"Magma Fincorp Limited Earnings Conference Call"

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Moderator Ladies and gentlemen good day and welcome to the Q1 FY12 Results conference call for Magma Fincorp hosted by IDFC Securities Ltd. As a reminder for the duration of this conference, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Vishal Purohit from IDFC Securities. Thank you and over to you, sir.

Vishal Purohit Thanks. Good morning everyone and thank you for joining us for the Magma Fincorp Ltd. Q1 FY12 results conference call. And on behalf of IDFC and everyone present on the call I thank the management for allowing us to host this opportunity. We have with us Mr. Sanjay Chamria – the Vice Chairman and the Managing Director, Mr. V L Narasimhan – the CFO of Magma Fincorp Ltd. to talk about the company's performance and the important events during the quarter ended June 2011. We will begin the call with the opening remarks of Mr. Chamria followed which will have the forum open for the interactive Q&A session. Mr. Chamria if you can start with how the quarter has been and also the changing face of the regulations, the impact it has on the global macroeconomic factors and also be NBFC's in particular. I now invite Mr. Chamria if you can take it over.

Sanjay Chamria Thank you Vishal and good morning and thanks to all of you for joining us on Magma's conference call for the quarter ended June 2011. And I will take you through the key highlights of the company and the performance indicators for the quarter, but before that as Vishal mentioned on the macro issues. The first quarter has been pretty eventful both in terms of changes in the regulatory guidelines on the way NBFCs function and the macroeconomic fundamentals as well as the quarter has been even full in terms of the specific changes in the Magma's business model and the capital base. Fortunately now the uncertainty surrounding the priority sector lending eligibility in respect of the securitization of receivables for loan transactions with eligible customers, has been set at rest and the Reserve Bank of India has clarified that the PFL benefits will continue to be available on securitization transactions.

On the other hand the sale of automobiles and equipment have hit a slow growth zone and is expected to remain so for the next few quarters given the apprehensions in the minds of the customers about the increase in the fuel prices and rising interest rates. All the auto manufacturers and financials have however pulling all stocks to ensure and maintain the growth rate around 10 to 12% and if that happens it will be considered to be a good year.

At Magma we have doubled our networth and it has now crossed Rs. 1000 crores with capital infusion from globally most reputed investors like KKR and IFC Washington, both of whom now own close to 27.75% in the equity of the company. We have completed the allotment on 30th of June, 2011. Along with the tier 2 capitals as on date, our total owned funds have now touched Rs. 1500 crores. This capital infusion will support the geographical expansion which we are aggressively pursuing all over India and much higher rate of growth in the loan disbursal as well as it will also enable us to retain the same on our balance sheets rather than selling the same to free off the capital something that we have followed for many years.

Having shared my view on the macro fundamentals and the change in the business philosophy and strategy at Magma, now I turn to the key highlights of our business and financial performance for the quarter. During the Q1 primary sale of cars recorded a growth of 8.8% and for commercial vehicles it was 14% out of which medium and heavy was 5% and LCVs was 22%. The tractor industry grew by 7% and construction equipment industry is expected to have grown by 10 to 12%.

In this background some of the key highlights from our perspective for Q1 - our disbursal has grown at a very robust pace of 36% and the total disbursal's amount to Rs. 1422 crores. And in car and tractors we have beaten the industry growth by a very wide margin. In car we have grown at 86% and in tractors we have grown at 99%. In commercial vehicles and construction equipment we are marginally below the industry growth. In CV we have grown 8% and in construction equipment a marginal degrowth of 5%. Our business growth in various products has been principally driven by the philosophy of maintaining healthy spreads and also growing the same at the same time. Accordingly our blended gross yield has increased by good 104 bps between the Q4 of last year and the 1st Quarter of this year, with the increase being seen across all products and all customer segments. As a result our net spread had also grown by 20 bps between the Q4 of last year and Q1 of this year.

Our strategy of growing the contribution of high yielding products in a moderate and consistent manner has been indicated by the performance of the portfolio with our overall collection efficiency once again during the quarter being, 100.1% and as a result the credit losses being at an all time low of 0.2% on an annualized basis of the total AUM which is again lower than the write-off percentage for fiscal year 2011. Our overall portfolio quality and I thrust upon including that of the high yielding products has continued to improve, although the high yielding products have contributed 22% of our disbursals during the quarter as against 19% sort of whole of last year. Our own book has grown aggressively by 62% a YoY basis and our Assets under Management at end of June 11 stood at 11,000 crores.

Before we get into the specifics of quarterly result, I wish to highlight our key business strategy and accounting policy changes that Vishal was talking about:

(a) We have not securitized / assigned any receivables during the quarter and hence we have nil income from securitization during the Quarter. Just to remind you, during the corresponding quarter in the previous year, the net income from securitization was Rs 27.02 crores. This change is quite significant in the history of Magma as it had happened first time after June 2003, which is after 8 years and

(b) We have also amortized an expense of Rs 11.59 crores pertaining to the origination cost and the dealer and the manufacturer discounts, over the tenure of the respective contracts in line with the principles enunciated in the proposed Accounting Standard 30 on financial instruments in the Indian GAAP as well as IFRS. These are the two principles business strategy and accounting policy changes.

I now move to the financial aspects of the results. The consolidated revenues during the quarter increased by 23% to Rs. 221 crores as compared to Rs. 179 crores in the Q1 of FY11. The assets write-off has gone down by 43%, even in absolute terms from Rs. 9.88 crores to Rs. 5.60 crores, despite 62% increase in the loan books. Interest and finance charges have gone up by 65% owing to the higher borrowings to fund the assets growth in loan book and the interest rate increases which is more than 1.5% over the same quarter in the previous year.

The PBT for the quarter was Rs. 25.38 crores against 27.71 crores during the corresponding quarter last year. As a consequence of the change in the business strategy of holding the entire book in our balance sheet and no securitization, it has resulted in PAT being marginally down by 5.7% to 17.1 crores during the quarter.

Our outlook for the 2nd Quarter is that the primary sale of vehicles and equipments as well as tractors will be moderate in line with the 1st Quarter. We at Magma hope to outperform the industry growth rates as we have achieved in the 1st Quarter and retain our guidance of achieving 50% growth in disbursal for the current fiscal.

The policy rates in our view are virtually at its peak level, although we expect maybe another 50 basis points increase during the balance part of this year. We will pursue our strategy of customer segmentation and product mix within the credit risk framework and maintain our net spreads.

With that I would like to end my opening comments. Lakshmi and myself are very happy to any take questions that you all may have. Thank you.

Moderator Thank you very much. The first question is from Rakesh Kumar from Daulat Capitals. Please go ahead.

Rakesh Kumar Why we are discontinuing the securitization process? Are you anticipating that the PSL recognition which has been allowed this time by the RBI may not be allowed going forward, or is there any other reason discontinuing the securitization process?

Sanjay Chamria In fact if you go to the transcripts of our several analysts call, we have consistently maintained that we wish to bring down the level of securitization over the last three four years. Actually we have brought it down from 70% to 52% last year. The reason why we are securitizing so much in the past was on account of the need to free up the capital to fuel the business growth. However having raised sufficient capital from very long-term investors, now we have decided to build our own book and therefore decided to not do the securitization. And henceforth going forward the securitization might be pursued not as a business strategy but maybe as a treasury tool.

Rakesh Kumar Thank you.

Moderator Thank you. The next question is from Arun Khurana from UTI Mutual Fund. Please go ahead.

Arun Khurana Couple of questions, one being, that despite your income increasing 25% your interest expenses have increased to 65%. Is it that you are not able to pass on the impact in the last quarter or is it that would you be able to pass it on in the current quarter, that being one. Secondly, you said that you expect the interest rates to move up 50 basis points from here onwards. Considering the fact that SBI's rate of interest is the lowest end being about 7% on a 7 to 14 days deposit and considering the fact that credit off take has not taken off at this point of time and considering the fact that it takes off in October and we have interest rate spike of more than 100 basis points if not 50 basis points. What kind of delinquencies and what kind of non possibilities of passing the interest rate hike to your customers is being looked at this point of time from the risk management perspective?

Sanjay Chamria Thank you Arun actually you have asked 3 to 4 questions. Let me try and answer them in a particular order. First of all, you are right; the income has gone up by 25% whereas the interest in finance expenses has gone up by 65%. The large part of increase in the interest cost is on account of increase in the borrowings level which is happened largely because instead of selling our assets we are now retaining them on our books. So when we sell our assets then the net which is the interest income minus the interest expense, net gain is recognized as an income, whereas when we retained in our balance sheet than the gross income is reflected on the income side and the interest expenses reflected on the debit side of the P&L. So a large part of that increase is on account of that. And secondly, the interest rate costs have also gone up by as I mentioned 1.5% between the first quarter of last year to the first quarter of this year. And out to 45% roughly about 20% of the increase in the IFC is on account of the interest cost increase and the balance is on account of the increase in the utilization of the bank limits. That is the answer to your first question.

The second question you asked about in terms of the outlook on the interest rate rise, see I think the rise in the interest rates would not necessarily be occasioned by the credit offtake being picked up as much as by the regulatory need to combat the inflation for which they have been raising the reference rates 10 times over the last 15 months. And therefore if the inflation does not come down to the tolerance level set by the government and the regulator, I am afraid that they may again resort to monetary policy as a means to beat the inflation. So therefore we could see probably on 27th of July when you have the credit policy, another 25 bps and thereafter by September if the rate does not come down maybe in October are the 25 bps. But my own personal feeling is that beyond 50 bps during the current year, the regulator may not want to take a risk because already we are seeing the imminent signs of slow down, be it in the index of industrial production, which yesterday we saw is at a nine-month low or any other lead indicators.

In terms of our ability we have increased our net spreads between the Q4, which is the March ended 2011 from 4.4% to June ended 2011, just concluded quarter to 4 .6%. So we have actually increased our NIMs by 20 bps, and that increase has happened one by, the increase in the contribution of the high-yield product which is also not very high from 19% to 22%. And secondly, it is also happened because we have been able to pass on some bit of the increase across all product segments. So therefore we have also tinkered with the product mix and the customer segmentation to be able to maintain our net spread which is our prime objective.

Your last question was with regard to the impact on the delinquencies and the asset qualities. We have seen that even during the global crisis in October 2008 and so far the fiscal year March 2009, we saw that our collection efficiency improved by 0.8%, from 97% to 97.8%. Of course in a FY10 it went up to 99.8% and last year it was 101.7%. So I think the increase in the interest cost by 1% or 2% does not have an impact on the asset quality as long as you are underwriting norms are strictly enforced and you have a strong collection infrastructure at ground level because large number of customers to whom we deal with they are not having the banking facilities and you need to be able to reach out to them every single month to collect your installments. And we do have a pretty strong collection network.

Arun Khurana Considering the fact that no practical tightening has happened in the last one year, though we keep on talking about tightening, tightening in terms of increase in CRR and the fact that the RBI has only increased the reference rate after having seen the interest rates rise as they more or less become permanent in nature. And considering the fact that oil prices remain very sticky after having seen lows of about $104 in terms of Brent crude, it has jumped back to levels of about 118-119 at this point of time. And considering the fact that FII flows are dwindling for the years as a whole of course we have seen some kind of a change in the FII routine in the last one month since July, of about 7000 crores that was again piggybacking on lower crude prices. Now my sense is there the possibility of revisiting 2008 September-October, about six months before which the oil prices were high and everybody was picked pretty much gung ho that the rates are going to come down and nobody was prepared for that kind of potential risk? What if oil prices remain sticky and what if liquidity damps expansion remains to be pretty much in the lower lines. And though you feel that we could have interest rates shot in the system which nobody is anticipating, sir?

Sanjay Chamria Arun, I do not know whether I'm qualified enough to comment on so many global factors. I think what I can do is, I can give you my own feeling of our business and how such adverse factors impact our business. So if I talk about the previous year global crisis that happened in October 2008, if that were to be repeated again then what I saw happened was the customers that we deal with usually they are all single vehicle owners or two or three vehicle owners or equipment owners. And they personally are at the site or driving these assets to earn their revenue and livelihood. Because 75 to 80% of our branches are also located in the rural and the semi urban market, there I found that these are largely insulated from these global changes and they are largely internal consumption led. To that extent I found that they were quite insulated. Yes, one negative impact that we saw was the overall sales of commercial vehicles and construction equipments fell. However even during that year the utility vehicles and the passenger cars had a nil growth situation, it did not have a degrowth situation and tractor grew even in that particular year. So that sort of goes to say that the 70% off the Indian population living in that part of the world which is largely consumption led, is to a much greater degree insulated from the global factors and therefore the companies like Magma which are dependent largely for their business model, on this part of the population are less likely to be impacted.

Arun Khurana Is there any guidance for your targeted ROEs that you are looking over the next two years, sir?

Sanjay Chamria Well actually we are doing pretty well on the ROA and the ROE front and last year like we did about 23.6% ROE and 2.3% ROA, now with the increase in the capital that we have done which has doubled our net worth and the change in the business strategy. So that our financial performance has been impressive and expected to be maintained but due to this change in the business strategy and the accounting policy changes it may be a couple of quarters before which you may see us reaching back to those levels and we're looking forward to a pretty optimistic future.

Arun Khurana Would that mean that we could see contraction down to about 15 to 16%, ROE in the current year and maybe coming back to about 20% over the next couple of years?

Sanjay Chamria Well as a policy Arun we have not commented on the future numbers, we can only talk about the business part. So I would refrain from commenting on that.

Arun Khurana Thank you.

Moderator Thank you. The next question is from Abhisekh Kothari from Way 2 Wealth Securities. Please go ahead.

Abhisekh Kothari Could you just give me AUM breakup in terms of your different portfolio and also the yield on your different portfolios vis-a-vie last year if you have?

Sanjay Chamria So far as the yields are concerned on different portfolios, I'll give you the yield for the quarter ended June. Last year is also there with me. So last year for example we had in car 13%, this is I'm talking about the fiscal year 2011. And for the first quarter it was 14% so it was up 1%. In commercial vehicle it was 11.6 now gone up to 12.6, so again up by 1%. And in retail fee it was 11.9, now it is 13.3, so by 1.4%. In the huge vehicle it was 18.2, now it is 18.7, so by 50 bps. In the strategic CE it was 10.2, is now 11.9. In SME loan it was 16.2, now 17, which is up by 80 bps. And in tractors it was 19.6, down 19.9, so therefore up by 30 bps. What I suggest so far as the portfolio breakup is concerned I do not have it right away with me, so maybe off-line you can get in touch with Atul who handles our investor relations and he can provide you the details.

Abhisekh Kothari The other question was on CV outlook. I guess you meant they depend on new CV for financing so how was the Outlook scene over the next two quarters?

Sanjay Chamria The outlook for the CV industry is grim to moderate and I would suspect that the growth rates will be in single digit. And it could be anywhere between 5% to 10%. Like 1st Quarter also it was 14% but the medium and heavy was 5% and the light commercial vehicles were higher. So the 2nd Quarter I had suspected it would be anywhere between 5% to 8% or 9% and so far as our product composition was concerned CV was the highest product contribution till last year contributing about 32%. This year car has already overtaken CV and the CV is now at the second level and car is now doing more than 30%. And this is the advantage Abhisekh, which I mentioned a couple of times earlier on the call that a diversified product company like Magma which has seven products, we have that if one particular product does not do well then we can re-group and re-claim our volumes growth from the other five products because it is very unlikely that all the products will go down at the same time.

Abhisekh Khotari Your outlook on NIM for the next couple of quarters would be?

Sanjay Chamria Well, I think we remain optimistic because we have been able to in trying circumstances increase the NIM from 4.4% in the March ending to 4.6% in the June ended quarter and we have also issued guidance that we wish to increase the contribution this year of the high yield product from 19 to 25%, so the 6% increase in the high yielding products should help our NIM to be extended to about 50 bps. So if we are able to pass on to further increase in the cost of fund then we should be able to maintain the NIM at PLR and grow it a little more. But if you are not able to pass on the entire increase then also at least to the extent of 50 bps we have our cushion and last year we earned a NIM of 5, so we should be able to reach there, this is what we would expect.

Abhisekh Khotari That's it thank you.

Moderator Thank you. The next question is from Yogesh Motwani from Padmakshi Financial Services, please go ahead.

Yogesh Motwani What is our leverage currently?

Sanjay Chamria See as per the current RBI guidelines NBFCs can leverage at the most to about 5.5 to 6 times and traditionally if you look at on our both Tier-I and Tier-II capital we are leveraged under 5 times. So we will continue to maintain the same and which is also permissible and okay with the regulator. So it should be anywhere between 5 to 5.5 times.

Yogesh Motwani And can I get a break up of your borrowings?

Sanjay Chamria Break up of borrowing in what sense?

Yogesh Motwani In terms of working capital and term loans?

Sanjay Chamria See with this no sale and no securitization during the Quarter 1, our working capital contribution is now higher at close to 60% and about 25% is by way of term loans around 10% is by way of NCDs and bonds and another 10% is by way of the sub debt and Tier-II capital.

Yogesh Motwani Alright, that's all from my side, thank you.

Moderator Thank you. The next question is from Deepti Chauhan from Asit C Mehta, please go ahead.

Deepti Chauhan I just have a few questions. One is, wanted your outlook on what are you expecting? Now we know that we are trying to grow our high yielding loan book, say tractors or SME loans, but we also know at the same time that these segments basically given the type of riskiness in them, and given that the interest rates are moving up, what is your expectation off how much you can grow and what would be the asset quality in turn for these segments?

Sanjay Chamria What I want to clarify Deepti that we have grown our yields across all products. We are not dependent on only the high yielding products for maintaining our net spread or for growing our margins going into the future. I wanted to, one, clarify that. And secondly, so far as the high yielding products are concerned you see in FY09 it was 9%, in FY10 it became 13%, in FY11 it became 19% and this year we want to take it to 25%. So I think we have been very cautious in the manner in which we have been growing our high yielding portfolio. Third, there again if you see we have three products in the high yielding, and that again makes us the most diversified company amongst all NBFCs in India that rather than depending upon one product for our high yielding contribution we have three products. So therefore, our dependence on one product will not drive us to take risky calls. Last but not the least, if I look at say, used vehicles, used vehicles our collection efficiency is more than 100% even in the just concluded quarter. So while we had overall 100.1 in used vehicles it was 100.3, 20 bps higher than the overall collection efficiency of all the products put together. In SME we improved our collection efficiency from 98.3% last year to 98.5% in the first three months of this year. And even in Tractors which is considered more risky as compared to the others, there also we improved our collection efficiency by 40 bps from 96% to 96.4%. So therefore, we are very much within the comfort zone and as asked by one of your other colleagues in the call, going forward also we are evaluating the performance of each of these portfolios and products and particularly the high yielding ones to see if there are any lead indicators which could indicate any stress on the portfolio quality and then itself our underwriting team they would take independent calls to either restrict on a geographic basis or on a particular customer segment.

Deepti Chauhan Okay, that's it from my side, thank you.

Moderator Thank you. The next question is from Anil Sarin from BVP India, please go ahead.

Anil Sarin I seek some clarity on the on-book versus securitized asset book, so when we say roughly around 11,000 crores of assets, how much of those are on-book as at end of fiscal 2011 and then the same figure if you can say for June 2011 also, on-book assets non-securitized?

Sanjay Chamria First of Anil, my congratulations to you, I read about your deal on the Snap deal.

Anil Sarin Congratulations is when we exit and make some money out of it.

Sanjay Chamria I was reading that in the papers today and I was remembering about you. Now coming to your question, As of March 2011 we had 54% on-book and 46% off-book in terms of securitized and non-securitized whereas on June 2011 now that we have stopped securitizing so 54 has grown to 61% and 39% is off-book.

Anil Sarin So in numbers what would that be?

Sanjay Chamria Number-wise like I said total loan book is now 11,000 crores of which on-book is now 6,800 and 4,200 is off-books.

Anil Sarin And as we project ourselves into 50% growth on the base of March 2011 and the percentage keeps on increasing towards on-book ,what would be a number that one can look at, at the end of the year for the book size?

Sanjay Chamria Well actually since we are not looking to securitize as I said as a business strategy it could only be as a treasury tool because more than 70% of our portfolio origination Anil, qualified for the priority sector loans and as I said in my opening comments that now the controversy has been set at rest and the securitization of PSL portfolio is eligible for the PSL benefit, so it could be used more a treasury tool rather than as a business strategy. Assuming if they do not securitized at all then our own book could be as high as 80% by March 2012 depending upon if we securitize something. Of course, here another point which I have not clarified so far and I think it is a good occasion for me clarify to the entire community that if at all we securitize something, then we have decided to not recognize the gain on sale itself but amortize the gain on securitization over the entire tenure of the contracts.

Anil Sarin I had a follow-on question now considering that there is a lot of own capital going to work the ROA should go up but as against that the securitization has been reduced or can discontinued for all practical purposes then the return on assets would diminish to that extent. So in that whole dynamic what can kind of an ROA are you comfortable projecting for the year?

Sanjay Chamria As a policy we don't project the profit of the ROA-ROE numbers, however, you are right that because of the change in the business strategy like our ROA numbers or the ROE numbers will look more muted than what actually it is, however, there will be proper mix getting reflected in the next few quarters then probably it will catch up with the past.

Anil Sarin So my question was not so much about the next few quarters but yours is a very diversified mix of assets and also now increasingly the proportion of higher yielding is going up so it becomes a safe but high return portfolio that you have got. Now when one compares with some people in the competition who have a large portfolio but who are standing on only narrow secondhand truck kind of business where ROA tend to be quite high, ours will be a little mixed because there will be construction equipment and lot of other things that are put in into the mix. However, the percentage coming from high yielding is going up so basically then the ROA would trend towards the level of the category leader who is only into secondhand trucks. But how much short would it be given that need for maintaining the well-diversified portfolio?

Sanjay Chamria What we decided in FY09 that we will grow our high yielding by 5% each year and we will cap it at 30% and then take a look as to how is the overall portfolio quality looking like and then take a further call in the board. So happily we are seeing that our portfolio quality when the high yielding mix was 9% the portfolio quality has rather improved when the high yielding mix is 22% and last year it was 19%. Even then we believe that we are in the business for a very long haul and therefore we have not felt still to straightaway go ahead to 45% to 50% contribution but we would rather take a look at it when it is reaching 30% but last year our ROA was 2.3 and our ROE was 23.6 and at 19% because our write-offs were much lower than anybody in the industry and secondly because we follow very aggressive policy on the write-off which is on 180 plus we don't make a provision of NPA. We write-off the entire principal, future outstanding as well as the past overdue so therefore we don't have any baggage. So that's also tends to have a positive impact going forward on the ROA-ROE. So what we're going to do is this year we will do 25%, next year we will do 30% contribution from the high yielding and then we will take a look and discuss at a board level in terms of our policy going forward. Yes we are also committed to produce higher returns reporting ROA-ROE terms. But we will like to err more on the risk side rather than on the returns side.

Anil Sarin Thank you, just one last question from my side. Over the last 6-7 months of the year RBI has been coming out with a series of letters and notification regarding NBFCs and there is the clear slant towards leveling the so-called playing field between banks and NBFCs meaning by which NBFCs are being subjected to lot of prudential norms. So what kind of an end game do you see over here, maybe from a very motivated standpoint I can see that there seems to be an attempt to put some curbs on NBFCs, how would you react to that? So standing apart looking at it over a period of last one-year it seems to me that RBI is trying to restrain NBFCs which can benefit banks but I don't think the purpose is to benefit the banks, the purpose is to somehow put some curbs on NBFCs. So what is a longer-term outlook will this trend of progressive escalation of restrictions continues such that the advantages endured by NBFCs would be completely nullified?

Sanjay Chamria Let me try and give a most summarized answer because my answer can be very long on this point. One as a Magma spokesperson and as also as an industry spokesperson I will be very happy to see the level playing field between the banks and the nonbanks because we believe that we don't have a level playing field. So if the level playing field is offered it will be much better for everyone and there will be no allegations of any bias in favor of or against someone in the market. We are of course systemically important NBFCs and subjected to much greater degree of scrutiny under prudential norm both on the risk concentration or on the income recognition or on the non-NPA provisioning all these three are the critical norms straight from last 5 years, also in terms of an inspection and oversight by the regulators. However, we have a much higher capital adequacy at 15% as against 9% for banks so therefore if at all we are being unfairly treated in the level playing field since. Secondly, corporate debt market is not so well developed wherein we can reach out to meet our credit needs rather than only depending on the banking system. So in our several interactions with the regulators as a industry spokesperson I have had the privilege and chance to listen to the top echelons of the regulator as well as the banking system and they feel that now they want to make some impact and dent in development of the corporate market so that the nonbanks of a certain size and shape can also attract that sum rather than only from a banking system. Third, I would agree with you that last 6 to 9 months there has been a lot of regulatory guidelines and circulars being issued and number of which have gone against the interest of the industry. So in our interaction with the regulators the sense that we have got was it was due to the feeling that there could be an element of misuse of some of the guidelines and thereby the concessional funds from the banking system were not finding its way to the intended end use in terms of the people to whom they wanted for a particular end purpose. And that is how the larger community suffers so a lot of representations now you see the benefit of the PSL being restored with regard to securitization, also there has been another circular which incidentally has gone unnoticed and which is on 2nd of July that RBI came out with which is a comprehensive circular in terms of flow of credits from the entire banking system to the NBFCs and therein they have actually captured last several years all the circulars and once again credit to be provided from the banking system and to say there are no restrictions from the regulators. I feel that there is a lot more maturity that is coming in and much greater degree of interactions with the regulator they are starting but we would also want the level playing field. If that happened it would be overall good for the sector and stronger players who want to stay for long-term in the course.

Anil Sarin Sanjay thank you very much.

Moderator Thank you. The next question is from Ritesh Nambiar from UTI AMC. Please go ahead.

Ritesh Nambiar Just to get a sense in fact what I had concluded in all the set of questions you have answered on securitization is that you used to do 100% upfront booking of income on securitization and that you have discontinued for this quarter and the impact of that is shown in the P&L, is it right?

Sanjay Chamria Mr. Nambiar what you're saying is right. I have also said that we have now decided not to securitize and not to sell our portfolio because the need for it was with a view to create our capital now that we have enough capital and our capital adequacy incidentally on June 2011 is 21.8% so we are well positioned and secondly I said also that if at all now we securitize which could be more as a treasury activity than as a business strategy we will rather amortize gain on sterilization than to account for it up front going forward in future.

Ritesh Nambiar So that means not a single income is left for the past securitization, so everything is being charged off?

Sanjay Chamria That is why I said that our income for the 1st Quarter which is although up 25% has nil income from securitization whereas last year same quarter it was 27 crores. So if you actually compare apple-to-apple then our income actually is up by much more than 40% over the last year 1st Quarter.

Ritesh Nambiar So sir I fail to understand why these 11.59 crores odd is is being amortized from this quarter? What is this? Is it related to securitization or it's the IFRS adjustment which you have said earlier?

Sanjay Chamria If you see the total origination cost that we incur is divided into two parts, one is the OpEx which is internal to the organization and that is accounted for and debited regularly then you have when you lend money against these assets you appoint a DSA, the direct selling agents and you pay them 2% or 3% commission then there is also some kind of paying by them to maintain the yield, then you also get subvention or discounts from the manufacturers or dealers who want to do the sale and all of those things. So again the recommended practice as per Accounting Standard 30 in the Indian GAAP and the IFRS that should be amortized over the tenure of the contract, however, because we were recognizing the entire income on securitization up front so we also used to treat these expenses upfront and not amortize it. So now that we have stopped securitization completely and we have also said that if at all we do some bit of securitization in future then we are also saying that to have a matching concept of revenue versus both income versus expenses these cost that the income on origination will be amortized over the tenure of the contract. So to that extent 11.5 odd crores is the unamortized portion which will be written-off in the subsiding quarters over the tenure of the contract.

Ritesh Nambiar So these belong only to the securitized pool of assets not to the on book assets?

Sanjay Chamria No it is for the on book assets because in securitized assets there is nothing. Everything has been charged off in the earlier years, there is not a rupee of origination cost which is there in our P&L account or in our balance sheet which is not written-off. So whatever this 11.59 is only on account of the origination done during the 1st Quarter of the current year for which the entire assets stand in the balance sheet is being stopped to be amortized over a period.

Ritesh Nambiar So for an apple-to-apple comparison what is the amount of the last year and last year same quarter?

Sanjay Chamria Which has been mentioned in our P&L we have 7.41 crores and last year it was 15.91 crores in the first quarter. So 11 plus 7 it is about 18 so as against 16 crores it is about 18.5 crores if you compare apple-to-apple.

Ritesh Nambiar That way we can compare. And sir your on-book borrowing would have risen by the same proportion as your on-book assets roughly around 1000 odd crores?

Sanjay Chamria Little less than that because we also got the about close to $100 million at the end of the quarter by way of capital. But then otherwise you're right because that happened only on 30th of June. So that quarter end balance has gone down otherwise in terms of utilization and the interest cost you're absolutely right it would have grown by the similar amount.

Ritesh Nambiar Sir just want the clarity on do you have personally keep in account the 90 plus DPDs because 180 plus you anyways write-off so as a banking standard do you have that 90 plus DPD figure which you what is that for Magma?

Sanjay Chamria It is 0.8% or 0.9% between 90 to 180 whereas 180 plus everything is written-off. There is not a trace of any account in our balance sheet.

Ritesh Nambiar And historically it fares the similar way, it would have been improved a lot?

Sanjay Chamria Actually improved by 10 bps between March and June. Mr. Nambiar that is the fun of it. Our asset quality- usually what happens in a 1st and the 2nd quarter your delinquencies go up because after the end of the year there is some bit of relaxation then 2nd quarter you have the rainy season plus last 9 quarters we have been improving our portfolio quality and this year even in the 1st quarter there is a 10 bps improvement in our 90 to 180 our portfolio as a percentage of the total AUM.

Ritesh Nambiar Thanks a lot sir.

Moderator Thank you. The next question is from Krishna Pophale from Financial Express. Please go ahead.

Krishna Pophale Sir this question on your NIMs compared to corresponding quarter last year it was 5.7 and this year it is 4.6, so it is only because of on the high interest rate continuous money tightening by the regulator of another reason and secondly when I last time talked to Mr. Lakshmi after the monitory policy was announced he said this will lag of 75 to 90 days before we pass on the cost to customer. So I would like to know why this lag of 75 as almost the 3 months lag because banks are almost passing it within month or so, so I would like your comments on that.

Sanjay Chamria This is the unfair level playing field that we have that banks we are wholesale customers so when they raise their base rates our rate is increased right from the next calendar day, whereas we are operating today with about 260,000 live customers who live in the villages or the small towns and we cannot reprice those loans first of all. Even for the new loan that we give from the next day we have about 5000 people in that field so to reach out to all our people by way of circular and we have seven products and 35 customer categories. So to tell them how our rates will increase and then send the circular and make it effective then we have 15,000 loan applications that we process every single month. So the pipeline you cannot make the changes, these are all driven by the market conditions. So, practically we have seen even for the time when they lend to the retail customer they also have a lag effect and we also have a lag effect.

Krishna Pophale My question is on NIMs. Is it only because of the increasing interest rate scenario?

Sanjay Chamria The NIM compression that happened between the last year first quarter and now the regulator from July 2010 and August 2010 they have made lot of other changes also, like they have stopped the LIBOR-linked daily put call borrowings by the NBFCs that itself push up the cost of fund, then the base rate as a concept was introduced from July or August 2010. Now before that there was benchmark PLR and RBI had only the repo and reverse repo rates. So there was no discipline and there was no mandatory requirement from the regulator to the banks to have the base rate below which they cannot lend but today the scenario is that every bank has a base rate which is minimum 9.5% and they cannot even subscribe to a commercial paper or a short-term loan below the base rate whereas earlier they could do so at even 4% and 5% so I think this kind of structural change has pushed up the cost of fund which is not really link to the increase in the repo and the reverse repo rate. So there are two kinds of impact that has happened between I would put it say pre-July 2010 and post-July 2010 and that is why there is a slight gap.

Krishna Pophale Thanks a lot.

Moderator Thank you. The next question is from Santosh Kamat from Franklin Templeton. Please go ahead

Santosh Kamat I have two questions on the slightly macro front with KKR now holding close to 15% equity what role do you see KKR playing in the company?

Sanjay Chamria It is too early because we have done the allotment on 30th of June and as a part of our investments and subscription agreement we have also appointed Mr. Sanjay Nayar who is the CEO of KKR in India as a director on our board, however, this is quite a significant investment from a KKR standpoint as well because this is the first investment they have made into a retail finance company in India and therefore we would look forward to our much closer interaction over the next several years in terms of growing the franchise and benefiting from the experience and expertise of not only Sanjay but other colleagues and KKR globally because financial services is one of the most preferred sector for investments within the KKR Group globally. This could be very cliché that getting global best practices and all that but I don't think that is clearly as important because today in Magma we are already benchmarking ourselves against the best practices. But on how to expand the market to get into new product businesses and how to scale up the business and make it the multibillion dollar enterprise I think these are all the strategic discussions and initiatives wherein if you have someone as a partner of the caliber of the KKR and as IFCW you look forward to. We had a choice of getting capital from five or six but then we wanted two very different set of players one KKR from the private equity side and other IFCW which is more from corporate governance overall risk standpoint.

Santosh Kamat And the second question was on your funding over the last so many years you have been predominantly funded by banks and securitization with very limited exposure on capital market players like us now with you stopping the securitization part of it most of the funding is predominated by bank funding. Now you mentioned all the risks and there are negativity because of the base rates coming up and immediately back and the base rate goes up and so on, so over a period of time do you see your funding now getting more diversified and you're looking at capital market players like mutual funds and insurance and so far?

Sanjay Chamria You absolutely right Santosh, in fact I was planning to seek a meeting with you over the next few weeks whenever I am next in Mumbai and me and Lakshmi, our CFO, we have actually decided to open several fronts which includes insurance companies particularly the life insurance companies which can also take longer term exposure and the mutual funds like yourself, we also take up to shorter one year exposures and provident fund and the pension fund because now with the expansion of our net worth but our own funds getting in the range of close to 2000 crores we are now eligible for investment by a number of these mutual funds, life insurance companies, provident fund, and the pension fund which eager to these are not tapping and also there was not much of a need but now that you want to retain everything on our balance sheet we would look at more sophisticated debt management within the company.

Santosh Kamat Thank you.

Moderator Thank you. The next question is from Venkat Rajesh from Premji Investment. Please go ahead.

Venkat Rajesh Just wanted to check what is the one-year borrowing rate from the banks currently available for you on your working capital borrowings?

Sanjay Chamria Venkat today we find the one-year rate would be in the range of 9.75 to 10% or so but then it depends from bank-to-bank and depending on the days of the week that you want to borrow but this is a range in which it will go.

Venkat Rajesh And my second question is on your securitization book just wanted to check whether any intent from any of the bankers who actually buy any part of the securitize book and which your intent that you didn't want to securitize any asset during this quarter or there was no demand from the banking sector as such to buy any securitized portfolio?

Sanjay Chamria The reason for the appetite of banks to buy the loan book is twofold, one is the credit growth has been sluggish Venkat and therefore it becomes easy for a bank which wants to have a good growth in their loan book to acquire it through the securitization route and second the clarification which has now come in July first week on the PSL benefit the appetite will be even greater amongst the banks those who want to fulfill the PSL norms which is about 40% for the domestic banks and 32% for the foreign banks. So therefore for last several years that also has been one of the major drivers as to why they've would want to buy the book and we of course have been approached because we have been one of the most significant players but then we did put out our message that right now we are not keen and we don't want to sell our portfolio because we have enough funds with us.

Venkat Rajesh That's it from my side. Thank you.

Moderator Thank you. The next question is from Hiren Dasani from Goldman Sachs Assets Management. Please go ahead.

Hiren Dasani Just one clarification on this amortizing the origination related expenditure over the life of the asset. Now earlier you must be booking upfront the entire expense from the origination irrespective of whether the origination has securitized or not?

Sanjay Chamria Yeah that's right Hiren.

Hiren Dasani In that sense are not you moving from more conservative policy to slightly more aggressive policy because you are not obviously doing entirely 100% securitization of the entire origination. But now you are deferring the amortization over the life for the entire originations.

Sanjay Chamria Yeah you are right so therefore we at the beginning of the year we had took a call we wanted to align with the IFRS principles, we wanted to stop the sell of our portfolio and we said that if at all we undertake any further sell or securitization in future then we are not going to also have an upfront recognition of gain on securitization because these are various questions that have come up and different players follows different norms. Even today as we talk there are different set of players who have different accounting norms. So then we consulted with the top notch accounting and audit firms and we were advised that today if you take a stand and want to go ahead in life then the best way would be to draw a line and look to the future and when the Indian GAAP Accounting Standard 30 gets applicable or you need to become the IFRS compliant and then this is how it should be and accordingly we at a board level took a call that one we will not be doing as a strategy sell of portfolio, two if we do it in a limited sell if at all we will not recognize the income upfront and on the other hand then we will also amortize the origination cost on the expense side and the subvention and discount on the income side also over the tenure of the contract to make it completely aligned.

Hiren Dasani The other thing is on the write-off policy you said that you write-off the entire overdues or entire principle on 180 DPD?

Sanjay Chamria Lets take an example if there as a loan contract having a loan amount of 10 lakhs of which 1 lakhs is the overdue and 9 lakhs is the balance principle outstanding which will fall due over the next 30 or 35 un-expired months then in the contract process 180 days we write-off entire 1 lakhs plus entire 9 lakhs so entire 10 lakhs is written-off.

Hiren Dasani The confusion was with the…..

Sanjay Chamria That is why I gave a very simple example that we remove the entire contract and write it off in the revenue. But that policy we are not changing Hiren so we will continue to follow that policy because we believe it puts good enough pressure in the system to maintain the asset quality at the AAA level.

Hiren Dasani But do you recognize it on the 90 DPD or on 180 DPD?

Sanjay Chamria 180 DPD because that's what the guidelines says but instead of recognizing it as a NPA and then making an accelerated provisioning, we do a complete write-off a surgical treatment in the books of accounts.

Hiren Dasani In that case logically there should be nil NPA in your portfolio?

Sanjay Chamria You are right absolutely we are zero NPA both at a gross level as well as at net level, it is zero we have no NPAs.

Hiren Dasani Thanks a lot.

Moderator Thank you. The next question is from Jigar Valia from OHM. Please go ahead.

Jigar Valia Sir my question is on your borrowing profile if you look at our assets most of it are fixed rate assets but if you look into our borrowing profile then we have a very significant working capital which is over 50% or even more and even the other loans probably which can be re-priced at some intervals. So any specific reason for why this fixed-floating ALM mismatch?

V L Narasimhan Sanjay mentioned sometime back in terms of we now having enough flow on and building up tier II as well and when taking a whole look at the borrowing side we are quite clear that going forward there are several instruments which we would be considering as being appropriate keeping in view the tenure mismatch as well.

Jigar Valia Absolutely defer insurance companies and mutual funds.

V L Narasimhan So as of now we were definitely following a funding model where we pick, park, and then sell that's the process we were following. So going forward definitely one is looking at an appropriate mix in terms of time, tenure, and the risk.

Jigar Valia Also the term loan would be largely banks, even while funding from largely depending on banks could be more on term loan rather than a working capital dependent?

V L Narasimhan You are right.

Jigar Valia I believe that for the broken period interest we follow cash basis of accounting and now we will take it on our books only on the first installment. I just wanted to know that remains as it is while there have been a lot of other accounting policy changes.

V L Narasimhan The accounting is completely done on accrual basis so that practice is quite uniform and that we have been following for quite a while now; there is no change in that one accrual is what we account for it.

Jigar Valia One more question is in terms of the securitized book, if you can throw some light in terms of how does it rundown or duration for that?

V L Narasimhan I would not have an off hand in terms of what is the run off is going to happen each year but what we are clear is we are not going to do anything more during this year other than as a treasury tool as Sanjay just now mentioned. So you could drop a query in terms of what are going to be run-offs in terms of the securitization book and will try to get on along with that.

Jigar Valia And sir my last question is that whatever the money that we, since we allotted the shares only on 30th June the money that we received share on book 440 crores that can be used to pay off some debt in the short-term and that benefit should now flow in from Q2 onwards?

V L Narasimhan Yes it should flow in completely from Q2 onwards.

Jigar Valia Thanks a lot sir.

Moderator Thank you. The next question is from Rahul Bhangadia from Lucky Securities. Please go ahead.

Rahul Bhangadia You had roughly 1000 crores of cash on the books as of March, how much of that was against the coal lateral for the securitized book?

V L Narasimhan Close to about 450 to 500 crores is what was we earmarked for the securitized book.

Rahul Bhangadia And that 450 to 500 crores was for what quantum of securitized book and what is the size of securitized book as of now or as of March?

V L Narasimhan 5015 was what it is securitized book as of March.

Rahul Bhangadia So roughly 10% is what you have had put up as collateral?

V L Narasimhan I am sure you realize that there are no run downs on the cash collateral that you give. And our collaterals have reduced from 6.5% to 7% range about three years back to close to about 3% during the last financial year.

Rahul Bhangadia And just one small question I missed it in the earlier part. You say your capital adequacy is around 21%?

V L Narasimhan 21.8.

Rahul Bhangadia So 21.8 out of this how much is Tier-I, Tier-II could just segregate?

V L Narasimhan Tier-I is 16.4 and Tier-II is 5.4 is the remaining.

Rahul Bhangadia Thank you so much.

Moderator Thank you. The next question is from Rakesh Kumar from Dolat Capital. Please go ahead.

Rakesh Kumar Just one question on the business strategy what you have, as you said that you would not go for securitization henceforth or if you go it would be a very small amount and because of that you will have capital constraint. My only argument here is that if you have this kind of a strategy then actually you will need capital after every two years or two and half years or maybe three years, so basically this is not a self sustenance process what you're trying to get into so there is a continuous equity dilution you will have because of that so just to continue with the business, what is your feel on that?

Sanjay Chamria Just one you briefly repeat your question I didn't get it.

Rakesh Kumar My question is that since henceforth you would not be going for securitization and whatever capital adequacy Tier-I you have 16% close to that and looking at the growth what you are looking for going forward you would require capital after every next two years. So basically to continue business you will go for equity dilution after every two years. So this is not the kind of self sustenance business model because you will be diluting the current shareholders after every two years, what is your feel on that?

Sanjay Chamria But why is it now the self sustaining model I don’t understand because if you look at different players in the industry both the banking player as well as nonbanking players if you're growing your balance sheet which is in excess of your return on equity and return on equity lets assume if it is 20% so if you grow your balance sheet in excess of 20% obviously it will call for dilution. So now the question that one needs to ask whether you want to sacrifice growth or you want to sacrifice dilution. So that would be an individual company or the bank specific decision that one needs to take. We would rather pursue growth over the next several years as we see a lot of opportunities and if we are able to improve our return on equity further then the dilution will be lesser and it will also give us a good exit to the existing stakeholders.

Rakesh Kumar Only thing is that the banks are not growing at the pace what NBFCs are in particular you are trying to grow? When you are trying to grow at very fast pace and your risk weighted asset is growing at much faster pace then actually your Tier-I will come down and so to maintain that Tier-I capital mandatory you will have to go for the dilution.

Sanjay Chamria Yeah this might happen I don't dispute that and as you rightly said Tier-I so we also have the option under the RBI guidelines to grow the Tier-II which could be 100% of Tier-I and thereby further defer the dilution. So it’s a little complex scenario if you have a ROE plus you have a Tier-II now the net addition of these two if you're asset growth further outstrip that then you need to do a dilution and then any management would be happy to go for a dilution if they are still able to grow faster than that and our endeavor would be to achieve that.

Rakesh Kumar Thanks a lot.

Moderator Thank you. Ladies and gentlemen that was the last question. I would now like to hand over the floor back to Mr. Vishal Purohit for closing comments.

Vishal Purohit On behalf of IDFC I thank the management Mr. Chamria and Mr. Lakshmi for giving us this opportunity to host the call and thank you all the investors and the brokers for making themselves available for the call and finally the vendor, Chorus Call for hosting the call. Thanks everyone and have a good day.

Sanjay Chamria Thank you.

Moderator Thank you. On behalf of IDFC securities Ltd that concludes this conference call. Thank you for joining us and you may now disconnect your lines.