"Magma Fincorp Limited Analyst Meet"

April 19, 2011

MODERATORS: MR. SANJAY CHAMRIA

V. Lakshmi : Welcome everybody, thanks so much for coming in at 4 o clock for this analyst conference. We will start off by a presentation by Sanjay, I think it should take about half an hour for that presentation and then we could take on questions intermittently as well, not that we need to complete the presentations for the questions to start, so three of us put together should be able to answer about 100% of the questions, if there are some residual pieces, we will kind of note it, drop a mail back to the respective person who is making that question, does that work for us, so thanks to IDFC for kind of taking the initiative and making this analyst conference for us, thanks Pathik, thanks Sarita and thanks Chinmaya and everybody else, so I request Sanjay to come and start the presentation.

Sanjay Chamria: Good afternoon to all of you and it gives me great pleasure in sharing the results of the company for year-ended March 2011. This actually was our last year's catchline, the next level after having put up the wonderful performance last year we said that now we need to go to the next level. This year's annual report for FY 2011 which will be in your hands in about two weeks time, the catch line and the title of this story is creating the benchmark, because we clearly think that on some of the qualitative parameters we have reached certain benchmarks which no one in the industry has been able to do so far and which is what I am going to share with you, so it will be more than the pure financial numbers. I would like to have your attention on them particularly. With some of you I am interacting for the first time, so I will just do a quick recap in terms of Magma as an organization. We started about 22 years ago from Calcutta, that was in 1988 December and now we have done about 22 years and over the last 22 years you can see on the extreme left we have now set up about 172 offices across 20 states and one union territory and we are actually present all over except North Eastern states and Jammu and Kashmir. Today we have over 5150 people in the company reason being none of the functions are outsourced, every single function right from origination of the lead till the collections and NPA recoveries are handled by our own people. In fact as on date the live customer base is almost about 240,000 and till date we have served about 500,000 customers and the disbursal last year we did was over 5400 Crores with a rise of 33% over the previous year and now we have crossed 10,000 Crores in terms of AUM. As I said that we have about 172 branches all over and you can see that the major focus in terms of the branches have been the rural and semi urban because that is the niche we identified for ourselves and that is where we have majority of our customer and we think we add value in providing financial support to them. Only about 20% of our branches are located in the urban centers. If you look at the geographical spread of the branches you will notice that North is the one which sticks out at 31%, otherwise East is 24, South is 23 and West is 22, so it is now pretty much even and I have shared in my last year's conference also with you that we took over a company four years ago which had a network in South and West and we were getting foothold in to the southern and the western markets and I can today share with you that we think that now we have got good amount of share in the western and the southern markets as well as you will see in some of the subsequent slides, here it is, you can in terms of the disbursal for 2011 in fact west has done highest at 29%, so we lent last year additional loans of 5400 Crores of which 29% share came from west and North actually which was highest last year is now second highest at 28%, you will remember like south which was a weaker area and we said that we were particularly strong only in Andhra, now you can see South is contributing 24% and as a result the share of east where the primary sale itself is lower, although we are a quarter now has come down to 19%. The other interesting observation here is that no single state contributes more than 12% and those of you where I have had the opportunity of interacting one on one you will remember that last year Andhra was contributing 13% which is now down to 12%, then Maharashtra which was contributing 13% is now down to 11%, so therefore it is becoming even more evenly distributed and the share of south which was less has now gone up with Kerala now has gone up to 5%, we are still weaker in Tamil Nadu which contributes to 3% and Karnataka which is 4%, so I think current year you will see our market share growing in Tamil Nadu and Karnataka as well.

On the left side is product wise, you will recall that we said we want to increase the contribution of the high yielding products from 13% in FY 2010 to 20% in FY 2011. We have actually achieved 19%, so 1% less than what guidance we had issued and in terms of the other three mainline products, passenger car has actually scaled up better and this share is now 24 and commercial vehicle which was I think about 37-38% is now down to 36 and construction equipment is down from 22% to 21%, so this again puts us in quite an envious position. No other company in our sector has such a wide product presence, we have seven of them and no single product you can see has 40% or higher contribution, so this geographical diversity and the product disbursal sort of derisks us from the cyclicality of the product or the regional fluctuations in terms of floods or drought or assembly elections and things like that.

So, that was more on the business overview and now we get on to the results where I think truly we believe that we have transcended the expectations and the guidance that we had issued in April or May last year, so here it is it, our disbursal purely has grown from 4065 to 5415 Crores which is a 33% increase. In terms of Q4 particularly if you see the scale up is even sharper and we have done 41% growth compared to the Q4 of fiscal 2010 and the more interesting part is out of 1955 Crores disbursal in the month of March we actually did 748 Crores. In terms of the net interest margins, now this is one question that I had faced from most of you that I or Lakshmi would have interacted during the year that in the rising interest rate scenario the NIMs would be under pressure, so what is our strategy and how do we propose to deal with the same. I have shared several times that we want to change the product mix and we want to change the customer segmentation but at the same time I used to say that we are very committed to maintain 5 and go beyond, I think we have managed to earn 5% NIM last year despite seven times increase in the funding cost which was announced after the reverse repo or the repo rate changes announced by the central bank. Going forward also in the current year there are headwinds in terms of the interest rate scenario but I think we will continue to follow the same planning and strategy that we followed in the last year and we hope to maintain and grow on our NIM percentages. As you can on the right side our yields and cost of fund, how 5% is arrived at. This 8.2% which is the cost of fund is a misnomer in the sense that first half of the year, our cost of fund was going down, but then it was from August-September that the Reserve Bank took a hawkish stand and then they announced five increases between August and March and therefore in the last quarter our cost of fund went up to as much as 9.2%, but on an annualized basis it was 8.2 for the additional borrowings that we did. This is something which we have not shared with you before, now this chart talks about the asset quality, because this was another point we have discussed that when we grow the high-yielding asset, that is susceptible to greater risk and the credit losses, so here as you can see the purple line which was in March 2009 at 6.8% is down to 1.6% and then you have the different product lines which shows that every single product has dropped, tractors which was 16.7% was the highest and is still the highest but down to 5.9% and this has happened over the last nine odd quarters over the last two years. The infant delinquency is measured as after the loan has been disbursed for the first time. For the first six months of billing even if one rupee is outstanding it is considered as zero plus bucket and so the percentage 1.6% overall that means the lending that we did in the last seven months only 1.6% of the total contracts where we had even one rupee outstanding, that means 98.4% of the contracts had no outstanding as on March 31. We are very proud of this particular metric, which is what relates to the title of this year’s annual report that creating a new benchmark.

This is the next one, which is early delinquency, so what I will do is first I define how we calculate this and then I explain the number, early delinquency is over a longer period. Infant delinquency was on six months of billing, early delinquency is on 12 months of billing and here we calculate with a three-months lag because we calculate what percentage of the contracts after the first 12 months of billing are in 60 plus bucket which means more than two installments are outstanding and therein if you see again the purple line which was at almost 3% in March 2009, you can see that line between 2.8 and 4 is now down to 0.6% just over 0.5, so this is again down over the last nine quarters, pretty consistently from close to 3% down to 0.6%, now this is a measure and there are a lot of analysts I can see here like you do a static pool analysis or you do a role forward analysis, so you will really appreciate that in terms of portfolio these are the early indicators of what kind of quality has been originated, so we are proud of these two metrics and as you know that we have verticalized the company, we do not operate like a traditional NBFC, we operate like a private banking model wherein the sales, credit, back office, collections and NPA recoveries, these are the five core functions handled by five different teams, so these two metrics which is the infant and the early delinquency are the metrics on which the underwriting team is measured and they earn their valuable compensation, so this was on credit side, now this is on the entire portfolio, that was six months portfolio and 12 months portfolio. We believe after the credit team has delivered the quality in the first year then they have achieved their objective, now it is up to the collections team, so this particular metric talks about how the entire portfolio in the company has performed and here again if you see we have given 12 quarters last three years FY 2009, 2010, and 2011 and all the four quarters, so total 12 quarters performance and you will see that lowest is 95.7 which was in the red line and the third quarter and thereafter it is 95.9, 99.2, 97.4, so it has moved in that narrow range and this is where we have actually implemented part of six sigma in the collections process and the results of at the end of the year and this is our proudest metric that we achieved the collection efficiency of 101.7%, now this means that whatever EMI that were due during the year we collected 101.7% of that which was comparable to 99.8% that we did in the previous year, so what happens when you collect at such level of efficiency your write offs will go down, your NPAs will go down, now as you know that we follow a very stringent norms on the NPA and we write off everything the moment an account becomes nonstandard, so therefore we do not make provisions for NPA at 10, 20 or 50% depending upon the age of the NPA, we write off 100%, as a result in our balance sheet we do not have any gross or net NPA, what we have in our P&L account is only the bad debts write off and that is what the right side shows which has gone down from 0.54% to just about 0.24% because when you are collecting 101.7 there is a very limited residual piece which is actually going up to the NPAs, I in fact last year also I think I voiced my concern that I really doubt whether we can improve 0.46 but actually speaking our collections team has improved and it is now down to 0.24% in terms of the write off, what at times I have heard from the investing community that when your denominator grows, it couches a lot of inefficiencies in the topline numbers, so I would like to share with you that even in terms of the absolute amount the write offs have reduced, in FY 2009 if was 41 Crores, in FY 2010 it was 40 Crores and in FY 2011 it was down to 24 Crores only, so while our asset base has grown to now close to 11,000 Crores our write off is down to 24 Crores and that is how that number of 0.24% comes, so all of these things ultimately will get captured in one single number which some would call as PAT, some would call as ROE and some would call as ROA, finally here we take a look first at the gross numbers. I will concentrate on the bottom side, which is for the year which is our total income grew by 21%, our PAT grew by 71% and our EPS grew by 45%. In fact if you look at the quality of earning is also in terms of its consistency, throughout the year, quarter-on-quarter we have been growing our PAT at 70%, so there is no skew which is what concerns the investment community at times.

If you look at some of the other ratios that we shared earlier, the cost to income, last year that has grown that was the only ratio, which has grown from 29.6 to 31.6; there are three extraordinary items, which resulted in this increase, which I think we will take up during the Q&A session. Our PAT you can see 40, 71 and 122, our ROA is up to 2.3% and ROE to 23.6, if you recollect last year I said that our target for the year is to cross 2% in ROA and 20% in ROE. We have overachieved that again and these are some key ratios, I think most of it we have covered as well except the capital adequacy which is quite comfortable at 18.2%, now RBI has increased the capital adequacy to 15% from March 2011 but we are quite comfortable at 18.2.

This is a new slide that we have added which is the spread analysis and if you see our total income to the average assets fell from 18 to 16.6, so was our interest expense to the average assets, as a result of that the gross spread remains same at 9.9, however the over rates marginally fell to 5.8, this write off in provision 0.7 actually is lower because I said there were three extraordinary items which increased our cost to income, so one item is here, Reserve Bank announced in January 2011 to bring parity between banks and non banks that even non banks have to make a provision on standard assets at the rate of 0.25% and on our entire assets as on balance sheet which is about 11,000 Crores we had to provide for almost about 11-12 Crores on that, so that is the hit because of which it is 0.7, otherwise it would have been less, but despite all of that our pretax spread is about 3.4 and that is how ROA of 2.3 comes after tax.

These are the shareholding structures, pretty simple, 42% held by ourselves as promoters, 40% by the FII and 9.7% by some domestic investors and the rest by public. Our shares are Rs. 2 each and total we have close to about 13 Crore shares outstanding in the market, so we continue to convert the dreams in to reality, that is why our catchline investing in the smallest dream that is what Magma is all about.

In terms of prospects and outlook for the year FY 2012, one I think on the GDP we hear your expert views every week, almost every day in the financial papers that expected to be between 8.5 to 9 and I do not have any reasons to believe otherwise, so we also hope that this will happen. The user industries, in fact instead of user I would say that the primary assets and we finance commercial vehicles, construction equipment, utility vehicles, passenger cars, tractors, all of these we expect to grow between 15 and 20, last year they had a trailblazing growth of 30%, so there is expectation of some moderation, so we have budgeted 15 to 20, however last year like you have seen our, what we call as diagnostics, you go to a medical center and have a diagnosis of the body, our diagnostics looks fantastic, so we want to really now gallop and grow much faster and that is why we are saying that assuming the industry grows between 15 to 20 will grow by 50 and we also want to change the product mix once again increase the contribution of the high-yielding ones from 19 to 25 which will have an impact on our NIM which we expect to take to 5.25%, so that is what in terms of our outlook is and we have also shown that how we have made inroads in to the very competitive and conventional markets of south and we have now started getting good market share, so we want to continue to deepen our presence in the interiors of south and west and about two weeks ago, we also received much awaited and delayed approval R1 for our insurance joint venture from the regulatory authority, so that is the biggest hurdle, now of course we have two minor hurdles to cross but there has not been a single instance where R1 has been issued and thereafter the business has not started and we do not hope to be an exception, so therefore during the current fiscal we hope to start our insurance JV as well, so that was about it from my side. I would be happy to take any questions along with Lakshmi and Dhiren. Thank you.

Question: Hi, this year you have reported around 33% disbursement growth, what gives you the confidence that while the industry may be moderating down on the overall growth you will be able to achieve around 50% growth year-on-year?

Sanjay Chamria: I shared that while 33% is growth we have achieved YOY, but QOQ we have achieved 41% and if you ask me what is the challenge that we have, I think, in the last six months we have been grappling with one challenge in the organization, how to build a very efficient sales organization, see in terms of credit, you have seen the metrics, in terms of collections you have seen the metrics, cost control you have seen, but the one thing which we are not as proud of as the other areas is sales and there we have taken lot of measures and we have seen that how it has been promising like within the first six months of taking those steps we have grown by 41% and there are lot of those measures, the benefits of which usually would flow about a year or two years time frame, so therefore starting with this year for the next three years we hope that we will be able to maintain a growth of 50% year-on-year.

Question: How much of the cash that you have on the books is against the collateral for the securitized assets?

Sanjay Chamria: Pretty large part minus 200-250 Crores, rest of it would be as cash collateral.

Question: What is the total quantum of securitized assets as of March?

Sanjay Chamria: About 5000 plus.

Question: Sir, what is the status on the insurance JV?

Sanjay Chamria: Like I shared we have received the approval on RI which is one of the three-stage licensing process but the most regressed one and that we have received in the board meeting which was held on March 28 and we received the letter last week and now we are in the process of filing our application for R2 which is more like the product offerings and the office structure, branch network and things like that and after that once you get the R2 then you just capitalize the company and file your details and then you get R3, that is the process.

Question: Would it be fair to assume that Q2 we would be actually out with a product in the market?

Sanjay Chamria: I do not think so because to roll out insurance product it is almost like banking and there is a lot of back-end preparation that you need to do in terms of the technology platform, in terms of setting up a risk underwriting team within the insurance company and the actuary team, I think what happens there is a lot of overlap that goes on while you are preparing for your R2 because this is to an extent procedural, so side by side you also gear up the organization so that the day you roll out your first policy you should have your complete back end ready, the advantage that we have is we are more than 200 people on our roles over the last few years because we have been doing cross sell of insurance on the sales side, operations side and claims handling, so I think what we need to do is to build a team on the underwriting side and the technology side.

Question: So probably before the year is over you would have your own policies?

Sanjay Chamria: God willing yes.

Question: For the 50% growth which you are expecting, how are you expanding your sales force, the number of branches and what is the growth you are expecting in individual business segments?

Sanjay Chamria: Last year we expanded our branches from 153 to 170, so about 20 odd branches we opened, we are going to open maybe another 20 odd branches this year, in terms of the catchment area we find that north, central, and east we are extremely well penetrated, we still have some vacancies in the markets of west and to a lesser degree in south particularly Tamil Nadu, so these are the areas where we are going to open more branches in the current year, however the growth of 50% that I am talking we have worked it out on our existing branches, so the new branches that we open will help us to achieve another 50% in the next fiscal which is FY 2013. The 20 branches that we opened last year are going to help us this year in terms of our growth. In terms of the product lines we expect the car, tractors, used vehicles, these three are the prime movers in terms of the growth and then of course the other products like commercial vehicles, construction equipment and SME will maintain their normal growth, this is how we hope to maintain the product wise growth. In terms of the addition in the sales team we have decided to follow a different path here. As I said to the first question that we are working a lot on the sales side and we propose to surprise the market as to what we can do in the sales side this year not only in terms of the topline growth but also in terms of qualitative improvement, so hopefully next time when we meet I should be able to share this story as to what kind of a de-bottlenecking we have been able to do on the sales side.

Question: Sir, what proportion of your AUMs comprises of securitized assets and how do you see that spanning out over the next couple of years?

Sanjay Chamria: See, about 5000 or so is the securitized out of 11,000 that is the breakup and in terms of going forward in future our endeavor is to gradually being able to reduce it like last year again it was marginally lower although just about marginally lower than previous year, which is what we would endeavor to do. Incidentally I think what I can share here with you again recognizing the excellent quality of assets that we have been originating all the portfolios that we sell down is rated by the rating agencies and in India the debt market is not very deep, so all the instruments have to be rated only AAA to be able to be sold in the market so all the portfolios that we have sold are rated AAA by CRISIL, CARE and these two agencies principally we deal with, so the loss percentages have come down from around 8% at the beginning of the financial year to about 3% in March 2011, so that is a steep reduction making the sell down transaction far more efficient for us.

Question: (inaudible) 31.41given that you are increasing the proportion of high-yielding loans from FY 2010-2011 is that a reflection of more competition in the market because of which yields across the board came down or is there some other product mix issue here?

Sanjay Chamria: If you see our FY 2010, our yield was 13.8 which actually went down to 13.2, so because of that the yields came down and secondly we also marginally reduce the level of sell down, because when we do a sell down the income is recognized upfront and that of course improves the overall yield because that is included therein, so if you sell down less also you will have an impact on the overall yield percentages.

Company Speaker: I think your question was on the yield on advances which we have made during the year, there if you look at, it has come down from 13.8 to 13.2%, the cost of fund has come down from 8.7 to 8.2, so if you look at the core products, the rates have been down as compared to the last year, for the high-yield share it has increased, so if those rates the cost of fund had not actually moved on the high-yield share percentage increase would have actually resulted in a higher NIM.

Question: Were you giving money at cheaper rates in the year for like-to-like products?

Company Speaker: 13.8 to 13.2 is the composite yield reduction that happened, so 60 basis point yields went down from FY 2010 to FY 2011, so if that happens your overall yield will go down.

Sanjay Chamria: Because I told when I was sharing that 8.2 is a misnomer because last quarter our cost was 9.2 but in the first half of the last fiscal year our cost of fund came down, so when your cost of fund comes down, your lending rates also come down, there is a positive correlation in the movement of your cost of fund with your lending rates, so therefore until September our gross yields were falling, our cost of funds were falling, then from October the cost of fund started going up, but the yields started going up only from November onwards because there is always a lag effect when you want to increase, sales team is very smart, whenever there is fall, they are the first ones to come and demand from tomorrow if you do not reduce we will lose market share but when the increase happens they always say no we cannot do it mid month, let us do it from next month, so there is always a lag effect that you have on the increased side, so this is how the yields fell, secondly as I said to her question that we have marginally reduced the level of sell down, so that also would have some basis point reduction in the overall yield, because to that extent I am getting lesser income.

Question: (Inaudible) 34.46 closer to 3988 Crores whereas your assets on finance was 3644 but incrementally assets on finance has almost increased by 1000 Crores whereas your loans had not gone up by that much, if you use the same argument you should have got a better yield, you mentioned that from September onwards your yield started moving up, right, so it should have got a better benefit in the fourth quarter and in the entire second half?

Sanjay Chamria: Actually the yield calculation is on a weighted average basis, so therefore till September of October whatever was the underlying denominator on that we would have earned a lower yield and then from November onwards the yields started going up, now what happens also is the disbursal that I do in the month of say December the first billing would happen in the month of February because there is always a monthly in arrears that is part of our installment, we mostly lend in the rural and semi urban markets and most of the products that we lend are for the productive revenue generation purpose, so it is not possible that I give a loan today and from tomorrow I get the installment, he will deploy the asset on his income and then pay the first installment to me, so when I give the loan to him in December he will deploy the asset in January on the money and pay me the first installment would fall due on February 1, so that is another deferment that happens in the income side.

Question: Fair enough, but you do without an accrual basis?

Sanjay Chamria: No, in fact that is one of the points which we had discussed with our CS what is called as broken period interest which is on an accrual method of accounting but we do not follow that, we follow it on a cash basis, so like the disbursals I told you we will disburse about 748 Crores in the month of March, there is not a single rupee of interest income that has been accounted for in these accounts because the billing for that will happen on May 1 although I would have earned some interest cost because I have disbursed during the month of March.

Question: Sanjay, just an extension of that question is you are recognizing on the sell downs entire income upfront, so that also is not getting apportioned during the life of the securitization, so to that extent the revenue recognition happens ahead of actual earning, am I correct in that understanding?

Sanjay Chamria: Yes, these are two different things, when we do a sell down we transfer the title and we de-recognize the assets from our books because we have given the title to the investor and therefore in keeping with the guidelines we recognize the income, so far as the income assets that we retain on our books there we follow the method that the first interest income recognition will happen when the first installment will fall due, now there is a 30 to 40 day credit period which is given from the date of disbursal till the date of the first billing, so that period is called a broken period which he is right that on an accrual basis you could account for which is accrued but not due in the pure accounting language, but then we do not account for that as an income.

Question: Actually on the sell downs, can you actually do it on accrual basis as and when you earn it effectively whilst you have done the securitization the earning actually happens over that period of time, based on accounting norms is it possible to spread it out during the term of the securitization?

Sanjay Chamria: There are two types of sell downs one can do, one is a PTC issuance of securitization in which what you are saying is what the Reserve Bank has specified three years ago that if you issue a PTC for the purpose of sell down then you amortize the income over the contracts original tenure, however when you do a pure sell down on bilateral basis with banking entities, then in such a case you have effectively transferred the title and you recognize the income as on the date of the same, however there are also entities which also amortize this as well.

Question: Sir, two small questions, one is on your funding pattern, like for financial year 2012 what would be your strategy on decreasing your cost of funds and second would be what is the head room available for issuing tier 1 PD and tier 2 bonds?

Sanjay Chamria: Well I doubt whether we can reduce our cost of funds in the current year because the guidance is that the cost of fund if at all will go up, so no matter what kind of different instrumentalities that we have for leverage, it is very, very doubtful, well nigh impossible to reduce the cost of funds, but I think the way we have last year cushioned the increase in the cost of fund and you can see like effectively over the year we are still at a lower cost of fund compared to previous year as against 8.7 it was 8.2 I think we will probably try and minimize the impact, but still it will be more than 9% in the current year because my last Q4 is 9.2, so therefore it cannot be less than 9, that is one, to answer your other question we have a head room because tier 2 capital can be equivalent of tier 1 capital and in 18.2% capital adequacy we have 6.9% tier 2 and 11.3% tier 1, so roughly about 4.4% which is about 40% vacancy we have still to raise tier 2 and we are at 18%, so we are comfortable.

Question: So, what would be the philosophy or securitized assets going forward, would you decrease it and what would be the rationale for that? Second Sir, what would be the impact on the collection metrics and cost structure going forward given your focus on high yield assets, should we require more intensive approach to them?

Sanjay Chamria: I will take your second question first. I think we have over invested in the collections infrastructure in the last three years and the result of that is seen in the very high collection efficiency and therefore that gives us the confidence that even if we were to maintain a 50 or a 60% growth in the disbursal then also we have the bandwidth to manage the collections, similarly on the underwriting front today there is a very strong credit culture within the organization, see I think here it is essential to understand that in our organization the sales guy who brings the lead he cannot influence the decision making, he does not have any say in the decision whether the loan can be sanctioned or not, there is a field investigation in every single case that is done by a field executive who does not report to sales, who reports to the underwriting team and based on that we take a decision to lend, so I think on the front of increase in the high yielding asset and collections infrastructure I think we are over prepared, I mean it may border on little overconfidence but the metrics performance over the last nine quarters I think gives us enough confidence on that front. Your first question was with regard to the policy going forward, I think we have a very stated stand on this over the last three four years we have brought down from 80% down to 52% and going forward we wish to further bring it down and that is also in response to some of the interactions that I have had with the bankers and investing community that we have too much of dependence of securitization, so therefore we have been bringing it down but then that has an impact on your capital adequacy, so I think we have to strike a good balance between how much capital we have and how much we can retain on our balance sheet. The luxury that we have is that we have enough and more support from the banking system given that 75% of our assets are priority sector, the asset quality is very good and we have a 20 year vintage in the industry which only four or five players can claim to have and therefore we can borrow as much money as we want, so therefore we can quickly shift gears from whether we want to retain on our balance sheet or we want to sell down.