“Magma Fincorp Limited Q1 FY13 Earnings Conference Call”

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Moderator Ladies and gentlemen, good day and welcome to the Q1 FY13 earnings conference call of Magma Fincorp Limited hosted by IDFC Securities Ltd. As a reminder for the duration of this conference, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need any assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. At this time I would like to hand the conference over to Ms. Sarita Shetty of IDFC Securities. Thank you and over to you Ms. Shetty.

Sarita Shetty Thank you Vibha. Good morning everyone and thank you for joining us on the Magma Fincorp Limited Q1 FY 13 results conference call. I have with us Mr. Sanjay Chamria – Vice Chairman and Managing Director, Mr. Lakshmi Narasimhan – CFO and Mr. Kailash Baheti- the Chief Strategy Officer of Magma Fincorp to talk about the company's performance and important events during the quarter ended 30th June 2012. We will begin the call with opening remarks by Mr. Chamria followed by question and answer session. I would like to invite Mr. Chamria to make his opening remarks now. Over to you sir.

Sanjay Chamria Thank you and good morning to all of you and I thank each one of you for joining us on the Magma's quarterly conference call for the results for the 1st Quarter of FY 13. I will first share my views on the key highlights of the economy, the financial sector and then discuss the performance of the companies for the quarter in detail.

During the last quarter India GDP growth rate clocked 5.3% which is the lowest in the last nine years. The full year's GDP growth at 6.5%, it is almost 2 percentage points lower than 8.4% clocked in FY11. The government expects the estimate for FY 13 at 7.3% which is slightly better than 6.5% of last year's even though most economists project an estimated GDP growth of less than 7% for this year.

The Q1 industry statistics continue to reflect a muted growth scenario. The sales growth rate of automobiles and equipments as well as tractors remained quite subdued and they are expected to remain so for at least the next couple of quarters. During the last quarter primary sale of cars and MUVs recorded a growth rate of 9.7% and Commercial Vehicles recorded a growth of 6.1%. Within commercial vehicles the medium and heavy vehicles had a 12% de-growth while the small commercial vehicles and the LCVs put together recorded a robust 20% growth. The tractor sales have remained flat in the range of 0 to 2% growth over last year.

On the regulatory front as has been the trend during the past year or two there has been intense activity in the last quarter. The RBI has issued guidelines on securitization (although it is applicable for banks) and Gold loans. Hopefully now that the uncertainty surrounding over securitization has subsided, it is positive for the sector. We also hope to see the final guidelines on the priority sector from RBI, which is expected to be in line with the Nair committee reports submitted in January 2012. With that it should provide us stable regulatory environment for the sector and pave the way for medium to long-term strategic planning by the individual players.

Now for some Magma specific items while most of what I'm going to inform you will have already been accessed by you from our investor's presentation which has been put up on the site late night. For those of you who have yet to access the same it may be helpful. This might be overall challenging environment; we had a 45% Y-o-Y growth in disbursals up from Rs. 1422 crores in the 1st Quarter last year to Rs. 2057 crores in the 1st Quarter this year. We have demonstrated a faster growth than the market in all the product segments thereby capturing higher market share across the board. The disbursal in the car segment grew by 51% and we have a market share of 3.3% in the car segment. Even in the commercial vehicle segment which has seen a very sluggish growth in the last quarter, we have increased our disbursal by 9% with a market share of 2.5%. The disbursal in tractors grew by 85% and now we command a market share of 7%. In construction equipment, the disbursals grew by 40%, In used commercial vehicle (Suvidha) the disbursals grew by 100% and in SME, the disbursals grew by 73%. The overall growth trajectory have resulted in a gross spreads of 7.6% up from 6.1% for FY12. The total loan book has also grown from 12,036 crores as on March 2012 to Rs 12,728 crores as on June 2012. However the earnings assets grown by 96% from the 1st Quarter of last year and now account for 86% of the total loan assets. The corresponding figure was 57% in the last year's June quarter. This is the outcome of the change in the business model and the accounting policy and it has provided a stable and healthy growth in our income quarter-on-quarter. Collection efficiency for the quarter is at 98.3% while net write-offs have increased from 0.2% last year to 0.35% in the 1st Quarter of this year, in line with our estimate.

On the income generation front our income from operations have increased by 54% from 212 crores in the 1st Quarter last year to Rs 325 crores in the 1st Quarter this year while the overall revenues have gone up by 59% from 220 crores to 352 crores in the 1st Quarter. Likewise the finance costs have also gone up by 53% from 121 crores to 185 crores in the 1st Quarter. Total expenses including finance cost have gone up by 55% from 196 crores to 303 crores in the 1st Quarter. PBT has gone up by 91% from 25 crores to 49 crores and PAT has gone up by 93% from 17 crores to 33 crores. As on June 2012 our capital adequacy is at 17.8% and Tier 1 CAR is at 12.3%.

Just to give a brief update on the new business initiatives; we have already launched gold business on 1st June 2012. We have also capitalized our general insurance JV with a view to commence business effective October this year and we have also applied to NHB seeking registration of our housing finance subsidiaries.

On the business front and we expect a mild recovery in the overall sentiments, both in the economy and the vehicle financing market from October onwards over the next one-year. However during the July to September quarter we expect primary sale of vehicles and equipments to remain muted on account of monsoons and lack of government impetus to push the economic growth. We also expect policy rates to come down only gradually as the economy comes back on track and inflationary pressures reduce. Nevertheless we at Magma believe that we will continue to outperform the market and maintain growth rates significantly higher than the overall industry. We have unleashed a number of sales and marketing initiatives over the last 15 months to improve our distribution reach, provide superior service levels to the channels, improve productivity, engage aggressively with the channels etc and all of these measures are expected to fuel our growth in the market share going forward. We have expanded distribution network by adding seven new branches in the last quarter and now we have 207 operational branches across the country. We have also added around 260 people in the sales teams and now we have over 1800 dedicated sales people across the country. We are ready to take a larger pie of the market and will be able to demonstrate a rate of growth in our business similar to what we have seen in this quarter to our stake holders going forward. We will continue to pursue our strategy of using the stringent credit risk evaluation parameters to maintain a robust portfolio quality. Now Lakshmi, Kailash and me would be happy to take any questions that you all may have. Thank you.

Moderator Thank you very much sir. Ladies and gentlemen we will now begin with the question and answer session.Our first question is from Santosh Kamath from Franklin Templeton, please go ahead.

Santosh Kamath Hi Sanjay and team good morning. I have only one question if you can just look at the slide number 10, couple of question on that slide. Your overheads to assets looks to be increasing from 4.2 to 4.7, I have to assume that your cost to income ratio should be coming down if your assets are building up so can you explain that 4.2 to 4.7 jump on the overheads to asset.

Sanjay Chamria **Can you pl** tell me the other question Santosh you have on the slide as you said you have couple of questions.

Santosh Kamath The second question was on the interest expense side so when you put an interest expense to assets that 8.4 looks to be quite low as compared to what bank base rates are so are these monthly figures or are they IRR terms can you again explain a bit on that one?

Sanjay Chamria In terms of the interest expense in the total income, we have aligned the reporting in line with what the other players have been doing. Till last year we used to report gross yields on the incremental disbursals and the cost of fund on the incremental borrowing for the quarter or for the year and that is how we used to show our NIM. But then on deference to the request from the investing community we are showing the total income for the quarter divided by the total asset as gross yields which is at 16% for the quarter. Similarly all outgoings on account of interest as a percentage of the total assets is shown. So the equity which has been also deployed towards the asset building has no interest cost and that is why this cost would appear lower.

Santosh Kamath But Sanjay even if you include that at 8.4 to 9.4 or 9.5 that also looks to be much lower than the bank base rates, right?

Sanjay Chamria No actually it would be higher, if you just calculate the cost of funds on the borrowings then it would be more than 10.5% because you are right the base rates for most banks is in the range of 10.75 to 11 and therefore the cost of funds would not be much lower than that. However what happens now that we have changed our accounting policy on securitization and therefore whatever securitization that we did last year the income would accrue over this year and over the next 2-3 years as well and therein the cost is lower and therefore to that extent it will bring down our cost of funds.

Santosh Kamath And overheads to assets it should be decreasing in a increasing AUM basis, right?

Sanjay Chamria So you are right. Overheads as a percentage of the assets should go down but we have been building up the infrastructure both in terms of opening of new branches as well in addition of the people. So in terms of the primary growth which has been between 2% to 9% we have grown at 45%. So usually we have seen that all this infrastructure building that you do the branches it all becomes viable and break even in about 18 months time. So while we take some pain in terms of a little higher overhead over a period of next 12 to 18 months it will give us more benefits. The second reason is because we have changed the accounting policy last year on the treatment of securitization income and the brokerage and commission expenses that we pay to the DSA for sourcing of business, we have started amortizing the DSA expenses. So the percentage is somewhat little higher compared to the number for Q1 FY12.

Santosh Kamath But last one, I think we have been talking on this very often on the product mix front. Do you have any soft caps on your tractor and Used CV of how much of their portfolio on overall basis could be in a high yielding set of tractors and Used CVs?

Sanjay Chamria When we started this business in FY08 and that's when we said we're not going to grow it in a hurry because these are all new activities for us, used CV or tractors or SME, and I have been consistently saying that we would like to complete one business cycle to see what are the learnings and once we are satisfied then only we will take a future vision. So now actually speaking we have completed more than one business cycle in all these products and therefore now we treat all of them as core products whereas there is no differentiation between the core product and the high yielding which is how we used to do until about a year ago. There is no cap per se and we would like to pursue our growth strategy in each of the six products lines depending upon the competition and the credit quality that we would get in each of these products.

Moderator Thank you very much. A next question is from Vikrant Khadilkar from JP Morgan. Please go ahead.

Ravi Sanjay hi Ravi here form JP Morgan Mutual Fund. My question is on slide number 15, capital market sources and mutual funds have increased from 21% to 32% so what is the average maturity on these debt instruments?

Lakshmi Narasimhan Is that the only question you have?

Ravi No I have one more question on the growth.

Lakshmi Narasimhan Let me finish this first then you can get on to the growth. In terms of maturities typically we have been borrowing in the region of about 3 to 5 years from the capital market. There are some at 3 and some at 5 so overall it covers the asset tenure of about 41 months. If you look at the weighted assets tenure from my book on one of those slides in the PPT which lists out product wise LTVs and product wise ticket sizes, you will see a weighted tenure of about 41 months. So the borrowing from the capital market would virtually kind of match up with that tenure of us on a weighted basis.

Ravi On the ALM side is the company having any mismatch or for example at the shorter end of the ALM is higher than the longer end or it is broadly balanced?

Lakshmi Narasimhan It is broadly balanced if you look at it from the perspective that about 30% of our borrowing would be coming in from the working capital line that we have with the bank and having a relationship for about 23-25 years now with different banks we match the borrowing from the working capital lines to the tenure of the assets. So from that perspective we will have positive matching terms of ALMs on the tenure.

Sanjay Chamria If I may add to what Lakshmi has said we have a bias in terms of an ALM mismatch and that is from a conservative standpoint. So if you look at the 0 to 1 year or greater than 1 year and after 3 years or more than 3 years in each of these buckets we have a positive bias in the ALM.

Ravi Okay. My second question is on growth, compared to last year the company has grown by 45% the asset book but looking at the current environment where GDP growth is around 6.5 to 7% is company taking incremental risk to take achieve this aggressive growth or in what kind of strengths the company is taking to ensure that the credit quality is not sacrificed?

Sanjay Chamria The way we operate is that , we have independent verticals which is a very alien concept in the NBFC but very common in case of the private bank which is the sales vertical, the under writing verticals and the collection verticals all operate as independent silos and the underwriting verticals is not measured on a disbursal growth that gets measured on the asset quality whereas the sales vertical is measured on the growth and the disbursal and the yields that they would earn. So therefore the growth that we are getting is by virtue of building the centers of excellence in each of the vertical. If you look at the performance over the last 13 quarters including this quarter we have created a clear benchmark in terms of collections in the industry. So we definitely look at risk adjusted return and if you go to slide 10 that talks about our gross spread at 7.6% and risk adjusted it is 6.9% which is up also from 5.7% for last year. So we would like to maintain the asset quality and then grow, not grow at the cost of the asset quality.

Ravi And last question from my side, what is the average cost of fund because this is on total income, interest expense by assets is 8.4 but if I were just look at the borrowing in there has the cost of fund, what is the cost of fund?

Lakshmi narasimhan If you look at what we are picking up during Q1, then it is between 10.7 in 10.9%.

Moderator Thank you very much. A next question is from Ritesh Nambiar of UTI Mutual Fund. Please go ahead.

Ritesh Nambiar Just wanted clarity on this write-off which has actually shot up this quarter and why you have actually discontinued showing all this infant delinquency and early delinquency slides you used to show.

Sanjay Chamria The write-off has gone up in this quarter and largely it is in respect of tractors and commercial vehicles followed by the other products like construction equipment and car in that order. Our total write-offs for last year was 0.2% and this has gone up to 0.35% for the 1st Quarter in this year. However the 1st Quarter the write-offs would usually be higher and then it tapers down like in the last quarter of the year you have a greater degree of recovery. So this is what we are showing and we are also showing the collection efficiency. We do have the numbers on the ED and the ID but then we have not shown it for the last 2 qtrs. As I said in response to the earlier question by Mr. Santosh, we are aligning our presentation in line with the industry norms so that there are common data points enabling the investor community to understand the results better.

Ritesh Nambiar One thing I wanted to know in fact seeing the earning asset percentage which has actually drastically gone up. But based on profitability I couldn’t see such kind of drives, why is that? Actually June 11 it is not there in the presentation I suppose its around the earning asset would be very low I suppose somewhere near 50s?

Sanjay Chamria I think I have shared that in my initial talk that 57% of the total loan book was income earnings as on June 2011 as opposed to 86% in June 2012 and since you are tracking the stock for certain time, you will recollect in our earlier call also we have said that because we have changed the policy, we took a hit in our P&L and for six quarters we will have this issue. Now only one more quarter left, which is July to September, and gradually we see that the percentage of the income earning assets will be going up and we estimate that by March 2013, 96% of our total loan book will be income earning and therefore the total income to the assets will keep growing.

Ritesh Nambiar As of March.

Lakshmi n Sorry just to that slide 9 has the figure for June 11 earning assets.

Ritesh Nambiar One thing I wanted to know as of March 12 your net deferred income was somewhere around 115 crores on the consol level so how much is that currently?

Sanjay Chamria Deferred income as in?

Ritesh Nambiar The securitization deferred income which you had.

Sanjay Chamria That would have gone down because in the 1st Quarter we have not done any fresh securitization so to that extent the income that would have accrued in the 1st Quarter of this year out of that Rs 115 crores would have gone down.

Ritesh Nambiar How much is that?

Sanjay Chamria I believe Rs 29 crores is what has been credited in the P&L on account of the amortization so 115 minus 29 about Rs 87 crores would still be there to be accounted for in future.

Ritesh Nambiar Because where I am coming into is that if you remove this 29 odd crores which was not there in June 11 and the one-off market entry fees on the profitability side how is the performance been?

Sanjay Chamria Well I disagree with your concept that you remove this 29 because this is what we used to have earlier and last five quarters we did not have this income and now it is comparable with the 1st Quarter of last year so how do you remove that I don't understand that concept.

Ritesh Nambiar What was that figure last year same quarter?

Sanjay Chamria We did not have because that's when we changed the accounting policy and last year if you remember we did say that we have not sold anything, just like this quarter we did not sell anything. So till Marsh 2011 we used to recognize the income upfront and therefore we did not have any opening balance of the unamortized income. so therefore in the 1st Quarter of last year there was no income.

Moderator Thank you very much. A next question is from Pankaj Agarwal of Ambit Capital. Please go ahead.

Pankaj Agarwal Sir can you throw some more light on asset quality, there has been a sharp jump in your write-offs so to what you would attribute this to jump?

Sanjay Chamria As I said Pankaj that the jump product wise if I look at then it is in tractors followed by commercial vehicle and then in the other products it is there and while the jump is sharp because till last year we had the lowest ever percentages but still if you look at 35 basis points it is the lowest in the industry and in terms of the collection efficiency as we have shared that 98.3% is what we have achieved and we are targeting this particular year because three years we did 100% so this year we are targeting about 99% plus because we know that we cannot have because all the earlier older debt which was there have dried up in the higher bucket portfolio. So therefore this year we are looking at about 99% and we don't see any alarm bells in the asset quality per se as of now. Just that the percentage of customer who were sitting in the zero bucket that was actually about 88% as of 31st March is now 86.5% as of 30th June. However the 1.5% customers who have moved from current to the non-current bucket are lying in the 1 to 60 bucket. So our interaction with our collections vertical and our underwriting vertical suggests that the customers do have a cash flow issue because they are not getting paid back in time from the business where they have deployed the asset. However once they migrate to the higher bucket then they are paying just about one installment. So they are not able to come back to zero and as a result of that zero bucket is gone down but my 90 plus bucket hasn't gone up. So those customers are sitting in to 1 to 30 or 31 to 60 and my own view will be that 2nd Quarter usually would also remain like that and it is only from of October with the onset of the festival season and the rains stop that's when the cash flows improve and maybe we will be able to roll back these customers back into the current bucket.

Pankaj Agarwal Increase in credit cost is broad-based or related to certain pockets of the country?

Sanjay Chamria Geographically it is not that a particular state for region is showing up a higher delinquency. But product wise as I said it is concentrated more in the two products and less in the other products.

Pankaj Agarwal Going forward as a percentage of AUM do you think you would be able to maintain this ratio or it could go further up from here?

Sanjay Chamria It is very difficult to gaze and crystal ball and say but since we have now got attuned and habituated to having such high level of credit quality that we don't want to lower our guards and therefore we would want to arrest that trend and hopefully bring it back to last year.

Pankaj Agarwal Finally in terms of assignments, now post new securitization guidelines have you been able to do any assignments transaction?

Sanjay Chamria See, as we shared Pankaj last year that now securitization or bilateral assignments we would want to use it more as a treasury tool and the new guidelines which have come in the month of May, like last year or even earlier in the 1st Quarter you hardly do any deals and like last year also till say two quarters we did not do any deals. So this year also we have not done any deals, we will probably scan the market when we find the time is right and also I think banks do take certain time to diagnose the guidelines, seek certain clarifications from the regulator in terms of what kind of deals will they be able to do under the new guidelines. I think it should happen sometime in this quarter or maybe in the 3rd Quarter.

Pankaj Agarwal But under the new guidelines do you think assignments are possible or you will have two more to the PTC route?

Sanjay Chamria I think we will rather wait for the bankers' response on this because these guidelines are applicable for the bank. The way we study and the expert advice we have received it is possible to do the assignment transactions but I think banks will be quite selective in terms of the entities with whom they do the bilateral assignment deals because there is no credit enhancement that is now permitted under the assignment deals and, therefore, to that extent the credit risk is passed on to the bank who will acquire the portfolio and that they cannot do in general with any player and every player. So to that extent maybe given the best asset quality that Magma enjoys in the industry it may give some competitive advantage to Magma.

Pankaj Agarwal Finally in terms of your AUM is growing really fast but your ROEs are in single digits, so do you think you might need capital by the end of the year to maintain your growth?

Sanjay Chamria One, our ROE has now touched the double-digit if you look at one of the slides. It is now actually around 10% in the Quarter 1. And secondly, I think we sit at about 17.8% capital adequacy and we have not done any securitization or assignment. So depending upon what kind of a growth do we achieve and what deals do we do, based on that plus this Tier-2 capital that we have not traced in a while, so I think during this year the kind of growth that we are maintaining and we do not need to raise capital.

Pankaj Agarwal I was saying because as you are doing less securitization going forward, there would be more own balance sheet assets going forward as a percentage of AUM, so because of that your risk weighted assets might be higher than …. So let us say even if there is a 25% growth in your assets, risk weighted assets might grow higher than that because of that probably the Tier-1 might come down if you do not do securitization going forward.

Sanjay Chamria Yes, it may come down and then we will evaluate accordingly because our earning book loan assets have grown up 96% compared to last year same quarter and this year also it will be growing compared on a sequential basis. So we will evaluate the position maybe in about 2-3 quarters as to how it is going and do we need to offload some assets because as we have maintained very consistently that it will be a treasury pull that we will be looking at securitization or assignment transactions.

Moderator Thank you very much. Our next question is from Shekhar Singh of Excelsior. Please go ahead.

Shekhar Singh I wanted to know this other income, what does it comprise of and this market entry piece, what does that mean?

Sanjay Chamria The other income has two components, one is like we have the windmills which we have installed some 4-5 years ago which is about 18 megawatts, so we have a sale of power. Then we have interest on trade advances that we gave to the dealers and the channel partners for giving us the…... Then in addition to this particular quarter we also had an income on account of fructification of our joint venture on general insurance with the German partner wherein as a part of the joint venture agreement when the capitalization of the JV company was to happen, Magma was to get a goodwill/allowing an access to the Indian market from the German partner and that money we received. So these are the three components in the other income.

Shekhar Singh So does it mean in the coming quarters we will basically find it difficult to sustain this level of other income?

Sanjay Chamria Obviously except for this goodwill and access to the local market income that we have received from the insurance partner, that obviously will not come through because it is non-recurring in nature whereas the other income is recurring in nature and it has been accruing over the last several years and that should continue in the normal course of the business with the growth of like 45% we had in the 1st Quarter, like last year we grew 36%. So with whatever kind of growth that we will get, we will get the other income from that point of view.

Shekhar Singh And how much was this income which you got from your German partner?

Sanjay Chamria This is about 13.95 crores.

Shekhar Singh One other observation like your finance cost on a Q-on-Q basis has hardly grown whereas your quarter-on-quarter revenue from operations has grown almost like 7% to 8%. So why is that? Because the interest environment was more or less same as the previous quarter, so your finance cost should have also gone up.

Sanjay Chamria As I explained to the earlier question that the securitization that we did until last year, that was in March 2011 we had no carry-over of the unamortized income. But from last year we changed the accounting policy. So as a result of that and we have taken a hit in our profit but now we are close to about 150 crores when we started the year on account of the unamortized income, so every quarter we will have 20-30 crores of income in which there is no finance cost. So, therefore you will find going forward that, that kind of an income accrual will be there because that is the net income which is the gross income minus the securitization expenses, the net income which is what will accrue. So that will continue to accrue on a quarterly basis.

Shekhar Singh Basically now as an analyst we should be tracking what is the addition to that unamortized income because that will give an indication of the sustainability of that 20-25 crores per quarter as a revenue generation.

Sanjay Chamria It could go up or go down because what happens we do not sort of securitize throughout the year and an uniform amount. If you securitize throughout the year and an uniform amount then it may remain like that, and not only us I think every player you will find that there is a skew in terms of securitization which usually happens in the second half of the year and more so in the last quarter of the year. So therefore you will always see that there is a bulge in the unamortized income towards the second half and the last quarter of the year and during the first two quarters of the year while you will have the accruals but then the unamortized portion will go down. So this is how the industry operates.

Shekhar Singh Lastly in terms of this write-off which has gone up to 0.35%, now what is the expectation going forward, is it going to increase from these levels or is it going to come down or how is it?

Sanjay Chamria Like as I shared, we achieved a write-off of about 20 basis points last year and which in the Quarter 1 is 35 basis point. Our experience over the last few years suggest that the 1st Quarter write-off usually is higher and then from the 3rd Quarter you start having a better recovery and 4th Quarter is usually the best and therefore the kind of losses that you have it tapers off in the 4th Quarter. So going by that and the growth in the AUM that we are witnessing my view is that it should kind of go down but then how much it will go down I cannot really predict. And also the customer mix and product mix that we are having we also budget for based on individual product and customer mix as to what kind of a write-off we will encounter. Like Mr. Kamath was asking first time in terms of what is my view on the used vehicles and on the tractor where we are on a higher yield. So we also budget for a slightly higher percentage of losses. When we look at the risk adjusted return as long as that is positive compared to the earlier quarter we are fine with this but yes, we would want to still contain the losses to the last year irrespective of favorable mix in favor of tractor and SME and the used vehicle.

Moderator Thank you. Our next question is from Rahul Vekaria of Axis Mutual Fund. Please go ahead.

Rahul Vekaria Just one thing, how do you see this gold loan business shaping in the product mix that you are having now in a year? Do we have an exposure as of June end?

Sanjay Chamria So actually we have just launched it last month and as per our policy we usually take time to get into the higher gear in terms of a growth rate product till the time we understand. While our initial estimates and based on the industry experience that gold loan usually does not have any kind of a write-off because of the excessive collateralization that one enjoys, and also now the regulatory position of a 60% LTV further improves the asset cover. So, therefore, whatever 50 or 40 basis point losses that the traditional players have been encountering even that should go down even further. So but then this business is where you have uncharacteristically low tenure and the ticket size is lower, therefore, the operating expenses are higher as the gross yields are also much higher despite the highly secured nature of the business. But I think what we will do is we will have a cautious approach in at least the first couple of years to see how it is contributing in terms of the bottom-line. We are worried, as I said, not on the credit losses front but on the OPEX front and depending upon how the business shapes up and how we are able to get traction with our existing branches from the customers I think we will take a call and then grow. So in my view this year and the next fiscal, that is FY13 and FY14, I do not expect a significant contribution coming in from the gold in our overall AUM.

Rahul Vekaria We are also starting the housing finance. When would we be getting into that sector of growth?

Sanjay Chamria We have already floated the company as a 100% subsidiary and we have filed our application with the NHB and we have also appointed the MD and CEO for the company and we are likely to start this business in the 3rd Quarter which is October to December sometimes as we are in the process of building up a technology platform for the mortgage business and we will also like we practiced with the other players, we want to undertake two products in this, one is the home loan which is for the individual home buyers and second is the LAP which is given to the SMEs against the collateral security of an office or residence of the promoter. Now since we already have a SME franchise so we will kind of expand the product offering. So we are making changes in our technology platform and we are also in the process of building up…there are two teams that we are building up here, one is the sales team and the other is the legal and the technical team, rest every other team will be common and which will help us to spread our OPEX over our one more product and whereby bring it down. So this is what my answer on the housing finance would be.

Rahul Vekaria We have had a lot of discussion on asset quality and all that but calculation front when I say 0.35 percentage is my write-off, on what is this percentage basically if I say 0.35 of what amount?

Sanjay Chamria 0.35 is on the total AUM, (Assets under Management).

Rahul Vekaria That is 12,730 crores?

Sanjay Chamria Let Lakshmi explain this.

Lakshmi Narasimhan This is 13,750 crores. 12,730 what you are seeing is the loan assets. We have other cash collateral, etc., given to the banks for the securitization that we would have done. So all the assets included is what is Assets under Management. So this 0.35 is a function of 13,750 crores.

Rahul Vekaria That comes to 48 crores. So why are we seeing 11.7 crores?

Sanjay Chamria What you are seeing is an annualized number.

Moderator Thank you very much. Our next question is from Subramanium PS of Sundaram Mutual Fund. Please go ahead.

Subramanium PS Firstly just a few clarifications, I understand that you had zero securitization income in 1st Quarter of last year, is that right?

Sanjay Chamria Yes.

Subramanium PS And what would have been the securitization income you have booked during the quarter?

Sanjay Chamria I think we had 29 crores.

Subramanium PS Secondly on the other expenditure front, other OPEX, there has been a sharp jump from 14 crores to 24 crores and also the brokerage commission has gone up in a significant manner from 7 crores to 18 crores. What would you attribute this to?

Sanjay Chamria As I was explaining Mr. Subramanium to the first question that the increase in the brokerage and commission just like the securitization income, both are the outcome of the change in the accounting policy whereas instead of recognizing the income upfront, we said we will recognize it across the tenure of the underlying contract. Similarly the DSA payouts that we give for procuring the business that also we amortized across the tenure of the asset but last year we changed that effective April 2011, so whatever DSA payouts that we gave last year or whatever securitization income that we accrued till last year, now we are getting the impact of that both on the income side and on the expense side and that is why it appears higher than 1st Quarter of last year.

Subramanium PS So is this the run rate that we should likely assume, just something like 0.9% or 1% of the disbursements that you will be recognizing?

Sanjay Chamria I did not follow, can you explain this particular point again?

Subramanium PS Just wanted to understand, what is the typical commission that you would be paying out on your loans, on your disbursements and if we amortize it over a period of three years what percentage it would look like?

Lakshmi n See essentially that figure is going to be a function of the underlying mix of assets that are coming into the books. Say for example, more of car business will result in more of channel expenses because majority of the car business is done through the channel route, so more of tractor coming into the books will have not as much expense getting added because tractor is direct business for us. So basically we have seen this percentage as a function of the business number will be between about 1.1 to 1.3% per annum. Until last year this was just about 0.9 to 1%, that has gone out because the car business is also growing up.

Subramanium PS On another thing which is the market entry fee that you got you said you would be getting this fee for another five quarters or was it another five years.

Sanjay Chamria I think what I explained that other income has three components of which this goodwill and the entry access fee that we got from the JV partner is non-recurring in nature, so that would not accrue again, however, the other two parts of the income which is the sale of power under the windmills as well as the interest on the trade advance to the dealers and the channels that we provide, that will continue to accrue as has been accruing over the last few years.

Subramanium PS What is the nature of this agreement? For instance, what I wanted to understand is currently we do not sell any general insurance is it for the loans that we do?

Sanjay Chamria Yes, currently we do not sell we just provide our infrastructure to the various insurance companies and there we get the infrastructure support services fee and under this joint venture that we have set up Magma Fincorp will become the corporate agent of its own sponsored insurance company. Hopefully we will be able to have a better conversion of the general insurance products that we sell to the customers who we are financing and that will accrue additional commission income on an arm’s length basis from the JV company to Magma.

Subramanium PS Got it. So this infrastructure sharing fee how much would we have recognized for last year?

Sanjay Chamria From the other insurance companies?

Subramanium PS Yes.

Sanjay Chamria I do not remember it right now. If we have it then we will try and give it to you or else we can give it to you offline.

Subramanium PS Okay. And also roughly assuming that you are able to have a 100% kind of a conversion ratio what kind of income do you think would accrue to the JV on this general insurance business?

Sanjay Chamria I wish what you are saying is true because it has not happened for at least about 7 to 8 players in our industry who have like us a joint venture on insurance, however, we have pretty good ratio and of the business that we have been doing so far, so I think we look forward to a good conversion ratio but what actually it will happen and we can only share once we start doing the business. As we said we hope to start operations in October this year for our insurance venture.

Subramanium PS Okay. And what is the stake that we are having in this venture?

Sanjay Chamria Magma holds 37% stake in this company.

Subramanium PS And the other partners would be?

Sanjay Chamria Our foreign partner owns 26% which is maximum permissible under the FDI guidelines and the balance 37% is held by the holding company.

Subramanium PS The holding company would be in what, sir?

Sanjay Chamria Holding company of Magma.

Subramanium PS Got it. So how much more capital would you think you would need to infuse into this business?

Sanjay Chamria This company already has a paid up capital of about 208 crores which is far higher than the minimum mandated 100 crores by the regulator and as per the business plans prepared and approved by the regulator, for the first three years we do not need any more capital beyond 208 crores. And in the first six years of the venture which is after the three years between the fourth year and the sixth year, the total capital would grow to about 300 cores odd, so may be about 92 crores may get added from the fourth year until the sixth and that will be contributed by the three partners in the ratio of their shareholding at that point of time.

Subramanium PS So another 100 crores after three years?

Sanjay Chamria Yes.

Subramanium PS Okay. And also wanted to understand one last thing, the new businesses that you would be getting into, are some of the costs already being reflected for the same in your consolidated financials or they are yet to be reflected in the same? The background behind asking this question is that while we have seen the business growing fast we have not seen the benefit coming down in terms of operating leverage or better profitability. So just wanted to understand why is it that, that is not happening?

Sanjay Chamria I think, one, as a prudent accounting principle whatever cost that have been incurred on the existing business as well as the proposed to be launched business, have all been debited on an accrual basis during the quarter. So if the benefits will flow in future so be it, but the expenses are already debited. And secondly, I disagree with your observation that the benefits have not come in, in fact our growth in the disbursal is 45% but our profits have gone up by 93% and even if you knock out the non-recurring income of the fee that we have received given that the profit growth is higher, and as I said in response to another question that due to the change in the accounting policy that we ushered five quarters ago, it is usually for a period of six quarters that you need to endure the low income and the profitability, so you have one more quarter and from October onwards and we do not have any impact of the change in the accounting policy. So, therefore, the profit growth should be accordingly higher.

Moderator Thank you very much. Our next question is from Venkata Rajesh of Premji Invest. Please go ahead.

Venkata Rajesh I have a couple of questions, both pertaining to asset quality. While the point that you made Q1 typically been higher right now so to that extent the 35 bps versus the 20 bps that we have seen should not be read into fully, but even compared versus Q1 FY12 of 25 bps this is relatively on the higher side, so can we conclude that the sweet spot in terms of asset quality we are parked the sweet spot in terms of asset quality and we have seen the returns though relatively lower versus the history but still elevated in cost or write off cost?

Sanjay Chamria Yes, you are right, in fact the asset quality in the 1st Quarter this year is inferior to the asset quality witnessed in the 1st Quarter of last year and to that extent it is inferior and at the same time as I said that we expect that during the 2nd Quarter it will remain on a status quo basis because you do not really expect a dramatic improvement on account of the monsoon but from October onwards once the festive season begins that is when the cash flows improve in the hands of the customer and then we hope to be able to bring it back and the 4th Quarter is the best quarter usually.

Venkata Rajesh And my second question is specific to the segments that you have mentioned, Tractors and CV. In my understanding both are distinct segments….. If you can explain or elaborate on the same based on the signal where exactly is the sector and in CV I understand that if the cash crunch would EPC contracts which is affecting but specific to tractors if you can explain?

Sanjay Chamria See, initially in case of tractors also you see it is not used exclusively for the farming purposes. Most of the tractors which are sold today are used for mixed applications, which is for the purpose of farming as well as for commercial applications in NREGA projects which are undertaken in the estate in the near vicinity of the territory where the customer is operating. So this slowdown which has impacted a lot all across, the customers who have deployed their assets either are not getting the full deployment of the tractors that they took into the local projects and wherever they did also the cash flows has been little tighter due to the financial tightness by the government department. So these are the reasons which have contributed to the rising delinquencies in the tractor business.

Moderator Thank you very much. Our last question is from Sudhakar Prabhu from Span Capital. Please go ahead.

Sudhakar Prabhu What are your capital commitment for your subsidiary business, the housing finance company for this year and next year?

Sanjay Chamria We have put in ten crores into the housing company as of now and the housing finance business depending upon the growth, we will have to put in the capital. We propose to be present largely in the sub-20 lakh segment which is considered priority and in which the risk weight is 50% and as you know the housing business as per NHB requires 12% capital adequacy as against 15% for the NBFC and, therefore, on a 50% risk weight the adequacy requirement is only 6%. So to that extent in proportionate to growth in the AUM, the requirement of capital will be lesser. So even if we were to build, for example, a 2000 crores book in the next two years' time, on a 6% basis we would need about 120 crores of capital which again can be a mix of both the Tier-1 and the Tier-2.

Sudhakar Prabhu And secondly in terms of leverage in ROE what level are you comfortable with? I mean if you look at your ROE its exact 10%, its still lower compared to your peers, so what kind of ROE are you targeting for the business?

Sanjay Chamria So till March 2011 we had more than 20% ROE and it was from April 2011 that consequent to the change in our model and the policy, the ROE took an artificial hit. In fact if you look we have given a bridge analysis of our profitability for the whole of the last fiscal and despite doubling of our capital on account of infusion, our ROE is actually 15.9% and which if you compare with our peers also in the year in which they will raise capital, the ROE would actually take to north because it takes about 15 to 18 months' time to reach back the normal levels of ROE. Having said that, as I said from October this year we should have a normalized curve in the earnings and, therefore, the ROEs should reach the normal levels. As a policy we never give out a guidance that whether I will achieve 20% or 25% or 15%.

Sudhakar Prabhu And in terms of leverage?

Sanjay Chamria In terms of leverage as 15% capital adequacy mandated by the regulator, we had said that our comfort level would be not 15 but may be about 16 to 17%, so that means we can leverage between 5.5 to 6x.

Moderator Thank you very much. As there are no further questions from the participants I would now like to hand the conference over to Ms. Sarita Shetty from closing comments.

Sarita Shetty Thank you. On behalf of IDFC Securities I thank all of you to participate on the call. I thank Mr. Sanjay Chamria and the team to take out time to address the investor queries as well. Thank you so much.

Sanjay Chamria Thanks so much.

Moderator Thank you very much. Ladies and gentlemen, on behalf of IDFC Securities Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.