

Company Name: Magma Fincorp Ltd
Company Ticker: MGMA IN
Date: 2013-07-19
Event Description: Q1 2014 Earnings Call

Market Cap: 16,716.20
Current PX: 88
YTD Change(\$): +8.05
YTD Change(%): +10.069

Bloomberg Estimates - EPS
Current Quarter: N.A.
Current Year: 10.686
Bloomberg Estimates - Sales
Current Quarter: N.A.
Current Year: 10265.429

Q1 2014 Earnings Call

Company Participants

- Nischint Chawate, Analyst
- Sanjay Chamria, Vice Chairman and CEO

Other Participants

- Unidentified Participant
- Prakhar Agarwal, Analyst
- Kunal Sabnis, Analyst
- Sunil Tirumalai, Analyst
- Srinivas Rao, Analyst
- Pankaj Agarwal, Analyst
- Deepak Malhotra, Analyst
- Kunal Shah, Analyst
- Jigar Valia, Analyst
- Amey Sathe, Analyst

Presentation

Operator

Ladies and gentlemen, good day, and welcome to the Q1 FY '14 Earnings Conference Call of Magma Fincorp hosted by Kotak Securities. As a reminder, for the duration of the conference all participants' lines are in listen-only mode. And there will be an opportunity for you to ask questions at the end of today's presentation. (Operator Instructions) Please note that this conference is being recorded.

I would like to hand the conference over to Mr. Nischint Chawate. Thank you and over to you, sir.

Nischint Chawate, Analyst

Hi. Good morning, everyone, and thank you for joining the Magma Fincorp 1Q FY '14 results earnings conference call. We have with us Mr. Sanjay Chamria, Vice Chairman & Managing Director of Magma Fincorp; and the senior management team to talk about company's performance and important events during the quarter.

We will begin the call with the opening remarks from Mr. Chamria, following which we will have an interactive session. I would like -- now like to invite Mr. Chamria to make his opening remarks.

Sanjay Chamria, Vice Chairman and CEO

Yeah, morning Nischint, and good morning to all of you on the call. I thank you for joining Magma's quarterly conference call for the unaudited results for the quarter-ended June 2013. Before I turn to the Magma performance, I'd like to share with you my view on the economic scenario, which has turned out to be more challenging than it's rated at the beginning of the year.

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And the situation has turned more grim due to deteriorating currency valuation. It has all resulted in a major degrowth in primary sale of all vehicles except tractors and has therefore impacted the new loan disbursements. Besides due to the lower off-take of industrial activity, virtually no new activity in the infrastructure and mining segment, the cash flows of all the existing customers have been adversely impacted, leading to delays in payment of installments.

In my view, the above two events have put enormous pressure on the performance of retail financials, and the revival of the business has to be preceded by the turnaround in the economic situation.

The commercial vehicles sales witnessed a negative growth of 8.1%, construction equipment industry by about 18% and the passenger car and neutrality vehicles by about 7.2%. Tractor was the only segment to hold up and grew by 26.2%, driven largely by the so far good monsoons and better price realization from crop sales in few states, including U.P. and Madhya Pradesh.

At Magma we have, as is stated in our January 13 analyst call, decided to follow a differentiated strategy on improving the collections performance through significant increase in field activities and tighter provisioning norms to bring higher degree of focus on asset quality. As you know, we have advanced the NPA recognition to 120 days past due and also increased the standard asset provisioning to 30 bps effective FY '13. And as a policy we don't restructure any account, as in my view it is not healthy to do so in retail financing business.

Further, we've tightened our credit norms as well for selection of new proposals to avoid ballooning of non-performing loans and the rather concentrate on improving the yields on new loans and maintaining asset quality of existing portfolio. I'm happy to share with you, the above strategy has been yielding good results, and coupled with normalization of income curve owing to the change in business model effective April 1, 2011 and change in the accounting policy on the income recognition for securitization transaction.

In spite of a challenging quarter gone by, with degrowth [ph] in primary sale of most segments, we have reported a strong performance driven by 45% growth in revenue and 38% growth in PAT. This is in the backdrop of 116-basis point increase in the spreads on a consolidated basis in comparison to Q1 of last fiscal as well as 24-basis point growth on a sequential basis over the March quarter.

Our performance highlights during the quarter; first, our loan book stands now at 16,274 crores as on June 30 at 28% Y-o-Y growth from 12,728 last year. Earnings assets comprise now 97% of the loan book and we are only one quarter away from full normalization of our income curve impacted by the accounting policy changes made by us in FY '12.

Our net interest spreads on the entire earning loan book increased to 5.54%, up from 4.38% in Q1 and from 4.91% compared to the full year of FY '13. The increase in the spread is primarily the outcome of increase in IRR on the first disbursements done over the last few quarters, as well as reduction in the cost of funds. The spread is expected to increase further as the older loan assets with the low IRR runs down and the new disbursements coming in at higher IRR and the spreads continue to be built in the books.

The increase in the spread coupled with higher sales of income earning asset is reflected in the Y-o-Y increase in the net interest income, from 138 crores in Q1 of last year to 205 crores in Q1 of this year, an increase of 48.6%. It will be appropriate also to mention that during the last four years through sustained efforts we have diversified our liabilities quite credibly. And as a consequence, the sale of debt from the debt capital markets have increased from a mere 4% in 2010 to 21% as on June 30.

Our collection efficiency for Q1 of FY '14 stands at 95.5%, which reflects the strength in the economy in a few segments, especially commercial vehicles and construction equipments. We're pursuing a lot of on-ground initiatives to improve the collection efficiency and we are confident of restoring the same to our expected levels over the course of the year.

We've incurred gross write-offs and bad debts amounting to INR36 crores in Q1 of FY '14. This is partly on account of the overall deterioration in the asset quality, as also partly an impact of the early adoption of the RBI draft guidance, which we shifted to in January 2013.

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During the last one year, we have commenced three new businesses, housing finance, general insurance and gold loans. While our traditional vehicle finance business is doing quite well and contributing handsomely to the bottom line, these new lines of business are also setting up well and are expected to contribute in our topline and bottom line growth in the coming quarters as we also derived the benefits of the scale.

Given the uniqueness of Magma in having diversified presence across 21 states with 278 branches and 8 products, we are well positioned to harness the growth opportunities in each of our businesses and then continue with our focus on deepening our relations with the general customer segments and now reap the benefits of cross-sell to the same customer.

My management team and myself would now be happy to take any questions that you all may have. Thank you.

Questions And Answers

Operator

Thank you very much, sir. We will now begin the question-and-answer session. (Operator Instructions) First question is from the line of Prakhar Agarwal from Edelweiss Securities. Please go ahead.

Prakhar Agarwal, Analyst

From Edelweiss. Sir, firstly on the credit cost and also the NPAs which have gone up, if you can use flavor in terms of the segments which are contributing to it. So is it majorly coming on the commercial vehicles side or say the used vehicles and say a semi, if you can just give the correlative comments on that?

Sanjay Chamria, Vice Chairman and CEO

So as I mentioned, during the course of my address, that commercial vehicle and construction equipment, these two are more stressed in terms of the asset quality and the connection efficiency has suffered in these two segments and even in the Suvridha, which is the used vehicle, is largely dominated by the commercial vehicles. So, these three products out of eight that we have are having a greater degree of impact in the provisioning and write-off.

Prakhar Agarwal, Analyst

Okay. And sir, how is this SME portfolio panning out as of now? And do you see any risk in the way you've mentioned like the overall macro seems to be more challenging and green. So is there any risk on the SME portfolio?

Sanjay Chamria, Vice Chairman and CEO

See, the SME portfolio as a whole contributes about 7% of our total loan book. So while it does not have a very high weightage, but -- and this is the only unsecured product that we have out of eight, but it has held up very well and in fact of our performance of SME last year also was pretty much as compared to the earlier year and even into this year first quarter it has performed quiet well.

Prakhar Agarwal, Analyst

Okay. And sir, in terms of disbursements, sir, how has been the disbursements during this quarter if we look at the absolute number or maybe what it was say --

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Sanjay Chamria, Vice Chairman and CEO

Okay. Absolute number-wise it's roughly about 1,900 crores and disbursements, as I mentioned, are muted, the reason being the -- except for tractors all the other product segments in which we are present are according negative growth rate consistently over the last several quarters. And it doesn't make sense to take a very aggressive positioning to grow the loan book.

So therefore, what we have decided is that we'd rather restrict that credit option that we do to the new customers and therefore we tightened our credit screen by product and by geography depending upon the performance. And secondly, we have rather gone on improving the yields, so therefore the profitability is not impacted by the lower disbursements.

Prakhar Agarwal, Analyst

Okay. And how about on the housing loan -- housing portfolio, I was just seeing some went down and is still continuing. So if I look at maybe the profitability of that book, the overall interest expense has gone up or even the OpEx has gone up. So, are we in the investment phase? When would we see the aggressive rollout in this particular segment? And how much would be disbursed in this space in say Q1, vis-a-vis the last year?

Sanjay Chamria, Vice Chairman and CEO

So, you are right. We completed the acquisition of the housing business from GE Capital in February 2013. And April, May, June was the first quarter post acquisition, so therefore, one, we have now successfully integrated the entire business into the Magma fold as well as the -- all the 50 odd people who also joined Magma from GE Capital when we acquired the company, they have successfully integrated in the Magma teams. And so I think that is now more or less taken care.

And we have also started the new loan offering under the housing business and both for the home loans as well as for the lab, which is the commercial loan certificate to the SMEs. And in the first quarter, we are -- actually had about 95% of the disbursement target, having started this business in the month of May. And the -- we acquired 10,000 live customer relationships. So, it has actually helped us to harness the existing customer relationships to do the top-up loans based on the past track record with us over the last several -- last 7, 8 years of the book that we acquired. In terms of the impact on the profitability, you see, there is an investors' presentation that we've put up on the site and in slide number 13 we have shown that while the ABF business has been contributing very handsomely to the profits, the new businesses of housing as well as insurance, these are now growing and they're in the growth phase.

So therefore, in the coming quarters you will see that even they will contribute very well to the bottom line and also it will offer to the parent company the benefits of scale, because as a policy we're not setting up separate infrastructure for these businesses and we are exploiting and using the Magma network of about 278 branches.

Also the common strength in collections, the operations, the treasury and accounting, only the sales (Technical Difficulty)

Prakhar Agarwal, Analyst

Hello?

Operator

Participants, please stay online as the management line has some disturbance.

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Sanjay Chamria, Vice Chairman and CEO

(Music) This is the management team. If you can hear us please shout out, because we can't hear anybody.

Operator

Mr. Rao?

Srinivas Rao, Analyst

Yes, I'm there.

Operator

Please go ahead sir, your line is unmuted. You can ask your questions.

Srinivas Rao, Analyst

But is the management team there?

Operator

Yeah.

Sanjay Chamria, Vice Chairman and CEO

Yes, we are there.

Srinivas Rao, Analyst

Sir, thank you very much. But sir, my question pertains to your CV portfolio. You mentioned the stress. Unfortunately, I am just downloading your presentation. Could you mention what is the collection inefficiency and what kind of moments you have seen in the portfolio in terms of some of the credit metrics?

Sanjay Chamria, Vice Chairman and CEO

So, commercial vehicle and construction equipment are the most expressed portfolio in terms of the collection and the impact on the write-offs. And even in terms of the disbursal growth, you see, our presence was largely in the medium and heavy commercial vehicle, and that has been degrowing at almost about 18 to 20%.

Srinivas Rao, Analyst

Correct.

Sanjay Chamria, Vice Chairman and CEO

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It was only on the last year that we've started growing the small commercial vehicle and the light commercial vehicles. And even these two segments now are having a muted growth, in fact one of them is having a degrowth -- in fact both of them, as I'm told, are having a degrowth now in terms of the primary sale in the quarter one. However, since we are as of a low base flow, still we are maintaining growth in one of them. And in terms of the collection efficiency, in fact there it is in the quarter one at about 96%, which is almost same as the overall, but because of the bucketing the impact on the provisioning is higher.

Whereas the Suvridha, which is the used commercial vehicle, the collection efficiency is down to about 91%.

Srinivas Rao, Analyst

Thank you, sir. Any feedback on any regional disparities or it's across the board --

Sanjay Chamria, Vice Chairman and CEO

It is largely across the board and -- but then there would always be some differentiation. So in our portfolio, particularly we see higher impact in the West as compared to the other three zones. But I have to still say that they are largely in the narrow range.

Srinivas Rao, Analyst

Okay. And sir, one more question. I mean, it's -- what we have noticed is that despite the downturn being fairly prolonged or been there for some time, generally finance companies, and yours is a good example, have reported reasonably good numbers or I would say have not shown stress in the portfolio for a fairly long time when we're really seeing it now.

Do you think that when there is an upturn, a similar process will happen where we will see improvement in your -- in the portfolio quality after discernible signs of upturn or we can expect it to see before the upturn actually happens?

Sanjay Chamria, Vice Chairman and CEO

No, I think so far as Magma is concerned, we had consistently very high performance till FY '12 and three years consequently we had a 100% collection efficiency. However last year, we had a drop to 98.3% and similarly our write-offs which went down to a historic low of 0.2% went up to about 0.55% in FY '13, which was an increase of 250% in terms of the impact. And this year, if you see like our -- sequentially while the write-offs are muted as quarter four to quarter one at about 36 crores. But if you compare with the quarter one of last year, again I think the increase is quite substantial. However now to theoretically answer your question, that in case the stress is not really seen then obviously when there is recovery, the recovery also -- whatever stress is there will also be elongated after the sign of revival is already filled by others who have seen greater degree of stress. There is no doubt about it.

Srinivas Rao, Analyst

Fair enough, sir. This is useful. And sir, one more comment, if you could, on the tractor side. It's been a bit of a surprise and -- for all of us. Any particular reasons why the numbers have been very strong for you and for the industry actually?

Sanjay Chamria, Vice Chairman and CEO

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Well, for us it's not very strong because we have grown the tractor disbursement by about 13% in quarter one while the tractor industry grew by about 27%.

Srinivas Rao, Analyst

True but -- yeah.

Sanjay Chamria, Vice Chairman and CEO

And you know like in our interactions with the TMA, which is the industry body for the tractor sector, they never expected that the industry will grow by this percentage. And also if you look at the growth in the tractor sale across the state, then you find that this kind of an increase again is not secular and the states of MP and Andhra are the ones which have -- and Maharashtra which have actually recorded growth in excess of 70-odd percent -- 50-odd percent.

So therefore, as a financial not everyone was well equipped to handle this kind of a growth.

Srinivas Rao, Analyst

Fair enough, sir. Fair enough. Thank you, sir. This is very helpful.

Sanjay Chamria, Vice Chairman and CEO

Thank you.

Operator

Thank you. (Operator Instructions) Next question is from the line of Kunal Sabnis from V.E.C Investments. Please go ahead.

Kunal Sabnis, Analyst

Hello, sir. Thanks a lot for taking my question. In terms of the asset book, the growth has been flattish. So, how do you -- how are you viewing the business internally in terms of it to grow over the next year or there is a substantial change in terms of the trajectory of growth that you've seen historically?

Sanjay Chamria, Vice Chairman and CEO

So Kunal, actually it's very uncertain times. So to give you a definite answer, I really need to be a genius to predict the future of the Indian economy. So, what we have taken internally as the various steps that we can do is, one, to control cost when you're not sure about the growth in the topline which we have done; two, in order to milk the market of whatever is available, we have decided to significantly step-up our engagement with the channels through a lot of BTL programs and a greater degree of field positions of the leaders in the market; and third is that -- how we can get the multi-product selling by the executives, because until now for the product that we have in ABF, a guy who is selling tractor was not selling car and the guy who is selling car was not selling commercial vehicle. So therefore, what we are seeing now when the markets are down, can we have a guy who's present in a particular district, sell multi-product and thereby achieve our productivity, which will, one, help us to reduce cost and on the other hand will help us to reach out to the customers faster, this is the second one.

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Third, we are not really enamored that in a difficult economic scenario like today's, if we don't grow our topline; however -- so therefore our focus is that on one end contain the cost, on the other hand improve the margins. And -- which is what in my address I was saying that while our margins compared to YoY has grown by 116 basis points, but even sequentially it has grown by about 27 business points.

And this is the impact of one growth in the gross sales and to the reduction in the cost of fund. And -- so until there are clear signs of revival in the primary sale, this three-pronged strategy will continue at our front.

Kunal Sabnis, Analyst

Right. Sir, with the respect to your cost of fund how does the latest RBI -- the guidelines affect the overall cost of funds with the spike seen in the short-term rates? And how does -- and in that backdrop, do you still expect the spreads to improve or they should be -- you should be able to at max maybe maintain it at this level?

Sanjay Chamria, Vice Chairman and CEO

So you see, the -- over the last one year RBI reduced the base rate a number of times, and we didn't really get the benefit of the reduction in the base rate. Similarly, the measure announce by RBI few days ago to contain the liquidity in the market, there has been a short-term spike in the cost of funds, which is yet to be felt by us, because I think even banks in their internal COEs or CODs will take a call has to how do they deal with the situation and take a call on passing on the increased cost to the borrowers.

So, still we have not got any communication from the banks. So far as our borrowing in the DCM market is concerned, over the last one week the market has been pretty muted and as I read in the paper that the school [ph] funds have rather been dealing with the redemption, so there is no fresh lending that they are doing and therefore there is no firm indication in terms of what is the prediction in respect of the cost of fund.

But my view is that at most, if I take a most conservative view, the cost of funds could go up maybe by about 20, 25 basis points in the short-term, but in the medium-term, I don't really see that is an issue for two reasons one, as I mentioned economic scenario I don't see that improving significantly in the next 7, 8 months, and therefore the credit growth will remain sluggish. And if the credit growth remains sluggish and where the deposits are growing at about 14%, 15%, the liquidity available in the banking system will be such that the banks will want to lend at competitive cost to the creditworthy corporates who are highly credit rated. And luckily Magma falls in that category. If you look at our cost of fund over the last three years, we compare quite favorably to our peers. And there we have not really seen any stress.

Kunal Sabnis, Analyst

Right. Just a final question from my side. The collection efficiency has dropped considerably over last couple of quarters and is at 95% and you expect it to increase going forward. Considering GDP growth stays at a similar level, do you still expect the same improvement in the collection efficiency and what according to you will actually drive collection efficiency going forward?

Sanjay Chamria, Vice Chairman and CEO

So we have analyzed the reasons for the fall in the collection performance and in our assessment this is twofold. One is the external tough economic environment and on which I maintain that it is unlikely to improve in the near future, and therefore there is little that we can do about it. And the second is our internal efficiency improvements where we feel that there is certain ground that we have to cover and therefore, over the last two months we have taken a series of steps and measures to improve the collection performance. Just like to a question by your predecessor, I was sharing as to

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how do we propose to deal with the top line growth in the current scenario, we have taken three measures.

Similarly, on the collection side, we have taken a few measures by which we hope to address our internal inefficiencies and thereby improve the collection efficiency. But I'm afraid that it is not -- it is very unlikely that we can claim to reach the glorious levels of 100% that we did in three years. So even if I think we reach the level of 98% or 98.5% that we did last year, I think we will surprise ourselves and all the investing community.

Kunal Sabnis, Analyst

Okay, great. Thanks a lot, sir.

Operator

Thank you. (Operator Instructions) We're going to take a follow-up question from the line of Prakhar Agarwal from Edelweiss Securities. Please go ahead.

Kunal Shah, Analyst

Yeah, sir, Kunal here. Sir, with these collection efficiencies coming off and the challenging environment, what is our outlook in terms of, say, the provisioning coverage which we are carrying today? So do we think, like, we'll be increasing or the write-offs which we are taking that would be, say, taking care of the overall stress and there is no need to inch it up from the current level?

Sanjay Chamria, Vice Chairman and CEO

So one, Kunal you see our provisioning coverage, if you look at what is called in the banking parlance, our technical coverage, I think is very high because until March '12 we used to write-off everything which was in 180 plus and for our technical coverage we also included the same both in the numerator and the denominator, and if you do so then it's very high.

And going forward, from April 1, 2012 effective we have advanced the provisioning of NPAs and de-recognition of income on the same from 180 to 120 days and -- which we thought in our Board Meeting in January that it's a good measure to deal with the volatility on account of the non-performing assets. And given the current level of collection efficiency and the measures that we have taken to improve the same, not with the stand in the current economic scenario, I think it should be fine but we will have to take a look at it once again in October depending upon how -- our performance is in this quarter.

Kunal Shah, Analyst

Okay. And sir, in terms of cost containment you highlighted like definitely that would be the focus. So, should we expect it to come down, say, quite significantly from the levels, so if AVMs were, say, somewhere around 3.5 as a percentage of assets, do we expect it to come off quite significantly, maybe because of the cost control measures?

Sanjay Chamria, Vice Chairman and CEO

Yeah. So see, what has happened in last year we had -- OpEx as a percentage of the average loan was about 3.30 and it has come down to 3.14 in the first quarter, which is quite insignificant. But what happens, the cost actually goes up when your topline goes down because it's not easy to reduce expenses immediately.

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So the fact that -- we in fact recognized this in the end of October last year and therefore we took certain measures starting number. So actually speaking, it's not that we took the measures in April and we are seeing the impact in the first quarter. We actually took the measures in November and see the impact now after three, four months in the first quarter.

However I think if the topline doesn't grow, then if we are able to keep the expenses at the same level in terms of percentage as last year of the average loan book, to me that will be a creditable achievement. However, if you are able to bring down the expenses as a percentage of the average loan book, then I think it will be a supreme achievement, because every year you've got to have increments, you've got to have higher other non-salary expenses by way of inflation, and if the topline doesn't grow then usually what is seen is that expenditure as a percentage of the asset goes up.

So our idea would be to, one, not allow it to go up as a percentage rather on the other end bring it down.

Kunal Shah, Analyst

And sir, one last question on -- sir, the SME side, you mentioned like on the CV there is not too much of -- say, there is a stress which is there and we may not want to grow over there. Tractors are growing, but sir, what is our outlook in terms of the SME loan portfolio growth in this environment?

Sanjay Chamria, Vice Chairman and CEO

See, SME as I mentioned, is performing very well. However, its weightage is low. But what we intend doing -- we're quite excited, one, about the housing. And while on one hand -- historically if I look at 3 year, 5 year, 10 years, the performance of the housing portfolio is usually the best in terms of delinquencies, and the sectors -- the geographical segments in which we are present, we find, are based on our months of presence that -- there is a space that a company like Magma can occupy.

Secondly SME actually is performing pretty well, both in terms of the delinquency and in terms of the return. So we hope to grow that, but I don't know how much upside is available in that. Tractor is doing pretty well and we've taken lot of measures to improve our business in the tractor.

Car again is the one in terms of delinquencies doing relatively better, and this has the highest weightage in our portfolio at about 34, 35% and therefore we intend growing this particular -- so these three, four products we intend growing very well. And so, that may offset the degrowth in, say, commercial vehicles and constructions equipment. So, this is how we are strategizing.

Kunal Shah, Analyst

Okay. So still like, sir, 15 to 20% growth would -- something which can come in from, say, some of these focus segments?

Sanjay Chamria, Vice Chairman and CEO

So, if I look at these three, four product segments that I talked about, then I think it will be more than 20, because one housing -- we have no base, so therefore it will all be growth. Whereas there will be a degrowth in the commercial vehicle and construction equipment, given the scenario. So on a blended basis, what will be the growth in the overall loan book, I think at the beginning of the year we've said that we intend growing by 20%, but right now I think it would be difficult to put a number. We rather need to see how does this quarter go.

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So our focus I think will continue to be on improving the yield profile of our loan book and to contain the NPAs like what we've done in the quarter one and to reduce the expenses as a the percentage of the loan book. I think these are the three things we believe are under our greater control, then to grow the topline.

Kunal Shah, Analyst

Okay, sir. Thanks a lot, sir.

Nischint Chawate, Analyst

Thank you.

Operator

Thank you. Next question from the line of Amey Sathe from JM Financial. Please go ahead

Amey Sathe, Analyst

Hello?

Sanjay Chamria, Vice Chairman and CEO

Yes.

Amey Sathe, Analyst

Yeah. Just one question on the UCV [ph], the collection number that you gave was 91%, right?

Sanjay Chamria, Vice Chairman and CEO

Yes.

Amey Sathe, Analyst

What was it last year?

Sanjay Chamria, Vice Chairman and CEO

Last year was 95.7%.

Amey Sathe, Analyst

Okay. And you see, what was the demand for UCV, do you think that is also moderating?

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Sanjay Chamria, Vice Chairman and CEO

Yes, that is also moderating.

Amey Sathe, Analyst

Okay. Okay. And this collection problem, you think it's a seasonal in nature or it is expected to continue?

Sanjay Chamria, Vice Chairman and CEO

I don't think it is seasonal in nature. It is more to do with the economic scenario and, in fact, you see a year before we had 99.8%, which went down to 95.7% and 91% around this year. So therefore, it's not seasonal in nature. It is more to do with the ability of the customer to whom we have given a loan for a UCV that he finds a deployment issue. And if he has a deployment issue, he does not have enough cash flows in his hands and, therefore, finds it difficult to repay the installments in time.

Amey Sathe, Analyst

Right. And so the UCV space, so is it getting more competitive because of lack of demand?

Sanjay Chamria, Vice Chairman and CEO

See, you are Amey?

Amey Sathe, Analyst

Yeah.

Sanjay Chamria, Vice Chairman and CEO

Yeah. So, unfortunately, every segment that we are present in are all competitive. There is no virgin market. I wish there was one and we're not going to lend there. And what I also find that all the products, if I divide that into four regions, in every region there are about three to four on the lower side and five to six on the higher side key players.

Amey Sathe, Analyst

Right.

Sanjay Chamria, Vice Chairman and CEO

So if I divide the country into Northeast, Southwest and for all the eight products and accordingly, you need to find your niche and then lend.

Nischint Chawate, Analyst

Yeah. Is there a follow-up question, Amey?

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Amey Sathe, Analyst

No, I got it, thanks. Thanks.

Operator

Thank you. Next question from the line of Sunil Tirumalai from Credit Suisse. Please go ahead.

Sunil Tirumalai, Analyst

Hi, thank you. My -- last part of my question got answered previously. So just one quick point I wanted was on your slide 12, the Summary Financials Consolidated, the operating expense decline was on a quarter-on-quarter basis was driven by what?

Sanjay Chamria, Vice Chairman and CEO

Sunil, I think your voice went very low. So could you repeat on slide 12, what was the question you asked?

Sunil Tirumalai, Analyst

Yeah, slide 12 the P&L statement consol.

Sanjay Chamria, Vice Chairman and CEO

Yes.

Sunil Tirumalai, Analyst

So the operating expense on a quarter-to-quarter basis has come down. Just -- and it seems to be primarily driven by overheads, just want to understand what has driven that.

Sanjay Chamria, Vice Chairman and CEO

So it is -- it has actually come down very insignificantly, but I think it becomes significant in the sense that there is inflationary impact, then there is an increment impact in these salaries effective April. So from that point of view, it becomes significant and there are two reasons for the reduction. One is that the expense containment that I talked about in the current scenario. And the second, as I mentioned that our housing business and insurance business, these two business are now growing up and -- like insurance has started from October last year and in the first quarter we did about 73 crores of premium mobilization, and the housing business also we started the disbursal in the last quarter.

So, there is a sharing of expenses which we incur across 278 branches and even in the head office for the common functions like the collections, the back-office operations, the accounting, treasury and all other support functions. It is only the self-function and the underwriting function in the housing and similarly in the insurance are core functions which are warehoused in the respective entities. So, that also is helping us to get the economies of scale and that is why these expenses are lower; these two reasons.

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Sunil Tirumalai, Analyst

Right. And secondly, in any of your segments -- this is a follow-up on the question on competition earlier, in any of your segments are you seeing any of increase in aggression from other lenders, I mean because of the slowing growth?

Sanjay Chamria, Vice Chairman and CEO

So increase in accretion, Sunil, I see from two angles; one, whether customer is very high creditworthy, then I'm seeing rates of 11% being offered. And we simply don't operate in those customer segments. And that's the analogy I drew when I was answering a question on our borrowing costs.

But today when I see the credit growth being sluggish, the banks are following head over heels to lend at very competitive rates to those corporate which are highly creditworthy and enjoy a good credit rating. So, that is a very similar analogy which I find on the asset side.

And the second line of accretion that I see is where the customer is not so creditworthy, I find the risk guards being lowered by the competition in order to maintain the topline, which in my view is disastrous because that can have a cascading impact over the next three years in terms of the asset quality and can impact the net worth.

Sunil Tirumalai, Analyst

So, is this in terms of -- are you seeing any increase in LTVs in any product?

Sanjay Chamria, Vice Chairman and CEO

In fact, it is there in most of the products; not only LTVs, in fact that's a very simple measure by which you can say is the aggression that you see. More than LTV today, the percentage of proposals that you receive which do not conform to the credit norms and therefore fall under the deviation norms are higher than ever before. And that means, there is a subjective call to be taken in a template-based lending approach organization.

Sunil Tirumalai, Analyst

Right. Got it. Thank you very much. This was helpful.

Sanjay Chamria, Vice Chairman and CEO

So, just by the way, you raised a question on the LTV, so our LTV in the quarter one for all the lending that we did was 72%, which compared to whole of last year was 73%. So it is pretty much the same. And that's where, as I said, we decided that we will not join this rat race of either matching the rate or matching the LTV or the deviation in terms of the subjective approvals, but rather have a lower disbursement, but improve the quality of earnings.

Sunil Tirumalai, Analyst

Thank you, sir.

Sanjay Chamria, Vice Chairman and CEO

Thank you.

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Operator

Thank you. Next question from the line of Srinivas Rao from Deutsche Bank. Please go ahead.

Srinivas Rao, Analyst

Sir, thank you very much. And just wanted to come back -- sir, on the UCVs, is there any -- are you seeing any fall in the values which might have an indirect impact on your LCVs, given as you said that the businesses, there is a kind of momentum is going down. That's my first question. If you can answer that, I can come back to the next one.

Sanjay Chamria, Vice Chairman and CEO

So you see, what we took last year as a view that earlier we were restricting the funding to about maximum five years, six years, I mean in terms of our acquisition of the business. And then we said that in order to improve our catchment, we will also fund about eight or nine-year-old vehicles, so that coterminous with the expanded should be less than 12 years.

And therefore, we started getting lesser value vehicles. As a result of that, there is a marginal reduction in the average ticket size, which was about 5.3 lakhs last year, down to 5.2 lakhs in the first quarter of this year. So the impact is yet to be felt. Similarly, now you see the significant growth in the LCVs that happened in the last five years, even those vehicles would now come in the market for refinancing and there the ticket size would be even lower.

Srinivas Rao, Analyst

True.

Sanjay Chamria, Vice Chairman and CEO

So I think it is yet for some more time for us to see that how does the ticket size get impacted and -- but the LTVs have remained flat between last year at 70% and the quarter one of this year at 70%. There is no change in the same.

Srinivas Rao, Analyst

No, sir, I also meant that there could be a -- I mean at the time of your lending, of course, you have been prudent enough to maintain a 70% to 73% norm. But if the depreciation of the vehicle is higher, particularly in such -- in times of stress like this.

Sanjay Chamria, Vice Chairman and CEO

Yeah.

Srinivas Rao, Analyst

So that's the question that are you seeing any more than what your models called for in terms of deterioration or depreciation of the vehicle value?

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Sanjay Chamria, Vice Chairman and CEO

In fact, even earlier when we used to offer 70%, whenever we repurchase, we always incurred a loss.

Srinivas Rao, Analyst

Okay.

Sanjay Chamria, Vice Chairman and CEO

So we incur a loss. It is just that the percentage of loss has increased.

Srinivas Rao, Analyst

I see. And are you seeing any income in -- I remember maybe couple of years back, there used to be a reasonable amount of inventory buildup on account of these kind of repossessions actually by couple of your competitors particularly; is that a trend which has started again or that still not yet -- you're not yet there?

Sanjay Chamria, Vice Chairman and CEO

Rather I'll give you an interesting analogy on this. On one end the inventory is building up, because if you (inaudible) the customer don't come to release.

Srinivas Rao, Analyst

Sure.

Sanjay Chamria, Vice Chairman and CEO

So, if you want to sell you incur losses. So we tell our refinance team that on one end you are not finding supply of your vehicles, so why don't you take these vehicles and you finance to your customers. But then, practical reality is that it doesn't happen. So therefore, it shows that there are certain imperfections in the market and these are the points that I was sharing, that there is nothing that as a company one can do about the overall economic scenario.

But what I think anyone would expect the management team to do is to take care of the internal inefficiencies in the system and try to remove all the slack and therefore put up the best ever -- best performance what is possible.

Srinivas Rao, Analyst

Okay, fair enough. Understood, this is very helpful. Thank you so much.

Operator

Thank you. Next question is from the line of Pankaj Agarwal from Ambit Capital. Please go ahead.

Pankaj Agarwal, Analyst

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Hello, sir.

Sanjay Chamria, Vice Chairman and CEO

Hi, Pankaj.

Pankaj Agarwal, Analyst

Hello, sir. Sir, now having applied for a banking license, what probability do you put on Magma getting a banking license? That is my first question. And second, what would be the challenges and opportunities for Magma if it gets a banking license, especially that RBI is not giving -- ready to give any forbearance on CRR, SLR and priority sector requirements?

Sanjay Chamria, Vice Chairman and CEO

So, what was your first question, Pankaj?

Pankaj Agarwal, Analyst

Probability you put on Magma getting a banking license?

Sanjay Chamria, Vice Chairman and CEO

Oh, I'll lend probably a USD100 million if I can accurately predict the probability.

Pankaj Agarwal, Analyst

No, but given the guidelines which are already out I mean --

Sanjay Chamria, Vice Chairman and CEO

So, that was on a lighter note, but Pankaj, you see, there are 26 applicants.

Pankaj Agarwal, Analyst

Right.

Sanjay Chamria, Vice Chairman and CEO

And I think everyone thinks that they stand the best chance to get the banking license, because everyone thinks that RBI will give at least about four or five banking licenses. So I think if you look at our business model, notwithstanding the banking license part, then what RBI is looking from a new aspirant is to implement the priority sector obligation from year one, is to have branches in the rural 25% minimum and also provide financial inclusion to the excluded customer segment at a cost effective manners, so that as a bank you remain profitable.

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I think if you look at -- these are the three a very clear, stringent criteria put by RBI. Now if you look at Magma, I think, over the last 15, 20 years, although we are in existence for 25 years, this is our 25th year in fact, we've actually been financing the customers who are excluded from the financial system, not as a priority sector obligation, but as an economically viable model. And I think I am sometimes on record that 37% of the customers to whom they gave a loan are taking a loan for the first time in their life when we are giving a loan. So if that is not financial infusion and that is not priority sector, than what it is?

So I think I'm not worried on that front. We are also not worried on the front of opening of 25% of the total branches, because today I have 81% of the branches which are in rural, semi-rural. Although they may not qualify -- all of them for the less than 10,000 village population -- 12,000 population villages, but then RBI also allows you to have innovative solutions in terms of a skeletal branch setup that you'd need to fulfill this criteria. So I'm not really worried on that front.

I think, however it is quite premature to talk at this stage as to what kind of a financial model we shall follow, what impact it will have on our profitability, while -- it is very obvious that the challenges remain for the SLR and CRR to be met from day one. So I think what at the Board we discussed after furnishing our application to RBI that RBI is going through a process of internal and external screening committee to be set up.

So once they're shortlist out of 26, I don't know how many and if we happen to be the fortunate one, who is shortlisted, then there will be a very detailed screening by the experts within the regulatory system and outside who will look at each applicant, their background and their ability to fulfill this criteria laid down by the Reserve Bank and certain properties and so on.

Even we have made it very clear in our application and so in our public addresses that we will follow our existing business model, whether we get a license or we don't get a license, because we have seen that this model has helped us to maintain a viable profitability model and grow the business. If we get a banking, obviously, then we will see that it will help us to improve our viability. So that is what my long answer to your two questions.

Pankaj Agarwal, Analyst

Okay. In terms of -- I mean, given your business model, is it better suited as an NBFC or under a banking umbrella, because some of your competitors have not applied for a banking license citing the reasons that their business model is more suited under NBFC umbrella rather than as a bank?

Sanjay Chamria, Vice Chairman and CEO

Yeah. So each one is entitled to their own valued opinion, just like I'm entitled to mine. And obviously, we thought on an overall scale it may make sense and that's the reason we applied for it.

Prakhar Agarwal, Analyst

Okay. Okay, sir. Thank you very much.

Sanjay Chamria, Vice Chairman and CEO

Thank you.

Operator

Thank you. Next question from the line of Animesh Sinha [ph] from Dalal & Shree [ph]. Please go ahead.

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Unidentified Participant

Sir, this is Animesh.

Sanjay Chamria, Vice Chairman and CEO

Yeah, Animesh.

Unidentified Participant

Sir, Indian banking industry has witnessed a strong growth in the past decade and also created wealth for stakeholders. What kind of opportunities do you oversee going ahead in the Indian banking sector?

Sanjay Chamria, Vice Chairman and CEO

Well, I'm not really qualified to speak on the banking sector. I can talk on the NBFC sector and I think even that has created value and we think that again we are at the cusp another growth, having crossed a major milestone of 15,000 cores AU and 1,000 -- 1,200 crores of net worth, and now I think, we are present across India 21 states with 7,500 people and we have got 8 products of that really makes us the most diversified company in the sector.

In fact, it's not a cosmetic presence. If you look at -- I think in one of the slides on the investors' presentation that no single state has more than 11% concentration of our overall loan book and similarly out of eight products, no product has more than 31% greater than our total loan book. And I think that really -- while of course we are impacted by the economic scenario, but we are more insulated than our peers in the industry. That's what I'd say.

Unidentified Participant

Okay, sir. Sir, where do you foresee major growth coming from, urban area or rural area? What your focuses would be, Tier 1 city, Tier 2 city or Tier 3 cities?

Sanjay Chamria, Vice Chairman and CEO

Well, our focus traditionally has been on the Tier 3 to Tier 6 and 81% of our branches are located there and about 60% plus of our business also comes from there.

Unidentified Participant

Okay.

Sanjay Chamria, Vice Chairman and CEO

And then future also, I don't see that changing because the urban markets are over-banked and I think there is a plethora of banks wanting to service the needs of the different customer segments. So therefore, we wish to be opportunistic in this regard and be present in the markets where we see less competition and more virginity.

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Unidentified Participant

Okay, sir. Sir, what kind of challenges you foresee for new players as against the already existing players?

Sanjay Chamria, Vice Chairman and CEO

Sorry, I didn't get your question.

Unidentified Participant

Sir, What kind of challenges you foresee for new players as against already established players?

Sanjay Chamria, Vice Chairman and CEO

In the NBFC space?

Unidentified Participant

Yeah.

Sanjay Chamria, Vice Chairman and CEO

I am not really seeing very many new players entering the NBFC space in the last few years. And if for example, somebody was to seek my advice, without charging I will give an advice that if you have deep pockets and I am not expecting a return for the next five years and are really willing to dif your heels and develop a team of 5,000 people, build an asset base of 10,000 crores and then build a book of 10,000 crores is then by you should get into this. Otherwise you can see, there are a lots of NBFCs which have been set up by the private equity funds with very large deep pockets, but then they are not really retailed in prisons. And therefore, they are doing more the funding to the -- what do you call, the promoters against the shares, or they are doing the commercial real estate, but that's not the segment that we are present in nor do we want to be present in those kind of segments.

So, the segments in which Magma is present in, I think the entry barriers are pretty high, one; from the point of your establishing a nationwide presence; two, developing the processes and systems, because you need to deal with cash; and three, to build a large team of people.

Unidentified Participant

Okay. Thank you very much, sir.

Sanjay Chamria, Vice Chairman and CEO

Thank you.

Operator

Thank you. Next question is from the line of Deepak Malhotra from Silverstreak Asset Management Company. Please go ahead.

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Deepak Malhotra, Analyst

Sir, maybe one question on your housing finance business; what exactly are your growth plans there because you said the team now has been integrated and you are looking at cross-selling and your focus is on Tier 3 plus towns, you are not really looking at the urban market. So what kind of ticket size you're looking, how really the business is going to flow, see, over the next three to five years, please? Thank you.

Sanjay Chamria, Vice Chairman and CEO

So, we are one -- quite excited about the housing business, because if I look at the overall universe of the retail finance business in India, mortgage comprises about 50% and in the other 50% you have the vehicle and the personal loan, unsecured loan and all sorts of businesses. So therefore, you find that the potential of the housing business is quite significant.

Secondly, when I was answering to a question sometime back that 37% of the customers -- and we have serviced till date over 900,000 customers, 37% of these customers took the loan for the first time when we gave them a loan for a vehicle or a tractor or an equipment. So, they also have the housing needs.

Now obviously, they don't have a housing loan. And we have a track record with those customers in terms of their ability to repay the monthly installments and our collection team has a comfort. And the places where they live in, there is a dearth of housing financiers. So, we obviously hope to harness the cross-sell opportunities through our existing customers where we have a good track record, and that's what we propose to build on.

In the next three to five years, while we will do cross-sell what we call as to our captive customers, we'll also build up an independent franchise in the housing finance using the network of about 3,500 agents that we have on our vehicle finance also to reach out to the other customers who are not Magma vehicle customers, but then we can provide them straight housing loans.

Deepak Malhotra, Analyst

What kind of ticket size you are looking at and what kind of competition really you envisage there?

Sanjay Chamria, Vice Chairman and CEO

So the ticket size, if you look at the segment of customers, it would be sub-15 lakhs, it could be 12 to 15 lakhs. And if you provide a 80% LTV, then it could be about 8 to 12 lakhs of loan. And in terms of competition, it's difficult for me to name them, but as you know that there are about 4 or 5 specialty housing finance companies which are present on an all-India business, then there are scores of private and the -- private banks and the scheduled commercial banks -- nationalized banks also who offer the loans on account of housing.

So, we will have to compete with them. Again I was saying sometime back that if you dissect the measure into 4 zones, then you'll find that in each product category, on the lower side there are 3 to 4, on the higher side there are about 5 or 6 competitors that you need to deal with.

Deepak Malhotra, Analyst

Since -- I mean you have kind of a policy where you like to limit your business to a -- kind of within -- proportionate, so that it doesn't really go beyond a particular level. What kind of book size then are you really envisaging here, because mortgage could be a bigger ticket size loan vis-a-vis what you are doing today, isn't it? So, would it be higher

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percentage when we look three or five years down the line, because there's substantial opportunity there as I see?

Sanjay Chamria, Vice Chairman and CEO

Because we are a late entrant into the housing business and currently it is about 8% of our overall book which is about 16,000 crores, and over the next three to five years, while this business is going to grow faster than our other business which are more mature, I would see that -- I would probably feel that this business may be about 15 or 20% of our overall loan book in the next three to five years.

Deepak Malhotra, Analyst

Okay, great. Okay, just one more question; although I know gold loan portfolio is not really a very significant part of your business as on date, I mean going forward how do you propose to grow that and what is it really going to be like? Thank you.

Sanjay Chamria, Vice Chairman and CEO

Well, it is very insignificant and it is currently at about 0.5%. Out of 16,000-crore loan book, the gold loan are standing as on 30th of June at about 80-odd crores. So, therefore it's about 0.5% and it's not by design, it's by default, because one, the ticket size in the gold loan is the lowest at about 50 to INR60,000; and secondly, the tenure in the gold loan is the shortest of which is about 12 months or lesser, whereas in vehicle finance, as you know, it is about 41 months for us and in the housing loan it is about more than 10 years, and therefore runoff is very quick in the gold loan. Because of these two reasons, the low ticket size and the shorter tenure, I don't really see the gold loan to be a significant portion of our loan book. But for any business to be relevant in the Magma system, I'd reckon that over a 3 to 5-year period, it should be at least about 4 to 5% of our overall business, so that it can get the management attention that any business would deserve.

Deepak Malhotra, Analyst

Fair enough. And one more last question if we can squeeze in; would you like to comment on your capital raising plans going further, please? Thank you.

Sanjay Chamria, Vice Chairman and CEO

Well, you are really squeezing me in. We have passed and we have got the shareholder and the Board resolution in April this year for a capital raise up to 500 crores and that is valid until April next year, answer number one. And two, our capital adequacy as at June end is about 16.52% as opposed to 16.58% as on March, and therefore we are comfortable. However -- and as I mentioned over the last one hour, that you don't really know the economic scenario, but then if we are lucky enough to grow our loan book without compromising on the asset quality and also improving our asset yields, then of course we can raise capital during the course of next maybe about 9 to 10 months, because the approval is valid till April 2014.

Deepak Malhotra, Analyst

Okay, great. Thank you.

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Sanjay Chamria, Vice Chairman and CEO

Thank you.

Operator

Thank you. (Operator Instructions) Next question is from the line Jigar Valia from OHM Advisors. Please go ahead.

Jigar Valia, Analyst

Good afternoon and thanks for the opportunity. Sir, one question is that for the year as whole towards the end, you -- what's your view in terms of the off-balance sheet book? Do you see as a percentage of the overall book to reduce, given the new norms where there would be distribution tax on the SPVs on a gross basis?

Sanjay Chamria, Vice Chairman and CEO

So, as we have maintained consistently that we propose to use the securitization as a means of funding and more from the cost of fund point of view rather than anything else, so -- and we are seeing that it's really panning out very well, given the comparatively excellent quality of assets that we enjoy in the industry. And therefore, there is a lot of appetite for the Magma paper by several banks, both public and private sector.

So therefore, currently also it is about 30% and I guess the percentage will remain thereabout; it could be, say, 30 to 33% even by the end of the year.

To your second question on the securitization distribution tax, that we have analyzed this internally and we find that on a post-tax basis it is neutral, however at a pretax basis it goes down, because what you receive at the end of the month from the trustee is the deduction of the securitization distribution tax at the same rate which you are paying on your PBT, but then the income that you receive is tax exempt, and therefore in terms of PAT there is no impact.

Jigar Valia, Analyst

Okay. Thank you.

Sanjay Chamria, Vice Chairman and CEO

Thank you.

Operator

Thank you. (Operator Instructions) As there are no further questions, I'd now like to hand over the floor back to Mr. Nischint Chawate for closing comments. Thank you.

Nischint Chawate, Analyst

Yeah. Thank you, Mr. Chamria, for your insight. Thank you, everybody, for joining us today. Thank you.

Sanjay Chamria, Vice Chairman and CEO

Company Name: Magma Fincorp Ltd
Company Ticker: MGMA IN
Date: 2013-07-19
Event Description: Q1 2014 Earnings Call

Market Cap: 16,716.20
Current PX: 88
YTD Change(\$): +8.05
YTD Change(%): +10.069

Bloomberg Estimates - EPS
Current Quarter: N.A.
Current Year: 10.686
Bloomberg Estimates - Sales
Current Quarter: N.A.
Current Year: 10265.429

Thanks a lot, Nischint.

Nischint Chawate, Analyst

Thank you.

Operator

Thank you. On behalf of Kotak Securities, that conclude this conference call. Thank you for joining us. You may now disconnect your lines. Thank you.

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