JM Financial Limited
Q2 and 1HFY20 Earnings Conference Call

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Earnings Conference Call of JM Financial Limited to discuss the company's financial performance for the quarter and half year ended September 30, 2019. As a reminder, all participant lines will be in the 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 then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vishal Kampani – Managing Director, JM Financial Group. Thank you and over to you, Sir.

Vishal Kampani: Thank you. Welcome everybody. On behalf of JM Financial, we extend a very warm Welcome to all of you to the conference call of JM Financial Limited to discuss our financial results, go through the second quarter and half year ended '19-20. I hope you all have had a chance to go through our presentation, press release, and the results. These have been updated on our website and also on the stock exchanges. Joining me for the call are Mr. Manish Sheth – Our Group CFO; Mr. Shashwat Belapurkar – CEO of JM Financial Credit Solutions; Mr. Anil Bhatia – CEO of JM Financial ARC; Mr. Ajay Mishra – Head of our Private Wealth Business; and Ms. Gitanjali Mirchandani – Head of Origination for JM Financial Credit Solutions.

I shall now provide an update on the performance of our businesses post which Manish will take you through the financial numbers and then we can open the floor for Q&A.

For the half-year FY '20, our consolidated revenue stood at 1,707.5 crores and net profit after tax was 256.9 crores. I will move onto our loan book details.

Our consolidated loan book stood at 13,810 crores, the breakup is as follows;

66% comprises of wholesale mortgages which is approximately 9,167 crores. The wholesale mortgage book registered a year-on-year degrowth of 18%,

8% comprises of capital market lending which is 1,100 crores. This book has degrown by 55.5% on a year-on-year basis,

21% comprises of corporate lending and promoter financing, which is at 2,904 crores. The corporate lending book was largely flat,

5% of the book now comprises of retail mortgages, which is approximately 639 crores. This book has registered a year-on-year growth of 61%, this book largely comprises of housing finance loans and SME LAP.

On asset quality, the gross NPA ratio of the lending business stands at 1.27%, net NPA stands at 1.11% and SMA-2 stood at 2.4% as of September 30, 2019. The comparative numbers for quarter ended June 2019 stands at 0.9% for gross NPA, 0.8% for net NPA, and 3.61% for the SMA-2.

On leverage and liabilities, our consolidated gross debt equity stands at 1.78 times and on a net basis after adjusting for cash and cash equivalents at 1.51 times. These have reduced from September 30, 2018, where the gross debt equity stood at 2.61 times and net debt to equity stood at 2.27 times. Over the last one year, we have been able to reduce our commercial paper borrowings from Rs.6,506 crores to Rs.2,003 crores. Our CP borrowings have reduced to 15% of total borrowings from 37% in September '18. During the half-year September '19, we raised approximately Rs.515 crores through a public issue of NCDs. Our borrowing mix currently is 82% long-term and 18% short-term as compared to 72% long-term and 28% short-term as of June 30, 2019. We also concluded a rights issue of JM Financial ARC of Rs. 200 crores last quarter.

Before we share the financials for half-year ended September 30th, I will take you through a brief update on the performance of each of the group's verticals.

We will start with the IWS segment. The segment had revenue of Rs.758 crores with a profit before tax of Rs.184 crores. This business has contributed 32% of our group's PBT and the profit after tax from this segment stood at 124 crores. The asset under advice of our wealth management business stands at Rs. 46,818 crores excluding custody assets. The equity component has increased by 21% year-on-year to Rs.13,765 crores of the total of Rs.46,818 crores. The pipeline of our investment banking division continues to be robust across all of the products we offer. The loan book for the IWS segment stands at Rs.5,374 crores, the gross debt to equity for IWS is at 2.15 times and the net debt to equity stands at 1.72 times. Moving onto the mortgage lending business; this segment has revenues of Rs.693 crores with a profit before tax of Rs. 313 crores. This business contributed 55% of our group's profit before tax. Profit after tax from this segment stood at Rs.100.7 crores. Our loan book here is at Rs. 8,302 crores, the debt equity for mortgage lending is at 1.73 times and the net debt to equity here is at 1.53 times for the same period.

Moving onto the distressed credit business. Our asset under management remained flat at approximately Rs. 14,000 crores. JM Financial ARC's contribution to the SR is approximately Rs.3,100 crores. The segment has revenues of Rs.219 crores with a profit before tax of Rs.49 crores. This business contributed 9% to our group's PBT, profit after tax from this segment stood at 16.57 crores. The gross debt to equity for distressed credit segment is at 1.6 times and the net debt to equity is at 1.44 times.

Moving onto the asset management business comprising of our mutual fund business, this segment had revenues of Rs.38 crores with a profit before tax of Rs.18 crores. This contributes 3% to group PBT and PAT from this segment stands reduced to approximately Rs.9 crores. The average quarterly AUM of the mutual fund is at Rs. 6,488 crores comprising of Rs.4,509 crores in equity schemes and Rs.1,979 crores in the debt schemes. With this brief update, I will now request Manish Sheth, our group CFO to present the group's financial.

Manish Sheth: Thank you, Vishal. Good Afternoon everyone, before I present the financials, I would like to bring to your notice that any forward-looking statements made on this call are based on management's expectation. However, the actual results may vary significantly, and therefore, accuracy or completeness of the expectations cannot be guaranteed. Now, let me take you through the groups' results which were announced yesterday and are available on our website. In Q2FY20, our revenue degrew by 12.74% year-on-year to Rs. 851 crores, PBT stood at Rs.271 crores, which is a decline of 28% year-on-year and PAT stood at Rs.129.6 crores. With regard to half-year numbers, the gross revenue stood at Rs.1,707.5 crores and net consolidated PAT is Rs.256.9 crores. This represents EPS of Rs.3.06 versus Rs.3.65 for the same period last year. As of September 30, 2019, net worth is at Rs.5,297.6 crores which is a book value of approximately Rs. 63 per share. The group's finance cost had decreased to Rs.699 crores for the half-year ended September 30, 2019, as against Rs.716 crores during the same period primarily on account of decreasing borrowings and overall gearing. Our cost of funds for the lending businesses stood at 9.9% compared to 9% year-on-year basis. The group's impairment on financial instrument increased to Rs.73 crores against Rs.42 crores during the same period primarily on account of conservative provisions made during Q2FY20. With this, I would like to conclude and we are ready to take any questions.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, we will now begin the question and answer session. The first question is from the line of Digant Haria from Antique stock Broking. Please go ahead.

Digant Haria: My question is for Vishal, in the last one year we have rundown CPs from Rs.6,500 crores to around Rs.2,000 crores, we have rundown capital market books in a big way and we have got these 12 months to look at all our exposure, so how do you see us as a company in terms of control exposure 12 months back and today?

Vishal Kampani: Digant, let me just give a little backdrop, so I think the last 12 months from an NBFC perspective has probably been the most challenging times for the sector a very, very long time and there has been unprecedented stress on liquidity of most NBFCs, so the first thing I would like to say is that I think JM and the team at JM has performed exceedingly well and above my as well as most expectations. Now, when you look at exposures I think we have predominantly been focused on risks, we have been conservative right through the cycle when the cycle was doing very well and that has kept us in very good stead and if you ask me today, I do not think that this sector as well as where we see the economy, we are out of the woods, but I see one still has to be prudent, one still has to be cautious and I think we will maintain that stand at least for the next six months if not longer, so for us balance sheet is more important, being liquid is more important currently than actually chasing growth. Also I would like to add that we have achieved this entire CP deleveraging without selling a single asset. We did not resort to selling a single asset on our books. All of this deleveraging has happened through natural repayments on the asset side, which clearly reflects the high quality of assets that we have been maintaining on our book.

Another issue that most NBFCs are facing especially the ones exposed to wholesale lending is at the cost of borrowing is very high, you know you have inflation running in the economy at 4% and you have people willing to borrow at 16%-17% for projects, which just does not make any sense. If you even look at the yields which AA rated NBFCs have to pay to borrow money over say AAA NBFCs, it is extremely wide and I am clearly seeing that our credit is mispriced and we should be actually issuing debt at much lower levels, so I think we will wait till the situation normalizes. We are not in a rush to borrow at high levels and we would be prudent over the next six months. Now, if I split that question in to how our book will move, on the wholesale mortgage side, we will only fund our existing clients. We will make sure all our projects are completed and almost three-fourth of our book is project financed which is in mid-to-late stage constructions and we want to make sure that most of their inventory is completed and so we get into an extremely low risk zone on the wholesale mortgage side. The quality of our developers is very high and we are confident that when projects are completed and during completion, sales will happen. Our escrows have been very strong for the last six months and when I look at month-on-month escrow numbers over the last six months, they have been at par or even better compared to the numbers with the previous year six-month, so luckily for us I think sales have held up. It is a combination of prudent lending and making sure your construction finance is covered, so I think on wholesale mortgages we will lend to complete our projects and that number is not very significant for us over the next one year, and therefore, we will see further deleveraging on the wholesale mortgage side and the debt equity for that business will actually go down to may be 1:1 level by next September 30, so a year from now. We will take a call again sometime in March, April, May, if we feel that there is more momentum back and we need to open up our book to lend to newer clients times and newer projects, so that is on the wholesale mortgage business.

Moving to the capital market lending business, this is a function of the markets, so we all get happy seeing the NIFTY and the SENSEX move, but the NIFTY and the SENSEX doing well does not mean that the general capital markets are doing well and that there is a lot of investor interest in direct trading of equity, so our capital market lending is largely retail lending to our equity broking customers and we are not seeing a quick revival in this segment as of now, but I think over the next six months to a year, we see a positive momentum in that book and we think that we will be able to scale this book at least 30% to 40% over the next six months to a year, but immediately over the next quarter I do not think that will happen. Our corporate lending and our promoter lending book has done well. We have taken a lot of opportunities to fund clients and other partners who had asset liability mismatches, and therefore, we have been able to lend frequently on short-term basis and keep the profitability going over the next six months and I do not see a slowdown in this book. I feel we will be able to grow this book over the next six months to one year quite confidently.

On retail mortgages, we are fairly confident our branch network is almost fully established for the next 12 months and they should be able to add momentum on this side and you will see high-growth numbers, of course coming of a small base but we will see high-growth numbers on the retail mortgage side. An important segment for us which I have been emphasizing for the last two to two-and-a-half - three years is of course the entire wealth management and the asset management play and I think we are seeing a lot of momentum on that side of the business, recruitment is up, we have been adding a lot of people. By March, our team would be up almost by 30% to 35%. We have a lot of people confirmed who will be joining us in the next three to six months, few have already joined last quarter, and we are very focused on pushing growth harder on the wealth as well as the asset management side, it has always been an important area. We feel that the power of JM brand is not fully utilized for this segment of business that we operate in and we are going to be very highly focused and making good headway in this space over the next 12 months.

On the ARC, we are facing some specific challenges and the challenges are all around the timeline of resolution. We have almost Rs. 1,000 crores worth of resolutions, which were to be completed and delivered as cash to us last year before December 31st and it is highly unfortunate that all of these have been delayed and that most of these delays are beyond our control, but the team is working very hard. A full team is working on recovery and frankly one large transaction in terms of Leela has gone through in this quarter and we are expecting many more to go through over the next three to six months, but yes, there have been some delays and most of these transactions are in NCLT and we had budgeted that these transactions would get completed, but we are hoping that over the next six months we will be able to have significant recoveries and we will be back in growth mode in FY '20-21, so this is kind of the overall picture for you.

Digant Haria: Thank you so much for the detailed explanation and also for the disclosure around the real estate book in the separate presentation. One more question, in the commentary you made that amongst all the wholesale lenders that we track, I think you guys have done the best, be it in terms of leveraging or be it in terms of reduction of and repayment, so does the market differentiate that at a conscious level because the borrowing costs are high just because people associate wholesale lending with risk, so which we probably will be the first one to see the spreads coming down once the environment normalizes?

Vishal Kampani: I think that is a great question. Let me answer that in two ways, the first is availability of capital and second is the cost of capital, so I can assure you that things have moved on the availability of capital and we have been able to raise capital over the last six months. What we are facing a big problem is really the cost of that capital because there are certain spreads which mutual fund investors want or banks want, which we are not wanting to borrow long-term money today because that would mean I will have to deploy that money at much higher rates and frankly we are not ready to lend at those high rates to the customers, it is not good for the customers, it is not good for us long-term and that is the principal reason why it is hard to grow a book in this environment, but having said that the availability of capital has started and once we see rates being more benign and being in favor for us, we will borrow and grow the book and you are absolutely right, our debt equity is stellar. I think we are the lowest debt equity among all NBFCs in the country, and therefore, we will be able to ramp up quite quickly when things change, but I do not see things changing over the next six months. I think it potentially could get worse before it gets better.

Moderator: Thank you. The next question is from the line of Shubhranshu Mishra from Bank of Baroda Capital Market. Please go ahead.

Shubhranshu Mishra: I just want to understand your retail mortgages in a little more detail, is it the numbers that we see are these purely organic or these are portfolio buyouts and how do we look at the strategy going forward, how much would be portfolio buyouts and how much would be organic expansion?

Vishal Kampani: In the 639 crores, roughly 50 crores is the portfolio buyout and the remaining is all organic. What we have done is we had built out almost 18 to 20 branches in total and this is absolutely retail with origination largely through our branch network, and we have roughly 300 people that we have hired in HFC. We are focused on the affordable housing segment as well as the salaried segment. The mix is going to be roughly half and half. In addition to that, we also do a bit of SME LAP lending and those yields are slightly higher, so if I were to break the yields up for you, the SME LAP lending goes in anywhere between 12% to 14%, the salaried loans are anywhere between 10% to 12%, and home loans are anywhere between 11% to around 13%, so that is kind of the rough breakup where the yields are on this business.

Shubhranshu Mishra: If you could help me in the ticket sizes and how do we look at this split maybe in the near-term, maybe one to two years from now, how does the book pan out?

Vishal Kampani: We are looking at on the home loan side, the average ticket size is approximately 20 lakhs or below, on the SME we have 2 crore limit, so everything below 2 crores, some are 40 to 50 lakhs and some could be above 1 crore. The average size over there is 1 crore today and we see this mix being almost 70% to 80% in favor of home loans and the balance in terms of SME LAP.

Shubhranshu Mishra: Second, what I wanted to understand is at the moment your asset management is around 3.5% of the profit and you alluded to ramp up in the manpower over there, but then you must be top 20 players, we are not in the top 10, so is there any vision to break into top 10 category or maybe hive off the business, get that capital redeployed somewhere else, why have a me-too kind of an AMC business where we are not differentiated or am I wrong in my thought?

Vishal Kampani: That is a good question again, so let me tell you at JM we are never enamored by being in the top five or top 10, you know we are more focused on how profitably we can grow our business and part of that also has saved us for the last five years, so the point for asset management I do not think we will have a me-too strategy, our strategy will be more to focus on taking some of the sort of the hidden expertise we have on the current side of our business and grow an AIF credit platform, number one. We have already raised our PE fund 2 successfully and we want to be a much larger player in PE. On the mutual fund side, yes, we will have select equity schemes as well as select credit schemes grow. We will also launch some passive funds and we are working on a passive fund strategy, so it would be a very detailed unit wise breakup within the asset management business and a focus on profitability on the same. We are also building a lot of scale on the distribution side as I said on the wealth management, a lot of changes have been made in the last 12 months to 18 months and you will see that distribution also will help us because our asset management product share as part of our wealth management AUM today is very, very small, so our own distribution will be able to ramp up a significant part of our own asset management growth, so I think there are some synergies on that part, but having said that we have no plans to merge the wealth in the asset management businesses; for us these are two completely distinct platforms and they will remain distinct.

Shubhranshu Mishra: While I do understand that there is synergy between wealth management and AIF or maybe as we have other alternate assets classes, but then distribution for your MF business in my understanding should be sourced by either international distributors or banks, at the moment how much of the pure play MF business is sourced by banks or national distributors?

Vishal Kampani: Yeah, that number today will be very low because if you see our MF is largely an institutional play, our retail share of the AUM is 20%, the institutional share is 80%, and the challenge again there is that when you go to a national distributor or big bank, just the upfront cost, the signup cost to basically get them to distribute are quite large, so when you look at the net profitability numbers and as you alluded in your question itself that if you try and be a very me-too brand, it may not be very profitable, so we are thinking that through very carefully. Again, as I said there are some interesting people joining us over the next six months which will also further define the strategy of what we are going to do going forward.

Shubhranshu Mishra: So how do I look at the split of your AUM going forward maybe two years down the line, how much would be AIF, how much would be equity, MF, how much would be debt?

Vishal Kampani: It is hard to give you a forward-looking number, but what I can tell you is the growth rate on the AIF and the PMS side will be higher than the pure mutual fund side and when I say AIF I include private equity AIF as well as the credit AIF, so the growth rate of those businesses will be higher than the pure mutual fund side.

Shubhranshu Mishra: Which makes sense, so why has the MF business at all in that case that is my simple question?

Vishal Kampani: MF is also in our view a good growth area, you know you have distribution, you have certain research synergies which are applied across varied businesses when you have one large asset management business being created, so it is not that the MF will not grow, I mean active asset management is still a significantly large part of Indian asset management and we will find ways to grow that slowly and profitably. If you see even this year this business will make almost Rs 40 crore PBT for us, so it is quite a profitable business without having AIF and the profit from this business can be easily used to develop the AIF business small because even the firms contribution in AIF needs to be larger as compared to mutual funds.

Shubhranshu Mishra: Just one question on your SMA-2, it has moved down sharply on a QOQ basis?

Vishal Kampani: Yeah, because we resolved some assets and therefore the SMA-2 has reduced here.

Shubhranshu Mishra: So how many assets, if you can give some color on that?

Vishal Kampani: Three assets in the real estate side have been resolved.

Shubhranshu Mishra: They are domiciled in Bombay NCR?

Vishal Kampani: No, they are in Bangalore, Kolkata, and Pune.

Moderator: Thank you. The next question is from the line of Anitha Rangan from HSBC. Please go ahead.

Anitha Rangan: If you could give a color on how your ALM is looking like at this point, that is my first question, and second question is like when you said that in your corporate book you are actually lending largely towards ALM mismatches, can you give some color there, are these NBFCs, if so what kind of security you are taking and so on?

Vishal Kampani: Your question is not very clear, but let me just try and repeat that, your first question is overall ALM color and your second question is the ALM color for the mortgage lending business.

Anitha Rangan: No, you said in your corporate book you are lending for ALM mismatches at this point and you said when you highlighted your, just wanted to understand is it like short-term and what kind of security you are lending and so on?

Vishal Kampani: Let me answer your second question first, as you know there has been a huge amount of regulatory change in terms of how promoters finance themselves, so lot of promoter lending which happened in the mutual fund space was happening at very low covers and now SEBI has come with regulations where the coverage requirement for most of these loans is at four times, so this obviously is created sort of ALM because the end of the day these promoters had certain plans to sell their shares or find someone needs to refinance their debt and that has not panned out and because of that the promoter finance opportunity for us to be able to lend from anywhere three months to one year has expanded sharply. The same thing has happened at the corporate level because there were lot of NBFCs and banks who have tightened their purse and are not financing for working capital financing for certain asset sale linked transactions and we have been able to step in and fund a lot of that on a short-term basis, so both these opportunities have allowed us to keep the corporate lending as well as the promoter finance book quite live and active and I think this will continue to stay for at least the next 6 months to 12 months. Once the financing normalizes for us and largely for the industry we will get back to doing more term lending at that point in time, but today this business is quite profitable and we see lot of opportunities on the ALM mismatch in the market where we standing strong with a good ALM and good cash reserves are able to supply the finance to do it.

On our overall ALM, I think if you see the Credit Solutions; presentation which has been put up, it gives you a very clear picture of the ALM for the mortgage lending business. The rest of the two NBFCs, JM Financial Capital is a very small NBFC, it is largely focused on retail margin loans, the debt equity is not even 1x. All the assets there are short-term with less than six-month maturity and we finance that with CPs and MLDs with an average maturity of nine months to one year, so there is no gap. On JM Financial Products, we are sitting with almost Rs. 1,000 crores of cash. We have cash in the group today which takes care of almost the forward 15 months of repayments, so I think there is on deeply haircut asset side repayment including, so we are literally running with zero ALM across buckets for a very long period of time.

Anitha Rangan: In your commentary you also said that you know things might get worse before they get better, how much worse do you think it will get from now and how long this will persist?

Vishal Kampani: Well, it is really hard for me to tell you how much worse it is going to get but if you just look at the slowdown in the economy, the risk aversion people generally have towards consumption whether it is in the auto sector, the housing sector, even general consumption, and then a very large risk on what happens to the global economy and the slowdown in the global economy in 2020 and the entire trade wars between the US and China, so it is very hard for me to tell you accurately how worse this can get. We still think that the financing outside of AAA credits has not opened up, liquidity is still extremely tight for most NBFCs. You have seen six to seven large NBFCs which have got downgraded in the last quarter, I open the newspaper every morning and I really do not feel like reading it, so it is just not a great sign. It is hard for me to tell you how worse this can get, but I can tell you it is getting worse before it gets better.

Moderator: Thank you. The next question is from the line of Dhruvesh Sanghvi from Prospero Tree. Please go ahead.

Dhruvesh Sanghvi: I just wanted to know a little bit more about the ARC, I am reading out two to three questions which I have noted which will help you understand my mindset, if we can understand how this Hotel Leela transaction was done in terms of cash flow that how much did we pay in terms of equity and in terms of debt, debt means the SR and when was that invested, how much has now come back though I think it is after Q2, but we have the clarity now and what kind of profit and what kind of absolute profits in IRR did we make in this transaction. If you can give some color it will help us understand the ARC piece a little bit better?

Vishal Kampani: I think if I describe the Leela transaction to you, I am giving you my trade secret.

Dhruvesh Sanghvi: I am saying whatever you can describe I understand that we cannot ask the absolutely trade details, but something which helps us understand how these transactions are done in terms of what are the thought processes invariably we will get into delays and regulatory aspects?

Vishal Kampani: I will tell you what happens is, I think I will just give you a backdrop of how we choose assets and that will be important for you to understand how the risk underwriting is done, how it is funded and then we can talk about potential IRRs on this, so ARC's idea is to basically pick good quality assets, so that is the most important criteria, the assets that we have underlined the SRs should be of the highest quality and should be industry defining, so if we bought into Leela, Leela has some of the best hotels, so that is number one and then we do an assessment that in the worst case will we be able to get our principal back if everything were to go wrong, will we at least get our principal back or not, so that is the worst case downside analysis and then we do an upside analysis based on a five-year view if we restructured the assets, if we sell couple of the assets what is the benchmark IRR we should be able to get and we model that IRR at a minimum of 25% and all I can tell you is that in Leela we have achieved everything that we had to achieve including the IRR.

Dhruvesh Sanghvi: In spite of the delay which happened otherwise it would have been even better?

Vishal Kampani: Yes, that is correct.

Dhruvesh Sanghvi: I think you said there are the SR stands at Rs.3,100 crores, if I am not mistaken in March 2019, it was at Rs.3900 crores is it right, I am sorry, the numbers are not handy with me right now?

Vishal Kampani: This is the outstanding SR that we have purchased, our investment obviously is a lot lower, the return on our investment is two-fold, it is not just a capital gain from the sale of the SR that we are holding, it is also the management fee we get because of spending time on restructuring and helping the asset, we get both management fee as well as we get income when we sell the assets. In Leela we did not need to provide any financing because Leela had a good EBITDA, but in many cases where we have to restart the asset and restart the operations, we also provide working capital financing which become the third source of income on the ARC books.

Dhruvesh Sanghvi: In case of Leela I think there was one announcement I think it was on Leela's circular, it said Rs. 70 crore was paid on the fees, we were the only bankers out there or it was shared?

Vishal Kampani: No, these fees include bankers fees, lawyers fees, counsel fees, it is a big bucket of fees that is all included, but yes in the bankers fee, we were the only banker on the transaction.

Dhruvesh Sanghvi: On the mortgage side, we are very happy that our gearing and our cash flows and I have always been complaining about the yields on the retail NCDs, but which you said that it is a perception issue maybe in the market at this point in time, but fundamentally being so cautious and still have borrowings at 10 and 11, will it then not actually hurt our profits further for the next two years?

Vishal Kampani: No, I will tell you we have been able to in the mortgage lending side whatever increase in borrowing we faced, we have been able to pass that onto our accounts our borrowers, right, but I think incrementally it is going to be a challenge and I will tell you the point is most of our projects I said are almost midway through construction, so we are really if I have increased the rate say on a loan which is 30% or 40% sold and there is a payback period only of one to one-and-a-half years then the borrower is only facing an incremental interest rate for that period, but today imagine if you want to do a new loan and new NBFC wants to fund a new five-year project and the borrowers borrow at 16%-17% because the NBFCs own borrowing is going to be say 10% to 12% and you will know that house prices have not gone anywhere and they potentially will be flat over the next five years and you know that if shoot up some inflation in cement and some of the input prices going forward. I think the margins of the developers are not as healthy as it used to be in the last 10 years, so you have to be extremely careful when you are building out a mortgage lending portfolio today compared to where you built it out say 10 years ago, so for new loans those yields are a challenge, so till our rates come down to levels of 8-8.5% or 9% then we are able to pass on at least keeping our 500 basis point spread, maybe lend to him at 13.5% to 14% to 14.5% then it makes sense to actually lock in business from a longer term perspective. The higher you lend at for longer term, the chances of you having higher NPA is greater here.

Dhruvesh Sanghvi: Then it means that it is not about the opportunity in the market, but it is about getting your cost in place?

Vishal Kampani: That is right, real estate there is an opportunity at any point in time to lend. Real estate fundamentally I think I have explained this before, this sector cannot exist without debt, so it is as such a well understood sector I am sure you know you go for a morning walk or an evening walk and 10 people will tell you where you should buy your house, so it is a very, very well discussed and understood sector. To make money you have to use leverage, and therefore, real estate will always have demand for leverage. The challenge in real estate today is simply there is a big lack of confidence, there has been a lot of overbuilding in a few areas in a few locations and a few micro markets, that inventory is going to take a long time to clear, and therefore, there is going to be price pressure and therefore one has to be very prudent.

Moderator: Thank you. The next question is from the line of Krishna Parekh from Alcazar. Please go ahead.

Krishna Parekh: Can you please give us some color on the SMA-2 book because from what I see this has come down by at least 120 basis point, but around only 40 basis point has moved towards gross NPA?

Vishal Kampani: As I said last time that we actively try and resolve most of our SMA-2 accounts, but we cannot assure that all of them will move back into normal or not and some will definitely slip into NPA, so that is the pretty normal movement, so some SMA-2 which are not resolved will obviously go into gross NPA and some which are resolved will no longer be SMA, so as I said the resolved cases in the SMA-2 were in Bangalore, Pune, and Kolkata. The one in Bangalore was resolved because the developer brought in equity by leveraging and selling his non core assets, the one in Pune had ready inventory which was sold to end users and they extensively used brokers and investor networks to sell those properties. The one in Kolkata we executed a JDA, which is a Joint Development Agreement with a stronger developer and moved the execution risk and sales risks to a much stronger brand and obviously that developer on his credibility can bring in money and therefore we resolved that SMA, and of course one or two could have moved into gross NPA and we are very focused on what has moved to gross NPA and we are very confident that we should be able to resolve those, but since they are going to gross NPA they can have a longer turnaround cycle, one is fundamentally they are stressed for a longer period of time and they are already NPA, so that can be a six-month to a one year cycle and SMA-2 is normally a shorter cycle. Having said that, we think our coverage on the mortgage portfolio is very strong. Our average cover is about 2.2 times on the loan book and even in the worst case, if there is an absolute worst case, we do not expect more than 20% LGD on the gross NPA, I mean I would be even shocked if we are 20% LGD, the number should be even lower than that.

Moderator: Thank you. The next question is from the line of Digant Haria from Antique stock Broking. Please go ahead.

Digant Haria: I just had one question on the numbers that I think making YOY comparison will not really make sense because what has happened in 12 months, but if I look at QOQ I think most of the trends have stabilized for us be it the loan book, be it the margin, read the OPEX, so would it be fair to say that in terms of trend we probably have bottomed out and we are moving in the right direction maybe except the provision, I understand they are function of what happens in six months?

Vishal Kampani: Digant couple of things, you know our numbers very well so if you see we have made a higher cautionary provision last quarter, what we have done is we have been again prudent and cautious and we have decided to increase our provision. We may even do that again this quarter and next quarter, the likelihood of us providing further will be higher and this is really being prudent because I genuinely believe that the next six months could be worse for the environment before it gets better, but you are also right if I look at JM I think we are very stable and if I would have compared the stress that we went through last October-November, I think we have are in an absolutely fantastic position from almost every metric possible, so I think we will just wait for the right opportunity I will just request investors to be patient for another six months to nine months.

Digant Haria: One more very good point which you made that you refinanced all the CPs through repayment, so if you know at some future rate you would like to publish anything on repayments that would be fantastic because I do not think any other player can boast of such a feat.

Vishal Kampani: That is a very good point. We will keep that in mind and do it.

Moderator: Thank you. The next question is from the line of Ritika Dua from Elara Capital. Please go ahead.

Ritika Dua: Sir, a few data points and then maybe I will ask another question, firstly just wanted to understand on net gain on share value changes which we have reported in Credit Solutions' presentation, we have seen a significant jump if you could just share what this related to?

Vishal Kampani: This is the profit, the large part of it is a profit from the mutual fund investments we made, the overnight fund money so that gets, from an accounting standpoint it comes under net value, net fair gains and in addition to that we have security receipts in our ARC, so as you know that has to go through mark to market on a quarterly basis, so that moves up, moves down depending on the view we take that quarter along with the auditors, so if I were to split the amount for the net gain, roughly Rs33 crores is from mutual funds and roughly Rs.24 crores is security receipts. Then we also have security portfolio of equity shares which is seen as minus Rs.1.2 crores change and we have a bonds and debentures position and fixed income trading business where we have seen a Rs.6 crores plus position, so a large part of that is really the mutual fund Treasury that we keep which has been on average almost Rs.2,000 crores in the group and the second large part of that is the fluctuation in the security receipts.

Ritika Dua: Sir, because I was specifically referring to credit solutions so the net gain there would also be of the same nature?

Vishal Kampani: That is only mutual funds, that is all nothing else.

Ritika Dua: Sir, secondly on the resolution front which you were sharing that if it would not have been on a slow pace, we were looking at some Rs.1,000 crores of resolution, any guidance, because we know that ARC you cannot say this year or next year phenomenon, any kind of profit pool you are expecting from this particular pool of resolution?

Vishal Kampani: That is a very good question, so I must tell you that see some part of that pool because of Ind-AS has already gone into our net worth directly and some part of the pool would be booked as and when we complete the resolutions, but having said that we suffered almost Rs.100 crores of additional interest payment which we have made over the last one year purely on delays of these resolutions and we are hoping that we do not have more delays of more than six months with everything now is literally final stage, it was in final stage one year ago also but I think most of the small issues that have come up have now been resolved and I am hoping next six months we should be able to resolve them, so roughly I think 50% of the profit would already be in our net worth and I think 50% would get booked over the next six months to nine months as and when the resolution happen.

Ritika Dua: Would we be making similar kind of may be a share lower IRR roughly because given that the things have been reduced, the interest cost?

Vishal Kampani: Our IRRs will definitely be reduced, as I said that we funded Rs.100 crores only purely on delay, so our IRRs will definitely be reduced, but I can tell you our IRRs are still healthy even after reduction.

Ritika Dua: Sir, on the Leela deal, can we say that while we know that we now have the legal issues being cleared, but in terms of the revenue recognition that we have done with?

Vishal Kampani: Yeah, Leela is completed and cash in the bank, the deal is closed.

Ritika Dua: Sir, actually firstly even I would like to say that the disclosure was really, really helpful and everybody has been seeking your opinion on the real estate sector and you have consistently been saying six-month and I know it is very difficult to put a number there but then you still want to oversee the state for six months and then turn positive, some more qualitative comments on that would be helpful?

Vishal Kampani: Why not I have my team also to talk about it, I have spoken a lot on real estate, so I will ask Shashwat and Gitanjali to add to what they think about the sector. I think it will be important for you guys to even hear them because they are actively managing the entire situation. All I want to tell you is that in our 11 years of lending in real estate, I have never seen it this bad.

Shashwat Belapurkar: Ritika, just two points for you, one is the S&P and FITCH has basically given kind of important data points, one is that FITCH is saying that they expect the Indian economy to print a 5% handle which I do not think is happened for a long time now that is the basic underlying theme which we are continuing right now, number one. Number two, the HFC financing part of it is a very important and critical component of financing which was in our cash flows, that slowed down particularly this quarter. I keep telling you guys that the overall number of 2 to 2.5 lakhs apartment sold for the last three years has been pretty constant. This quarter I hope that is an aberration with a slight dip in the sales number and I think it is primarily on account of lesser housing finance, so that is really what we are continuing with. There is absolute pessimism on the street, people who are on the sidelines are not really, really making up their decisions, so in this market we like to be positive, but underlying obviously the entire what do I say the flavor is not very strong and you have to respect that.

Vishal Kampani: Shashwat and me are pessimist risk managers, so I will have Gitanjali comment who is the Head of Origination who is always an optimist on real estate, so she has both sides of the view?

Gitanjali Mirchandani: I just hope I can be optimistic at this point, but I will just go a little back on how real estate has fared in the last decade, we have obviously seen that we have gone through multiple issues from regulatory issues to changes in terms of issues that happen in terms of demonetization- followed by RERA and then GST, so there has never been a good period of stability as far as the sector is concerned since I think 2012-13, however, you had lot of money chasing the sector in that period as well, so that obviously has helped keeping the sector in good stead in spite of these issues. Unfortunately, since the last one year that liquidity seems to have disappeared completely and right now you have only the sales which is pending, the repayment which is actually the interest payment as well as the construction. To take Shashwat's point forward and to add to that, you have agencies not even being able to disburse money's not even aggressively even to actually eligible people in time that when demands are raised money are not, so in such a situation with very little choice that is left. The only thing you can think of is equity option, but in the sector they are not really too many players who are looking at equity in the sector. In spite of all of this, I feel that there is significant opportunity even today and if today you have the right amount of capital, there is a lot of opportunity out there to go and underwrite good transaction at very good yields, because I think we are bottoming out as far as the problem is concerned for the sector, real estate because sales are still happening, they are still happening in the same volumes they were happening five years. I think there is a lot of financing myth which is there around the sector, which needs to be cleared out before we can see as a uptick that happen, so that is my view.

Moderator: Thank you. The next question is from the line of Manoj Dua, an Individual Investor. Please go ahead.

Manoj Dua: As you have written in the press release that real estate is getting consolidated very fast and we have so many regulatory changes in the last year so how do you see going forward in medium to long term, you are in touch with all the real estate players, so what is going in their mindset say if their project is complete, will they launch in future or they will tie up with credible developers with their land parcel? Two days back one of the leading developers said that we will do long-term based the sense we are getting from Mumbai market, so I want to how do you see the market in real estate from medium to long term?

Gitanjali Mirchandani: So consolidation taking that point forward, so we dealt with most of these large mid segment and even some smaller developers. The major point of attraction for this sector has always been the margins and those margins have been shrinking very rapidly, one because of the increase of cost, and two, because of the premium which are involved in this sector that cost has also increased substantially. On the other hand selling prices has not gone up in the same proportion or at least it has been flat with the last five to six years, so most of the smaller developers I do and with all the complexity which are involved in the sector, they do not see the risk reward ratio to be anywhere close to where it used to be and hence we see more and more people wanting to exit the sector. We have developers in second generation do not want to take the business forward and hence a lot of this consolidation in the sector is happening, but on the other side when you talk to the larger developers they are obviously seeing this as an opportunity, they are seeing this as an opportunity to go acquire new project. They feel that this is the right time to go and start shopping for new projects because the rights value in terms of acquisition of project because there is no land especially in markets like Mumbai, when there is no land available it is a good opportunity to go and acquire some under construction project at a good price, so you will have a lot of consolidation, you will see the market share of these guys going up significantly and the margins being rationalized between 15% to 20% which earlier used to be a multiple of that, yes, so you will see a lot of consolidation happening in this sector and this is what is going on in the minds of developers as well.

Manoj Dua: My question is that real estate also like when the pessimism is there supply also gets constrained and this sector also has to turnaround, the question will be after one year or two years, so it can be anybody's call, when the things stabilize do you feel that smaller developers will come or it will be only the/ bigger will stay. New entrant will be restricted in the medium to short-term?

Vishal Kampani: Let me take that question, it is not a function of just only smaller or larger developer, I think it is also a function of the leverage and prudence with which that developer has done business, so there are a lot of larger developers also in the country who have not made prudence about the way they have done projects and manage their leverage and there are a lot of smaller developers who have done that brilliantly, they have not taken much leverage, they finished their projects on time, they are very hands-on on the execution and they have basically taken on what they can execute, so what Gitanjali is referring to is the mix, so if you had 30% or 40% market share with the top 20 developers in a city that market share is probably going to move to 60% or 70% for those top 20 developers, but you will still have a lot of small and medium developers who have been prudent who have executed well, but they will have a lot lower market share compared to what they have today or they have had five or 10 years before and the sector has to turnaround, so if you ask me long-term this is one of our best businesses and will continue to be one of our best businesses, but we have to be prudent over the next six months to one year. We have to manage our balance sheet well and I am very confident growth will come back.

Manoj Dua: Going forward when the number of players will reduce, so we will find challenge to fund as the number of customers have reduced, will our competitive advantage to what lending rates will reduce going forward in medium-term?

Vishal Kampani: I think the speed at which this crisis will continue, there will be lower NBFCs and lower developers left in the next six months to one year, so right now I would worry more about the financials and worry about the developers my friend.

Moderator: Thank you. The next question is from the line of Saurabh Dhole from Trivantage Capital. Please go ahead.

Saurabh Dhole: Sir, two questions one is on the ARC side like you in your opening remarks mentioned how the pace of resolution in the ARC business has kind of disrupted your calculation, I just want to understand how does this incrementally impact the incoming assets if any, and the second question is on the developer funding book, is your incremental funding to the existing accounts towards the last mile funding part of their requirements or is it part of whatever you had calculated at the beginning of the relationship?

Vishal Kampani: First question, the answer is very simple we are not looking at any new asset acquisition over the next six months, we are only focusing on resolution. We want to make sure we get Rs.1000 crores plus of more recoveries completed over the next nine months to 12 months, once we do that we see progress on that, we will get back to adding more assets. On the second question, yes, almost three-fourth of the incremental funding that we are doing will be on completing last mile projects and construction finance commitments which we have made in the past.

Saurabh Dhole: Just to elaborate on the second part, so this last mile funding was part of your initial arrangement that you had with the developer or is it something that that was initiated during the course of the relationship?

Vishal Kampani: This is sanctioned facilities for construction finance which they are drawing down on and in certain cases they require incremental construction finance because sales would have been slow, so 75% would be in my view sanctioned we already have and 25% would be incremental money required to finish the projects in a timely manner because sales have slowed.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I now hand the conference over to Mr. Vishal Kampani for closing comments.

Vishal Kampani: Thank you very much, I wish you all a very Happy Diwali and prosperous New Year and if any of you have any further questions, you can please reach out to us directly and we will be happy to take on the question. Thank you very much.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of JM Financial Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.