio panning out?

Umesh Revankar: We have added around 50 branches last year, but they were not in the new location they were all in the locations where we already had rural centres. It is mostly conversion of rural centres into branches so we already had business there, so we have not incurred additional expense in these branches and we had recruited in the first half of the year little aggressively and that is continuing, those employees are getting continue to be used. We have not recruited further in the last quarter. Our net increase in employee count is not there in the last quarter and going forward also, we would be converting some of our rural centres into branches, and we have sufficient manpower as of now. We always keep around 1,000 people on training, so we have enough manpower to be managed for the next quarter and if at all we see a good scope in expanding our branch network next year, then probably we will add more manpower. So at any point of time we would be having people under training because we do not make any recruitment laterally, we recruit only fresh graduates. The cost-to-income should remain at the present level around 23%, maximum it may go up to 24%.

Sneha Ganatra: When you are guiding for the double digit growth for this fiscal, the mix would be remaining more or less similar or any changes in the mix is expected?

Umesh Revankar: For this year, we may end up with 8% to 9% growth because already three quarters are over. Next year, we are looking at low double digit growth and if at all environment changes significantly, positively then we may look at little faster growth.

Sneha Ganatra: This faster is because of just an economic environment or any other rationale to this?

Umesh Revankar: Only economic environment, we react to the economic development and environment.

Sneha Ganatra: For the next year what would be your credit cost guidance?

Umesh Revankar: We should be around 2%.

Sneha Ganatra: Sir, last question, any repossession has been going on and the increase in the size of the repossession of the vehicle, have we seen the last three to four months?

Umesh Revankar: We have not witnessed any increase in repossession of vehicle from our side, but there have been some talk about the other market players have increased their repossession, so maybe most of those players, they were in new vehicle financing and we are always in used vehicle financing. The rural environment being reasonably good, we did not see any kind of pressure on more repossession. That is the only explanation I can give and our portfolio is also behaving better and improving all the time.

Moderator: Thank you. We have the next question from the line of Pranav Tendulkar from Rare Enterprises. Please go ahead.

Pranav Tendulkar: Sir, any lead indicators that you are tracking are improving or worsening, for example, one is vehicle utilization, second is the cash flow, and freight rates that existing customers are getting, and third is that are enquiries for second-hand vehicles, second hand CVs increasing in various parts of India?

Umesh Revankar: Basically, I would like to tell you, overall, the cash flows are little tight in the market especially from the corporate and the Government sector. The cash flows are little tight and slower, but as far as the rural market agricultural commodities, the cash flows are quite good and they are moving faster and improving, so we have not seen any kind of a challenge to our customers. And as far as enquiries are concerned, the used vehicles enquiries are quite good, only thing is earlier we used to have certain percentage of our customer wanting to buy new vehicle to upgrade themselves, those enquiries have come down significantly because of uncertainty in the discounting because the manufacturers have been discounting their product to clear off their inventory and therefore, the resale prices or even the customer's expectation of the vehicle price is, there is no clarity. Therefore, I feel there has been sluggishness and that will improve immediately after March 31st because whatever is the inventory now of BS4 vehicle will have no value next year, only the BS6 vehicle has to be sold. Then I think the resale value of used vehicle will go up significantly and for us the asset coverage of our existing portfolio will go up, so that will be very positive for everyone of us.

Pranav Tendulkar: According to fleet utilization would have also bottomed out and freight rates?

Umesh Revankar: No, freight rates have been quite good I do not see freight rates being low, only thing is certain segment like car carriers imagine, if car carriers have been utilized for certain level and if the car sales have come down by 10-15 basis point, the car carrier utilization will come down by 10-15%, that is how certain sectors have impact. Mostly industrial sector where the particular activity has come down that has an impact, but overall the consumption based and Agri based vehicles, their utilization levels are constant.

Moderator: Thank you. We have next question from the line of Akshat Haria from Multi-Act Equity. Please go ahead.

Akshat Haria: Sir, I would like to what would be our landed cost of foreign borrowings for the current quarter?

Umesh Revankar: Overall this quarter it should be around 9.6% landed cost that is in January what we raised.

Akshat Haria: And the previous tranche landed cost would be?

Umesh Revankar: It is around 10-20%.

Moderator: Thank you. We have next question from the line of Anirban Sarkar from Principal India. Please go ahead.

Anirban Sarkar: Sir, I have two questions, one is that on the fee and commissions line we have a rather big spike in this quarter so I wanted to know if there is a one-off component here, and my second question is regarding your funding mix so the proportion of securitization has been quite high and just wanted to know how are we viewing this, so like if funding environment improves, do we look to bring this down, what is the kind of spread that you earn on this portion and what is the view in general on this, how do you view this?

Umesh Revankar: We have been focusing more into cross selling over the last two years and insurance cross selling is one which we have been doing quite aggressively and we have received an amount which was a cumulative of nine months this quarter. Therefore it is looking little high. Then coming to the funding mix, securitization has been a regular source of borrowing for us for several years. Every quarter we do, earlier it used to be happening mostly in the year-end and when last two years since they do not maintain it every quarter, it is happening every quarter, it has not gone up significantly because it is QOQ, there has been more regularity rather than a year-end phenomenon, that is the only thing.

Moderator: Thank you. We have next question from the line of Pratik Poddar from Elara Securities. Please go ahead.

Pratik Poddar: Sir, I just have one bookkeeping question, can I know the disbursement amount for the quarter?

Sanjay Mundra: The total disbursement was Rs. 11,607 crores, the new vehicle was Rs. 476 crores, used was Rs. 10,807 crores, Rs. 122 crores for others.

Moderator: Thank you. We have next question from the line of Darpin Shah from HDFC Securities. Please go ahead.

Darpin Shah: Sir, one of the media articles suggested that Shriram Capital has put on-hold the merger plans because RBI has asked for reducing the stake in the insurance business, so if you can throw some light on it?

Umesh Revankar: We have been looking at various different options of structures and which is best possible structure that will bring efficiency, synergy, and the profitability, and also stakeholders to benefit, so it is not true that from RBI there has been any kind of instruction or suggestion on that.

Moderator: Thank you. We have next question from the line of Abhinav Ganesghan from SBI Pension Fund. Please go ahead.

Abhinav Ganesghan: You had given the breakup of the loans that are given to used vehicles in one to four years, so what would be the number for last couple of years if you could give it?

Parag Sharma: We do not have right now; you can contact Sanjay who will be able to give.

Abhinav Ganesghan: Or broadly can you just give a direction has that gone up?

Umesh Revankar: It would have gone up by around 2% in the younger vehicle in this year and new vehicle has come down that is all. Overall, it will remain almost same.

Moderator: Thank you. We have next question from the line of Prashant Kothari from Pictet Asset Management. Please go ahead.

Prashant Kothari: Around the branch expansion, you explained how the rural centres have been converted into branches but there have been expansion on urban side, so there are many more branches compared to last year, can you explain why expanding so aggressively and what is happening to the branch level profitability there, Sir?

Umesh Revankar: Basically, what we look at is we wait for the rural centres to come to particular level of customer base and the efficiency. Typically, around 500 customers if we have in the rural centres, that we convert into branch and by the time it will breakeven, so that is the rough calculation we have and also sometimes it depends upon the faster development in particular geography. So there is no additional cost per se, because most of our branches have minimal cost, and therefore, it will not have any impact on the overall cost of the operation.

Prashant Kothari: But we are seeing that your operating expenses have gone up like 18% YOY, so basically there is a cost to all the branches?

Umesh Revankar: We have witnessed increase in cost which is ranging between 8% to 10% every year in administrative cost and operating cost and since the growth has been little lower maybe as a percentage it may look as if a little higher, so once we grow that will catch up and we are also looking at various method of improving our efficiency through technology. We are also focusing on building a digital framework where most of the transaction can happen through mobile, so there could be some investment now on that and ultimately it will have huge beneficial impact. So over the next two years we feel the digital interface or the technology should help us to bring down our overall administrative cost and also operating cost, so we would definitely have best of both, bricks and mortar and technology-based.

Prashant Kothari: Considering your comment that your customers are generally okay because we are more focused towards the Agri and consumption kind of activity, would you think that the current level of stress in the assets that we have got, is it like a normal cycle for us or do you think they are higher than the normal?

Umesh Revankar: This kind of cycles keep happening because what happens is the industrial activity requires support from global activity also because our export also is down and overall capital into new business or new manufacturing also is down. Even the Government spend on infrastructure was also down in the last one year because of various reasons. I feel the election was a big distraction, we could not have one full year of proper functioning of a Government, that could be the main reason. I feel this year onwards things will become normalized and at least in local economic activity and industrial activity, we will be quite busy, only export part of it we are not very sure how global economy will grow. So I think once the uncertainties are reduced, I think there will be both activity on industrial side, Government spend, and also rural and the Agri and consumption being normal that should have a further positive impact for us apart from having a normal comfort with the current situation.

Moderator: Thank you. As there are no further questions from the participants, I now like to hand the conference over to Mr. Umesh Revankar – Managing Director and CEO, for closing comments. Sir, over to you.

Umesh Revankar: Thank you for all of you joining this Q3. Q4 is always the biggest quarter and volume numbers and also in the efficiency. We are confident that Q4 will be much better, before that I would like to tell one or two lines on the budget. Budget has been quite positive towards NBFC especially our Finance Minister had talked about partial guarantee scheme to be enhanced, hopefully, it will come with some better enhancement to reach more NBFC because we feel our overall NBFC industry being robust and good helps everyone in this industry and also FM has announced allocation to various infrastructure activity both in rural and urban separately. That also is quite encouraging. So we feel that since budget is ruled out and once this business session starts, business session typically starts post budget from March onwards, all Government activities should start helping the economic activity to resume aggressively and everyone to benefit, so we expect very good Q4 and Q4 numbers. Thank you very much for joining again.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, on behalf of Shriram Transport Finance Company Limited, that concludes this conference call. Thank you for joining with us and you may now disconnect your lines.